PhD Thesis (Commercial Law)

An Analysis and Critique of Secured Lending in South African Law, including Cession *in Securitatem Debiti* as a Means to Secure the Repayment of Loans for Consumption

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SUBMITTED TO THE UNIVERSITY OF CAPE TOWN

in fulfilment of the requirements for the degree PhD (Commercial Law)

Faculty of Law

UNIVERSITY OF CAPE TOWN

Date of submission: 06 June 2022

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Declaration

I, Adnaan Kariem,* hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university. I authorise the University to reproduce for research either the whole or any portion of the contents in any manner whatsoever.

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Acknowledgements

All praise be to God, Lord and Master of the entire Universe.

I was inspired to read for my PhD to achieve excellence in knowledge and in my profession. I dedicate this doctoral thesis to my Creator and my parents.

I wish to thank my supervisors, Professor Tracy Gutuza and Professor Dale Hutchison, for their invaluable contribution, constructive criticism and continual feedback. I am humbled and honoured to have learnt from great intellectuals such as yourselves.

The inspiration for excellence in knowledge came from values instilled in me by my parents that my Creator and the religion of my birth demand excellence in all aspects of life. It is based on the teachings of my parents, Kamaal and the late Rogaya Kariem, who through their knowledge and example, continually encouraged me to grow by exceeding my boundaries and limitations. My mother, who passed on many years ago, remains in my heart and prayers. My father is the primary reason for me deciding to read for this doctorate, and his last wish is for me to obtain this degree and for him to see me graduate. I hope, Dad, that I have done you proud. My brothers Jameel Kariem and Dr Saadiq Kariem, encouraged me in this endeavour and had the confidence in my ability to obtain this doctoral degree. The constant prayers of my stepmother Mariam and sister-in-law Nisa assisted me. The years spent reading for this doctoral degree would not have been possible without the unconditional love, support and understanding of my dear wife Zainab Fakier, who through toil dedicated herself to my success. In the middle of the writing of this thesis, my daughter 'Aliyah Kariem was born, the joy of my life.

After more than 21 years in practice as a corporate attorney specialising for the most part in banking and finance law, I thought the time was opportune to undertake this amazing journey.

To my family, your unconditional love and support are written in these pages.

Signature: Date: 06 June 2022

Table of Contents

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JIBAR	Johannesburg Interbank Agreed Rate
Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review*	DR Johnson 'Reflections on the Bundle of Rights' (2007) 32 *Vermont Law Review* 247
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LMA	Loan Market Association
LMA's Multiple Borrower Term and Revolving Facilities Agreement	LMA's investment grade South African law unsecured single currency multiple borrower term and revolving facilities agreement, 21 December 2018
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SARB	South African Reserve Bank
Scott 'A Footnote to Nienaber's Analysis' 2012 *South African Mercantile Law Journal*	S Scott 'Security Cessions and Beneficiary Appointments: A Belated but Necessary Footnote to Nienaber's Analysis?' (2012) 24 *South African Mercantile Law Journal* 323
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UN Assignment of Receivables	United Nations Convention on the Assignment of Receivables in International Trade, New York, 2004
UNCITRAL	United Nations Commission on International Trade Law
UNCITRAL Explanatory Note	Explanatory note by the UNCITRAL secretariat on the United Nations Convention on the Assignment of Receivables in International Trade
UN Guide	UNCITRAL Legislative Guide on Secured Transactions, New York, 2010
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An Analysis and Critique of Secured Lending in South African Law, including Cession *in Securitatem Debiti* as a Means to Secure the Repayment of Loans for Consumption

1 Chapter One: Introduction

1.1 The context

The movement of capital through loans in the markets constitutes an essential aspect of the growth of economies.[1] Through the movement of capital, companies are able to grow their businesses by increasing their turnover and hence grow their market share. Companies' growth in market share contributes more broadly to economic growth. The growth of the South African economy is therefore due in part to the growth of companies' market share, which results in increased productivity, revenue and taxes.

In South Africa, banks lend billions of rands annually to their clients.[2] Statistics published by the South African Reserve Bank (SARB) indicate that, as at April 2020, there are 4 mutual banks, 4 co-operative banks, 16 local branches of foreign banks, 19 registered banks and 30 foreign banks with approved local representative offices in South Africa.[3] SARB further states that, as at April 2020, of all loans advanced by banks, home loans constitute ZAR1,044 billion, commercial mortgages ZAR352 billion, credit cards ZAR126 billion, overdraft loans[4] ZAR247 billion and term loans ZAR1,126 billion.[5] A report published by Thomson Reuters in 2016 provides statistics on the size of the loan markets and funding deals in Africa and South Africa. The statistics show that, in the first quarter of 2016, syndicated lending in Africa totalled US$3.23 billion, down from US$11.84 billion, or 73 per cent less than the statistics for the same time in the previous year. These statistics do not include bilateral loans. In South Africa, some notable loan transactions in recent years include the following: the Standard Bank of South Africa borrowed US$600 million from a syndicate of international banks in a term loan facility in 2016;[6] Investec borrowed US$400 million from a syndicate of international banks in a term loan facility in 2015;[7] listed real estate company Redefine Property acquired a 75 per cent stake in a Polish real estate portfolio in a €1.19 billion deal funded by an offshore bridge facility settled by the sale of

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[1] Goode 'Security in Cross-Border Transactions' (1998) 33 *Texas International Law Journal* 47 para I. Goode states persuasively that '[w]ithout an adequate legal regime for personal property security rights, it is almost impossible for a national economy to develop' (at 47).

[2] On 17 April 2012, for example, the then Deputy Governor of SARB estimated the banking sector in South Africa to be worth about ZAR3 trillion, a significant portion of which is used in lending, including ZAR50 billion used in unsecured loans. See 'The impact of the Eurozone financial crisis on African Economies, Lesetja Kganyago, Deputy Governor of the South African Reserve Bank, NEPAD BUSINESS FOUNDATION, Sandton, 17 April 2012' available at www.resbank.co.za. The International Monetary Fund, in its Country Report No 14/340 titled *South Africa Financial System Stability Assessment* (December 2014) at 16 para A.10, read with Appendix Table 4 Financial Soundness Indicators at 34, indicates that the sectoral distribution of loans and advances as at the end of the second quarter of 2014 was as follows: (a) household loans constitute 43.6 per cent of bank lending with a large proportion being floating rate mortgages; (b) non-financial corporations constitute 31.8 per cent; (c) general government constitutes 0.6 per cent; and (d) SARB and other financial corporations constitute 12.7 per cent. Loans and advances to South African residents constituted 88.6 per cent of loans whilst loans to non-South African residents constituted 11.4 per cent of loans.

[3] See the document titled 'Selected South African banking sector trends, April 2020' available at www.resbank.co.za.

[4] An overdraft loan is classified in this thesis as a form of a revolving loan as analysed in section 3.1.1 *Availability of the loan* under the heading *Revolving credit facility*.

[5] See the document titled 'Selected South African banking sector trends, April 2020' available at www.resbank.co.za.

[6] Standard Bank of South Africa Limited, available at https://sponsorships.standardbank.com/CIB/Latest-News/Standard-Bank-secures-US$1-billion-loan-from-top-international-banks.

[7] Thomson Reuters LPC, available at https://www.reuters.com/article/uk-investec-loans/investec-bank-signs-400-million-loan-idUKKBN0LE13C20150210.

convertible bonds in Europe;[8] and Steinhoff offered to acquire a European electric goods retailer for £920 million, using a multi-currency bridge loan.[9] As is evident from these statistics, loans or debt finance, as it is known, is important in the South African economy. Recently, in South Africa and elsewhere, private equity firms, insurers, medical aid schemes and pension funds have started competing against, and sometimes syndicating with, banks to become lenders in the debt market.[10]

The international growth in the loan markets over the last 20 years has acted as a catalyst to the loan markets to form voluntary lenders' associations and standardise loan documentation.[11] In the United Kingdom, the Loan Market Association (LMA) was established in 1996 as a voluntary association dedicated to *inter alia* producing standard loan documentation for the syndicated market.[12] These and other factors have contributed to an abundance of literature on secured lending transactions in, amongst other countries, the UK and the USA. The literature can be broadly categorised into the accounting, economic and legal disciplines, and covers a wide variety of topics.[13] In South Africa, however, the literature on secured syndicated lending is very sparse.[14] The difference in the literature reflects the age and size of each of the three markets, with the markets in the UK and the USA being established at or before the turn of the century,[15] well before the establishment of the South African market.[16] Given the limited literature on secured lending laws in South Africa, this thesis contributes to the body of literature in South Africa by analysing secured lending laws, with a particular emphasis on syndicated secured lending and security in the form of the pledge and cession *in securitatem debiti* of rights, measured against international trends in security laws.

1.2 The background

Internationally, companies are financed through debt or loans, equity, or a combination of both.

Equity funding occurs when a person or entity subscribes for shares in a company, which allots and issues its authorised shares to the subscriber against payment to the

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[8] Bloomberg, available at https://www.bloomberg.com/news/articles/2016-03-01/redefine-buys-75-of-echo-prime-properties-for-1-2-billion-euros.
[9] Thomson Reuters LPC (n 7).
[10] To demonstrate the point, the following observations are made. Drucker & Puri 'On Loan Sales, Loan Contracting and Lending Relationships' (July 2009) 22(7) *The Review of Financial Studies* 2835–2872 note that banks are increasingly selling loans to other banks and non-financial institutions in the secondary loan market. They report that the American secondary loan market volumes increased by a compounded annual growth rate of 25 per cent from US$8 billion in 1991 to an amazing US$238.6 billion in 2006. In South Africa, no data or statistics are available regarding loans made by non-bank lenders.
[11] See www.lma.eu.com.
[12] The role and function of the LMA is discussed in detail in section 2.2 *The nature and genesis of loans in South African law* and in section 3.3 *The Loan Market Association standard-form loan documents and English law lessons*.
[13] See, for example, Bratton *Corporate Finance* (2012); McCormack *Secured Credit Under English and American Law* (2004); Wright *International Loan Documentation* (2014); McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017).
[14] See, however, the works of Brits, Hutchison, Lubbe, Scott, Silberberg and Schoeman and Nienaber amongst others. See also Gumbo *A Theoretical and Empirical Analysis of the Libor Market Model and its Application in the South African SAFEX JIBAR Market* (PhD thesis, UNISA, March 2007) and Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008).
[15] The USA market is so well-established that, for example, different classes of lenders often litigate against each other in intercreditor disputes, as discussed by Stangland and Ferguson 'Intercreditor Case Law Update' (2012) 129(3) *Banking Law Journal* 280–288; Buchheit 'The Search for Intercreditor Parity' (2002) 8(1 & 2) *Law and Business Review of the Americas* 73–80.
[16] This view is based on an internet search of the available literature.

company of the subscription price. Debt or loan funding occurs when a loan for consumption is made by a lender delivering money, which is a consumable or fungible thing, to a borrower, who consumes it and returns the same number of units, with or without interest, to the lender at a future time. The types and forms of debt differ significantly, and include bonds, debentures and notes, term loan facilities, leveraged loan facilities, revolving credit loan facilities,[17] and companies borrowing against their receivables.[18] In a bilateral loan, one lender lends money to a borrower while in a syndicated loan, a group of lenders lend money to a borrower(s).

Debts or loans are typically either secured or unsecured[19] with the risk profile of a secured loan, because of the security, being comparatively lower than that of an unsecured loan. In a secured loan, the borrower and/or a third party grants the lender an encumbrance against its assets or incorporeal rights that provides credit support for the performance by the borrower of its loan obligations.[20] Accordingly, as security for the debt, a company grants a lender encumbrances against, or security rights in respect of, its assets, or a charge[21] against its assets, or assigns its assets.[22]

The asset or incorporeal right is therefore appropriated to the debt. The encumbrance could take the form of personal security, which is a claim held by a lender that requires performance by the person or entity granting the security,[23] or real security, which is a claim held by a lender against a thing, enforceable against the world at large.[24] South African law recognises different types of security interests that are discussed immediately below.[25] In contrast, in an unsecured loan, neither the borrower nor any third party grants the lender any encumbrances against its assets or incorporeal rights as security for the borrower's obligation to repay the loan. The lenders' risks of non-recovery of an unsecured loan are typically compensated by lenders charging higher interest rates.

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[17] The principal differences between term loan facilities, leveraged loan facilities and revolving credit loan facilities are discussed elsewhere in this thesis. There may also be other forms of raising capital. It is worth noting that Bratton *Corporate Finance* (2012) 291 states that (i) there is no inherent or legally recognisable definition that distinguishes bonds, debentures and notes; and (ii) bonds, debentures and notes are simply a promise made by a borrower to pay a specified amount with interest on a specified date on the terms set out in the governing agreement. In this sense, Bratton contends, bonds, debentures and notes are simply 'promissory notes issued pursuant to and governed by longer contracts'. The impact of international banking regulation, including capital adequacy requirements that banks are required to maintain, on banks' capacity to lend and on the structure of debt facilities, both prior to and after the 2007 to 2008 international financial crisis, falls beyond the scope of this thesis.

[18] Bratton *Corporate Finance* (2012) 301–306; McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 110 –111 paras 3.1.1–3.1.3.

[19] Davies 'Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law' (2006) 26(3) *Oxford Journal of Legal Studies* 559–583 states that '[t]here is evidence that significant levels of lending are available to SMEs on unsecured terms' and that in the USA 40 per cent of debt to small businesses is unsecured (at 561 n 11). These statistics are stated as at 2006.

[20] A 'secured loan' is often referred to in English and US literature as 'secured credit' or a 'secured transaction'. See, for example, McCormack *Secured Credit Under English and American Law* (2004) and n 1 to the UN Model Law. The concepts of 'security', 'security interests' or 'security rights' are usually synonymous.

[21] A distinction should be drawn between the concept of a 'charge against assets' in the legal sense and in the colloquial sense. In the legal sense, a 'charge against assets' is an English law concept analysed in chapter 7 *Cession of Personal Rights: Lessons from International Instruments, the United Kingdom and the United States of America.* In the colloquial sense, a 'charge against assets' means an encumbrance against an asset or assets that is provided as security for settling a debt.

[22] McCormack *Secured Credit Under English and American Law* (2004) 54. McCormack notes that the charge may be either fixed or floating. The differences between the two types of charges are discussed elsewhere in this thesis.

[23] *Scott on Cession* (2018) 15; Brits *Real Security Law* (2016) 2.

[24] The distinction between personal security and real security is discussed in more detail in section 4.5 *Personal and real security, and the registration of security rights* below.

[25] Numerous judgments that discuss the different forms of security are analysed throughout this thesis.

In South African law lenders can use different forms of security, including registering mortgage bonds over immovable property, registering notarial bonds over movable property, a pledge of rights over movable property, a pledge and cession *in securitatem debiti* over incorporeal or personal rights,[26] and quasi-security such as suretyships and guarantees. In particular, cession *in securitatem debiti* of rights is a form of security that is regularly used in South Africa to secure borrowers' obligations to repay loans.[27] This type of cession is the basis on which millions of rands are loaned annually in South Africa.

On the borrower's default or its insolvency, the rights exercisable by secured and unsecured lenders are governed by the Insolvency Act 24 of 1936 and the applicable common law. The lender of a secured loan will itself or through the appointed liquidator (on insolvency) realise its rights in the asset or incorporeal right and use its proceeds to settle the outstanding loan, whereas the lender of an unsecured loan will, if it is not paid in the ordinary course, be paid only after the insolvent[28] borrower's secured creditors and preferent creditors have been paid.[29]

1.3 The research question

The thesis will analyse and critique secured lending laws in South Africa by examining the contractual basis (i) on which money is loaned, with a focus on syndicated loans; and (ii) for the provision of security in the form of personal rights as credit support for such loans. While South African law has no meaningful jurisprudence on secured, syndicated loans, there is significant contract law, security rights law and insolvency law jurisprudence on secured bilateral loans for consumption.[30] The principles and rules from the latter jurisprudence are extrapolated to form the basis of, and to analyse, secured, syndicated loans and the use of personal rights as security. The thesis accordingly sets out the South African common-law principles on loans for consumption and the South African structure for secured bilateral and syndicated loans, and analyses in detail the applicable law on security rights, particularly the pledge and cession *in securitatem debiti* of rights *in personam*.

The thesis acknowledges the substantive clarity that exists in the South African law on loans for consumption and security rights laws, and addresses the controversies, deficiencies and inconsistencies in South African security rights laws. The thesis concludes that aspects of South African secured lending laws need to be reformed to create legal certainty for investors who wish to lend to South African companies. The reform should achieve certain commercial objectives by applying legal principles and practical

[26] Encumbrances over incorporeal rights are discussed in this chapter, in chapter 5 *The Law of Cession* and in chapter 6 *The Law of Cession in Securitatem Debiti.*
[27] In practice, loans are typically secured through security rights granted by borrowers in their assets, property or incorporeal rights.
[28] As contemplated in the Insolvency Act.
[29] Meskin *Insolvency Law and its Operation in Winding-Up* (1991). See the discussion on the ranking of creditors' claims in section 3.2.8 *Insolvency considerations.*
[30] For the differences between bilateral loans and syndicated loans, see section 3.1.4 *The number of lenders: Bilateral loans and syndicated loans* and section 3.2.2 *Bilateral loans and syndicated loans: Advantages and disadvantages.*

considerations that are discussed in the thesis.

1.4 Structure of the thesis

Chapter 1 provides the context and background to the research question, namely, an analysis and critique of secured lending in South African law that is focused on syndicated lending, including cession *in securitatem debiti,* as a means to secure the repayment of loans for consumption.

In order to understand lending in South African law, chapter 2 analyses the genesis and the development of the South African law on loans for consumption, legal title to money in loans, the role of the banker–customer relationship in loans, and the position of foreign lenders.

Chapter 3 sets out the bases of classifying loans, analyses the principal distinctions between the different types of loans, and sets out the law relating to the nature of secured syndicated loans. Loans for consumption can be structured either as bilateral loans or syndicated loans in the primary loan market. Bilateral loans can be syndicated later in time by applying the transfer provisions in a facility agreement, which is typically a trade executed in the secondary loan market. Loans are analysed through the lens of syndicated loans because syndicated loans involve a number of lenders with differing payment rights and levels of security, which allows for an analysis of the different elements underlying loans for consumption. The chapter concludes with a discussion of the LMA's standard-form loan agreements that were written for the South African market, and analyses certain English law lessons from which South African lenders can learn.

Chapter 4 analyses the principles applicable to security, the nature of rights that are pledged as security for loans for consumption, with a particular emphasis on the meaning of *'security'* in South African insolvency law, cessions *in securitatem debiti* of incorporeal rights, guarantees and a range of principal issues that apply to a lender when realising its security rights if the borrower or other obligors default on the loan repayments or become insolvent.

Given the frequent market use of cession *in securitatem debiti* as a form of security for loans in South Africa, chapters 5 and 6 analyse the legal nature of cession, its doctrinal foundations, and the applicable consequences of the competing theories on which cession *in securitatem debiti* is founded in South African law, namely, the pledge theory and the *pactum fiduciae* theory. The pledge theory is found to be more legally sound and more commercially feasible than the *pactum fiduciae* theory.

Chapter 7 considers international trends to standardise the law on security interests, the English law on charges, and Article 9 of the American Uniform Commercial Code. These laws are analysed because the secured lending markets in the UK and the USA are mature, and are compared to the South African law on cession *in securitatem debiti* of personal rights and lessons are drawn from these laws. The principles to reform South African law

are analysed.

Chapter 8 concludes the analysis and critique of South African law on secured lending, finding that the law is substantively clear in certain respects. However, the law on security rights, especially the pledge and cession *in securitatem debiti* of personal rights, is fraught with doctrinal controversy and systemic deficiencies. In light thereof, I submit that the time is opportune to reform South African secured lending laws. The proposals made will improve the current law, and specifically the law on cession *in securitatem debiti* of personal rights, will provide greater legal certainty to market participants, and will align South African law with international trends to standardise the law on security interests.

1.5 Concluding remarks

A few remarks need to be made about the terminology used in this thesis.

The parties to a loan transaction and related security transactions are often described by using different terms for the same party. The use of different terms to describe the same party is not a result of inconsistency, but rather reflects the capacity in which that party contracts in the relevant class of contract. Therefore, a 'lender' is also a 'creditor', and in a pledge and cession *in securitatem debiti* of assets or incorporeal rights, the 'lender' or 'creditor' is also a 'cessionary'. Similarly, a 'borrower' is also a 'debtor', and in a pledge and cession *in securitatem debiti* of assets or incorporeal rights, the 'borrower' or 'debtor' is also a 'cedent'. The term 'obligor' is used to describe, individually or collectively, the 'borrower' or any third party that has given security for the borrower's loan obligations.

The decision to use different terms to describe the same party is determined by the class of contract discussed in the chapters. So, for example, in chapters 2 and 3 on loans, the person advancing the loan is a 'lender' and the recipient is the 'borrower'. It would be inappropriate and, in fact, incorrect to describe the 'lender' as the 'cessionary' in chapters 2 and 3, even though the borrower may pledge and cede *in securitatem debiti* its assets or incorporeal rights in favour of the lender as security for the loan. In chapters 5 and 6 on cession generally and cession *in securitatem debiti*, the 'borrower' that pledges and cedes *in securitatem debiti* its assets or incorporeal rights to the 'lender' is described as a 'cedent', and the 'lender' who is the recipient of the benefit is described as a 'cessionary'. The terms 'facility agreement' and 'loan agreement' are used interchangeably, even though in practice typically the former denotes a facility against which multiple draws are made and the latter denotes a one-off loan.

References to the 'Appellate Division' are to the Appellate Division as it then was, now the Supreme Court of Appeal, and references to the old provincial divisions of the High Court under the previous South African legal dispensation are to those divisions as they then were.

2 Chapter Two: The Law of Loans

The South African law on loans for consumption provides the foundation for bilateral lending and syndicated lending. The parties' intentions, ownership and the thing lent are of particular importance to loans for consumption. This chapter sets out the nature and genesis of loan agreements in South African law.

2.1 Background to the South African law of loans

The South African law on loans is, depending on the type of loan, governed by the common law and/or legislation. In the last century, the South African courts adjudicated different disputes arising from loans (including the enforceability of loans, ownership of or title to money loaned, the enforceability of a lender's security interests to recoup an unpaid loan or interest, and whether interest on loans and losses arising from the non-repayment of loans are deductible from the taxpayer's income in terms of the Income Tax Act[31]) and disguised loans.

2.2 The nature and genesis of loans in South African law

The genesis of loans for consumption in South Africa is to be found in classic Roman law and Roman-Dutch law. While a discussion of the history of Roman law and Roman-Dutch law on the contract of *mutuum* is beyond the scope of this thesis, the historical characteristics relevant to secured lending and security provide an important background to understanding South African law regarding these matters.[32]

Roman-Dutch law in the Netherlands was influenced by Roman law in the fifteenth and sixteenth centuries. Roman-Dutch law *'became part of the legal system of the Cape of Good Hope in 1652'.*[33]

The most significant difference between Roman law and Roman-Dutch law in regard to loan transactions is that Roman law required delivery of a consumable or a fungible thing to create or constitute a binding loan, while later Roman-Dutch law did not, as mere consensus to lend and borrow was sufficient to create a binding contract.

Roman law

The concept of loans for consumption originated in classical Roman law where the contract of *mutuum* was one of four contracts *re*, which are real contracts.[34] The contracts *re* were (i) *mutuum*, which was a loan for consumption of any fungible (such as money, oil or wheat) where an equivalent amount had to be returned; (ii) *commodatum*, which was a loan of

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[31] Income Tax Act 58 of 1962.
[32] Zimmermann *The Law of Obligations* (1990) 153–187 eloquently discusses the history and substance of *mutuum* in Roman law.
[33] Malan & Pretorius 'Contemporary Issues in South African Banking Law' (2001) 64 *THRHR* 268 at 268.
[34] Zimmermann *The Law of Obligations* (1990) quotes Rudolph Sohm *The Institutes* (trans. James Crawford Ledlie, 3 ed, 1907) where he said: *'The … real contracts, we read, are "real" in the fullest sense of the term; by the very nature of the case they are, and always will be, real contracts, because they all involve an entrusting of property by one person to another [with a duty in that other to restore it], so that the "res", in this instance, determines both the ground and the nature of the obligation. Accordingly, the nominate real contracts are real contracts to this very day: a claim for a return of property can only be supported on the ground of the previous delivery.'*

non-perishables where the thing lent had to be returned; (iii) *depositum*, which was the gratuitous transfer of a thing that gave the depositee bare detention; and (iv) *pignus*, which was the transfer of possession of a thing to the creditor as security for the debtor discharging its obligations to the creditor. The feature common to all contracts *re* is described by Thomas[35] as *'agreements which became binding upon the transfer of a thing, from one party to the other, to be returned, in specie or in equivalent, or otherwise disposed of at the end of the transaction'*.

Loans for consumption were regulated by statute as early as 533 AD, and possibly much earlier.[36]

Delivery played an important role in Roman law. The contract became binding upon delivery of the thing that was the subject of the transaction, which is fundamentally different to the position in later Roman-Dutch law, where consensus, without delivery of the thing, was sufficient to create a binding contract.

In the Roman legal system, the lender transferred title or ownership in the consumable or fungible thing to the borrower, although it was not a requirement that the lender itself had such title.[37] Zimmermann states that ownership of the thing lent passed to the borrower after a *datio* (allotment) took place.[38] In the case of a loan of money, the borrower was not obliged to return the money he had received, but an equal sum, or in the case of other fungibles, objects of the same kind, quality and quantity. If the borrower failed to do so, the lender had recourse to the *condictio* in the form of the *actio certae creditae pecuniae* to enforce the obligation to return the money.[39] Zimmermann states further that the *mutuum* gave rise to only this one action, and consequently this one obligation (to return an equivalent thing to the one lent). A claim for interest could therefore not be sustained, as the *condictio* was in fact an *actio stricti iuris*.[40] As time passed, the consensus element *'came to be increasingly emphasized'*.[41]

In later Roman times[42] and then in Roman-Dutch times, the maxim *nemo plus iuris ad alium transferre potest quam ipse haberet* developed, in terms of which the holder of a right could not transfer greater rights than he or she had.[43] In respect of fungibles, the possessor became the owner thereof by *commixtio,* which is a legal principle rather than a method of

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[35] Thomas *Textbook of Roman Law* (1976) 271.
[36] The *Institutes* of Justinian were promulgated on 21 November 533 and came into force on 30 December 533 (with the Digest published on 10 December 533). In Book III, Title XIV of the *Institutes* of Justinian, a loan for consumption is defined.
[37] Voet *Loan for Consumption* at section 8, page 764, states: *'Nay indeed even though coin given on loan is said to have been spurious, if nevertheless it has been expended as genuine by the receiver, I think it rather the case here too the payor's right of credit has been settled by the spending.'* At section 9, page 765, he states: *'What is more, a loan is also understood to acquire beneficial validity even before the spending of the money paid over by a non-owner in his own name, if the receiver has won it by usucapion when still not yet spent. The lender's own right of credit has become firmly settled for him by such usucapion so completed, since he is the person who afforded the receiver the opportunity of exercising usucapion.'*
[38] Zimmermann *The Law of Obligations* 153.
[39] Ibid 36 n 13, where Zimmermann indicates that in the case of the *condictio certae pecuniae* the condemnation issued was for the specific sum of money owed.
[40] Ibid 154. Zimmermann later states that this approach would prove to be problematic because it excluded any claim for interest.
[41] Ibid 156. Here Zimmermann discusses how, initially, the mental aspect of the loan (*animus*) merely served to qualify the purpose for which the *datio* was made. This developed in later times into a proper obligationary contract that was based on consensus.
[42] Ibid 279 and 293; D.50.17.24.
[43] Lubbe 'Cession' *LAWSA* (2013) para 171.

delivery.[44] If fungibles were mixed (*commixtio*), the possessor became the owner when such mixing took place. Delivery of the consumable or fungible thing was a precondition to creating enforceable rights and obligations, as opposed to delivery being performance of the contract. Delivery made the loan operative and was also a requirement of the other contracts *re*.[45] In Justinian's time, money consumed but not repaid was recoverable by the *actio certae pecuniae creditae*.

Roman-Dutch law

Roman-Dutch law adopted and endorsed some, but not all, of the characteristics of the Roman law on loans for consumption. In later Roman-Dutch times, all contracts required consensus to create valid and binding rights and obligations between the parties. Contracts were therefore considered covenants, underlain by obligations.[46]

Voet described a loan for consumption in Roman-Dutch law as a loan –

> *by which some consumable thing is given another on condition that a thing in the same class, or of the same good quality and amount shall be returned.*
>
> *The effect of a loan on the side of the lender is that both the ownership in and the risk of consumable things lent passes to the receiver. It is settled that in loan an alienation of the articles lent takes place, and that not the articles themselves which were measured, weighed or counted out, but only other like them ought to go back to the lender.*
>
> *It is certain that it is founded upon a thing (re), and that it is not completed without delivery. Yet this is to be taken in the sense that there is no need for strictly genuine delivery to take place, but that even a fictitious delivery is enough, ...*[47]

As is evident, the transfer of ownership in the thing lent was necessary to create a contract of loan. In later Roman-Dutch law, when all contracts were consensual, a loan for consumption bound the lender to give a consumable thing to the borrower on condition that the borrower would return a similar thing. Contract law evolved from real contracts requiring delivery in the Roman era to consensual contracts in the Roman-Dutch era. The contract in the Roman-Dutch era was completed by delivery, whether genuine or fictitious, of the consumable thing. Delivery was discharge or performance of the lender's obligation.

South African law

South Africa's loan history can broadly be divided into two eras: the usury loan era and the post-usury loan era.

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[44] The legal principle *commixtio* is discussed in section 2.3 *Legal title to money and the role of the banker–customer relationship.*
[45] Justinian *Institutes* 202.
[46] See Voet *Loan for Consumption* at section 1, page 752 as to contracts defined generally and classified. Also see n 41 above where I discuss the transformation of the mental aspect (*animus*) into consensus that underlies the obligationary contract of *mutuum*.
[47] See Voet *Loan for Consumption* at section 1, page 752 for the definition of a loan for consumption; section 4(a), page 755 for the requirement of delivery; and section 14, page 768 for the effect of the loan on the lender and *dominium.*

For more than 37 years,[48] loans in South Africa were regulated by *inter alia* the common law and the now-repealed Usury Act.[49] Since 1 June 2006, certain loan types have been regulated by the common law and the National Credit Act.[50] Loans that fall outside the National Credit Act are regulated only by the common law.

In terms of South African law, in its most basic form, a loan may be classified as a loan for use or a loan for consumption.

In a loan for use, the lender delivers the subject matter to the borrower, who is obliged to return the same thing, with or without compensation or reward to the lender. The elements of a loan for use are the parties' intentions, the retention of ownership and the thing lent. The lender intends to lend the thing to the borrower by granting it possession whilst retaining ownership, and the borrower intends to use the thing lent, returning it at the agreed time.

In a loan for consumption, the lender delivers a consumable or a fungible thing to the borrower, who may use or consume the consumable or fungible thing. The borrower is obliged to return the same number of units, with or without interest, at a future time. The feature that distinguishes a loan for consumption from a loan for use is that, in the former, the borrower may consume the subject matter by acquiring legal title thereto, whilst in the latter, the borrower may not.[51] It is in this context that a loan of money is classified as a loan for consumption.

The nature of a loan for consumption was succinctly described in 1931 by De Villiers JP in *Moser v Meiring*:[52]

> *A loan for consumption (mutuum) is defined as a contract by which a fungible thing is delivered to another who undertakes to return a thing of the same kind, quality and quantity. (Voet 12.1.1). A 'loan of money' therefore is a contract by which money is delivered to another who undertakes to repay an equal sum.*

The learned Judge President seems to have been describing the common-law position on loans for consumption. This position was again succinctly described by Boshoff J about 44 years later in *Western Bank Ltd v Registrar of Financial Institutions and Another*:[53]

> *At common law the contract known as 'verbruiklening', mutuum or loan for consumption, is classified as a contract founded on a thing (re) and is not completed without delivery. It is a contract whereby one person delivers some fungible thing to another person who is bound subsequently to return to the former a thing of the same kind, quality and quantity; Grotius, 3.10.1; Voet, 12.1.1; Van Leeuwen, R.H.R., 4.10.1; Van der Linden, 1.15.4. A loan of money is therefore*

[48] The Usury Act 73 of 1968 was in force from 1 April 1969 to 1 June 2006.
[49] Usury Act 73 of 1968.
[50] National Credit Act 34 of 2005.
[51] Joubert 'Loans' *LAWSA* (2008). See Roman-Dutch law as expounded by Voet *Loan for Consumption* section 1, page 752 for the definition of a loan for consumption.
[52] *Moser v Meiring* 1931 OPD 74.
[53] *Western Bank Ltd v Registrar of Financial Institutions and Another* 1975 (4) SA 37 (T) 43D–44B (*'Western Bank'*). *Western Bank*, insofar as the principles applicable to loans are concerned, was quoted with approval in *C & T Products (Pty) Ltd v M H Goldschmidt (Pty) Ltd* 1981 (3) SA 619 (C).

basically a contract whereby money is delivered to another who undertakes to repay an equal sum at some future time; Moser v Meiring, 1931 OPD 74 at p. 77.

Boshoff J discusses the nature of a loan of money. His words *'is not completed without delivery'* above probably refer to the original common-law position.

In *Mogudi v Fezi*[54] the court held as follows:

A contract of loan for consumption comes into existence when parties agree that the lender will deliver to the borrower a quantity of consumable or fungible things for consumption by use, subject thereto that the borrower will return the same quantity thereof at some future time.

The legal position in *Mogudi* must be qualified if the loan for consumption is subject to the fulfilment of conditions precedent in that the conditions precedent must be fulfilled before the contract becomes binding in the manner discussed below.

In South African law, for an agreement to constitute a binding loan for consumption, it must contain the *essentialia* of a loan agreement for consumption or a *mutuum*. The *essentialia* of a loan are the intention to lend and borrow, and the lender passing title in the thing to the borrower. Loan agreements also contain *naturalia*, terms that arise *ex lege* and are implied by law whether or not the parties contemplated the inclusion of such terms in the agreement. Some *naturalia* are directory – they apply if the parties have not agreed otherwise; other *naturalia* are peremptory – they are prescribed by law. Parties sometimes vary the *naturalia* applicable to the loan by consensus. The *incidentalia* are terms incorporated by the parties, either by way of a departure from the *naturalia* or for which the law does not make provision.[55]

Furthermore, in South African law, a signed facility agreement binds the parties to certain types of obligations therein (discussed below) although a condition precedent or a suspensive condition postpones or suspends an obligation until certainty is reached with respect to that condition by it being fulfilled, which is when the obligation becomes binding and operative or, if the condition is not fulfilled, the condition precedent fails and the obligation fails as a consequence.[56] The fulfilment of the conditions precedent creates an enforceable loan for consumption, which obliges the lender to lend and entitles the borrower to draw down on the facility. Conditions precedent are imposed for the lender's benefit, with the borrower being required to fulfil the conditions precedent at its cost.[57]

The LMA standard-form loan documentation, which is widely used across the world and in South Africa, has standardised conditions precedent in its standard-form facility agreements. These conditions precedent can be classified as documentary conditions precedent and factual conditions precedent.[58] The LMA is a voluntary association of asset managers, commercial and investment banks, non-bank investors, institutional investors,

[54] *Mogudi v Fezi* [2007] JOL 20679 (C) 6.
[55] Van Rensburg, Lotz & Van Rhijn (updated by Sharrock) 'Contract' in *LAWSA* vol 9 (Third Edition, 2014) para 355.
[56] Lubbe *Contract: General Principles* (2020) 336 para 10.50.
[57] Wright *International Loan Documentation* (2014) 83–87. The LMA South Africa conditions precedent are discussed below.
[58] LexisPSL at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document under the heading *Conditions precedent.*

law firms, service providers and rating agencies, with its stated business objectives being to improve –

> *liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa (EMEA). By establishing sound, widely accepted market practice, the LMA seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.*[59]

As at 2022, the LMA has 779 member organisations covering more than 65 nations.

The LMA developed standard-form loan documentation for different types of lending arrangements. The purpose and effect of the standard-form loan documentation is to standardise lenders' approaches to loans, especially syndicated loans. The documentation narrows the issues that are to be negotiated between lenders and borrowers.

After signing the facility agreement and prior to fulfilment of the conditions precedent, only the obligation to fulfil the conditions precedent and selected clauses, such as some of the representations and warranties, the *domicile* clauses and certain events of default, bind the parties. The important, operative provisions of the facility agreement that contains the obligations to lend and repay money are not binding in this period until the conditions precedent are fulfilled to the lender's satisfaction.

The loan for consumption and the related facility terms bind the parties once the initial conditions precedent have been fulfilled, whether or not the borrower has drawn down on the facility.[60] The lender's obligation to advance the loan against the borrower's draw is typically dependent on the fulfilment of further conditions precedent. Accordingly, the lender's conditional commitment becomes unconditional once the conditions precedent have been fulfilled. The LMA South Africa structure for facility agreements provides that the borrower may not utilise or draw down on the facility unless the facility agent is satisfied that *inter alia* the initial conditions precedent have been fulfilled.[61] These include the obligors furnishing, and the facility agent being satisfied with, (i) their constitutional documents, authorising board and shareholder resolutions; shareholder registers; specified certificates;[62] (ii) executed finance documents which include security documents;[63] (iii) an enforceability legal opinion (provided by lender's counsel) and a capacity and authority legal opinion (provided by borrower's counsel);[64] (iv) other documents and evidence required by the lender.[65] Even if these conditions precedent are

[59] See www.lma.eu.com. The work of the International Factors Group deals with factoring, namely, companies buying debt or invoices from other companies at a discount and then collecting the debt at its full value, thus making a profit. It is regarded as a form of invoice discounting (www.tradefinanceanalytics.com). The work of the International Chamber of Commerce deals with trade, market and industry issues. While some of the work of these associations may be relevant to peripheral aspects of this thesis, it is not considered to be directly and substantively relevant to the research question, and their work is therefore not analysed. By comparison, the work of the LMA is directly and substantively relevant to the research question, as demonstrated throughout this thesis.
[60] Lubbe *Contract: General Principles* (2020) 336 para 10.50 and para 10.54, and 336–337 para 10.55.
[61] The LMA's Term Facilities Agreement, clause 4.1 (*Conditions of utilisation, initial conditions precedent*); Wright *International Loan Documentation* (2014) 83–88.
[62] The LMA's Term Facilities Agreement, clause 1 *(Original obligors)* of Part I of Schedule 2 *(Conditions precedent).*
[63] Ibid clause 3 *(Finance documents)* of Part I of Schedule 2 *(Conditions precedent).*
[64] Ibid clause 4 *(Legal opinions)* of Part I of Schedule 2 *(Conditions precedent).*
[65] Ibid clause 5 *(Other documents and evidence)* of Part I of Schedule 2 *(Conditions precedent).*

fulfilled, the lender is obliged to advance the loan only if, on the date that the borrower delivers a utilisation request, the further conditions precedent – that there is no default and certain repeating representations made by obligors are true – are fulfilled.[66] Repeating representations are intended to ensure that certain basic facts relating to the borrower remain as they originally were.[67] A distinction is made between representations that are required to be true (i) initially on execution of the facility agreement; and (ii) on draw down of the facility (the date of a utilisation request) and the first day of each interest period, and are therefore repeated.[68] Wright's view is that if a repeating representation is no longer true, the lender can refuse further draws and accelerate the loan.[69] Wright further cautions that duplicating repeating representations as undertakings or events of default can lead to inconsistencies and uncertainty in the facility agreement.[70]

A utilisation request is a standard form request typically annexed to the facility agreement[71] that the borrower must complete and deliver to the lender, which notifies the lender of the amount and the date on which the borrower wishes to draw down from the facility. The utilisation request (i) is subject to terms in the facility agreement such as that the intended utilisation date is a business day in the availability period,[72] the amount and currency complies with the relevant clause[73] and it sets out the first interest period which complies with the interest period clause.[74] Typically, the borrower may request only one loan in each utilisation request;[75] and (ii) contains its own (internal) terms such as (a) the date, the amount and the interest period;[76] (b) confirmation that the further conditions precedent of the facility agreement are fulfilled on the date of the request;[77] (c) the account details to be credited;[78] and (d) that the utilisation request is irrevocable.[79] A facility agreement sometimes contains conditions subsequent, which in South African banking practice are conditions that the borrower must fulfil either after signature of the agreement or after fulfilment of the conditions precedent by a date stipulated in the agreement if the borrower wishes to draw down on the facility.[80] Failure to fulfil conditions subsequent prevents the borrower from drawing down on the facility.

Although there are standardised conditions precedent in the LMA South African facility agreements, the actual conditions precedent in a real transaction may differ, depending on the specific type of finance required and the circumstances.[81] Wright indicates that the

[66] Ibid clause 4.2 (*Further conditions precedent*).
[67] Wright *International Loan Documentation* (2014) 88.
[68] The LMA's Term Facilities Agreement, clause 18.29 (*Repetition*).
[69] Wright *International Loan Documentation* (2014) 15 and 155 - 156.
[70] Ibid 15 and 156.
[71] The LMA's Term Facilities Agreement, Schedule 3 (*Requests*).
[72] Ibid clause 5.2(a)(i) (*Completion of a Utilisation Request*).
[73] Ibid clause 5.2(a)(ii) (*Completion of a Utilisation Request*).
[74] Ibid clause 5.2(a)(iii) (*Completion of a Utilisation Request*).
[75] Ibid clause 5.2(b) (*Completion of a Utilisation Request*).
[76] Ibid Schedule 3 (*Requests*) clause 2.
[77] Ibid Schedule 3 (*Requests*) clause 3.
[78] Ibid Schedule 3 (*Requests*) clause 4.
[79] Ibid Schedule 3 (*Requests*) clause 5.
[80] In practice, it is often the case that if the borrower cannot timeously fulfil a condition precedent, the lender agrees to defer it to a condition subsequent so that the borrower may draw on the facility, but is obliged to repay the loan if the condition subsequent is not fulfilled. Conditions subsequent are not typically of the type that fundamentally affect the borrower's capacity or authority to borrow. In English law, conditions subsequent have to be fulfilled after the agreement becomes binding on the parties; see McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 134 para 3.9.3.
[81] See the different types of the LMA's South African facility agreements.

lender has three independent checks at this time to protect its interests.[82] These are its own due diligence on the borrower, the lender's independent review in the form of its lawyer's legal opinion, and the borrower's representations.[83]

Once all the conditions precedent have been fulfilled to the lender's satisfaction, the borrower is entitled to issue a completed utilisation request in the standard form.[84] Upon receiving this request, the lender's obligation is to transfer title in the money to the borrower by placing the borrower in possession of the money, or by delivering the money to the borrower, to enable the borrower to consume the fungible.[85] The lender may discharge its obligation to transfer title to the money to the borrower in different ways, including direct delivery to the borrower or its agent, or fictitious delivery. Delivery of the money is performance of an obligation under the loan agreement. The lender's failure to deliver the money is therefore a breach of the agreement. The lender's other obligations include to receive and process contractually compliant utilisation requests issued by the borrower as discussed above,[86] to receive any information contractually required of the borrower, and to receive payment made by the borrower of the capital and interest.[87]

However, if the lender were to advance a loan in circumstances where the conditions precedent are not fulfilled,[88] the lender is still entitled to repayment of its loan (performance restored) in terms of the inchoate agreement.[89] The enforceability of the facility agreement entitles the lender to remedies if the borrower defaults after grace periods, if applicable, have lapsed without the default having been remedied.

The borrower's obligations include repaying an amount equal to the amount of the loan on an agreed date, with or without interest. The repayment obligation, even if payment is instalments, is an indivisible obligation[90] as performance cannot be separated into parts.[91] The money must be repaid in legal tender,[92] and in the currency in which the loan was advanced, unless the agreement otherwise stipulates. Foreign currency and cheques are not regarded as legal tender and the lender may justifiably refuse the borrower's payment in foreign currency unless the agreement records that the debt was incurred in that currency.[93] If the loan was advanced in one currency but is repayable in another currency, the facility agreement usually requires the borrower to repay as much as is needed in the other currency to ensure full repayment of the advanced amount.[94] The borrower has other

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[82] Wright *International Loan Documentation* (2014) 83.
[83] Ibid.
[84] The LMA's Term Facilities Agreement, clause 5.1 (*Utilisation, delivery of a utilisation request*), clause 5.2 (*Completion of a utilisation request*), clause 5.3 (*Currency and amount*) read with Part I (*Utilisation request*) of Schedule 3 (*Requests*).
[85] Ibid clause 5.4(a).
[86] Ibid clause 5.1 (*Utilisation, delivery of a utilisation request*), clause 5.2 (*Completion of a utilisation request*), clause 5.3 (*Currency and amount*) and Part I (*Utilisation request*) of Schedule 1 (*Requests*).
[87] Ibid clause 6 (*Repayment*).
[88] Whether the lender advanced the loan in the erroneous belief that the conditions precedent were fulfilled or otherwise.
[89] *Lamula Partnership v Masingita Group (Pty) Ltd and Another* [2008] 2 All SA 650 (W) para 17; R Sharrock 'The General Principles of the Law of Contract' 2008 *Annual Survey of SA Law* 432.
[90] Harms 'Obligations' *LAWSA* vol 19 (Second Edition Replacement, 2016) para 232 defines a divisible obligation as one where the 'performance due can be divided'.
[91] Ibid.
[92] Section 17 of the South African Reserve Bank Act 90 of 1989 contains a definition of legal tender.
[93] Harms 'Obligations' *LAWSA* vol 19 (Second Edition Replacement, 2016) para 237.
[94] Joubert 'Loans' *LAWSA* (2008) para 300.

ongoing obligations, such as ensuring that representations made are correct,[95] furnishing the lender with crucial information (such as its financial statements),[96] complying with financial covenants,[97] and not defaulting on the facility agreement's terms and conditions.[98]

The borrower must, according to case law and Voet, be able to enjoy the advantages and use of the money before it becomes repayable.[99] In *Credit Corporation of SA Ltd v Roy*[100] the court held that:

> *Voet, 12.1.19, says that in the case of a loan for consumption, where no time for repayment has been fixed, the money must be repaid not forthwith, but after the passage of a moderate time, so that in the meantime the borrower will have been able to enjoy at least some advantages out of the loan and the use of the money. The period will have to be fixed at the discretion of the Judge as each case arises.*[101]

It could be argued that a lender's demand for repayment, where no repayment date has been agreed, and the borrower has not been able to enjoy the advantages and use of the money, is premature and that such demand can be met with a valid defence that the loan is not repayable until the borrower has been able to enjoy the use of the money.[102] The requirement that the borrower must have been able to enjoy the advantages and use of the money is a moot point if the lender cancels the signed facility agreement for a justifiable reason, such as a default by the borrower. In these circumstances, the borrower's obligation is to repay the outstanding loan(s) if any draw(s) was or were made,[103] because the LMA South Africa structure treats each draw under a facility as a separate, independent loan, to which the facility agreement's terms (such as the obligation to repay loans)[104] and the security rights apply.[105]

In the context of current banking and finance practice, it is submitted that the defence that a loan is not repayable until the borrower has been able to enjoy the use of the money is questionable if the lender has, pursuant to a binding loan agreement, fulfilled its obligation to transfer title in the money to the borrower by delivering it to the borrower or placing the borrower in possession thereof. Surely, in these circumstances, the lender can claim repayment of the loan as title in the money would have passed, whether the borrower has been able to enjoy or consume the money or not? This is even more applicable where the parties have agreed on a repayment date, but the borrower has not used the money and the repayment date has passed without the borrower having repaid the loan. The requirement that the borrower must have consumed the money simply means that the borrower must have spent the money.

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[95] The LMA's Term Facilities Agreement, clause 18 (*Representations*).
[96] Ibid clause 19 (*Information undertakings*).
[97] Ibid clause 20 (*Financial covenants*).
[98] Ibid clause 22 (*Events of default*).
[99] *Credit Corporation of SA Ltd v Roy* 1966 (1) SA 12 (D); [1966] 1 All SA 114 (D).
[100] Ibid.
[101] Ibid 117 (emphasis added).
[102] Ibid.
[103] The LMA's Term Facilities Agreement, definition of *'Loans'* read with clause 6 (*Repayment*).
[104] Ibid clause 6.1 (*Repayment of loans*).
[105] Ibid. For example, if the lender's commitment is to lend ZAR100 million and the borrower draws only ZAR50 million in two draws of ZAR25 million each, then each ZAR25 million draw is treated as a separate standalone loan.

There is conflicting South African case law on whether interest is a legal requirement to create a binding loan contract. Some judgments hold that interest is essential to create a binding loan contract and other judgments hold that it is not essential. In 1988, in *Nedbank Ltd v Capital Refrigerated Truck Bodies (Pty) Ltd and Others*,[106] the court held that fixing an interest rate does not appear to be an essential term of a contract of loan, which is what an overdraft agreement is.[107] In 1998, in *NBS Bank Ltd v Badenhorst-Schnetler Bedryfsdienste BK and Another*,[108] the court held that, in a money lending contract, the interest rate is one of the essentials that the parties must agree upon, failing which the contract will, at common law, be rendered void for vagueness.[109] In 2007, in *Mogudi*,[110] the court held that the lender and the borrower may agree, explicitly or tacitly, on the interest payable, thereby distinguishing a contract of loan from a contract of donation.[111] The court stated that delivery of the consumable or fungible thing and the charging of interest on the loan[112] are not required to create a binding contract. Interest compensates the lender for the risk that the lender takes that the borrower may not repay the loan.

The *Nedbank* judgment is, it is submitted, the more correct, preferred view because the consensus between the parties must be in respect of the loan itself and not the interest, and the judgment is aligned to the position in Roman-Dutch law. If interest does apply to a loan, the determination thereof must be certain or ascertainable, whether interest is positive or negative. Negative interest may erode the capital due. If, as in *NBS,* interest is an *essentiale* of a loan, then as long as the parties agree on what the interest rate will be, it does not matter whether it is positive or negative.

2.3 Legal title to money and the role of the banker–customer relationship

Where money passes through the parties' bank accounts, the ownership path in a banker–customer relationship, where a customer has both general banking facilities with its bank and borrows from its bank, becomes rather complex. An analysis of the ownership path and its historical origins is provided.

Roman law and Roman-Dutch law

In Book III, Title XIV of the Institutes of Justinian, the transfer of title by the lender to the borrower is described as essential,[113] but this is not an *essentiale* as it is understood in modern-day South African law to create a valid loan agreement.

The transfer of title was a consequence of the loan being implemented in Roman-Dutch law. Thus, Voet stated:

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[106] *Nedbank Ltd v Capital Refrigerated Truck Bodies (Pty) Ltd and Others* 1988 (4) SA 73 (N).
[107] Ibid 74F–G.
[108] *NBS Bank Ltd v Badenhorst-Schnetler Bedryfsdienste BK and Another* 1998 (3) SA 729 (W).
[109] Ibid 736D–E.
[110] *Mogudi v Fezi* [2007] JOL 20679 (C)
[111] Ibid paras 21–33.
[112] This is not to suggest that either Roman law or Roman-Dutch law required the application of interest to create a binding contract. Roman law required a separate contract (*stipulatio*) to create an obligation to pay interest.
[113] Justinian *Institutes* 202.

> *The effect of the loan on the side of the lender is that both the ownership in and the risk of consumable things lent passes to the receiver. It is settled that in loan an alienation of the articles lent takes place, and that not the articles themselves which were measured, weighed or counted out, but only others like them ought to go back to the lender.*[114]

Voet held that certain persons could not lend money in Roman-Dutch law. So, a person could not lend in his own name without the owner's consent. The reason for this was apparently that the true owner could vindicate the amount loaned without his consent[115] if ownership had not passed. This seems to suggest that the lender had to be the owner. Vindication was unlikely if the borrower had consumed the money, as the borrower would have become the owner of the money by *commixtio.* In these circumstances, the money or, for that matter, any other fungible such as oil, wine or corn (these were frequently traded as commodities and, if mixed with other fungibles, their identity could not be separately determined) could therefore not be vindicated. Other persons who could not lend included a ward without his guardian's authority and governors of a province holding temporary office.

In Roman-Dutch law, *spending*[116] the object of the loan for consumption meant (i) disbursement, in the case of cash; (ii) use, in the case of oil, wine or corn; or (iii) being mingled with the receiver's property (not only a borrower) so that it cannot be separated (*commixtio*), in the case of cash, oil, wine or corn.[117] Spending the money in Roman-Dutch times was the performance of an obligation under the contract, and had to be distinguished from title passing, which was a legal requirement to create a loan contract.

South African law

Once a valid loan agreement has been concluded, and all the loan conditions have been fulfilled, the lender must implement the loan agreement. In South African law, the lender's obligation is to transfer legal title or ownership in the money to the borrower, to enable the borrower to acquire title to, and consequently consume, the money. The lender should therefore have title and the capacity to transfer title. However, if the lender is not the owner and transfers the money to the borrower, the borrower becomes the owner thereof by *commixtio*, which is the commingling of fungibles without the owner's consent, so that the original fungibles cannot be separately identified or are no longer readily separable.[118] Legal title to money is therefore significantly affected by the principle of *commixtio,* which is an integral part of South African law.

In a loan for consumption, the lender that advances money to the borrower thereby transfers title to the money to the borrower, who intends to acquire title to the money. In *Ovenstone v Secretary for Inland Revenue*,[119] the Appellate Division held that a disposition

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[114] Voet *Loan for Consumption* section 14, page 768.
[115] Joubert 'Loans' *LAWSA* (2008) para 299; Voet *Loan for Consumption* page 764.
[116] Voet uses the term 'spending' which can be interpreted as 'consuming'.
[117] Voet *Loan for Consumption* section 9, page 765.
[118] Van der Merwe 'Things' *LAWSA* vol 27 2 ed (2008) para 189.
[119] *Ovenstone v Secretary for Inland Revenue* [1980] All SA 25 (A). The court had to determine whether *inter alia* loans made by the appellant to his two minor children to enable them to acquire shares was a disposition for purposes of s 7(3) of the

in section 7(3) of the Income Tax Act[120] included a loan of money or *mutuum.* The court considered the meaning of disposition in a *mutuum* and held that *'the borrower has to repay an equivalent sum, for the lender parts with, gives or makes over the rights to or dominium of the money to the borrower when it is advanced to him'*.[121] The Appellate Division in *Ovenstone* therefore endorsed Voet's definition of a loan.

Ownership of money when the lender is not a bank

At first blush, the matter seems simple, but as money passes through the parties' bank accounts, the ownership path becomes rather complex. Although the parties intend to pass title to the money *ex contractu* from the lender to the borrower, it is submitted that where the lender is not a bank –

(i) when the lender deposits the money into its own bank account, intending to advance it as a loan to a borrower, title passes *ex lege* from that lender to its bank by virtue of *commixtio* to the extent that it commingles with the bank's monies in that account,[122] with the lender acquiring a personal right against its own bank to the credit balance;

(ii) the said personal right entitles the lender to demand payment from its bank of an equivalent sum originally deposited when the lender must, under the loan agreement, advance the loan;

(iii) on advance by the lender of the money into the borrower's bank account, title then passes from that lender's bank to the borrower's bank by virtue of *commixtio*, with the borrower similarly acquiring a personal right to the credit balance against its own bank.

It appears, therefore, that the borrower never really acquires ownership of the money even though it consumes the money, unless the borrower withdraws the money so deposited from its bank account and then spends (consumes) it.

The flow of funds and ownership is schematically depicted below.

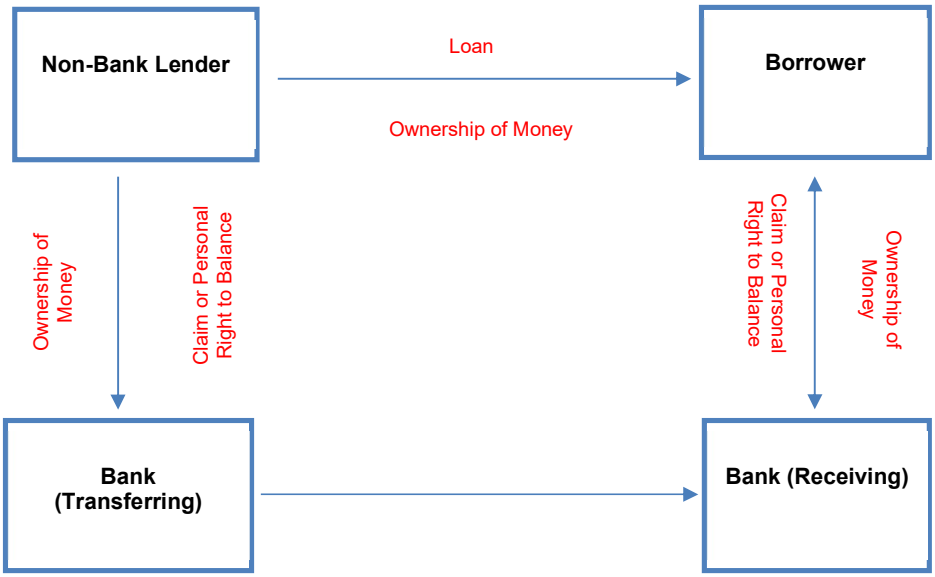
Income Tax Act. The interest on the loans was 8.5 per cent, and the loans and interest were to be repaid from the dividends to be declared in respect of the shares.

[120] Income Tax Act 58 of 1962.

[121] *Ovenstone v Secretary for Inland Revenue* [1980] All SA 25 (A) at 35.

[122] Pretorius 'Aspects of Bank Guaranteed and Certified Cheques' (1999) 11(4) *South African Mercantile Law Journal* 564 at para 2.

Ownership of money: Non-bank lender



Ownership of money when the lender is a bank

Where the lender is a bank, and the loan proceeds are transferred from that bank lender to the borrower's bank account, the relationship between the bank and its client can, based on case law, be classified either as one of mandate[123] or as *sui generis.* The two classifications are not mutually exclusive. A third classification, which regards the banker–customer relationship as one of *mutuum*, appears to have fallen into disuse over the years.

South African common law generally classifies the legal relationship between the bank and its customer as one of mandate, with the parties standing in a debtor–creditor relationship. The client is the mandator and the bank is the mandatary. It is submitted that the mandate classification is the judicial classification preferred by most South African courts. The bank, as the mandatary, acquires ownership of money deposited into its account by application of the common-law principle of *commixtio*.[124] The customer acquires a personal right against its own bank to the credit balance. As the owner of the money, the bank is entitled to trade the money by, for example, advancing loans and making a profit or loss for its own account. In implementing the loan, the bank can deposit the money into the borrower's account at the same bank or at a different bank. Ownership in this scenario can be described as follows:

[123] Historically, in Roman law, the contract of mandate was one in which the mandatary acted gratuitously. In the Roman-Dutch law era, however, the mandator agreed to compensate the mandatary, although a distinction was drawn between wages and a fee. However, the distinction between wages and a fee is not entirely clear. Wages were said to be repugnant to a mandate, which was based on duty and friendship: Voet, Book XVII, Title 1, The Action and Counter-Action on Mandate, in Percival Gane *The Selective Voet being the Commentary on the Pandectas, Johannes Voet* vol 3 [Books XIII – XXII] (1956) at section 2, pages 191–192; De Villiers 'The Theory of the Roman Law of Contract' (1928) 40 *Juridical Review* 234.

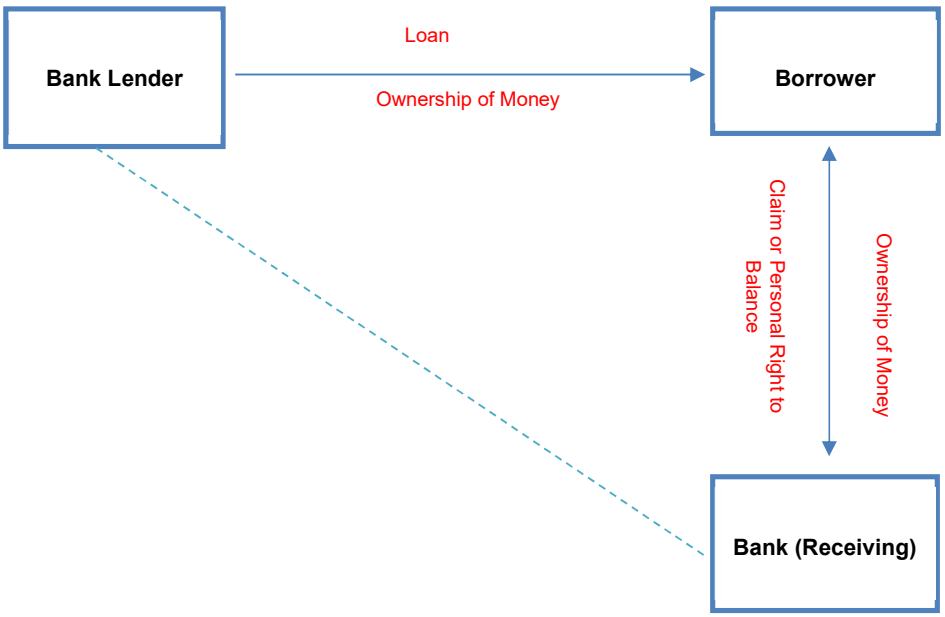
[124] *Trustees of the Insolvent Estate of Grahame Ernest John Whitehead v Dumas and Another* 2013 (3) SA 331 (SCA); [2013] JOL 30865 (SCA); *Louw NO and Others v Coetzee and Others* 2003 (3) SA 329 (SCA); [2003] 1 All SA 34 (SCA) para 12; *Ehlers v Nedcor Defined Contribution Fund and Another* [2002] 3 BPLR 3141 (PFA) para 19; *Standard Bank of SA Ltd v Absa Bank and Another* 1995 (2) SA 740 (T); [1995] 1 All SA 535 (T); *Rennie NO v The Master and Glaum v The Master* [1980] 3 All SA 799 (C) at 811–812; Pretorius 'Aspects of Bank Guaranteed and Certified Cheques' (1999) 11(4) *South African Mercantile Law Journal* 564.

(i) when the customer deposits the money into its bank account, title passes *ex lege* from that customer to its bank by virtue of *commixtio* to the extent that it commingles with the bank's monies in that account, with the customer acquiring a personal right against its own bank to the credit balance;

(ii) the bank, owning the money, can lend and advance it to a borrower by depositing it into the borrower's account at a different bank or the same bank. Title then passes from the lending bank to the borrower's bank (if it is a different bank) by virtue of *commixtio*, with the borrower similarly acquiring a personal right against its own bank to the credit balance.

The borrower never really acquires ownership of the money even though it consumes the money, unless the borrower withdraws the money deposited from its bank account and then spends (consumes) it. The flow of funds and ownership is depicted schematically below.

Ownership of money: Bank lender



Upon transfer of ownership of the money to the bank, the bank simultaneously incurs an obligation to pay, on the account holder's instructions, the amount standing to its credit to the payee. The account holder acquires the status of creditor of the bank, which becomes the debtor. The account holder has a concurrent claim against the bank on its liquidation.[125] This is the legal position arising from the banker–customer relationship.[126]

[125] *Louw NO and Others v Coetzee and Others* 2003 (3) SA 329 (SCA); [2003] 1 All SA 34 (SCA) para 12. The *dictum* in para 12 was applied in *Trustees of the Insolvent Estate of Grahame Ernest John Whitehead v Dumas and Another* 2013 (3) SA 331 (SCA); [2013] JOL 30865 (SCA) and in *Genesis Medical Scheme v Registrar of Medical Schemes and Another* 2015 (4) SA 91 (WCC).
[126] *Trustees of the Insolvent Estate of Grahame Ernest John Whitehead v Dumas and Another* 2013 (3) SA 331 (SCA); [2013] JOL 30865 (SCA); *Ehlers v Nedcor Defined Contribution Fund and Another* [2002] 3 BPLR 3141 (PFA) para 20.

In 2002, in *Di Giulio v First National Bank of South Africa Ltd*[127] (*'Di Giulio'*), the court held that the relationship between the bank and client is a contractual one where the bank is the debtor and the client is the creditor.[128] The court cautioned against classifying the relationship as one of agency, given the varying types and forms that agency may take.[129] The court held that agency and mandate are not equivalents, with agency being broader than mandate, and that the relationship is one of mandate.[130]

South African law on the banker–customer relationship is based on our common law, and the position in English law is the same as in South African law, as described in the English case of *Foley v Hill*,[131] applied and quoted with approval in *R v Stanbridge*.[132]

In the court *a quo*'s judgment in 1995 in *Standard Bank of SA Ltd v Oneanate Investments (Pty) Ltd*,[133] the court described the legal nature of the relationship between banker and customer as follows:

> *The law treats the relationship between banker and customer as a contractual one. The reciprocal rights and duties included in the contract are to a great extent based upon custom and usage. Although historically the original objective of a depositor was to ensure safekeeping of his money, over time jurists have considered characterising and explaining the basic relationship as one of depositum, mutuum or agency. All of these approaches have on analysis proved to be inadequate. It is now accepted that the basic, albeit not sole, relationship between banker and customer in respect of a current account is one of debtor and creditor.*[134]

South African law regarding the nature of the banker–customer relationship is furthermore based on English law dating back to the 1918 judgment of Lord Finlay LC in *London Joint Stock Bank Ltd v MacMillan and Arthur*,[135] approved of by our courts in 2002 in the *Di Giulio* judgment, where the court held:

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[127] *Di Giulio v First National Bank of South Africa Ltd* 2002 (6) SA 281 (C) para 17.
[128] Ibid para 19.
[129] Ibid.
[130] Ibid.
[131] *Foley v Hill* 2 H.L.C (1848 – 50) 36.
[132] *R v Stanbridge* 1959 (3) SA 274 (C) 278; also applied and quoted with approval in *Ehlers v Nedcor Defined Contribution Fund and Another* [2002] 3 BPLR 3141 (PFA) para 19. In *Stanbridge* the court held as follows:

In Foley v. Hill, 2 H.L.C. (1848-50) at p. 36, the following appears in the judgment of the LORD CHANCELLOR:—

'Money, when paid into a bank ceases altogether to be the money of the principal; it is then the money of the banker who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's account, is money known by the principal to be placed there for the purpose of being under the control of the banker: it is then the banker's money; he is known to deal with it as his own; he makes what profit he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers in some places, or the principal and a small rate of interest, according to the custom of bankers in other places. The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his principal, but he is of course answerable for the amount, because he has contracted, having received that money, to repay to the principal, when demanded, a sum equivalent to that paid into his hands.

That has been the subject of discussion in various cases, and that has been established to be the relative situation of banker and customer. That being established to be the relative situations of banker and customer, the banker is not an agent or factor, but he is a debtor.'

[133] *Standard Bank of SA Ltd v Oneanate Investments (Pty) Ltd* 1995 (4) SA 510 (C). This judgment was subsequently overturned on appeal by the Supreme Court of Appeal, and the appeal judgment was in turn overturned by the Constitutional Court in the *Paulsen* judgment, insofar as *Oneanate* suspended the operation of the *in duplum* rule *pendente lite* so that interest could run uncapped from the commencement of litigation.
[134] Ibid 530 G-H. This aspect of the court *a quo*'s judgment was not overruled on appeal.
[135] *London Joint Stock Bank Ltd v MacMillan and Arthur* [1918] AC 777 (HL).

In the well-known case of London Joint Stock Bank Ltd v MacMillan and Arthur [1918] AC 777 (HL) Lord Finlay LC said the following in his speech (at 789):

> *'The relationship between banker and customer is that of debtor and creditor, with a super-added obligation on the part of the banker to honour the customer's cheques if the account is in credit. A cheque drawn by the customer is in point of law a mandate to the banker to pay the amount according to the tenor of the cheque.'*

In 1988, in *GS George Consultants and Investments (Pty) Ltd and Others v Datasys (Pty) Ltd*,[136] the court held that it cannot be doubted that the contract is *sui generis* but that this did not exclude it possibly being a contract of *mutuum.* However, in 1994, in *Commissioner of Customs and Excise v Bank of Lisbon International Ltd and Another*,[137] the court held that the banker–customer relationship is a debtor–creditor relationship, with the customer having a 'special property or interest' in the money. The court, quoting Cowen,[138] stated that the contract is *sui generis*, containing elements of several contracts. In 1992, in *Nedcor Bank Ltd t/a Nedbank v H Bhyat Wholesalers CC and Another*,[139] which was approved in 1995 in *Standard Bank of SA Ltd v ABSA Bank Ltd and Another*,[140] the court endorsed the concept in the *Nedcor* case that the banker–customer relationship was *inter alia* a *sui generis* relationship. The court tried to develop this further by stating that the relationship was a *'collection of a number of complex juristic relationships which tend to vary from customer to customer, depending on the specific agreement which has been entered into between the customer and the bank'*.[141] The court went on to state that sometimes the relationship would have principal–agent features, sometimes loan for consumption features, sometimes debtor–creditor relationship features, and sometimes a collection of all of the aforegoing features.

The contract *sui generis*, yet also a contract of mandate, construct is favoured by Malan *et al*[142] because of its complexity. Malan contends that the loan from the account holder to the bank does not determine the nature of the relationship as *mutuum*. Instead, the contract between the account holder and the bank is one of mandate because it obliges the bank to render services *de caisse* on the customer's instructions. The mandate is comprehensive because it includes a loan to the bank, the bank undertaking to repay the amount on demand by honouring cheques drawn on the bank, and the bank rendering other services to the account holder.

As both Roman law and Roman-Dutch law treated a contract of *mandatum* and a contract of *mutuum* as two distinct and separate classes of contract, it is submitted that a contract of *mandatum* does not, by its nature, include a contract of *mutuum* or loan for consumption. Roman-Dutch law did not provide for loans in a contract of *mandatum*.[143]

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[136] *GS George Consultants and Investments (Pty) Ltd and Others v Datasys (Pty) Ltd* 1988 (3) SA 726 (W) 735–736.
[137] *Commissioner of Customs and Excise v Bank of Lisbon International Ltd and Another* 1994 (1) SA 205 (N) 213–214.
[138] Cowen *Cowen on the Law of Negotiable Instruments in South Africa* 4 ed 1966.
[139] *Nedcor Bank Ltd t/a Nedbank v H Bhyat Wholesalers CC and Another* Case Number 31228/92 (unreported).
[140] *Standard Bank of SA Ltd v ABSA Bank Ltd and Another* [1995] 1 All SA 535 (T).
[141] Ibid 540–541.
[142] Malan, Pretorius & Du Toit *Malan on Bills of Exchange and Promissory Notes* 5 ed (2009) 295–296 para 217.
[143] Voet, Book XVII, Title 1, The Action and Counter-Action on Mandate, in Gane *The Selective Voet being the Commentary on the Pandectas, Johannes Voet* vol 3 [Books XIII – XXII] (1956) 190–213.

Classifying the banker–customer relationship as one of *mandatum* does not explain the terms on which the customer advances his or her money to the banker, as *mandatum* fails to account for (i) the *essentialia* of *mutuum;* and (ii) the banker acquiring ownership of the customer's (the lender's) money by *commixtio* once deposited into the banker's account. A pragmatic approach to classifying the banker–customer relationship is to acknowledge that, given the different legal aspects of this contract, the banker–customer contract simultaneously embodies the characteristics of different categories of contract, namely, *mandatum*, *mutuum* and *depositum.*

Since the banker–customer relationship is primarily one of mandate, it imposes obligations on the bank that are *naturalia* in nature, which require the bank to behave in a certain manner. In *McCarthy Ltd v ABSA Bank Ltd*[144] the Supreme Court of Appeal held that the operation of a cheque account is a contract of mandate that imposes the following *naturalia* on the bank: (i) to pay cheques properly drawn by the customer from the account, provided there are funds in credit; and (ii) to collect cheques properly deposited for collection. The bank must perform these obligations with the required degree of care and good faith, and without negligence.[145]

When a bank lends money to its customers, the relationships of mandate and *mutuum* co-exist. In the latter relationship, the bank is the creditor, and the customer is the debtor, so that the roles played by the parties in the mandate relationship (where the parties stand in a debtor–creditor relationship, with the bank being the debtor and the customer being the creditor)[146] are swapped. Typically, these two contractual relationships are linked by the bank's right to set-off amounts owed to it by the customer under the *mutuum* from amounts owed by the bank to the customer under the mandate.[147] The bank, in terms of its contractual relationship with its customer, is entitled to appropriate moneys from the customer's account to extinguish mutual obligations by set-off. If, however, the customer has no entitlement to the money in its account because it was deposited for a third party's benefit, and the bank has knowledge of this fact, any set-off by the bank of amounts owed by it to the customer against amounts owed by the customer to the bank is not possible and invalid because the customer has no entitlement to the money and there is no mutuality of debts.[148] Set-off is *'a method of debt settlement."*[149] If a loan is not repaid by the bank applying the principles of set-off, it can be repaid in cash by the borrower under the terms of the facility agreement. The UN Guide states that the laws of certain countries give the bank's set-off rights priority over a security right of another party to credit balances in the same bank account so as to avoid a conflict between the bank's set-off rights and the other party's security right.[150] In South Africa there is no such law, and the matter is typically

[144] *McCarthy Ltd v ABSA Bank Ltd* 2009 (2) SA 398 (W).
[145] Ibid paras 16 and 17.
[146] Analysed under the heading *Mandate* below.
[147] Van Deventer 'The Enforcement of Credit Agreements through Set-off: Evaluating the Impact of the National Credit Act 34 of 2005' (2017) 134 *South African Law Journal* 415.
[148] *Firstrand Bank Limited v Spar Group Limited* 2021 (5) SA 511 (SCA) paras 43, 46–50.
[149] Van Deventer 'The Enforcement of Credit Agreements through Set-off: Evaluating the Impact of the National Credit Act 34 of 2005' (2017) 134 *South African Law Journal* 415.
[150] UN Guide, Chapter V, Priority of a secured right, B. Asset-specific remarks, 2. *Priority of a security right in a right to payment of funds credited to a bank account* at 227 para 162.

regulated contractually by the parties.

2.4 Foreign lenders

In terms of the Protection of Investment Act,[151] a foreign lender may make a loan to a South African borrower[152] and may take security for the loan.[153] Although the Protection of Investment Act does not specify whether the loan is a loan for consumption or a loan for use, one can infer that it is a loan for consumption from the fact that security can be provided for the loan[154] and that funds can, subject to the payment of taxes, be repatriated to the foreign lender.[155] A foreign lender is entitled to the same treatment as a South African lender[156] and enjoys the protection of its property under section 25 of the Constitution.[157] A foreign lender would also have to comply with other relevant South African laws.[158]

2.5 Concluding remarks

In this chapter the nature and genesis of loans for consumption, the legal title to money, and the banker–customer relationship in relation to lending were analysed. In summary, the legal requirements for a valid and enforceable loan have evolved from the position in Roman law where, in real contracts, delivery was one of the *essentialia* to create or constitute the contract, to Roman-Dutch law where contracts were consensual, thus not requiring delivery. South African law is based on the legal position in Roman-Dutch law, where all contracts were consensual. In this manner, a signed facility agreement binds the parties to certain types of obligations therein (discussed above). Conditions precedent postpone or suspend the obligations to lend, borrow and repay the loan until certainty is reached with respect to those conditions, in other words, until the conditions precedent are fulfilled and a compliant utilisation request is delivered, which in itself is subject to conditions. These aspects constitute the lending component of secured syndicated lending laws, and lay the foundation for classifying loans for consumption and syndicated loans.

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[151] Protection of Investment Act 22 of 2015.
[152] Ibid s 2(1) (*Investment*) read with s 2(2)*(c)*.
[153] Ibid s 2(1) (*Investment*) read with s 2(2)*(b)*, *(d)* and *(e)*.
[154] Ibid.
[155] Ibid s 11 (*Transfer of funds*).
[156] Ibid s 8 (*National treatment*).
[157] Ibid s 10 (*Legal protection of investment*).
[158] See, for example, *Doing Business in South Africa* (2020), published by Cliffe Dekker Hofmeyr Inc.

3 Chapter Three: The Classification and Nature of Secured Syndicated Loans

3.1 Classification of loan forms

A loan may be classified on different bases that determine the loan form. Generally, the *essentialia* and *naturalia* of a loan for consumption are fixed features as contemplated in law, although parties may vary the *naturalia* and add *incidentalia* to suit their particular finance transaction.[159] Wright contends, correctly, I submit, that the principal bases for a loan are (i) the availability of the loan; (ii) the purpose of the loan; (iii) the lender's credit decision; and (iv) the number of lenders[160] which results in the loan being classified as a bilateral loan or a syndicated loan.

The loan forms and accompanying characteristics described in this thesis represent the general position, based on market trends in South Africa, the UK and the USA. They are not to be read as cast in stone as the nature of the finance structure may, depending on the country, dictate a different loan form and characteristics.

3.1.1 ***Availability of the loan***[161]

The availability of the loan depends on the manner in which the lender makes the money available and the borrower draws down on the facility. The principal loan forms using this criterion are (i) term loan facilities; (ii) revolving credit facilities; and (iii) demand loans.[162]

Term loan facility

A term loan is a loan advanced on the basis that the borrower will repay the capital and interest in stipulated instalments over a term or repay the capital and interest in one lump sum on a specified repayment date.[163] If the borrower repays capital and interest in instalments, the loan is known as an 'amortising term loan'. If the borrower repays capital and interest in one lump sum, the loan is known as a 'bullet term loan'. In this facility, the borrower needs a fixed amount of money for a specified purpose. The facility is committed in that the lender ensures that there are always funds available to the facility limit for a specified time period.[164]

The capital and interest instalments can be structured differently, for example: (i) equal monthly or quarterly instalments of capital and interest; (ii) biannual or annual instalments of capital and interest; (iii) a full capital repayment at maturity, plus monthly or quarterly interest payments; or (iv) the interest is rolled into the capital and the full amount of capital plus interest is repaid by a bullet payment at maturity. Once a term

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[159] The *incidentalia* of a loan agreement are the terms incorporated by the parties either by way of a departure from the *naturalia* (terms implied by law) that would ordinarily have applied to a loan or for which the law does not make provision.
[160] Wright *International Loan Documentation* (2014) 3–7.
[161] Ibid 3–4.
[162] Ibid 4.
[163] Ibid 3–7; Gregoriou & Hoppe (eds) *The Handbook of Credit Portfolio Management* (2009) 101–102.
[164] As to the risks to banks arising from committed facilities in the USA, see Avery 'Loan Commitments and Bank Risk Exposure' (1991) 15 *Journal of Banking and Finance* 173–192.

loan is repaid, the loan is completed, and it may not be redrawn.

Revolving credit facility

A revolving credit facility is a committed facility made available on the basis that the borrower may draw down on the facility and redraw the amount paid up to the facility limit at any time during the loan term.[165] The facility is committed in that the lender ensures that funds are always available to the facility limit for a specified time period when the lender receives a utilisation request from the borrower.[166] The facility is therefore underwritten by the lender and binds the lender to advance the amount, whereas an uncommitted facility is one that is not so underwritten. The debt incurred is long-term debt on the borrower's balance sheet. In this facility, the borrower needs a fluctuating amount of money for a specified purpose. The facility remains operative until unutilised amounts are automatically cancelled at the end of the availability period.[167] The borrower's right to draw down on the revolving facility and to redraw paid amounts is subject to its ongoing satisfaction of any conditions subsequent, repeating representations being true on each draw down date and the first day of each interest period and no event of default having occurred.

An overdraft facility[168] is, it is submitted, a form of a revolving credit facility because the borrower may redraw the amount paid. For this reason, it can be terminated by the lender on written notice. Its term is typically of shorter duration and this facility may be committed or uncommitted. The overdraft facility is effectively an on-demand facility as the borrower can redraw moneys when needed, and the lender must, if the borrower has complied with the terms of the agreement, advance the requested moneys. Bucher and Von Frowein submit that an overdraft facility is an uncommitted facility for which no collateral exists, and that it is a general-purpose facility.[169] Whether or not the lender requires collateral for an overdraft facility is determined by the lender's assessment of the borrower's credit-worthiness and the many benefits that security affords the lender.[170] Consequently, Bucher and Von Frowein's view that collateral is not required for an overdraft facility is questionable.

Demand loan facility

A demand loan facility (which is an uncommitted facility) is a facility that the lender is able to either cancel on notice or require settlement of at any time. The loan is thus repayable on demand by the lender. The lender is not committed to funding the facility.

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[165] The LMA's Single Borrower Term and Revolving Facilities Agreement, clause 5.1 (*Utilisation, delivery of a utilisation request*), clause 5.2 (*Completion of a utilisation request*), clause 5.3 (*Currency and amount*) and Part I (*Utilisation request*) of Schedule 1 (*Requests*); clause 7.7(d).
[166] Ibid clause 5.4 (*Lenders' participation*).
[167] Ibid clause 5.5 (*Cancellation of commitment*) (b).
[168] There is very little authority on the nature of overdraft facilities as standalone facilities in South African law. There is, however, some authority that where a bank's customer draws a cheque against his bank in the absence of an overdraft facility, it is in fact a loan application. See Pretorius 'Aspects of Bank Guaranteed and Certified Cheques' (1999) 11(4) *South African Mercantile Law Journal* 564 at 568–569. However, the relevance of this legal principle is questionable given that most, if not all, South African banks have done away with cheques.
[169] Cited in Gregoriou & Hoppe (eds) *The Handbook of Credit Portfolio Management* (2009) 103–104.
[170] McCormack *Secured Credit under English and American Law* (2004) 4.

This form of facility is somewhat unknown in South African banking practice.

Combined facilities

Often, term and revolving facilities are combined into a single facility agreement.[171] Each facility has terms applicable to only that facility[172] in the single agreement whilst other terms apply to both facilities.[173] The borrower can draw against the term facility, typically to acquire an asset or business, and against the revolving facility, typically to finance its operations. The popularity of such combined facilities in the market is evidenced by the LMA having produced standard-form agreements for it.[174]

3.1.2 ***The lender's credit decision***[175]

Loans can be categorised based on the borrower's ability to repay the loan, its financial position, and the source from which it will be repaid.[176] Whilst the availability of the loan includes a consideration of the borrower's ability to repay the loan, the manner and form in which the lender avails the money is the primary consideration which is the determining criterion.

Corporate finance

As an example, in 'corporate finance', which generally refers to debt or equity or a hybrid form of finance, the lender advances a loan based on the borrower's balance sheet strength. Wright contends that, in this type of finance, the lender does not rely on a specific asset or income stream from which the borrower will repay the loan, but rather relies on the borrower's strong balance sheet as evidence of its ability to repay the loan.

Asset finance

By comparison, in asset finance, the lender advances a loan to enable the borrower to acquire an identified asset, the value of which features significantly in the lender's decision to grant the finance.

Project finance

In a project finance transaction, the borrower is usually the project company, typically a company incorporated solely for the purpose of undertaking and executing the project. The assets and revenue are owned by the project company and comprise its business. The lender advances a loan to the project company to enable it to undertake a project, the revenue of which will be used to repay the loan. The lender also typically requires

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[171] The LMA's Single Borrower Term and Revolving Facilities Agreement and the LMA's Multiple Borrower Term and Revolving Facilities Agreement.
[172] As an example, the LMA's Single Borrower Term and Revolving Facilities Agreement, clause 6.2 (*No reborrowing*) applies to only term facility amounts repaid.
[173] As an example, the LMA's Single Borrower Term and Revolving Facilities Agreement, clause 4 (*Conditions of utilisation*) applies to both the term facility and the revolving facility.
[174] The LMA's Single Borrower Term and Revolving Facilities Agreement and the LMA's Multiple Borrower Term and Revolving Facilities Agreement.
[175] Wright *International Loan Documentation* (2014) 4–5.
[176] Ibid.

the sponsors or shareholders to fund, from their own resources, up to 30 per cent of the funding required by the project company. The assets of the project company are pledged, its property is bonded and its revenue, equity and claims are pledged and ceded *in securitatem debiti* to the lender or a security special purpose vehicle company ('Security SPV') if the loan is syndicated.[177] The lender or the Security SPV may take various types of additional *quasi*-security, including guarantees and suretyships. In the ordinary course of recovering a loan, the lender or the Security SPV has recourse to all the borrower's assets, property and revenue that were encumbered if the loan is not repaid, naturally pursuant to a court order if one is needed. However, in project finance transactions, the lender or the Security SPV contractually agrees (i) to limited or no recourse to the shareholder's assets, property or revenue if an event of default occurs; and (ii) to confine its recourse to recover the loan and interest from the (liquidated) project assets, property and revenues. This type of finance is therefore known as limited recourse or non-recourse financing, due to the contractual limitations on the lender or the Security SPV's legal recourse in the event of a default.

3.1.3 ***The purpose of the loan***[178]

In this category, the lender's decision to advance a loan is based on the purpose for which the borrower will utilise the loan proceeds.[179] The purpose could be specifically stated in the agreement or stated more generally, depending on the borrower's needs. The purpose clause therefore states the commercial purpose for which the borrower requires the loan. It induces the lender to contract to provide the loan to that end. The lender is under no obligation to monitor or verify that the borrower in fact utilised the loan proceeds for the stated purpose.[180] Under South African law, the borrower's use of loan proceeds for a purpose other than the purpose stated in the facility agreement may amount to a default because it contravenes the agreed purpose. However, a lender is unlikely to call a default if it does not affect the borrower's ability to repay the loan, except if the borrower uses the loan proceeds for an illegal or unlawful purpose.

Acquisition or leveraged finance

Acquisition or leveraged finance is used by the borrower to acquire a business or a company. The terms 'acquisition' and 'leveraged' are used interchangeably.[181]

Bridge or bridging finance

This type of finance is used by the borrower to bridge a gap between its immediate

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[177] See section 4.11 *Security structure and security rights of syndicate lenders* for an analysis of the Security SPV structure.
[178] Wright *International Loan Documentation* (2014) 5–7.
[179] Ibid.
[180] The LMA's Term Facilities Agreement, clause 3.2 (*Monitoring*). McKnight *et al* state that in English law, the lender may contend that after disbursement but prior to the use of the funds, for as long as the funds are identifiable, the lender enjoys a trust over the funds. If the borrower uses the funds for a purpose other than the agreed purpose, the lender can reclaim the funds; see McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 118 para 3.5.2.
[181] Wright *International Loan Documentation* (2014) contends that the term 'leveraged finance' is derived from the scenario where the borrower is highly leveraged in that its debt to equity ratio is higher on the debt side. Bratton *Corporate Finance* (2012) 304 contends that the term 'leveraged' refers to the state of the borrower's capital structure that is leveraged, presumably to borrow against, and not the loan itself. He further explains that a leveraged loan is made to a non-investment grade borrower, which is a borrower that is not graded by a ratings agency.

funding needs and its long-term funding needs. A borrower may, for example, require long-term funding to acquire a business or fund its operations but may use bridge finance to fill the gap until the long-term funding is available.

Mezzanine finance[182]

A mezzanine loan is typically a subordinated loan that fills the gap between senior finance and equity in terms of risk and reward.[183] A mezzanine loan carries high interest rates[184] and its repayment is subordinated to the repayment of, and the security rights attached to, the senior loan. Mezzanine finance can therefore be described as middle-ranked or intermediate finance that falls between senior debt and equity, and it is a hybrid form of finance because it may combine debt and equity characteristics.[185] Pratt and Crowe[186] state that mezzanine finance may take different forms and that the form is determined by the transaction. The forms that mezzanine finance takes include preference shares with covenants, and financial instruments that cumulatively offer a 'middle return/middle risk position'.[187] An advantage of mezzanine finance, compared to equity finance, is that the borrower is funded without diluting its ownership.

Mezzanine lenders may participate in the profits arising from the funded transaction by using equity kicker or profit participation provisions. Vargo states that, in a real estate finance transaction, a lender may share in the income derived from the property.[188]

Swingline facilities

This type of finance funds a borrower's short-term liquidity needs. It is usually made available on the same day as the notice requesting it is issued and it must be repaid within a matter of days.

3.1.4 *The number of lenders*[189]*: Bilateral loans and syndicated loans*

In a bilateral loan, one lender lends money to a borrower while in a syndicated loan, a group of lenders each lend money separately, but as a group, to a borrower(s).[190] In this structure, each lender has its own contract with the borrower even though it is all typically contained in one facility agreement.[191] A loan can initially be structured either as a bilateral loan or a syndicated loan in the primary loan market. A bilateral loan can

[182] The origin of mezzanine finance is discussed in section 3.2.10 *The origins of mezzanine finance.*
[183] Silbernagel & Vaitkunas 'Mezzanine Finance' *Bond Capital* (updated Spring 2012).
[184] *Structured Mezzanine Investments (Pty) Ltd v Davids and Others* 2010 (6) SA 622 (WCC); [2011] All SA 583 (WCC) paras 7, 8 and 9.
[185] Amon & Dorfleitner 'Financial Crisis' 2013 *Journal of Small Business & Entrepreneurship* 171; Pratt & Crowe 'Mezzanine Finance' 1995 *Bank of England Quarterly Bulletin* 370; Davis 'Mezzanine – going through the Roof' September 2000 *The Treasurer* 45; Silbernagel & Vaitkunas 'Mezzanine Finance' *Bond Capital* (updated Spring 2012) 2.
[186] Pratt & Crowe 'Mezzanine Finance' 1995 *Bank of England Quarterly Bulletin* 370.
[187] Ibid.
[188] Vargo 'Equity Participation by the Institutional Lender: The Security Status Issue' (1985) 26 *South Texas Law Journal* 225 at 226, whose views could be applied to mezzanine finance.
[189] Wright *International Loan Documentation* (2014) 7.
[190] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 452 para 9.1.3.
[191] Ibid; Proctor *The Law and Practice of International Banking* (2015) 430 paras 21.32ff; Hooley 'Enforcing syndicated credit agreements: All for one and one for all?' (2016) 2 *Journal of International Banking and Financial Law* 74.

be syndicated later by applying the transfer provisions in a facility agreement.[192] Loan transfers are also described as trading loans in the secondary loan market[193] which originated in 1983.[194] A loan may be traded many times.[195]

The transfer provisions of facility agreements entitle the lender(s) to transfer the loan or portions thereof to new lenders.[196] The LMA's position is that the new lenders must be in the business of loans, securities or financial assets for a loan to be transferred to them.[197]

3.2 Syndicated loans in South African law

3.2.1 *Introductory remarks*

Historically, the rights of joint lenders who lent at one time were recognised in Roman-Dutch law. As the debt was divisible, each lender had an action against the borrower for his proportionate share, unless the lenders had *inter se* agreed that one lender could reclaim the entire debt,[198] and would distribute the amounts due to each lender. This was the earliest, most rudimentary, yet sophisticated, form of syndicated loans. According to Voet, in the case of joint borrowers, joint but not several liability existed, unless the parties agreed otherwise.

It is widely accepted in modern international banking practice that the syndicated loan market consists of the primary loan market and the secondary loan market. The primary loan market is the market in which new loans, bilateral or syndicated, are originated. The international primary syndicated loan market value is astronomical at US$3.8 trillion as at September 2021.[199] The secondary loan market is the market in which existing loans are sold by a lender (who became a lender in the primary loan market) and transferred to a new lender, for value.[200] The liquidity in the secondary loan market is the ease with which loans can be traded as assets in this market[201] and the use of standardised LMA documentation to trade and transfer extant loans that

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[192] The LMA's Term Facilities Agreement, clause 23.1 (*Cessions and delegations by the Lenders*). The LMA's precedent agreements for South Africa each contain transfer provisions that are virtually identical to clause 23.1 (*Cessions and delegations by the Lenders*) of the LMA's Term Facilities Agreement.

[193] The secondary loan market is discussed elsewhere in this thesis. So significant is the secondary loan market that the LMA (i) states that one of its objectives is to promote *inter alia 'liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa (EMEA)';* (ii) includes a standard transfer certificate in its precedent facility agreements such as Schedule 4 (*Form of Transfer Certificate*) in the LMA's Term Facilities Agreement; and (iii) has published a number of documents dealing with trading debt in the secondary loan market such as the *LMA Guidance Note – LMA Recommended Forms of Secondary Debt Trading Documentation* dated February 2011. Moorcroft *Banking Law* (2021) para 36.4 states that syndicated loans can be ceded to a third party by the *'transferable loan certificate'* that is attached to a loan agreement.

[194] Buckley 'The Practice of Emerging Markets Loan Sales: Part 2' (1999) 14(5) *Journal of International Banking Law* 151–154 at 151.

[195] *Tael One Partners Limited v Morgan Stanley & Co International plc* [2015] UKSC 12, 2015 WL 997491 at 9 (Westlaw version). The legal mechanisms to transfer a loan are analysed in section 3.2.4 *The nature of syndication*.

[196] See section 3.2.4 *The nature of syndication* and section 3.3.1 *LMA standard-form loan documents for South Africa* for an analysis of the legal mechanisms used to transfer loans.

[197] The LMA's Term Facilities Agreement, clause 23.1 (*Cessions and delegations by the Lenders*).

[198] Voet *Loan for Consumption* section 15, page 769.

[199] Refinitiv's *Global Syndicated Loans Review First Nine Months 2021 I Managing Underwriters.* Refinitiv is Thomson Reuters former financial and risk business. Quesada and Renner 'Contractual Business Networks: The Case of Syndicated Loans' (2017) 13(2) *European Review of Contract Law* 164–194 at 175 state that the syndicated loan market consists of lenders that are heterogenous with more of the lenders being investors and non-bank entities.

[200] LexisPSL at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document under the heading *Secondary trading and loan portfolio sales-overview.*

[201] Ibid under the heading *Banking & Finance Glossary-L.*

originated in the primary loan market *"improves liquidity in the secondary loan market."*[202] Loans can be originated as bilateral or syndicated in the primary loan market and as syndicated in the secondary loan market. The increasing popularity of syndicated lending over the last 20 years in the primary loan market is indicative of its relevance. Syndicated lending enables banks to share the risk of non-repayment across the syndicate. Syndication extends the credit cycle by allowing other lenders, who may be non-bank lenders, to participate in the loan.[203]

Despite the increasing popularity of syndicated loans, South African law has no meaningful jurisprudence on secured, syndicated loans *per se* although there is some jurisprudence on secured, bilateral loans. The syndication of loans in South Africa is, it is submitted, based on a combination of (i) the legal principles, rules and practices applicable to bilateral loans; and (ii) international law and practice in respect of syndicated loans. Applying these principles, in a South African syndicate, lenders would commit to lending money to a borrower(s) in a ranked loan for consumption against the provision of security by the obligors.

The syndicate comprises various parties, including administrative parties who act as agents on behalf of a group of lenders.[204] As discussed above, a syndicate may initially be established as a syndicate, with each lender having a separate contract with the borrower although all these contracts are contained in one document (the facility agreement),[205] or it may later become a syndicate by the original lender selling and transferring portions of the loan to new, incoming lenders.[206] The new lenders are required to accede to the loan terms in writing.

3.2.2 *Bilateral loans and syndicated loans: Advantages and disadvantages*

Bilateral loans and syndicated loans are both loans for consumption as both involve the loan of money, although their lending, operation and security structures are substantively and functionally different.

In a bilateral loan, a single lender is liable to advance the moneys to the borrower, but in a syndicated loan, the lending obligation is shared between the lenders on a *pro rata* or proportionate basis.[207] Syndicate lenders' obligation to lend is several, and not joint and several, so that no lender is liable for fulfilling the other lenders' lending obligation.[208] In a bilateral loan, a single lender holds all the security rights directly in its

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[202] Ibid under the heading *Overview of the key documentation in a typical secondary debt trade.*
[203] Ivashina & Scharfstein 'Loan Syndication and Credit Cycles' (May 2010) 100 *American Economic Review: Papers and Proceedings* 57–61 at 57. See http://www.aeaweb.org/articles.php?doi=10.1257/aer.100.2.57.
[204] I discuss the parties to a syndicate in section 3.2.5 *The parties to a syndicate and their functions*.
[205] Moorcroft *Banking Law* (2021) para 36.1. An alternative approach that is sometimes used in practice is that each lender enters into a standalone, short-form facility agreement with the borrower that contains all the essential financial terms of the loan, and all the parties enter into a common terms agreement that, as the name suggests, contains terms common to all the loans.
[206] I explore the differences between, and the significance of, bilateral loans and syndicated loans in section 3.1.4 *The number of lenders: Bilateral loans and syndicated loans*, section 3.2.2 *Bilateral loans and syndicated loans: Advantages and disadvantages* and I discuss the nature of syndication in section 3.2.4 *The nature of syndication*.
[207] LexisPSL at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/docfromresult under the heading *Bilateral or syndicated?*.
[208] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 454 para 9.2.1; Proctor *The Law and Practice of International Banking* (2015) 432 para 21.34. If a South African law governed facility agreement does not state whether the

name, but in a syndicated loan, the security rights are held by a Security SPV[209] and the lenders are the beneficiaries of the owner trust that owns the issued shares in the Security SPV.[210] In a syndicated loan, the lenders thus do not hold the security rights directly. In a bilateral loan, the borrower will face a single lawsuit from the lender if it defaults on the loan agreement. Similarly, if the borrower defaults on a syndicated loan agreement, it would face a single lawsuit from the agent or the Security SPV if loan repayment is claimed and/or the security rights are enforced. Bilateral loans are used to finance smaller amounts, while syndicated loans are used to finance larger amounts.[211] In practice, however, bilateral loans are used to fund multi-million-rand transactions and these loans can be sold and transferred to a syndicate of lenders if transfer provisions are included in the facility agreement.

Bratton is of the view that syndication has a number of advantages, including the following: (i) borrowers are provided with a stable income source; (ii) borrowers can raise larger sums of money; (iii) transactions can be arranged quickly and discreetly, which can be advantageous in takeover transactions; and (iv) loan commitments can be fairly easily cancelled by the lenders,[212] although, depending on when cancellation occurs in the loan process, it is at a cost to the borrower. Other aspects of syndication include repayments by the borrower of the loan amount, how the loan is managed, and defaults.[213]

However, syndication is not all positive. Godlewski and Weill express a contrary view that the seniority of a loan negatively affects a decision to syndicate as seniority may not apply to all participating banks but only to the lead bank. This results in syndication being less attractive and limits the *'possibility to syndicate a loan'*.[214]

3.2.3 *Issues arising from syndicated loans*

As a form of secured lending, loan syndication raises a range of complex contractual and inter-creditor issues. The scope of the research question is limited to certain contractual and inter-creditor issues arising from syndicated loans as a form of a loan for consumption, the ranking of the claims of syndicate lenders, and their security rights.[215] Payment and other aspects arising from the inter-creditor issues are beyond the scope of this thesis.

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lenders' liability to lend is joint and several, then the lenders liability is joint in that each is liable for its share of the obligation, not joint and several; see *FirstRand Bank Limited v Malan and another* [2015] JOL 33547 (GJ) where the court applied this principle to the bank's claim against two respondents as borrowers arising from a loan agreement.

[209] See section 4.11 *Security structure and security rights of syndicate lenders* for a discussion of the Security SPV structure.

[210] Ibid.

[211] Ibid; Bratton *Corporate Finance* (2012) 536–537.

[212] Bratton *Corporate Finance* (2012) 536–537.

[213] Burgess *Corporate Finance Law* 2 ed (1992) 260–262, paras 7.54, 7.55, 7.57 and 7.58.

[214] Godlewski & Weill 'Syndicated Loans in Emerging Markets' 2008 *Emerging Markets Review* 214.

[215] In section 1.3 *The research question* and section 2.2 *The nature and genesis of loans in South African law*, I discuss loans for consumption.

3.2.4 *The nature of syndication*

In a syndicated loan, a group of lenders agree *inter se* and with the borrower to lend, on a proportionate basis, the loan amount to the borrower.[216] The lenders jointly advance the loan amount to the borrower, often using a single facility agreement as the contractual basis therefor that contains each lender's contract with the borrower.[217] Syndicate lenders enjoy *pro rated* rights, that is, rights that are proportionate to the amount each lender has lent.[218] The loan is of course a loan for consumption. A syndicated loan may, like any other loan, be secured or unsecured.

If, as recommended in this thesis, South African law accepts syndication as a form of a loan for consumption, its juridical nature must be determined. There are differing views on this topic. Quesada and Renner contend that the legal nature of syndicated loans is unclear because in English law syndicated loans are viewed as a contract law matter while German law views it as a company law matter.[219] In US law, the Supreme Court of New York in 1985 in *Credit Francais International, S.A. v Sociedad Financiera de Comerco C.A.*[220] construed the nature of an international consortium of nine lending banks that loaned US$ 3,000,000 to the defendant, a Venezuelan financial institution, as a joint venture that shared profits and losses, and had joint and several liability, that characterises a partnership. This characterisation is questionable since (i) syndicate lenders do not share profits and losses in an agreed ratio as joint venture partners do[221] because each lender is due its own *pro rata* debt; (ii) each lender's loan has its own terms (which are typically identical as between lenders of the same class, although terms applicable to senior and mezzanine loans differ) despite all loans being contained in one document, namely, the facility agreement; and (iii) a syndicate is by no means a partnership of any sort.

A syndicated loan is distinguishable from participation or sub-participation[222] in a loan where the lender lends the entire amount to the borrower and then enters into a contract with new lenders in relation to that loan to enable the new lenders to benefit from the loan.[223] Some important observations are made. There are two types of sub-participations, namely, a funded sub-participation and a risk sub-participation. A funded sub-participation typically involves a lender who advances a loan to a borrower, and a new lender as a sub-participant (as its participation is derived from the lender's

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[216] LexisPSL at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/docfromresult under the heading *Bilateral or syndicated?*
[217] Moorcroft *Banking Law* (2021) para 36.1.
[218] Wright *International Loan Documentation* (2014) 7.
[219] Quesada and Renner 'Contractual Business Networks: The Case of Syndicated Loans' (2017) 13(2) *European Review of Contract Law* 164–194 at 166.
[220] *Credit Francais International, S.A. v Sociedad Financiera de Comerco C.A.*3491/84 490 NYS No 2(d) 670.
[221] LexisNexis, Commentary, Corporate and Commercial, Business Contracts Compendium, Joint Ventures (2014), Contracts, clause 5.1.
[222] According to Penn, participations are better known as sub-participations in the European market. Penn, 'Promoting liquidity in the secondary loan market: Is sub-participation still fit for purpose?' (2022) 37(3) *Journal of International Banking Law and Regulation* 85–102. The terms *participation* and *sub-participation* are used interchangeably as meaning the same thing.
[223] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 717–718 para 12.8; Moorcroft *Banking Law* (2021) para 36.2 describes sub-participations as the lender inviting other banks to acquire an undivided interest in the loan; Ajibo 'Syndicated Lending: Re-conceptualising the Role of the Managing Bank and Agent Bank' (2015) 30(9) *Journal of International Banking Law and Regulation* 476–486 at 3 (Westlaw version).

participation). The lender agrees to pay the sub-participant amounts equivalent to the principal, interest and related amounts received by the lender from the borrower under the facility.[224] In consideration, the sub-participant will pay the lender amounts equivalent to the amounts due by the borrower under the facility, and the sub-participant thereby acquires an economic interest in the underlying loan.[225] The sub-participant's reward is the borrower's performance and similarly its risk is the borrower's failure.[226] McKnight *et al* note that sub-participations constitute *' 'significant risk transfer' for the purposes of the EU Capital Requirements Regulation and thereby provide a regulatory capital benefit for the grantor. Indeed, obtaining that benefit is often an important reason for the grantor entering into a sub-participation.'*[227] A risk sub-participation is where the sub-participant agrees that if the borrower defaults on its loan repayments, the sub-participant will pay the lender the outstanding amount due. In consideration, the lender will pay the sub-participant the interest (all or some) it receives from the borrower until default, and thereafter the lender will pay the sub-participant the capital and interest it receives from the borrower. Wright puts it differently by stating that a risk sub-participation provides the lender with a guarantee for a portion of the loan for a fee, resulting in the lender relying on the sub-participant in respect of that portion.[228] If the guarantee is called upon, the sub-participant's rights are subrogated to the lender's rights against the borrower.[229] A controversial aspect of sub-participations is whether the sub-participant acquires a proprietary interest in the underlying loan.

The legal nature of sub-participations is substantially different in certain North American decisions and in UK decisions. Certain North American decisions have held that participation agreements constitute assignments in that the primary lender acquires the role of a trustee and the participant becomes a beneficiary.[230] These and other US judgments hold that participations/sub-participations create an ownership interest in favour of the sub-participant in the loan or proceeds.[231] English law adopts a very different approach. The Privy Council in 2013 in *Lloyds TSB Bank PLC v Clarke (Liquidator of Socimer International Bank Ltd) and Chase Manhattan Bank Luxembourg SA*[232] ruled on the juridical nature of sub-participation agreements. It heard an appeal as to whether a sub-participation agreement between two banks conferred a proprietary interest on the sub-participating bank in the bonds or its proceeds to which the sub-participation agreement related.[233] The issue arose because the grantor bank, which granted the sub-participation, had gone into liquidation, before paying over monies it

[224] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 717–718 para 12.8.1; McCormack *Secured Credit under English and American Law* (2004) 247.
[225] Ibid McKnight *et al*.
[226] Ibid McKnight *et al*. It is also said that the sub-participant acquires a double credit risk, namely, the risk of both the borrower and the lender defaulting or going insolvent.
[227] Ibid McKnight *et al*. The EU Capital Requirements Regulation is cited as Reg (EU) 575/2013, Articles 243 and 244.
[228] Wright *International Loan Documentation* (2014) 255–256.
[229] Ibid.
[230] Proctor *The Law and Practice of International Banking* (2015) 455 para 22.29(h); Penn, 'Promoting liquidity in the secondary loan market: Is sub-participation still fit for purpose?' (2022) 37(3) *Journal of International Banking Law and Regulation* 85–102.
[231] Ibid.
[232] *Lloyds TSB Bank PLC v Clarke (Liquidator of Socimer International Bank Ltd) and Chase Manhattan Bank Luxembourg SA* [2002] UKPC 27, [2002] 2 All ER (Comm) 992.
[233] Ibid at paragraph 2.

received to its participant. The court held that sub-participation agreements are back-to-back non-recourse funding arrangements related to loans rather than bonds, that does not create any proprietary or beneficial interests in the loan, and that it creates a debtor-creditor relationship.[234] The sub-participant thus enjoys no privity of contract with the borrower and the original loan between the lender(s) and borrower remains in tact. As the sub-participant acquires no proprietary or beneficial interests in the loan, the court held that the sub-participant was an unsecured creditor in Socimer's liquidation. It is worthy noting that very few US decisions have in fact adopted positions similar to the English law approach.[235]

McCormack states that in a sub-participation, the loan originator *'sells part of it, i.e. an undivided interest in the loan and any security given in respect of the loan to a third party, which would normally be another financial institution'*,[236] with loan sub-participations having a dual purpose, namely, to help banks get the loans off their balance sheets for capital adequacy purposes, or to reduce the banks' exposure to particular borrowers.[237] Crampton describes a sub-participation as a *'contract which sells the cash stream from an underlying bank loan to a third party.'*[238] Buckley describes a sub-participation as a separate contract concluded between the lender and the sub-participant whereby the sub-participant pays the lender an amount in exchange for the lender remitting the principal and interest received from the borrower to the sub-participant.[239] Similarly, Crampton describes a sub-participation as a loan participation agreement that is concluded between the bank and a third party or parties.[240] Moorcroft states that in a sub-participation, the facility agreement remains between the lender and the borrower.[241] Facility agreements typically do not require the borrower's consent to a sub-participation because a sub-participation leaves the facility agreement intact.[242] Moorcroft views the sub-participant's role as a surety against which the mandated lead lender has limited recourse.[243] Moorcroft uses the concept of *undivided interest* in respect of participations as opposed to syndication, whereas McCormick uses it in respect of syndication. Wright states that in a sub-participation *'[t]he new lender acquires rights against the existing lender, but not against the borrower.'*[244]

Historically, the sub-participant had no claim against the borrower, and this was considered to be the main weakness of sub-participations.[245] As sub-participations

[234] Ibid at paragraphs 16 and 17.
[235] Proctor *The Law and Practice of International Banking* (2015) 455 para 22.29(h).
[236] McCormack *Secured Credit under English and American Law* (2004) 247.
[237] Ibid.
[238] Crampton 'Originating Lender Bank Liability to Participants in the B-Tranche of a Leveraged Loan: Mending the Gap Between Federal Banking and Federal Securities Regulation' (1997) 1 *North Carolina Banking Institute* 255 at 258.
[239] Buckley 'The Law of Emerging Markets Loan Sales: Part 1' (1999) 14(4) *Journal of International Banking Law* 110–114 at 114.
[240] Crampton 'Originating Lender Bank Liability to Participants in the B-Tranche of a Leveraged Loan: Mending the Gap Between Federal Banking and Federal Securities Regulation' (1997) 1 *North Carolina Banking Institute* 255 at 258.
[241] Moorcroft *Banking Law* (2021) para 36.2.
[242] Buckley 'The Law of Emerging Markets Loan Sales: Part 1' (1999) 14(4) *Journal of International Banking Law* 110–114 at 114.
[243] Moorcroft *Banking Law* (2021) para 36.2.
[244] Wright *International Loan Documentation* (2014) 255.
[245] Buckley 'The Law of Emerging Markets Loan Sales: Part 1' (1999) 14(4) *Journal of International Banking Law* 110–114 at 114. There are also many other concerns and reservations about the efficacy and risks for sub-participants in loan

evolved, sub-participants, who had initially accepted ineffective rights to the underlying loan, sought direct involvement in enforcement of that loan given that their fortunes were tied up with the loan repayments.[246] Over time, sub-participations evolved from being a simple method used to transfer the economic risk and benefit in extant loans from the lender to the sub-participants, to a more sophisticated form of participating in a loan that not only entitles the sub-participants to the economic risk and benefit but also entitles them, on borrower default, to be elevated, at their or the lender's request, to the status of a lender with rights akin to those held by the lender.[247] Sub-participations, in their original form, were thus derivative of, or mimicked, the underlying loan. Once sub-participants acquire the status of lenders under the facility agreements by exercising the elevation rights, borrower consent is not required to transfer the loan to these lenders, naturally a cause for concern for borrowers.[248] Sub-participations have raised a number of important issues that have permeated academic opinion and court judgments internationally and that are beyond the scope of this thesis. These include determining the point in time when a secondary debt trade becomes enforceable given that these trades are often concluded telephonically followed by email confirmation and formal agreements,[249] whether a member of the syndicate can enforce its rights to repayment of its debt that is due if the majority of the lenders by loan value decline to enforce their rights,[250] the concern that the current form of sub-participations may adversely affect the liquidity of loan assets in the secondary loan market[251] and practical aspects such as decisions required to be made (as between the lender and the sub-participant but that would of necessity involve the borrower) in respect of operating the facility, the lender's rights in respect of the facility and executing enforcement action on a default.[252]

A syndicated loan is further distinguishable from loans that are tranched or tiered and subordinated. According to Crampton, tranche lending originated from the fact that borrowers in need of finance could not repay all their debt simultaneously.[253] Lenders, in response to this and to avoid leveraged loan risks, tranche the loans by attaching different risk profiles to each tranche.[254] Tranches are assigned different ratings, maturities and some have *'back-ended amortisation'*, with banks retaining the rated, shorter maturity tranches that are amortised more aggressively as less risky A-tranches.[255] The tranches (sometimes unrated) with higher default risks because of

participations: see Crampton 'Originating Lender Bank Liability to Participants in the B-Tranche of a Leveraged Loan: Mending the Gap Between Federal Banking and Federal Securities Regulation' (1997) 1 *North Carolina Banking Institute* 255.

[246] Penn, 'Promoting liquidity in the secondary loan market: Is sub-participation still fit for purpose?' (2022) 37(3) *Journal of International Banking Law and Regulation* 85–102.

[247] According to Penn ibid, the LMA Master Funded Participation Agreement, for example, confers extensive rights on the sub-participant in respect of a distressed trade. Since such rights cannot be legally granted because a sub-participation is derivative, the sub-participant, through an independent contract between it and the lender (to which the borrower is not a party), controls and directs the lender's responses in respect of the underlying loan agreement.

[248] Ibid.

[249] Proctor *The Law and Practice of International Banking* (2015) 446 para 22.05.

[250] Penn, 'Promoting liquidity in the secondary loan market: Is sub-participation still fit for purpose?' (2022) 37(3) *Journal of International Banking Law and Regulation* 85–102; Hooley, 'Enforcing syndicated credit agreements: All for one and one for all?' (2016) 2 *Journal of International Banking and Financial Law* 74.

[251] Ibid Penn.

[252] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 719 para 12.8.5.

[253] Crampton 'Originating Lender Bank Liability to Participants in the B-Tranche of a Leveraged Loan: Mending the Gap Between Federal Banking and Federal Securities Regulation' (1997) 1 *North Carolina Banking Institute* 255 at 268.

[254] Ibid.

[255] Ibid.

longer maturities that only amortise after the A-tranches, are sold to non-bank institutions as B-tranches.[256] These lenders remain financially exposed to the borrower's repayment capabilities for longer periods because the A-tranches are repaid first, but the B-tranches compensate for this by having higher returns.[257] In these types of loans, one lender lends in priority to another lender, with loans ranked as senior and subordinated. Ideally, the lenders' respective interests should be regulated in a loan agreement or an intercreditor agreement. It seems that tranche loans are not used often in South Africa,[258] and if they are used, it is typically for a specific commercial reason (such as financing a project[259] or refinancing[260]), with each tranche carrying its own pricing and maturity,[261] and the loan tranches are equally secured with the same security. Unfortunately, there is no South African law on tranche loans.

A bilateral loan can be drafted in the facility agreement so that it can be transitioned to a syndicated loan by the lender selling portions of the loan to new, incoming lenders at a later time. A syndicated loan can also be further syndicated in a secondary syndication after the first syndication is completed. In both scenarios, the sale and transfer is a trade that typically occurs in the secondary loan market. Transitioning a bilateral loan to a syndicated loan, or syndicating an already syndicated loan even further, is achieved by the LMA's South African facility agreements providing (i) that as a matter of construction, the contracting parties include their *'successors in title, permitted cessionaries and permitted transferees to, or of, its and/or obligations under the Finance Documents'*;[262] and (ii) the lender with the right to cede and/or delegate all or any of its rights under the facility agreement to another bank, financial institution or entity whose business it is to provide loans, securities or other financial assets.[263]

In South African law, a loan can be transferred in one of three ways, the first two of which have been sanctioned by our courts. The first way is by novation, whereby the loan as a current, valid obligation is extinguished and substituted with a new loan obligation.[264] A novation can take the form of creating a new obligation between the same parties, or either the creditor or debtor can be substituted by a new party.[265] In the latter instance, novation is termed a delegation.[266] A novation must comply with general contract law principles to be valid, including that the parties must be *ad idem* as to (i) the intention to novate[267] by replacing a current, valid obligation with a new obligation;

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[256] Ibid.
[257] Ibid.
[258] *ITC 1845* 73 SATC 80; *Trinity Asset Management (Pty) Ltd v Grindstone Investments 132 (Pty) Ltd* 2018 (1) SA 94 (CC).
[259] *ITC 1845* 73 SATC 80, where the tranche loan was used to finance the construction of a prison.
[260] SARB's 2005 US$1,5 billion Dual-Tranche Syndicated Term Loan Facility was announced by Mr Tito Mboweni, the then Governor of SARB, on 18 July 2005, where SARB restructured then existing facilities by borrowing US$1,5 billion from 33 banks. Information regarding this transaction is available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2005/4184.
[261] Ibid.
[262] The LMA's Term Facilities Agreement, clause 1.2(a)(i) is an example.
[263] Ibid clause 23.1.
[264] Reinecke *et al* 'Novation and Delegation' *LAWSA* vol 12 2 ed (2012) para 146; Moorcroft *Banking Law* (2021) para 36.4; Buckley 'The Law of Emerging Markets Loan Sales: Part 1' (1999) 14(4) *Journal of International Banking Law* 110–114 at 110.
[265] Harms 'Obligations' *LAWSA* vol 19 (Second Edition Replacement, 2016) para 240.
[266] Reinecke *et al* 'Novation and Delegation' *LAWSA* vol 12 2 ed (2012) para 129.
[267] Lubbe *Contract: General Principles* (2020) 582–583 para 14.34; *Proflour (Pty) Ltd v Grindrod Trading (Pty) Ltd* 2009 JDR 1402 (KZD) para 10 where the court held that intention to novate is never presumed and it must be expressly stated. At para

and (ii) the subject matter of the novation.[268] If there are any formalities that must be complied with to give effect to a novation, then compliance must occur. Novation not only extinguishes and substitutes obligations; it also releases securities, pledges and sureties given for the extinguished obligation.[269] A refinance is a classic example of extinguishing a loan obligation by using the proceeds of a new loan to settle that indebtedness, which then creates a new loan obligation. Such payment releases the security rights held by the lender(s). The parties to the intended novation would conclude an agreement to give effect to the novation.[270] The second way is by an out-and-out cession, whereby an existing right is transferred in its entirety,[271] coupled with a delegation of the related obligations.[272] An out-and-out cession must comply with general contract law principles to be valid and the specific principles applicable to the law of cession. The new lender concludes a contract with the existing lender and the borrower that gives effect to the out-and-out cession. The third way is by a sub-participation discussed above. Here the new lender only concludes a contract with the existing lender, which gives effect to the sub-participation, but not with the borrower. The LMA's South African structure uses the second method, namely, cession and delegation to empower the lender in a bilateral loan to sell and transfer that loan or part of it to new lenders.

The effect of the lender exercising its right to syndicate the loan (as opposed to granting participations in the loan) after it is advanced is to split the lender's claim against the borrower (and the other obligors) for repayment between the initial lender and the new lenders. In South African law, splitting a claim is unlawful if the borrower has not consented.[273] For this reason, the borrower (and the other obligors) typically consent to splitting the claims in the facility agreement.[274]

In the second method discussed above, an out-and-out cession of rights, the security rights held by the lender are, automatically by operation of law, transferred to a cessionary by virtue of the *Pizani* principle,[275] although certain types of security rights must be registered with governmental authorities to be effective.[276] However, if the lender remains a lender after selling portions of the loan to new lenders, the security rights will have to be shared with the new lender on a basis that is proportional to each

12 the court went on to hold that such intention may not necessarily be found in the agreements and that consequently the circumstances of the case, including the parties' conduct, would have to be examined by the court.
[268] Lubbe *Contract: General Principles* (2020) 581–582 para 14.33 and 582–583 14.34.
[269] Ibid 584 para 14.37.
[270] In clause 23.1 (*Changes to the Lenders*) of the LMA's Term Facilities Agreement, the borrower consents to the lender ceding and/or delegating its rights and/or obligations under any finance document to a new lender, and consents to a splitting of claims arising from such a transfer. Cession and delegation are different legal constructs to novation. Clause 33 (*Remedies and waivers*) of the LMA's Term Facilities Agreement requires the parties to consent to novation for it to be effective.
[271] The concept of out-and-out cession is analysed in section 5.1.2 *Cession in security versus out-and-out cession.*
[272] The concept of delegation is analysed in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?*
[273] The splitting of claims is discussed in section 5.4 *Partial cession: Splitting the claim.*
[274] The LMA's Term Facilities Agreement, clause 23.1.
[275] The *Pizani* principle is analysed in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?*
[276] See section 4.5.2 *The registration of security rights.*

lender's risk of non-payment.[277]

3.2.5 *The parties to a syndicate and their functions*

The syndicate is led by a mandated lead arranger or mandated lead lender, often the initial lender. If the mandated lead arranger acts as principal, the syndicate members each place the lead lender in funds sufficient to advance the full commitment.[278] If the mandated lead arranger acts as agent, the syndicate members each pay their loan portions into the agent's bank account, who in turn pays (or loans) the capital to the borrower.[279] The syndication either takes place on a *'best efforts basis'*, where the lender uses its best efforts to raise the capital required by the borrower, but is not contractually bound to raise such an amount, or the mandated lead arranger (or a group) underwrites the deal. In the latter structure, the mandated lead arranger assumes the risk, and invites other lenders to co-lend, failing which the mandated lead arranger advances the full amount committed.[280]

The book-runner manages the syndication process, manages the final composition of the syndicate, manages the primary distribution, sells the underwritten commitment or arranges the syndication on a *'best efforts basis'*, and is also a lender.

The facility agent is appointed by the lenders as their agent,[281] but its fees are paid by the borrower. Its function is primarily that of an administrator and facilitator, co-ordinator of the facility and the lenders, and the lenders representative.[282] The facility agent represents the lenders, administers the facility, reviews the fulfilment of the conditions precedent, acts as the conduit for (i) all payments made[283] and the facility agent then pays the amounts due to the lenders; and (ii) notices issued under the facility, receives and distributes borrower information, calculates interest rates, calls defaults, exercises the lenders' right to accelerate the loan due date, exercises the lenders' discretionary rights, and attends to the mechanics for loan transfers to new lenders.[284] There are conflicting schools of thought as to whether the facility agent owes fiduciary obligations to the syndicate lenders. The one school contends that as the agent fulfils traditional agency functions and has wide discretion when doing so, it consequently has fiduciary obligations to the syndicate lenders.[285] The other school contends that as the facility agent performs administrative duties on an arm's length basis, and as the facility agreement typically excludes any fiduciary relationship between the facility agent and

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[277] The methods for sharing security rights between lenders and the transferability of security rights are considered in section 4.11 *Security structure and security rights of syndicate lenders.*
[278] Burgess *Corporate Finance Law* 2 ed (1992) 260 para 7.53.
[279] Ibid para 7.53.
[280] Loan Market Association 'LMA Syndicated Loans Workshop Bonds, Loans and Sukuk Africa' Cape Town, 15 March 2016; Bratton *Corporate Finance* (2012) 304–305. At 304, Bratton defines syndication as '[a] very large loan made to one borrower by a group of banks'.
[281] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 520 para 9.6.1.1.
[282] Ibid at 520–521 para 9.6.1.1; Proctor *The Law and Practice of International Banking* (2015) 425–426 para 21.23; Wright *International Loan Documentation* (2014) 272–273; the LMA's Term Facilities Agreement, clause 25.3 (*Duties of the agent*).
[283] See section 3.2.5 *The parties to a syndicate and their functions.*
[284] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 520–521 para 9.6.1.1; Proctor *The Law and Practice of International Banking* (2015) 425–426 para 21.23; Wright *International Loan Documentation* (2014) 272–277.
[285] Ajibo 'Syndicated Lending: Re-conceptualising the Role of the Managing Bank and Agent Bank' (2015) 30(9) *Journal of International Banking Law and Regulation* 476–486 at 2 (Westlaw version), who cites commentators such as Tennekoon at n 14 and Qu and Menges at n 15 as proponents of the position that agency implies fiduciary obligations to the syndicate lenders.

the lenders it represents, the facility agent has no fiduciary obligations.[286] The better view, it is submitted, and which is in fact the view of the English court in *Torre Asset Funding Ltd v Royal Bank of Scotland plc*[287] *('Torre')* and the LMA,[288] is that the facility agent's obligations are not intended to create a fiduciary relationship between the facility agent and the lenders[289] if one considers the administrative and technical nature of the agent's duties, and the contractual exclusion of any such fiduciary relationship. In *Torre,* the facility agent in its capacity as agent for the junior lenders, discussed rescheduling the borrower's debt with the borrower not realising it constituted an event of default. The court limited the facility agent's role to what was stated in the agreement. It declined to extend the facility agent's obligations, and accepted that the agreement excluded a fiduciary relationship between the facility agent and the lenders.[290] Facility agents are averse to attracting fiduciary obligations to lenders they represent because of the potential liability they would be exposed to. Facility agreements tend to exclude the facility agent's liability and responsibility that may be alleged the facility agent has within a duty of care, to protect the lenders' interests,[291] in the performance of its obligations. These obligations include exercising discretionary rights or ensuring the adequacy of documentation or information on which the lenders rely. The facility agent's discretionary rights in performing its obligations do not, in the LMA's Term Facilities Agreement, attract fiduciary responsibilities.[292]

The facility agent takes its instructions from all lenders if the matter requires an all-lender decision,[293] and, in all other instances, it takes its instructions from the majority lenders.[294] The types of matters requiring all-lender decisions and those requiring majority lender decisions can be highly contested areas as between the classes of lenders. Instructions given to the facility agent by the majority lenders bind all the finance parties, which include mezzanine and junior lenders, and override any conflicting instructions, unless that matter is reserved for decision by another lender.[295] Majority lenders are defined as lenders whose commitments aggregate more than 66.6 per cent.[296] If no instructions are forthcoming, the facility agent can exercise its discretion to act in the lenders' best interests.[297] Contractually, the facility agent is obliged to execute the majority lenders' instructions regardless of the loan repayments at that time. So, for

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[286] Ibid. Ajibo cites commentators such as Clark and Farrar at n 16, Mugasha at n 17 and Skene at n 18 as proponents of the position that the agent has no fiduciary obligations to the syndicate lenders; McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 524–525 para 9.6.2.1.4.
[287] *Torre Asset Funding Ltd v Royal Bank of Scotland plc* [2010] All ER (D) 295 (Oct); [2013] EWHC 2670 (Ch).
[288] The LMA's Term Facilities Agreement, clause 25.5(a) (*No fiduciary duties*).
[289] Ajibo 'Syndicated Lending: Re-conceptualising the Role of the Managing Bank and Agent Bank' (2015) 30(9) *Journal of International Banking Law and Regulation* 476–486 at 2 (Westlaw version).
[290] *Torre Asset Funding Ltd v Royal Bank of Scotland plc* [2010] All ER (D) 295 (Oct); [2013] EWHC 2670 (Ch); Proctor *The Law and Practice of International Banking* (2015) 426–427 para 21.25; Wright *International Loan Documentation* (2014) 273.
[291] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 530–531 para 9.6.3.4.
[292] The LMA's Term Facilities Agreement, clause 25.5(a) (*No fiduciary duties*) read with clause 25.7 (*Rights and discretions*).
[293] The LMA's Term Facilities Agreement, clause 25.2(a)(i)(A) (*Instructions*); McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 456–457 para 9.2.3.
[294] The LMA's Term Facilities Agreement, clause 25.2(a)(i)(B) (*Instructions*); McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 456–457 para 9.2.3.
[295] The LMA's Term Facilities Agreement, clause 25.2(c) (*Instructions*).
[296] The LMA's Term Facilities Agreement, clause 1.1, definition of *'Majority lenders'*. Multiple lender transactions distinguish between senior lenders, mezzanine lenders and junior lenders. Each of these categories will then have its own majority lender thresholds for decision-making and voting purposes.
[297] Ibid clause 25.2(e) (*Instructions*).

example, the facility agent must obey the majority lenders' instructions while the senior loans remain outstanding, even if second ranked security was created to secure the mezzanine and junior lenders' interests, unless that matter is reserved for decision by another lender or a lender group.

Then one has all the lenders, who may be categorised as senior, mezzanine and junior lenders. A syndicate can be as simple as consisting of one senior lender and one mezzanine lender, or as complex as consisting of multiple senior lenders, multiple mezzanine lenders and multiple junior lenders.

3.2.6 *The phases of syndication*

Godlewski and Weill[298] provide an insightful analysis of the factors that affected a bank's decision to syndicate loans in emerging markets in Asia, Central and Eastern Europe, the Middle East and Latin America, during the period 1992 to 2004. In their analysis, they describe bank syndication as a sequential, three-phase process. In the pre-mandate phase, the borrower invites competitive bids from banks, chooses a lead bank, and mandates it to form a syndicate. The borrower and the lead bank, acting as the syndicate's agent, negotiate the preliminary loan terms. The syndicate is not a legal *persona* in that it has no capacity to contract, sue or be sued. Although the syndicate may have been formed, the syndicate members may not yet have subscribed for their portion of the loan. In the post-mandate phase, the lead bank initiates the syndication process, which includes preparing an information memorandum that contains information about the borrower, preparing a package for possible members, inviting them to participate in the syndicate, and drafting a facility agreement. The lead bank tries to manage the subscriptions to the loan so that it is neither over-subscribed nor under-subscribed, and then determines each bank's loan allocation. In the third phase, the loan becomes operational and the parties are legally bound[299] in the manner contemplated in section 2.2 (*The nature and genesis of loans in South African law*).

The LMA describes the phases similarly, although somewhat differently.[300] In the pre-mandate phase, the mandated lead arrangers and book-runners negotiate market terms with the borrower, obtain credit approval, and devise and execute a syndicate strategy (for example, on an underwritten basis or a 'best efforts basis'). In the post-mandate phase, the information memorandum is prepared, the syndicate is launched, legal counsel drafts the loan and security documentation, which are negotiated between the banks and the borrower, and participations in the loan are allocated amongst the syndicate members. In the last phase, the transaction is closed by the parties signing all the loan and security documentation and holding a closing meeting if needed. Once the transaction is closed, the facility agent is responsible for the transaction.

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[298] Godlewski & Weill 'Syndicated Loans in Emerging Markets' 2008 *Emerging Markets Review* 206.
[299] Ibid 208 para 2.1.
[300] Loan Market Association 'LMA Syndicated Loans Workshop Bonds, Loans and Sukuk Africa' Cape Town, 15 March 2016.

3.2.7 *The contractual and economic relationship between the syndicate lenders*

In a syndicated loan, lenders agree contractually to rank the repayment of their loans *pro rata* and rank the enforcement of their rights and security interests, in the same order of priority. Any repayment or enforcement priorities that are not *pro rata* are dealt with either in an intercreditor agreement or by structural subordination. The lenders further agree on a payment waterfall or a funds flow waterfall, where incoming funds paid by the borrower in settlement of the loan are distributed between the lenders in stipulated amounts and in a specified order of priority to settle the borrower's debt.[301] If incoming funds received by lenders exceed the amount due to them or are not repaid in the specified order of priority, but are repaid in a different order, unpaid lenders or lenders who were paid less than the amount agreed will have claims against the borrower or the other lenders for the repayment of their loans. The intercreditor agreement ensures the orderly and structured settlement of claims and the enforcement of security rights. Although an intercreditor agreement is, for these reasons, fundamental to a syndicated loan, its enforcement can be mired in controversy if it seeks to alter lenders' rights *inter se* on the borrower's insolvency.[302]

A facility agreement typically also contains a so-called sharing clause which facilitates the lenders being repaid equally from a payment made to a lender in preference to other lenders.[303] The clause states that if a lender receives or recovers amounts directly from an obligor otherwise than in accordance with the agreed repayment structure, that lender is obliged to notify the agent who will determine if such payment exceeds the agreed repayments. If so, the recovering party is obliged, within three business days of the agent's demand, to pay such amount over to the agent who then redistributes such amount between the lenders in accordance with the contracted payment structure.[304] McKnight *et al* contend, correctly so, that the sharing clause gives effect to the *pari passu* distribution of payments amongst the lenders.[305]

The lenders' respective commercial and legal positions are as follows. The capital required by the borrower and the associated risks are apportioned between the lenders. The senior lender, typically a secured creditor, lends most of the capital, is repaid first in the payment waterfall from incoming repayments, and holds first ranked security. The mezzanine lender lends subordinated debt, with its claims and security ranking after those of the senior lender. The mezzanine lender usually charges a high interest rate.

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[301] Johns 'Financing as Governance' (2011) 31(2) *Oxford Journal of Legal Studies* 391–415 at 401 n 38. The payment waterfall typically distinguishes between pre- and post-enforcement scenarios. In the pre-enforcement scenario, as an example, the payment priority includes all debts of the borrower paid in this order (i) all costs, charges and fees due under the finance documents; (ii) operating costs; (iii) taxes; (iv) interest due under the loan; (v) capital repayments due under the loan; (vi) mandatory prepayments of the loans; (vii) voluntary prepayments of the loans, and so forth.

[302] Morrison 'Rules of Thumb for Intercreditor Agreements' 2015 *University of Illinois Law Review* 721–734 where Morrison discusses the conflicting positions taken by US courts on enforcing intercreditor agreements that assign or waive creditors' bankruptcy rights.

[303] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 455 para 9.2.2.1; Proctor *The Law and Practice of International Banking* (2015) 435 para 21.40.

[304] The LMA's Term Facilities Agreement, clause 27 (*Sharing among the finance parties*). The clause contains related terms and nuances not relevant to this thesis. The origins, development and complexities of (applying) the sharing clause are not dealt with in this thesis. In this regard, see for example, Proctor *The Law and Practice of International Banking* (2015) 435–437 paras 21.40–21.45.

[305] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 455 para 9.2.2.1.

Amon and Dorfleitner,[306] relying on information and statistics of the Directorate-General for Enterprise and Industry in 2007 and Henson's view,[307] contend that, in Europe, with mezzanine lenders seeking returns of between 15 and 25 per cent on their loans, the overall costs of these loans are higher than senior debt. The mezzanine lender is repaid next in line in the payment waterfall, after the senior debt has been repaid. The junior lender lends the least, ranks last in the payment waterfall, and usually lends on an unsecured basis.

The economic relationship between senior debt and mezzanine debt, and by implication the relationship between senior lenders and mezzanine lenders, has been studied in Europe. In a limited study examining the influence of mezzanine financing on medium-sized European businesses, Amon and Dorfleitner[308] reviewed 4,728 mezzanine transactions as at 31 December 2010, worth €64.4 billion, that were transacted in Europe between 1971 and 2010 as part of 28,400 private equity transactions. They found that, before the 2007 to 2008 international economic crisis, transactions comprised a higher senior debt proportion and a lower subordinated debt proportion, whilst during the crisis the proportions were inverted, with lower senior debt proportions and slightly higher subordinated debt proportions. Their hypothesis, factually proven by the data set analysis, was that senior debt and mezzanine debt are negatively correlated to each other.

Drawing on this conclusion, it is theoretically probable in the financing of medium-sized European businesses that the senior debt to mezzanine debt ratio was, during the 2007 to 2008 crisis, inversely proportional to each other. A similar study would have to be conducted in South Africa to determine the correlation between senior debt and mezzanine debt to understand the relationship between senior lenders and mezzanine lenders.

The syndicate lenders may, however, not require security for the loan if the borrower's balance sheet is strong, the borrower is classified as 'investment grade',[309] or the lenders are satisfied that the risk of non-payment or borrower insolvency is remote. In such instances, the lenders' interest rates are usually higher than if they had security, to compensate them for not having security.

3.2.8 *Insolvency considerations*

South Africa's insolvency laws rank syndicate lenders' rights *inter se* against the borrower's insolvent estate and distinguish between secured, preferent and concurrent creditors, which categories apply equally to syndicate lenders regardless of their title as

[306] Amon & Dorfleitner 'Financial Crisis' 2013 *Journal of Small Business & Entrepreneurship* 173.
[307] Henson 'The Pros and Cons of Using Mezzanine Capital' (August 2010) *Denver Business Journal* 6–12.
[308] Amon & Dorfleitner 'Financial Crisis' 2013 *Journal of Small Business & Entrepreneurship* 174, 175 and 178.
[309] According to Investopedia, investment grade is the quality of a company's credit rating, and a company must have a credit rating by Moody's or Standard and Poor of 'BBB' or higher. A rating of below 'BBB' is considered to be non-investment grade. See https://www.investopedia.com/ask/answers/what-does-investment-grade-mean.

senior, mezzanine or junior lenders.[310] Syndicate lenders in South Africa are mainly secured creditors (in the South African insolvency law sense) and are unlikely to be preferent or concurrent creditors. Secured creditors rank either as senior[311] or mezzanine[312] if they hold security, with both classes of creditors due to be paid out of realised assets or property that were ringfenced to satisfy the borrower's debts owed to them. However, if the realised proceeds are insufficient to settle secured lenders' claims, the balance of their claims rank as concurrent, to be paid from any free residue.[313]

In South African law, the effect of a lender subordinating its claims against the borrower in favour of another lender's claim is to render the cause of action of the subordinating lender's claim temporarily incomplete so that its claim cannot be enforced[314] until the lender in whose favour its claim is subordinated[315] has been paid in full.[316] The liquidator is obliged to implement the terms of a valid subordination agreement in force at the date of winding up the company,[317] provided it does not seek to alter the *concursus creditorum.*[318] If, however, the subordinating lender's claim is subject to the condition that the borrower achieves solvency, that claim is not conditional as required in the Insolvency Act and the lender will never be able to prove its claim if the borrower remains insolvent.[319] Framed differently, the condition to which the subordinating lender's claim is subject will never be achieved if the borrower remains insolvent. If the subordinating lender's claim is merely subordinated in favour of other lenders' claims, but not until the borrower achieves solvency, then it will be able to prove its claim.[320]

Secured claims that rank *pari passu*[321] contractually rank equally and without preference.[322] In this scenario, the syndicate lenders share the security rights through a Security SPV.[323] However, secured claims that do not rank *pari passu* will be paid out of the proceeds of realised assets that formed the subject of that security. As each asset value will differ, the payments will in consequence differ. In limited instances, the Insolvency Act applies the *pari passu* principle to certain types of claims[324] and there is

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[310] Insolvency Act 24 of 1936. See the discussion in section 4.4 *The meaning of 'security' in the Insolvency Act*, which explains the differences between secured, preferent and concurrent creditors.
[311] The LMA's intercreditor agreement for leveraged acquisition finance transactions (senior/mezzanine), 20 March 2020, clause 2.1(a) in respect of payments and clause 2.2(a) in respect of security.
[312] Ibid clause 2.1(b) in respect of payments and clause 2.2(b) in respect of security.
[313] Meskin *Insolvency Law and its Operation in Winding-Up* (1991); Sharrock 'Secured Creditors and Realisation of Secured Property' *LAWSA* vol 11 2 ed (2008) para 323 onwards.
[314] See the discussion in section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims*, which explains the principles of subordination in South African law in the section *Subordination*.
[315] For example, if the lender as a secured lender had subordinated its claims in favour of other secured lenders, the subordinating lender's claim will be paid only once all other secured lenders' claims have been paid in full.
[316] *Ex Parte De Villiers and Another NNO In Re Carbon Developments (Pty) Ltd (In Liquidation)* 1993 (1) SA 493 (A) at 505.
[317] Ibid. See Morrison 'Rules of Thumb for Intercreditor Agreements' 2015 *University of Illinois Law Review* 721–734 for an exposition of the controversy regarding the enforceability of intercreditor agreements in the USA where such agreements assign or waive creditors' bankruptcy rights.
[318] The *concursus creditorum* is analysed in section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims* under the heading *Subordination*.
[319] Section 48 of the Insolvency Act; Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 9.3.
[320] Section 48 of the Insolvency Act.
[321] *Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries* 1979 (3) SA 713 (W) 715B. See section 4.8 *Pari passu ranking of security*.
[322] Ibid. For example, secured lenders may agree in an intercreditor agreement that their claims rank *pari passu.*
[323] See section 4.11 *Security structure and security rights of syndicate lenders.*
[324] See ss 96(3) (*death-bed expenses*), 97(2)*(c)* (*costs of sequestration*) and 99(2) (*preference in regard to certain statutory obligations*) of the Insolvency Act.

no statutory application of the *pari passu* principle generally to all creditors of an insolvent estate.[325] At common law, the principle *paritas creditorum* (equality of creditors) applies to all unsecured creditors whereby each creditor will be paid an amount proportionate to its claim, without any creditor being advantaged over other creditors.[326] Subordination alters the *pari passu* ranking of claims because the subordinated claim will be paid after the other claims are paid, not equally with and when such claims are paid. The type of risk that the syndicate lenders are willing to undertake in relation to repayment and security rights determines their ranking. In turn, the syndicate lenders can then determine their pricing for such risk.

3.2.9 *Tranche wars among syndicate lenders*

If the borrower defaults on repaying the loan to both the senior lender and the mezzanine lender, the lenders, in seeking to enforce their competing claims to repayment and security, may engage in litigation aptly described as a tranche war.[327] Although intercreditor agreements may contain contractual mechanisms to manage the competing lenders' claims, tranche wars may still arise if parties interpret such mechanisms differently. This occurred in 2010 in a New York court decision by Judge Lowe in *Bank of America, NA v PSW NYC LLC*,[328] which strengthened the position of senior lenders in relation to mezzanine lenders in a structured or tiered loan.[329] The court found in favour of the senior lenders that the mezzanine lenders had to cure all senior loan defaults committed by the borrower, and dismissed the mezzanine lenders' arguments, as did the Court of Appeals.

In South Africa, tranche wars have not yet come before our courts, and it remains to be seen if our courts will follow the approach and rationale of the New York courts. The South African courts will most likely give effect to the parties' intentions set out in an LMA-styled intercreditor agreement. The nature of the remedy afforded by South African courts to lenders will be determined by *inter alia* the terms of the intercreditor agreement, and considerations of fairness and public policy. The probabilities are reasonably strong that, in a similar dispute, the South African courts may enforce a mezzanine lender's obligation to cure senior loan defaults prior to allowing it to realise its security rights. Such enforcement will most likely occur because both legal systems recognise the hierarchical ranking of senior, mezzanine and junior claims.[330] The position under English law is similar. In South Africa, whether senior, mezzanine and junior lenders are

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[325] There is no such principle cited in the Insolvency Act other than in respect of ss 96(3), 97(2)*(c)* and 99(2). The seminal insolvency works of Meskin *Insolvency Law and its Operation in Winding-Up* (1991) and Sharrock 'Secured Creditors and Realisation of Secured Property' *LAWSA* vol 11 2 ed (2008) make no mention of such a general *pari passu* principle.
[326] Brits *Real Security Law* (2016) 2.
[327] Bobbit 'Mezzanine and Mortgage Lenders' 2012 *Columbia Business Law Review* 240–283. The term 'tranche war' arose in the context of real estate finance but can be extended to disputes between lenders of all types of finance.
[328] *Bank of America, N.A. v PSW NYC LLC* 918 N.Y.S.2d 396 (2010); Stangland & Ferguson 'Intercreditor Case Law Update' (2012) 129(3) *Banking Law Journal* 280 at 283.
[329] In *Bank of America, N.A. v PSW NYC LLC* 918 N.Y.S.2d 396 (2010) the court adjudicated a dispute between senior lenders with loan claims aggregating $3 billion and 11 separate mezzanine loans aggregating $1.4 billion arising from the borrower defaulting on both senior and mezzanine loans.
[330] South African courts acknowledge the distinction between senior, mezzanine and equity/junior funding even though these have not been accepted into South African law as forms of funding. See for example, *Maleth Investment Fund (Pty) Limited v Paget* 2014 JDR 0968 (GSJ) and *Structured Mezzanine Investments (Pty) Ltd v Davids and Others* 2010 (6) SA 622 (WCC); [2011] All SA 583 (WCC) where the court *inter alia* acknowledged the existence of mezzanine funding as a form of funding.

simultaneously secured, preferent or concurrent creditors under our insolvency law is a matter of fact determined by the nature of the security rights held by them.

3.2.10 *The origins of mezzanine finance*

Mezzanine finance, which forms an integral part of syndicated lending, was initially used to fund only sector-specific transactions in South Africa, the UK and the USA. The 2007 to 2008 international financial crisis resulted in senior lenders being less willing to fund companies. Amon and Dorfleitner,[331] for example, state that according to Standard & Poor's third quarterly review of the European market for 2010, senior debt in Europe dropped from €165.5 billion in 2007 to €53.6 billion in 2008. It is submitted that because banks were cautious about advancing senior loans, mezzanine finance becoming an alternative and popular funding source.

Bobbitt[332] contends that mezzanine lending in the US real estate sector arose out of the pitfalls of second mortgage financing, which came to light in the savings and loan crisis of the late 1980s. Pratt and Crowe[333] note that mezzanine lending in the UK was introduced in the 1980s by US banks that funded management buyouts, whilst Amon and Dorfleitner[334] cast the net wider by contending that it was in fact introduced into Europe in the 1980s to fund leveraged buyout transactions.

3.3 The Loan Market Association standard-form loan documents and English law lessons

Secured lending in South Africa, also referred to internationally as secured credit or secured loans,[335] occurs in an international context. The LMA, headquartered in the UK, has standardised loan documentation for the South African market.

3.3.1 *LMA standard-form loan documents for South Africa*

The LMA has published different types of facility agreements for use in the South African market for investment grade financings.[336] Some of the important aspects of the LMA's South African facility agreements are analysed in this thesis. However, the LMA has not produced any facility agreements for non-investment grade financings or security agreements for the South African market, in respect of which the risks faced by lenders will probably be different to investment graded borrowers. The facility agreements are standard-form agreements and are typically negotiated by the lender(s) and borrower(s), amended to reflect such negotiations, and then signed.

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[331] Amon & Dorfleitner 'Financial Crisis' 2013 *Journal of Small Business & Entrepreneurship* 170.
[332] Bobbitt 'Mezzanine and Mortgage Lenders' 2012 *Columbia Business Law Review* 240–283.
[333] Pratt & Crowe 'Mezzanine Finance' 1995 *Bank of England Quarterly Bulletin* 371.
[334] Amon & Dorfleitner 'Financial Crisis' 2013 *Journal of Small Business & Entrepreneurship* 171.
[335] See, for example, McCormack *Secured Credit under English and American Law* (2004) and Wright *International Loan Documentation* (2014).
[336] These are (i) Unsecured Single Currency Single Borrower Term Facilities Agreement; (ii) Unsecured Single Currency Multiple Borrower Term Facilities Agreement; (iii) the LMA's Single Borrower Term and Revolving Facilities Agreement; (iv) the LMA's Multiple Borrower Term and Revolving Facilities Agreement; and (v) Single Currency Secured Term Facilities Agreement. The concept of *investment grade* is discussed in n 309.

In addition to standardising lenders' approaches to loans, the LMA standard-form loan documentation promotes the transferability of loans, thereby increasing liquidity in the markets.[337] As Ivashina and Scharfstein put it, the significance of transferability is that it extends the credit cycle.[338]

3.3.2 *English case law lessons regarding acceleration notices and the priority of claims*

While the UK body of case law in respect of disputes arising from bilateral and syndicated facility agreements and the related security agreements, and therefore disputes about secured lending, is developing, there is virtually no South African case law on syndicated lending and the related security. Two recent notable English judgments of the High Court of Justice of England and Wales dealing with acceleration notices, and the priority and subordination of claims can provide guidance to South African law on secured loans because the LMA's South African facility agreements contain acceleration rights.[339] South African law has some jurisprudence on the subordination of claims.[340]

Acceleration notices

In English law in 2016 in *African Export-Import Bank and Others v Shebah Exploration and Production Company Ltd and Others*[341] (*'African Export'*), the claimants (the lenders) sought summary judgment against the first defendant (the borrower) and the second defendant (the guarantor) for an amount of US$144.2 million plus interest, the principal debt having been borrowed pursuant to a syndicated loan facility.

When the first defendant breached the facility agreement by not repaying the loan, the claimant issued an acceleration notice on 6 September 2013, and contended that the notice took effect on 16 October 2013 (one month after the 16 September 2013 instalment was due) without the claimant having to issue any further notices. The defendants disputed the effectiveness of the acceleration notice as it was expressed to be effective at a future date, whereas the acceleration clause required the outstanding amount to be immediately due and payable. Judge Phillips granted summary judgment in favour of the claimants against the defendants and held that the acceleration clause did not entitle the claimants to pick a future date of their choice on which the loan was due and payable and that the loans must be immediately due and payable to fall within the clause. In other words, for an acceleration notice to be valid, it must set out that the loan is immediately due and payable, not that it will become due and payable at a future date if the borrower fails to repay the loan on maturity. The relevance of this judgment is discussed in section 3.3.3 (*The consequences of an event of default*).

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[337] See www.lma.eu.com; Hughes 'Transferability in Syndicated Lending' (2007) 1(1) *Law and Financial Markets Review* 21–24.
[338] Ivashina & Scharfstein 'Loan Syndication and Credit Cycles' (May 2010) 100 *American Economic Review: Papers and Proceedings* 57–61 at 57. See http://www.aeaweb.org/articles.php?doi=10.1257/aer.100.2.57.
[339] The nature of acceleration rights is discussed in section 3.3.3 *The consequences of an event of default.*
[340] Subordination is dealt with below under the heading *Subordination.*
[341] *African Export-Import Bank and Others v Shebah Exploration and Production Company Ltd and Others* [2016] EWHC 311, Queen's Bench Division, Commercial Court.

Priority

The priority of claims over other claims is effectively the subordination of claims to other claims. Subordination of claims is a feature of syndicated, secured lending in South Africa and internationally, and is a legal construct accepted in both South African law and English law. A brief discussion of the position in English law and the position in South African law follows.

In 2013, in *Bank of New York Mellon (London Branch) v Truvo NV and Others*[342] (*'Mellon'*), the claimant and defendant, two lenders, each contended that different consent levels were required under a senior facilities agreement to amend a particular provision. The clause that was being amended concerned the application of mandatory prepayments as between the senior lenders and the second *lien* lenders. The parties wished to amend the order in which payments would be made in certain circumstances. Millar, the holder of the senior debt and the second *lien* debt, contended that the senior facilities agreement required the consent of only two-thirds of the lenders. Deutsche Bank, AG (London branch), also a holder of senior debt and second *lien* debt, contended that the senior facilities agreement required the consent of 100 per cent of the lenders, which included the second *lien* lenders. The court held that it made no commercial sense to contend that a lower percentage lender consent level was required for an important decision, and a higher percentage lender consent level was required for a less important decision. The court held that the majority lenders could amend the mandatory prepayment proceeds clause without each second *lien* lender's consent, which made commercial sense. This was the position especially where there was a real possibility of a distress event occurring. After considering a number of arguments, the court concluded that Millar's construction that the consent request signed by the majority lenders did not have the effect of amending or changing *'the order of priority or subordination under the ICA within the meaning of Clause 40.3(a)(v) of the SFA and there is nothing in the ICA (including Clauses 14 or 27) which would justify a contrary conclusion'*[343] was correct. Accordingly, the consent of all lenders was not required, and the consent of the majority lenders and Truvo to the amendment was sufficient to constitute an effective and valid amendment.

It is submitted that two important lessons can be learnt from the *Mellon* judgment, which ought to be applied in South African law insofar as mandatory prepayments are concerned. First, the terms *'priority'* and *'subordination'*, although used to rank payments to creditors on the borrower's insolvency, need not be restricted to this situation. Such terms can also be used to rank payment to creditors in a mandatory prepayment scenario where the debtor is solvent. Second, the parties to the loan ought to stipulate in the loan documentation if priority and subordination will apply to the mandatory

[342] *Bank of New York Mellon (London Branch) v Truvo N.V. and Others* [2013] EWHC 136, Queen's Bench Division, Commercial Court; Kariem 'Lender Consent: Priority, Subordination and Mandatory Prepayments' *Finance and Banking Alert* Cliffe Dekker Hofmeyr Inc., 16 May 2016.
[343] *Bank of New York Mellon (London Branch) v Truvo N.V. and Others* [2013] EWHC 136, Queen's Bench Division, Commercial Court, para 95.

prepayment provisions, and what level of lender consent is required to alter the mandatory prepayment ranking. Ordinarily, the facility agreement contains a clause that ranks all payments received under that agreement into the payment waterfall which ought to expressly stipulate that priority and subordination will apply to mandatory prepayment proceeds.

Subordination

In South African law, subordination is an *incidentale* of the loan created contractually between lenders whereby the priority of one lender's claim(s) over another is agreed, and the enforceability of the subordinating lender's claims is postponed or is put in abeyance. In English law, Gough offers an instructive definition of priority (the same concept as subordination) that applies with equal force in South African law:

> *Priority is the process of ranking proprietary claims of different parties arising from successive charge assignments, each being valid as between assignor and assignee.*[344]

The *'process of ranking proprietary claims of different parties'* is exactly what lenders achieve by a subordination contract in South African law. Bratton suggests that subordinated debt is issued to enable borrowers to *'access or conserve borrowing room in their capital structures'.* He further suggests that companies may find that their capital structure will not support further long-term, senior, unsubordinated borrowing.[345] In *Cape Produce Co (PE) (Pty) Ltd v Dal Maso NO and Another*[346] the Appellate Division held as follows:

> *The debt is unenforceable because while the condition subsists the creditor's cause of action itself is deficient. The creditor has no valid claim until the condition the subordination agreement spells out has been fulfilled. Until then the principal debtor has no need to invoke either a defence personal to him- or herself, or the extinction, discharge or invalidity of the debt: the principal debtor is immune from suit simply because the non-fulfilment of the condition, so long as it endures, renders the creditor's cause of action incomplete.*[347]

It is market practice for lenders to agree in a facility agreement or a subordination agreement to subordinate their claims in favour of other lenders to enable a company to achieve an intended financial position such as solvency, or to borrow from lenders who want their claims to be first ranked, because if the company wishes to borrow, it is compelled to subordinate. In a syndicated loan, the subordination by an obligor of any of its claims in the borrower in favour of the lender's claims is typically a condition precedent or a utilisation condition to advancing the loans.[348] In other words, an obligor must subordinate or back-rank its claims against the borrower in favour of the lender's claims against the borrower so that the lender's claims can be paid first. It is the obligor's

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[344] Gough *Company Charges* 2 ed (1996) 741 para 3.
[345] Bratton *Corporate Finance* (2012) 382.
[346] *Cape Produce Co (PE) (Pty) Ltd v Dal Maso NO and Another* [2002] JOL 9674 (A).
[347] Ibid para 6.
[348] The lender's term sheet and the facility agreement typically state that the subordination of the obligor's claims against the borrower is a condition precedent, and its fulfilment is typically confirmed in the enforceability legal opinion issued by the lender's legal counsel which opines on the enforceability of the finance documents.

obligation to fulfil this condition precedent by entering into a subordination agreement in favour of the lender. We state above that subordination alters the *pari passu*[349] ranking of claims because the subordinated claim will be paid after the other claims are paid, not equally with such claims.[350]

Lenders may seek to alter contractually the insolvency law ranking of claims by subordination. A liquidator cannot give effect to the subordination if its object is to vary by contract the statutory ranking of claims (the so-called *concursus creditorum*) on the company's insolvency, as envisaged in the Insolvency Act. The *concursus creditorum* in respect of a company comes into being by operation of law when the application for liquidation is lodged with the registrar of the court, provided it is thereafter granted.[351] It does not come into existence before then and is not a contractual term on which the loan is based. In *Walker v Syfret*,[352] Innes J held that the *concursus creditorum* is when *'the hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order'*.[353] The *concursus creditorum* thus occurs when the liquidation of a company occurs, regardless as to whether the loan is being traded to new lenders. The liquidator is, at that point, bound by the statutory ranking and any attempt to alter it is of questionable validity. An agreement between concurrent creditors to rearrange the payment of their claims whether in respect of value or the payment sequence, so that it does not affect the *concursus creditorum* ranking of other creditors, may well bind a liquidator to pay such claims in the agreed order. It is submitted that subordination cannot make an insolvent company solvent merely because it back-ranks the subordinated claim(s). The fact that one lender has priority, in that its claims are paid first, does not absolve the borrower from its debt, the payment of which is merely postponed.

A distinction is drawn between contractual subordination and structural subordination. In a contractual subordination, the lender agrees to subordinate its claim. In a structural subordination, according to Wright, the loan may be made by a lender to a shareholder as the borrower so that the loan is made to a borrower that is higher up in the group structure, without the lender taking security rights against the income-producing subsidiary of the shareholder.[354] The lender subordinates its claim against the shareholder to whom it loans the money, and depends on the repayment of its loan from dividends declared by the subsidiary (after paying its creditors) to the shareholder (who is the borrower), and the shareholder receives payment of its claims only after the subsidiary's creditors have been paid. The subsidiary uses its income not to declare

[349] See section 4.8 *Pari passu ranking of security*.
[350] See section 3.2.8 *Insolvency considerations.*
[351] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 5.20.
[352] *Walker v Syfret* 1911 AD 141.
[353] Ibid 166.
[354] Wright *International Loan Documentation* (2014) 326.

dividends immediately, but first to repay its creditors. In this way, the claim of the lender is structurally subordinate because the available cash from the income-producing subsidiary is used, first, to pay the subsidiary's creditors and, second, to declare a dividend to the shareholder which is used to repay the loan.[355]

3.3.3 *The consequences of an event of default*

In the LMA's South African facility agreements there are three principal consequences if the lender declares that the borrower has committed an event of default. First, the lender has the right to cancel any of its further funding obligations. The event of default does not automatically trigger the said cancellation.[356] If the lender exercises its rights, then its declaration of an event of default contractually releases it from performing any further funding obligation. Second, if the lender exercises its rights to accelerate repayment, then advanced loans are immediately due and payable[357] by the borrower on demand by the facility agent if a majority of lenders so decide.[358] Wright states that in the latter instance, the lenders can declare the loan to be payable on demand without actually demanding repayment.[359] The reason for this, according to Wright, is that the law in certain jurisdictions requires companies to stop trading after they are unable to pay their debts, so having this event of default avoids triggering that scenario for the company.[360] Third, the facility agent may, or the majority lenders may, direct the Security SPV to exercise any of its discretions, powers, remedies or rights under the finance documents.[361]

In South African law, the mere existence of an acceleration clause in a contract does not necessarily trigger an obligation to pay the capital amount if the debtor fails to pay.[362] Instead, it entitles the creditor to demand payment of the capital amount if the debtor fails to pay.[363] Acceleration clauses in facility agreements are contractually agreed *incidentalia* in terms of which any borrower's default, including potential defaults, entitles the lender to accelerate the loan maturity date and/or exercise its security rights.[364] Acceleration clauses are typically framed widely so that they net all borrower breaches. It has not been decided in South African law whether a lender can accelerate the loan maturity date by reason of the borrower defaulting on an administrative obligation or an information obligation if the borrower is servicing the loan by making the agreed repayments.[365] Acceleration rights are particularly important given the extensive list of defaults contained in the LMA's South African facility agreements that can give rise to

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[355] Ibid.
[356] The LMA's Term Facilities Agreement, clause 22.22(a).
[357] Ibid clause 22.22(b).
[358] Ibid clause 22.22(c).
[359] Wright *International Loan Documentation* (2014) 245.
[360] Ibid.
[361] The LMA's Term Facilities Agreement, clause 22.22(d).
[362] *Stadler v Hamilton Plase (Edms) Bpk* 1977 (1) SA 211 (NC).
[363] Ibid.
[364] The *incidentalia* of a loan agreement are the terms incorporated by the parties either by way of a departure from the *naturalia* (terms implied by law) that would ordinarily have applied to a loan or for which the law does not make provision.
[365] There is no indication in Joubert 'Loans' *LAWSA* (2008) that such a scenario has come before the South African courts.

exercising the right to accelerate the loan repayment.[366]

South African lenders should not, given the legal position in the *African Export* judgment, issue acceleration notices prematurely, before the debt is contractually due and payable, because such a notice has no contractual effect as the debt is not, at that time, due and payable. An acceleration notice must be issued when the debtor fails to pay a debt that is actually due and payable. The maturity date must therefore have passed without the borrower having made payment. In other words, an acceleration notice should not be issued in anticipation of, or on the assumption that, the borrower will breach its loan obligations. It is necessary to distinguish this issue from anticipatory events of default, which are typically events of default. It seems unlikely that a South African court would enforce a notice issued prematurely prior to a default occurring.

3.4 Concluding remarks

The different loan forms or types of loans that are recognised in the South African market are all loans for consumption despite their differences. However, the South African legal system is yet to formally recognise syndicated lending as a loan form. The insolvency law consequences and effects of syndicated lending will most likely be dealt with when such recognition takes place. Similarly, loan participations are yet to be formally recognised by the South African legal system.

[366] The LMA's Term Facilities Agreement, for example, lists 21 instances of default that a borrower could commit; see clause 22 (*Events of default*) of the LMA's Term Facilities Agreement.

4 Chapter Four: Security for Loans

4.1 General remarks

The principles that govern the legal nature, purpose and function of security rights in South African law, including the differences between security rights *in rem* and rights *in personam*, are examined in this chapter. Specifically, security is analysed to lay the conceptual groundwork and theoretical foundation for the analysis of cession and security in the form of cession *in securitatem debiti* in chapters 5 and 6 respectively.

Security interests in personal rights are examined because in current loan structures, lenders rely heavily thereon, especially security interests created by cession *in securitatem debiti.* Often personal rights are as valuable, if not more valuable[367] than traditional assets and immovable property that borrowers encumber as security for loans. The analysis demonstrates that, regardless of the type of personal rights in which a security interest is granted (whether it is the rights to moneys in bank accounts, debtors' books, shares, insurances or intellectual property), the common, underlying conceptual approach to security lies in the general principles applicable to security, the nature of security in personal rights, and its realisation on the borrower's default.

The borrower's failure to repay the loan, non-compliance with the loan obligations, or the borrower becoming insolvent[368] each constitute a material risk to the lender, and each is treated as an event of default under the facility agreement. The LMA's South African facility agreements specifically define events of default by the borrower.[369]

These risks are mitigated by a lender typically requiring security for the borrower's repayment obligation. Security provides credit support for the repayment of loans for consumption by providing the secured lender with legal recourse to the borrower's assets or property, or that of a third party, if the borrower defaults on the loan repayments,[370] and ranks the secured lender's claim in priority to unsecured claims on the borrower's insolvency.[371]

Although the legal principles that govern security rights are generally sound, as some of them have been tested by our courts, it is submitted that systemic deficiencies plague our security system.[372]

A distinction should be drawn between security contemplated in the Insolvency Act and *quasi*-security that is not contemplated in the Insolvency Act. The latter reduces the lender's

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[367] Pogue 'The Spectrum Plus Case: Fixed or Floating Charges over Book Debts in England' (2005) *Banking Inst* 419 at 425, where she states that book debts are the *'primary asset of a company'* and *'the bank has control over a very valuable asset that provides the working capital for the company'*. Book debts are an example of personal rights under discussion here.
[368] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 323.
[369] The LMA's Term Facilities Agreement, for example, lists 21 instances of default that a borrower could commit – see clause 22 (*Events of default*) of the LMA's Term Facilities Agreement.
[370] *Van Oudtshoorn v Investec Bank Limited* 2011 JDR 1609 (SCA) 22 para 32; McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 815–816 para 14.1.1.
[371] Gullifer *Legal Problems of Credit and Security* (2013) 1 para 1-101.
[372] The systemic deficiencies are analysed partly in this chapter but mostly in chapter 8 *The Reform of South African Law on Secured Lending, specifically including Cession in Securitatem Debiti.*

risk of non-payment of the loan, and examples thereof are reservation of title agreements,[373] guarantees and suretyships.

4.2 Principles of security

An analysis is undertaken of the general principles applicable to all security rights and specific principles applicable to some types of security rights. The common-law principles that are analysed apply to bonds, cessions *in securitatem debiti* of incorporeal rights, and pledges of corporeal assets. These principles foreground cession *in securitatem debiti* as credit support for loans.

The case law[374] reveals that principles that apply, and are common to, all forms of security include: the Insolvency Act's meaning of security; the distinction between personal and real security rights; the accessorial principle; the effect of indebtedness on continuing covering security; the realisation of security, including achieving a fair price for pledged assets; and the distinction between *pacta commissoria* and conditional sales.

Security interests enable lenders to *'maximise the … prospects of recovery in the event of the debtor's insolvency'*.[375]

The judicial meaning of *security* has been held to be that which makes *'money assured in its payment or more readily recoverable.'*[376] Security for insolvency law purposes is security over the assets of the insolvent estate but not the assets of third parties.[377]

Security can take the form of personal security, which is a claim that requires performance by the security provider,[378] or real security,[379] which is a claim enforceable against the assets of the security provider and the world at large.[380] South African law recognises different types of personal and real security interests, such as bond registrations,[381] cessions *in securitatem debiti*,[382] pledges,[383] and *quasi*-security such as suretyships[384] and guarantees.[385]

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[373] *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and Others* 2014 (4) SA 319 (SCA); Moorcroft *Banking Law* (2021) para 26.1 at n 2.
[374] Reviewed in this chapter and in chapter 5 *The Law of Cession.*
[375] McCormack *Secured Credit under English and American Law* (2004) 4.
[376] *Seamen Bros v Collet* 1928 EDL 170 at 173.
[377] *Ex Parte The Master, Re Dutton and Seymour* 1921 TPD 347 at 351–353. See section 4.4 *The meaning of 'security' in the Insolvency Act*.
[378] *Scott on Cession* (2018) 15; Brits *Real Security Law* (2016) 2.
[379] Voet *Loan for Consumption* at section 7, page 763, where Voet states that not only does a loan for consumption result in a personal action for the lender to recover the money lent, but also results in other actions *in personam* or *in rem* in respect of securities given for the loan. Also see Moorcroft *Banking Law* (2021) para 26.1.
[380] The distinction between personal security and real security is discussed in more detail in section 4.5 *Personal and real security, and the registration of security rights*.
[381] Voet *Loan for Consumption* at section 28, page 784, where a mortgage over immovable property was recognised. Also see Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) paras 326ff and Moorcroft *Banking Law* (2021) para 26.2.
[382] Lubbe 'Cession' *LAWSA* (2013); Moorcroft *Banking Law* (2021) para 26.3. Moorcroft favours the *pactum fiduciae* theory of cession *in securitatem debiti*. See section 6.5 *The pactum fiduciae theory*; *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[383] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) paras 405ff.
[384] Henning 'Suretyship' *LAWSA* vol 26 2 ed (2020) paras 280ff; Moorcroft *Banking Law* (2021) para 26.5.
[385] Guarantees and suretyships are *quasi*-security because they do not constitute security as defined in s 2 of the Insolvency Act.

The three primary forms of real security,[386] which are based on asset types, may be broadly classified into: (i) bond registrations over immovable or movable property; (ii) rights pledged and ceded *in securitatem debiti* where the proceeds of such rights are the subject of the security;[387] and (iii) rights to corporeal property that are pledged.[388]

The hallmark of security contemplated in the Insolvency Act is that an asset is appropriated to a debt or, put differently, ring-fenced to satisfy a debt.[389]

In the case of bond registrations, cessions *in securitatem debiti* and pledges, which are asset-backed security, the parties agree that if the borrower fails to repay the loan, the asset will be sold and the proceeds used to settle the loan; alternatively, the lender will retain the asset as its own by acquiring legal title to it and set-off its price (which the lender will owe the borrower for the asset) against the debt (which the borrower owes the lender).[390] The lender may do so using permitted summary execution clauses by which the lender transfers ownership or legal title in the asset to itself and credits the borrower with a fair price for the transferred asset or, if prescribed by law, by obtaining a court order.[391] Although cession *in securitatem debiti* is considered real security for insolvency law purposes[392] because it is in the nature of a pledge,[393] it is also simultaneously considered personal security because it is a claim that requires performance by the security provider and can be claimed from its estate.[394]

In the case of suretyships and guarantees, which are not backed by assets, the surety or guarantor must make the required payment on demand from the lender.

The legal basis on which a personal right is ceded as security for a debt has been the subject of legal controversy for a long time. In this regard, security is put in place either by the cedent granting the cessionary a limited right to realise the economic value of the personal right (pledge theory) *or* by a complete transfer thereof to the cessionary subject to the cessionary's obligation to re-cede the ceded personal right to the cedent when it repays the loan (*pactum fiduciae* theory). These aspects are analysed in chapter 6.

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[386] The nature of real security is discussed below. Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 323 states that in the case of real security, the asset that forms the subject of the security belongs to the debtor or someone acting on the debtor's behalf. Also see *National Stadium South Africa* (*Pty*) *Ltd and Others v Firstrand Bank Ltd* 2011 (2) SA 157 (SCA); [2011] 3 All SA 29 (SCA); [2010] ZASCA 164 (SCA) para 31.

[387] Lubbe 'Cession' *LAWSA* (2013); *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA). See the analysis of cession *in securitatem debiti* in chapter 6 *The Law of Cession in Securitatem Debiti*.

[388] *Goosen's Trustee v Goosen* (1883–1884) 3 EDC 368; Berwick *Commentary on the Pandects* (1902) in the chapter titled *Lib. XX Tit.I. Of Pledges and Hypothecs;- How they are Contracted;- And of the Pacts Annexed to Them* at 269.

[389] Gullifer *Legal Problems of Credit and Security* (2013) 1 para 1-101; Zimmermann *The Law of Obligations* (1990) 115; Moorcroft *Banking Law* (2021) para 26.1. Similarly in English law, security involves appropriating an asset to secure an obligation so that if the borrower or debtor does not fulfil the obligation, the lender or creditor will have recourse against the asset, either by selling the asset or other otherwise realising its value, to satisfy the obligation. See McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 815– 816 para 14.1.1.

[390] Generally, there is no formal legal process in South African law by which a lender transfers ownership to itself in an asset held as security, but there are common-law principles with which such a lender must comply. See section 4.9 *The realisation of security* and section 4.10 *Pacta commissoria and conditional sales*.

[391] Ibid.

[392] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 9.1.2.1; *Scott on Cession* (2018).

[393] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235.

[394] *Scott on Cession* (2018) 15; Brits *Real Security Law* (2016) 2.

In the case of real security, the strength of the cessionary's security lies in having an unassailable right against the cedent's (the borrower's) assets that enables the cessionary to control its economic value.[395] The parties' intention is that the lender acquires a temporary security interest in the borrower's or third party's assets to secure the unpaid debt, while the borrower or third party retains ownership of the asset. The security interest or limited right lasts for as long as the debt remains unpaid. In the case of a bridge loan facility and a term loan facility,[396] the security remains in place until the loan is repaid on the stipulated repayment date, whereas in a revolving loan facility[397] it remains in place for as long as the borrower draws on the facility, repays the loan, and then redraws on the facility. The borrower or third party as owner, for as long as it does not default or become insolvent, continues to enjoy the economic benefit, use and enjoyment of the asset, but subject to the lender's rights arising from the cession *in securitatem debiti*.

A number of theoretical issues are embedded in the seemingly simple concept that security rights can be held in personal rights. These are examined in chapter 6 dealing with the law of cession *in securitatem debiti*.

In English law, the concept of *all monies security* effectively defines the scope of the debtor's obligations as being all monies owed by the debtor to the secured creditor.[398] Gullifer indicates that the English courts interpret widely drafted all monies security clauses narrowly, so as not to *'be inconsistent with the commercial nature of the transaction.'*[399] Thiele states that if the secured debt is transferred, all monies security does not render the *'security non-transferable'*[400] and that it will only secure the transferred debt, not all debt owed to the transferee.[401] Although South African law does not have a comparable concept, it is customary practice to use bonds, cessions *in securitatem debiti* and pledges to secure existing and future debts, or put differently, all monies owed. The parties' intentions to secure all debts must be clearly stated in the relevant security document.

4.3 Debt

The word *'debt'* has different meanings under South African common law. The meanings of debt are relevant to the research question as security is given for a debt.

The case law analysis demonstrates that *'debt'* for prescription law purposes means an obligation to pay, deliver goods or render services, while *'debt'* for insolvency law purposes means a firm obligation to pay and excludes a contingent liability. The two definitions of debt are similar in that both deal with an obligation owed by the debtor to the creditor, but differ regarding what the debt or obligation is and consequently what the performance is.

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[395] McCormack *Secured Credit under English and American Law* (2004) 7.
[396] A term loan facility is discussed in section 3.1.1 *Availability of the loan* under the sub-heading *Term loan facility.*
[397] A revolving loan facility is discussed in section 3.1.1 *Availability of the loan* under the sub-heading *Revolving loan facility.*
[398] Gullifer *Legal Problems of Credit and Security* (2013) 51 para 1-75.
[399] Ibid 52 para 1-75.
[400] Thiele *Collective Security Arrangements, A Comparative Study of Dutch, English and German Law* (2003) 150 para 347.
[401] Ibid.

With regard to the use of the concept of *'debt'* in the Prescription Act,[402] in 1981, in *Electricity Supply Commission v Stewarts and Lloyds of SA (Pty) Ltd*[403] (*'Eskom'*), the Appellate Division held that the meaning of the word *'debt'* in the Prescription Act was that ascribed to it in the *Shorter Oxford English Dictionary*, namely, *'that which is owed or due; anything (as money, goods or services) which one person is under obligation to pay or render to another'*.[404]

In discussing the definition of debt, the 2016 judgment of the Constitutional Court in *Makate v Vodacom Ltd*[405] noted that the definition of debt was similarly applied in *Desai NO v Desai and Others*[406] and in *LTA Construction Ltd v Minister of Public Works and Land Affairs.*[407] The court declined to interpret the word *'debt'* as the applicant asked the court to order Vodacom to negotiate his compensation with him. However, the court held that the word *'debt'* must be interpreted in a manner least intrusive of the right of access to court and it acknowledged the meaning ascribed by the *Eskom* judgment to *debt* as *'an obligation to pay money, deliver goods or render services'*.[408]

In *Barnett and Others v Minister of Land Affairs and Others*[409] the Supreme Court of Appeal held that *'debt'* has a general and wide meaning, which may include an obligation to do something or to refrain from doing something.

However, for the purposes of insolvency law generally, the Appellate Division held in 1982 in *Joint Liquidators of Glen Anil Development Corporation Ltd (In Liquidation) v Hill Samuel (SA) Ltd*[410] (*'Glen Anil'*) that *'debt'* in section 88 of the Insolvency Act had a narrow meaning in relation to a monetary obligation. The court held that a conditional liability was not a debt for purposes of section 88, and that the ordinary meaning of debt was a firm obligation to pay, whether now or later. If the legislature intended a wider meaning, it would have added an adjective such as *'conditional'* before the word *'debt'*.

Both meanings of debt are relevant to the thesis given that lenders may require security for both types of debt.

4.4 The meaning of *'security'* in the Insolvency Act

I will now consider the congruency between the different types of security rights in respect of the manner in which they are created and their status, on the obligor's insolvency, under insolvency legislation.

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[402] Prescription Act 68 of 1969.
[403] *Electricity Supply Commission v Stewarts and Lloyds of SA (Pty) Ltd* 1981 (3) SA 340 (A).
[404] Ibid 344 F.
[405] *Makate v Vodacom Ltd* 2016 (4) SA 121 (CC). The court also held that all legislation must be interpreted through the 'prism of the Constitution'; that courts must, when interpreting legislation (such as the Prescription Act), bear in mind s 39(2) of the Constitution and the 'purport, spirit and objects of the Bill of Right'; and that the Prescription Act must be construed in accordance with s 39(2) of the Constitution.
[406] *Desai NO v Desai and Others* 1996 (1) SA 141 (A).
[407] *LTA Construction Ltd v Minister of Public Works and Land Affairs* 1992 (1) SA 837 (C).
[408] *Makate v Vodacom Ltd* 2016 (4) SA 121 (CC) para 92.
[409] *Barnett and Others v Minister of Land Affairs and Others* 2007 (6) SA 313 (SCA).
[410] *Joint Liquidators of Glen Anil Development Corporation Ltd (In Liquidation) v Hill Samuel (SA) Ltd* 1982 (1) SA 103 (A).

It should be borne in mind that security rights cannot be enforced if the secured debt is in dispute. Until a court resolves the underlying disputed debt or obligation, the security cannot be realised.[411]

The Insolvency Act defines the term *'security'* as *'in relation to the claim of a creditor of an insolvent estate, … property of that estate over which the creditor has a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention'*.[412] The term *'preference'* is defined as *'in relation to any claim against an insolvent estate, … the right to payment of that claim out of the assets of the estate in preference to other claims; and "preferent" has a corresponding meaning'*.[413]

The Insolvency Act uses the term *'secured creditor'* but does not define it. It means a creditor that holds security as defined.[414] Security for insolvency law purposes applies only to a creditor's claim against an estate in which that creditor holds security as defined. A special mortgage,[415] landlord's legal hypothec, pledge or right of retention all confer the status of a secured creditor on the recipient.[416]

South African insolvency law distinguishes between secured, preferent and concurrent creditors.[417] A secured creditor is one who has a preferent right over the borrower's property on insolvency, which right arises from any one or more of the following: landlord's legal hypothec, a pledge, a right of retention, a mortgage bond registered over immovable property, or a notarial bond registered over movable property.[418] A preferent creditor is one who holds no security for its claim[419] and whose claim is payable out of the borrower's property on insolvency, that is, from the free residue generated from the sale of the secured property, which is what remains after the secured creditors' claims are paid. Preferent creditors' claims are paid after the secured creditors' claims, but before the concurrent creditors' claims.[420] If the term 'preferent creditor' is used in the wide sense then it could include a creditor who has a secured claim,[421] although it is preferable to use it in the narrow sense as defined in the Insolvency Act. A concurrent creditor is one whose claim is neither a secured claim nor a preferent claim. Concurrent creditors' claims are paid after the secured creditors' and preferent creditors' claims are paid, and they are thus paid last.[422]

Lenders' insolvency ranking is determined by the nature of their security interests on insolvency, not the title or label ascribed to them. The rights perceived to be attached to

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[411] *Delpech v Holloway and Others* 2011 (2) SA 194 (GSJ) para 7; *SA Bank of Athens Ltd v Van Zyl* 2005 (5) SA 93 (SCA) para 7. Obligors may challenge the enforceability of security rights by attacking and disputing the principal loan obligation that the security rights secure.
[412] Section 2.
[413] Ibid.
[414] Mars *The Law of Insolvency in South Africa* 10 ed (2019) para 20.1.
[415] In terms of s 31(5) of the Ship Registration Act 58 of 1998, subject to s 31(6), a mortgage of a registered ship or of a share in a registered ship is deemed to be a special mortgage as defined in s 2 of the Insolvency Act and ranks and is dealt with as if it were a mortgage bond hypothecating immovable property situate in South Africa. Section 31(6), in turn, defines a *'mortgage'* and *'registered'*.
[416] Insolvency Act, s 1, definition of *'security'*.
[417] Insolvency Act.
[418] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 9.1.2.1.
[419] Sharrock 'Secured Creditors and Realisation of Secured Property' *LAWSA* vol 11 2 ed (2008) para 323.
[420] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 9.1.2.2.
[421] Mars *The Law of Insolvency in South Africa* 10 ed (2019) para 20.2.
[422] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 9.1.2.3.

the labels *'senior lender'* or *'mezzanine lender'* are trumped by insolvency laws, which prevail over any contractual ranking of claims that seeks to alter the *concursus creditorum.*

Interestingly, the definition of *'security'* in the Insolvency Act does not include cession *in securitatem debiti* nor guarantees. The LMA's standard definition of security is wider and includes cession *in securitatem debiti.*[423]

Cessionaries as creditors

As with all types of security, cession *in securitatem debiti* gives cessionaries (the lenders) the assurance that, should the cedent (the borrower) default in repaying the loan, not comply with its loan obligations or become insolvent, the unpaid loan will be settled from the proceeds of the realised security rights. The claims typically ceded by the cedent as security include its claims against (i) a bank to pay it the credit balance in its account; (ii) debtors to pay book debts due; (iii) a company (issuer) to economic and voting rights arising from shares; and (iv) its insurer to an insurance pay-out.

In this context, the omission of cession *in securitatem debiti* from the definition of *'security'* in such a fundamental piece of legislation as the Insolvency Act begs the question as to whether the legislature intended to exclude creditors who are cessionaries as secured creditors. The question affects an entire category of creditors who advance loans assuming that a cession *in securitatem debiti* of personal rights entitles them, on the borrower's insolvency, to repayment first as secured creditors before all other creditors. A brief analysis of cession is necessary to determine whether cessionaries are secured creditors for insolvency law purposes.

Cession is a bilateral juristic act in terms of which, by mere agreement, a cedent transfers its rights out of its estate to the cessionary's estate.[424] The duty to cede is created by consensus in an obligatory or obligationary agreement such as a contract of donation, a contract of exchange, a contract of sale, a contract of settlement, a payment[425] or a debtor's undertaking to cede its claim against another as security for satisfying a debt.[426] The agreement or duty to cede is also known as the *pactum de cedendo*[427] and constitutes the *causa* for the cession.

Cession of a right or a principal debt may also be given to secure another debt,[428] such as the borrower's obligations under a *mutuum.* The duty to cede is discharged or given

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[423] The LMA's Term Facilities Agreement defines *'Security'* in clause 1.1 as *'a mortgage bond, notarial bond, cession in security, charge, pledge, hypothec, lien or other security interest securing any obligation of any person or any other agreement or arrangement having a similar effect.'*
[424] Lubbe 'Cession' *LAWSA* (2013) para 128; Lubbe *Contract: General Principles* (2020) 493 para 13.1.
[425] *Johnson v Incorporated General Insurances Ltd* 1983 (1) SA 318 (A) at 331F–I; *Botha and Another v Carapax Shadeports (Pty) Ltd* 1992 (1) SA 202 (A) at 214.
[426] Lubbe *Contract: General Principles* (2020) 497–498 para 13.6.
[427] *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68 para 15.
[428] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA); *Millman NO v Twiggs and Another* 1995 (3) SA 674 (A) at 676G–I.

effect to in a transfer agreement[429] and is also known as the *pactum cessionis*.[430] However, the duty to cede and the discharge of that duty are distinct or discrete juristic acts, and the two juristic acts should not be conflated.[431] They remain discrete juristic acts despite the fact that the duty to cede and the cession itself may be contained in one agreement or be subject to the fulfilment of the same conditions precedent.

Incorporeal rights are pledged to the lender and the pledge is given effect to by cession *in securitatem debiti.* The reason for this construct lies in the fact that it is not possible to deliver a pledged right of action in the physical sense; delivery is therefore achieved by cession of the right. In this way, the court in *Muller NO v Trust Bank of Africa Ltd and Another*[432] held that the pledge is perfected.

In 1911, in *National Bank of South Africa Ltd v Cohen's Trustee*[433] (*'Cohen's Trustee'*), the Appellate Division held in relation to an insurance policy that personal rights could be pledged as security for a debt, and that the pledged rights were delivered or transferred by cession *in securitatem debiti* to make the pledge effective.

In 1987, in *Bank of Lisbon and South Africa Ltd v The Master and Others*,[434] the Appellate Division held that *'an incorporeal right falls within the meaning of "property" and "movable property" and can constitute the subject-matter of "security" as defined in the Act'*.[435]

For insolvency law purposes, the cessionary of a personal right ceded to it *in securitatem debiti* is therefore a secured creditor because, at common law, a personal right can be pledged and ceded *in securitatem debiti*, and it is considered to be *property* (not in the conventional sense, of course) in which the cessionary acquires a real right of pledge.[436] Meskin holds the view that a cessionary of a right that was ceded to it *in securitatem debiti* is a secured creditor as at the commencement of the *concursus creditorum*.[437] I submit that Meskin's view is correct, as it accords with the common law. This position applies to the cessionaries of both personal and real rights. Scott[438] appears to be of a similar view, which is that the cessionary of a right is a secured creditor because it holds a limited real right, but she distinguishes the cessionary's legal position before insolvency in these scenarios: (i) before the pledge vests (which is when the cession is effective by notice of the pledge to third party debtors);[439] (ii) after the pledge vests but

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[429] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *LTA Engineering Co Ltd v Seacat Investments (Pty) Ltd* 1974 (1) SA 747 (A) at 762; *Johnson v Incorporated General Insurances Ltd* 1983 (1) SA 318 (A) at 331F–I; *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* 1992 (1) SA 867 (A) at 873; *First National Bank of SA Ltd v Lynn NO and Others* 1996 (2) SA 339 (A); *Headleigh Private Hospital (Pty) Ltd t/a Rand Clinic v Soller & Manning Attorneys and Others* 2001 (4) SA 360 (W) at 366; *Lynn & Main Inc v Brits Community Sandworks CC* 2009 (1) SA 308 (SCA) para 6; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[430] *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68 para 15.
[431] Ibid.
[432] *Muller NO v Trust Bank of Africa Ltd and Another* [1981] 1 All SA 321 (N).
[433] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235. This judgment is also discussed in chapter 6 *The Law of Cession in Securitatem Debiti*.
[434] *Bank of Lisbon and South Africa Ltd v The Master and Others* [1987] 1 All SA 286 (A); 1987(1) SA 276 (A).
[435] Ibid 290I–J.
[436] Proponents of the so-called *pactum fiduciae* theory criticise the notion of a real right in a personal right as being a legal impossibility. This aspect is discussed in chapter 6 *The Law of Cession in Securitatem Debiti*.
[437] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 9.1.2.1.
[438] *Scott on Cession* (2018) 449 para 9.2.4.3.
[439] Ibid 455–456 para 9.2.4.3.2(1).

before maturity of the pledge (which is when the principal debt is due but the cedent fails to perform, or put differently, the cedent is in default);[440] and (iii) on maturity of the pledge,[441] from the cessionary's legal position after insolvency of the cedent and the cessionary.

It is evident that the omission of cession *in securitatem debiti* from the definition of *'security'* in the Insolvency Act is incongruent with the inclusion of *'pledge'* in that definition, given that a right must be both pledged and ceded *in securitatem debiti* in order for the right to constitute security. The omission therefore presents an incomplete picture of the law in this regard.

Guaranteed parties as creditors

I now consider whether the legislature intended to exclude lenders in their capacities as guaranteed parties as secured creditors from the Insolvency Act since guarantees are not mentioned in the definition of *'security'* in the Insolvency Act.

A lender typically requires a third party, usually but not necessarily related to the borrower, to guarantee fulfilment of the borrower's obligations under a *mutuum* and for it to provide security for its guarantee obligations by pledging and ceding *in securitatem debiti*, to the lender, its personal rights to its bank accounts, debtors' books, shares and/or insurance policies. Contractually, a guarantee is a principal obligation whereby the guarantor promises to make good any loss suffered by the lender, in other words, pay the borrower's debt, if the borrower fails to pay the debt.[442]

As with cession *in securitatem debiti*, a guarantee performs an important function as security for the loan because it gives the guaranteed party (the lender) the comfort that, should the borrower default in repaying the loan or go insolvent, the guarantor will settle the outstanding loan. A guaranteed party's status under insolvency law is therefore important.

A guarantee is not a form of security that is contemplated in the Insolvency Act and historically it was never a form of security for insolvency law purposes.[443] It is not accessory to the original debt because it is a standalone principal obligation, and it is not a mortgage, landlord's hypothec, pledge or right of retention as contemplated in the definition of *'security'* in the Insolvency Act.

A guaranteed party is therefore not a secured creditor for the purposes of the Insolvency Act,[444] although it is widely accepted in the South African market as a form of security.

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[440] Ibid 456 para 9.2.4.3.2(2).
[441] Ibid 459 para 9.2.4.3.3.
[442] *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd CTA* 2010 (2) SA 86 (SCA); *First Rand Bank Limited v Brera Investments* CC 2013 (5) SA 556 (SCA); *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* (050/13) [2013] ZASCA 202. In *Nedbank v Procprops* (108/13) [2013] ZASCA 153, the Supreme Court of Appeal confirmed the judgments in *Lombard* and *First Rand*. Also see Van Rensburg, Lotz & Van Rhijn (updated by Sharrock) 'Terms' *LAWSA* vol 9 3 ed (Replacement Volume 2010) para 372. While, in South African law, guarantees are principal obligations, suretyships are accessory obligations as discussed in the cited suretyship sources.
[443] In earlier versions of the Insolvency Act, namely, the Insolvency Act 32 of 1916 and the Insolvency Amendment Act 29 of 1926, the definition of *security* also did not include a guarantee. See *Hunt, Leuchars and Hepburn v JE Vorster and Co* 1930 WLD 261 at 262 and 266.
[444] Mars *The Law of Insolvency in South Africa* 10 ed (2019) para 20.1.

Furthermore, a guarantee does not entitle the guaranteed party to a secured claim against the property of the insolvent estate over which the creditor has a preferent right. In other words, there is no asset or property appropriated to the debt under a guarantee for insolvency law purposes. It is further submitted, and it is accepted in practice, that as a guarantee is not 'security' as contemplated in the Insolvency Act, it ranks the guaranteed party, on the guarantor's insolvency, as a concurrent creditor (not a secured creditor) in the guarantor's insolvent estate.[445]

The omission of *'guarantee'* from the definition of *'security'* in the Insolvency Act is in line with the purpose of security, which earmarks assets or property to settle outstanding debts.[446]

Once the guarantor pays the lender the amount owed to it by the borrower in accordance with the terms of the guarantee, the guarantor acquires a claim against the borrower for repayment of that amount. The claim is, however, not based in subrogation but is either a common-law claim, or a contractual claim if an agreement was concluded between the guarantor and the borrower regarding the borrower's liability to the guarantor if it pays under the guarantee.[447]

4.5 Personal and real security, and the registration of security rights

The purpose of this section is to discuss South African law regarding the nature of personal and real security rights, and the registration of security rights.

4.5.1 Personal and real security

Legal distinction between personal and real security rights

The distinction between personal and real security rights determines, in the case of cession, what is ceded *in securitatem debiti* and the relief to which a lender is entitled, which is relevant to the research question.[448] When a borrower is in default of the terms of the facility agreement or is insolvent, either because the borrower's liabilities exceed its assets (technical insolvency),[449] or because the borrower is unable to pay its debts as they fall due (commercial insolvency),[450] a lender can exercise its personal security rights or its real security rights, or both, if it is entitled to both.

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[445] Ibid.
[446] However, it is market practice for lenders to require guarantors to provide security for their guarantee obligations.
[447] Subrogation in South African law is unclear and is confined to insurance law. It was received into South African insurance law from English law, but it is by and large not applied to South African substantive law, other than insurance law. The doctrine allows an insurer to act in the insured's name, but it does not involve a transfer or a cession of the insured's rights to the insurer. See *Scott on Cession* (2018) 105, 107–108 para 3.8; *Goodwin Stable Trust v Duohex (Pty) Ltd and Another* 1998 (4) SA 606 (C) at 623 E–F.
[448] A concise explanation of the different theories that explain the distinction between real rights and personal rights, and the criticisms of each theory, can be found in Van der Merwe 'Things' *LAWSA* vol 27 2 ed (2008) para 60. These theories are not relevant to this thesis.
[449] The Insolvency Act contains numerous references to a debtor's liabilities exceeding his or her assets, such as ss 30, 135(1) and 135(3), but does not use the term 'technical insolvency', which originates in case law and practice.
[450] The Insolvency Act contains numerous references to a debtor being unable to pay any or all of his or her debts, such as ss 8*(g)*, 8*(h)* and 78(1), but does not use the term 'commercial insolvency', which originates in case law and practice.

The current classification of rights into personal and real is based mainly on property law distinctions.[451] The classification forms the basis of the distinction between personal and real security rights. It originated in Roman law which recognised the distinction.[452] Unlike in modern times, personal security was then considered more valuable than real security, because of the Roman value system of friendship, on the one hand, and the harshness of personal liability, on the other hand.[453]

The basic distinction between personal and real rights generally was concisely explained by the Supreme Court of Appeal in *National Stadium South Africa* (*Pty*) *Ltd v Firstrand Bank Ltd*[454] where the court said:

> *The first concerns the distinction between real and personal rights. Real rights have as their object a thing (Latin: res; Afrikaans: saak). Personal rights have as their object performance by another, and the duty to perform may (for present purposes) arise from a contract. Personal rights may give rise to real rights; for instance, a personal obligation to grant someone a servitude matures into a real right on registration. Real rights give rise to competencies: ownership of land entitles the owner to use the land or to give others rights in respect thereof. Others may say that ownership consists of a bundle of rights, including the right to use the land, but it does not really matter who is right on this point.*[455]

The legal distinction between personal and real rights is applied to security rights. The Insolvency Act's requirement that a creditor must have a claim over *'property of that estate'*[456] in order to qualify as holding security applies to security interests in personal rights and real rights, because rights are property.[457] Personal and real rights have a monetary value, and security rights acquired in these rights constitute, on the borrower's insolvency, an asset in the creditor's estate.[458]

Personal security rights

Personal rights are rights that require performance by another person, and are enforceable *inter partes* against a person, and not against the world at large. A personal right entitles the holder to claim that the debtor behaves in a certain way and its exercise may result in the acquisition of a thing, such as money. For example, a creditor who is owed money for the sale of goods has a personal claim against its debtor for payment. If the claim is exercised, the debtor behaves in a way that results in the creditor receiving its money. Similarly, in personal security, an undertaking is given by an entity or person

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[451] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) chapters 3 (*Classification of property*) and 4 (*Property rights*).
[452] Zimmermann *The Law of Obligations* (1990) 115.
[453] Ibid.
[454] *National Stadium South Africa* (*Pty*) *Ltd and Others v Firstrand Bank Ltd* 2011 (2) SA 157 (SCA); [2011] 3 All SA 29 (SCA); [2010] ZASCA 164 (SCA).
[455] Ibid para 31.
[456] Discussed above.
[457] Meskin *Insolvency Law and its Operation in Winding-Up* (1991) para 5.1.
[458] *Scott on Cession* (2018) 16 para 1.3.2 and the authorities cited at n 87; Brits *Real Security Law* (2016) 273–274; Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.6. As to the monetary value of reversionary interests, see *Bank of Lisbon and South Africa Ltd v The Master and Others* 1987 (1) SA 276 (A), *Big Sixteen (Pty) Ltd v Trust Bank of Africa Ltd and Another* 1978 (3) SA 1032 (C) at 1035H and *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC) para 48.

to perform the debtor's obligations should it fail to do so.[459] Another example is a guarantor (as opposed to a surety) who promises as a principal obligation, to pay the debt of a debtor in case of its default.[460] If the claim is exercised, the guarantor behaves in a way that results in the creditor receiving its money. Another example is a surety (as opposed to a guarantor) who bound himself or herself as an accessory obligation to the creditor, to pay the debtor's debt if the debtor fails to do so.[461] Silberberg and Schoeman contend that personal security offers a creditor less security than real security.[462] Brits states that a creditor's right to claim that a debtor renders performance is a personal right as it can be claimed from the debtor in his personal capacity or from the proceeds of his estate.[463]

Real security rights

Real rights are rights acquired in respect of a thing and are enforceable against the world at large[464] if persons disturb or interfere with possession or ownership of that thing. The holder can protect its rights by applying to court for an interdict.[465] The legal effect of the right as between the parties is thus the same as against third parties. The United Nations recognises this as one of the approaches adopted by certain countries in respect of security rights.[466] However, in South Africa, only some security rights are statutorily registrable, thereby giving notice to the world of the security rights, whilst there are no registration requirements for other security rights. Real security confers on a creditor a limited real right in another's movable, immovable, tangible, or intangible/incorporeal property (personal claims) as security for an obligation.[467] The real right is said to be limited because ownership remains vested in the security provider. Real security may be classified on different bases.[468] It can be classified either according to the manner in which it is created, or according to whether control of the property is acquired by the creditor.[469] Applying the manner of creation as the basis for its classification, real security is created either contractually by consensus between the creditor and debtor,[470] or *ex lege* by the common law or statute.[471] The forms of real

[459] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1. In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP) the court held at para 42 that where the bank's rights under a general notarial bond had not been perfected, the bank held only personal security, not real security, and the personal security entitled it to a preferent claim on insolvency.
[460] See section 4.4 *The meaning of 'security' in the Insolvency Act* for an explanation of guarantees and their exclusion from the definition of 'security' in the Insolvency Act.
[461] Henning 'Suretyship' *LAWSA* vol 26 2 ed (2020) para 280. The contract of suretyship must comply with the General Law Amendment Act 50 of 1956, which requires contracts of suretyship to be in writing in order to be valid.
[462] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1. A lender's right acquired under a cession *in securitatem debiti* is sometimes referred to as personal security as performance is personal to the borrower.
[463] Brits *Real Security Law* (2016) 2.
[464] As Brits puts it, limited real rights are enforceable *erga omnes*, or against the world at large; ibid at 3.
[465] Van der Merwe 'Things' *LAWSA* vol 27 2 ed (2008) para 9.
[466] UN Guide, Chapter II, Creation of a security right (effectiveness as between the parties), A. General Remarks, 1. Introduction at 65 para 2.
[467] Brits *Real Security Law* (2016) 3; Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1; Henning 'Suretyship' *LAWSA* vol 26 2 ed (2020) para 280.
[468] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1.
[469] Ibid.
[470] At common law, a contract comes into existence only if there is consensus between the parties about the contract, that is, the parties are *ad idem* (of the same mind) as to the nature and the terms of the contract.
[471] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1.

security created contractually by consensus are bonds,[472] pledges and cessions *in securitatem debiti* of personal rights[473] and pledges of movable property,[474] while *liens* and a landlord's tacit hypothec are examples of common-law real security rights.[475]

Although the focus of this thesis is secured lending, and specifically syndicated lending, secured by pledges and cessions *in securitatem debiti* of rights, I briefly consider the nature of aspects of selected forms of real security created by agreement and by the common law, that are relevant to bilateral and syndicated lending. A synopsis of mortgage bonds, notarial bonds, pledges and a landlord's tacit hypothec is provided, which are all forms of security rights used by bilateral and syndicate lenders. A landlord's tacit hypothec applies if a syndicate lender is also a landlord of the borrower.

A mortgage bond is defined in the Deeds Registries Act as a bond attested by the registrar of deeds, specially hypothecating immovable property.[476] The deed or instrument is the agreement whereby the mortgagor agrees to create a limited real right in its immovable property in favour of the mortgagee as security for a principal obligation owed by the mortgagor, such as a debt.[477] If the parties so intend, the obligation to lend or extend credit may be reciprocal to the obligation to create a real right of mortgage so that the said loan obligation and the mortgage undertaking are *pari passu*.[478] A mortgage bond may be registered to secure an existing debt or a future debt or both.[479] The mortgage bond contains *'contractual and hypothecary aspects.'*[480] The contractual aspect relates to the terms of the principal obligation, while the hypothecary aspect relates to the mortgage relationship. The limited real right of security is created when the mortgage bond is registered in the deeds registry, not when the mortgage bond is notarially executed.[481] Once the registrar affixes his signature to the mortgage bond document, registration is deemed to have occurred.[482] The date on which the mortgage bond was so registered determines its ranking in relation to other bonds passed or registered over the same property, and mortgagees can agree that a bond registered later in time will rank equally or take precedence over an earlier bond.[483] A mortgage is accessory in nature in that its validity depends on the validity of the principal obligation which it secures.[484] However, a void loan does not necessarily extinguish a mortgage bond if its terms are not limited to the debt arising from that loan, but extend to securing

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[472] Voet *Loan for Consumption* at section 28, page 784 where a mortgage over immovable property was recognised; Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) paras 326ff; Moorcroft *Banking Law* (2021) para 26.2. Bonds must be registered in terms of the Deeds Registries Act 47 of 1937 in order to create the security rights.
[473] Lubbe 'Cession' *LAWSA* (2013); Moorcroft *Banking Law* (2021) para 26.3. Moorcroft favours the *pactum fiduciae* theory of cession *in securitatem debiti*. See section 6.5 *The pactum fiduciae theory*; *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[474] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) paras 405ff.
[475] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1.
[476] Section 102 of the Deeds Registries Act 47 of 1937.
[477] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 326.
[478] Ibid para 349.
[479] Section 50(2) of the Deeds Registries Act 47 of 1937.
[480] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 328.
[481] Ibid paras 326, 351 and 366.
[482] Ibid para 354.
[483] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.3.4(b).
[484] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 328; *Panamo Properties 103 (Pty) Ltd v Land and Agricultural Development Bank of South Africa* 2016 (1) SA 202 (SCA) para 28. See section 4.6 *The accessorial principle*. However, if the mortgage bond is to be used as security for debts other than the secured debt, its accessorial nature has been questioned: see Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 333.

the debt arising from an enrichment claim.[485] An enrichment claim is an indebtedness that a mortgage bond can secure, if it is so worded.[486] This position is fortified if the bond is a covering bond because it can secure more than one debt.[487] The mortgagee's status in insolvency law is that it is a secured creditor under the Insolvency Act.[488] As its function is limited to affording the mortgagee security to satisfy its claim, the mortgagee cannot *ipso iure* use and enjoy the property.[489] Neither a mortgage bond nor a notarial bond can be passed in favour of an agent acting for a principal.[490] This is relevant to the use of a Security SPV that holds the lenders' security rights because, for that reason, the mortgagor agrees to owe an actual obligation to the Security SPV in the form of a guarantee and the Security SPV is not technically an agent for the lenders under this construction.[491]

A notarial bond is defined in the Deeds Registries Act as a bond attested by a notary public hypothecating movable property generally or specially.[492] It hypothecates the debtor's specific assets, or all its movable assets.[493] A notarial bond may be registered to secure an existing debt or a future debt or both.[494] The status in insolvency law of a mortgagee of a notarial bond is generally that it is a secured creditor under the Insolvency Act, but there are some exceptions.[495] A notarial bond is considered a better security instrument than a pledge of movable assets because, for a pledge to be valid, the creditor must possess the movable assets for the duration of the pledge, thereby depriving the debtor of possession thereof, whereas the notarial bond does not require the creditor to possess the movable assets in order to constitute valid security.[496]

The Deeds Registries Act sets out the requirements that must be met in order for a mortgage bond and a notarial bond to validly provide mortgagees with preferences or priority if they secure future debts. A mortgage bond and a notarial bond provide the mortgagee with no preferences or priorities (of claims) unless the bond stipulates that it secures future debts generally or it secures a specifically described future debt and fixes a sum beyond which future debts are not secured.[497]

The law of pledge of movable property is analysed in section 6.6 (*The pledge theory*). A synopsis is provided here to facilitate the understanding of real security law, but it must be read with section 6.6 (*The pledge theory*). A pledge is a limited real security right over the debtor's movable property.[498] A pledge is constituted by the pledgor

[485] *Panamo Properties 103 (Pty) Ltd v Land and Agricultural Development Bank of South Africa* 2016 (1) SA 202 (SCA) paras 29–31.
[486] Ibid.
[487] Ibid para 31.
[488] Mars 'The Law of Insolvency in South Africa' 10 ed (2019) para 20.1.
[489] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 328.
[490] Section 54 of the Deeds Registries Act 47 of 1937.
[491] See n 771 and section 4.9 *The realisation of security*.
[492] Section 102 of the Deeds Registries Act.
[493] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 398.
[494] Section 50(2) of the Deeds Registries Act.
[495] Mars *The Law of Insolvency in South Africa* 10 ed (2019) para 20.1.
[496] The pledge of movable property is discussed in section 6.6 *The pledge theory* under the heading *A comparison between the pledge of movable corporeal property and cession in securitatem debiti.*
[497] Section 51(1) of the Deeds Registries Act.
[498] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 405; Mars *The Law of Insolvency in South Africa* 10 ed (2019) para 20.5.

delivering its movable property that is the subject of the pledge to the pledgee, to possess for the duration of the pledge.[499] The parties enter into a pledge agreement to this effect.[500] The pledge agreement, like a mortgage, contains *'contractual and hypothecary aspects.'*[501] The contractual aspect relates to the pledge agreement, and the consequent rights and obligations, while the hypothecary aspect relates to the pledge relationship.[502] The pledgee is a secured creditor on the pledgor's insolvency.[503] Dendy indicates that pledge and mortgage have many common characteristics.[504]

A landlord's tacit hypothec is a hypothec over the movable property present on the leased premises that automatically comes into existence if the tenant is in arrears in paying its rent.[505] The movable property covered by the hypothec is all movable property, whether belonging to a tenant, a sub-tenant if it owes rent to the tenant, or third parties.[506] The accessorial principle, namely, that a security right must be accessory or ancillary to a valid principal obligation, is the reason why the hypothec (security) comes into existence as soon as the tenant defaults on its rental obligation.[507] For the same reason the hypothec terminates when the tenant remedies its default by paying the arrear rent.[508] The hypothec must be perfected through a court order to attach the movable property in order to create a limited real right for the landlord.[509] The hypothec serves as security for unpaid arrear rent,[510] but there are conflicting academic and judicial views as to whether it includes other debts owed to the landlord, such as damages.[511]

As is evident from the aforegoing analysis, the hallmark of real security is that an asset is appropriated to a debt or, put differently, ring-fenced to satisfy a debt.[512] The secured creditor enjoys a right of preference to be paid if the asset or property is realised.[513] Unsecured creditors, on the other hand, derive comfort from the fact that applying the *paritas creditorum* (equality of creditors) principle will result in their claims being settled proportionately and equally.[514] Real security rights create payment priorities for secured creditors over unsecured creditors, ranking secured creditors in preference to unsecured creditors, which effectively back-ranks the *paritas creditorum* principle.[515] Syndicate lenders in South Africa, in my experience, prefer real security[516] as the core of their security, but compliment it with forms of personal security such as

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[499] Ibid.
[500] Ibid.
[501] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 405.
[502] Ibid.
[503] Ibid. See the definition of *security* in s 2 of the Insolvency Act.
[504] Ibid.
[505] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 17.2.
[506] Ibid.
[507] Brits *Real Security Law* (2016) 437 para 6.9.2.
[508] Ibid.
[509] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 17.2.
[510] Ibid; Brits *Real Security Law* (2016) 437–440 para 6.9.2.
[511] Brits *Real Security Law* (2016) 437.
[512] Gullifer *Legal Problems of Credit and Security* (2013) 1 para 1-101; Zimmermann *The Law of Obligations* (1990) 115; Moorcroft *Banking Law* (2021) para 26.1; Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1(a).
[513] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.1(b); Insolvency Act.
[514] Brits *Real Security Law* (2016) 2.
[515] Ibid 5.
[516] Zimmermann *The Law of Obligations* (1990) 115 is of the same opinion.

guarantees and, rarely, suretyships, as analysed in section 4.11 (*Security structure and security rights of syndicate lenders*).

4.5.2 The registration of security rights

The registration of security rights in an asset or property with governmental authorities is regarded as the publication or notice of the encumbrance that makes the security rights effective against third parties.[517]

South African law does not require the registration of either personal or real security rights with any governmental authority, except in the following instances: (i) different types of bonds over immovable property or movable property, in terms of the Deeds Registries Act;[518] (ii) listed, uncertificated securities;[519] (iii) aircraft in terms of the Convention on the International Recognition of Rights in Aircraft Act;[520] (iv) ships in terms of the Ship Registration Act;[521] (v) registered trademarks in terms of the Trademarks Act;[522] and (vi) prospecting rights or mining rights in terms of the Mineral and Petroleum Resources Development Act.[523]

Section 39 of the Financial Markets Act[524] requires the registration of a pledge or cession *in securitatem debiti* of uncertificated securities, or an interest in uncertificated securities, in the central securities account or the securities account. Securities (shares and similar) that are not listed or registered in the central securities account or the securities account are automatically excluded from the registration requirement in section 39. Uncertificated securities are defined as (i) securities not evidenced by a certificate or written instrument; or (ii) certificated securities held in collective custody by a central securities depository or its nominee in a separate central securities account, both of which are transferable by entry without a certificate or written instrument.[525] The definition applies only to uncertificated securities held by a central securities depository, participant, authorised user or nominee.[526] The name of the pledgee or cessionary, the number or nominal value of the uncertificated securities, the interest ceded or pledged, and the date of entry are required for registration.[527] The basis is that there is consensus between the pledgor or cedent and the pledgee or cessionary to create a security interest in the securities. Strate[528] views electronic registration or flagging (as it is known) of listed securities as sufficient compliance with section 39 of the Financial

[517] See, for example, recommendations 42 and 43 of the UN Guide and s 39(1)*(d)* of the Financial Markets Act.
[518] Deeds Registries Act 47 of 1937.
[519] Financial Markets Act 19 of 2012. See also the discussion in the paragraph that follows.
[520] Convention on the International Recognition of Rights in Aircraft Act 59 of 1993.
[521] Ship Registration Act 58 of 1998.
[522] Trademarks Act 194 of 1993.
[523] Mineral and Petroleum Resources Development Act 28 of 2002.
[524] Financial Markets Act 19 of 2012.
[525] Section 1 of the Financial Markets Act.
[526] Section 39(1)*(a)* of the Financial Markets.
[527] Section 39(1)*(a)*(i) and (ii) of the Financial Markets Act.
[528] Strate is South Africa's central securities depository. It is a regulator-licensed financial market infrastructure company that owns technology to securely hold equities, bonds and money market securities in electronic form so that purchasers and sellers can exchange ownership of these securities once they are successfully traded.

Markets Act to perfect the pledge of such listed securities.[529]

A pledge or cession *in securitatem debiti* of securities is, once registered in terms of the Financial Markets Act, effective against third parties, and there is an express prohibition, presumably on the pledgor or the cedent, against dealing with or transferring uncertificated securities or an interest in uncertificated securities that have been so pledged.[530] The exception is that if a person is entitled by operation of law to have a pledge or cession *in securitatem debiti* in uncertificated securities or an interest in uncertificated securities registered in his or her name, then the central securities depository or participant is empowered to effect the same.[531] The position at common law in respect of unlisted securities is similar yet different. It is similar in that the pledgee can, because it possesses the securities, prevent third parties from acquiring possession or ownership of the pledged securities by a court interdict, and the pledgor cannot deal with or transfer such securities; and the pledge and cession *in securitatem debiti* of listed securities (governed by legislation) and the pledge and cession *in securitatem debiti* of unlisted securities (governed by the common law) both create rights *in rem.* The position is different in that there is no central, public register in which the cession *in securitatem debiti* of unlisted securities is registered, and this, it is submitted, is a deficiency as potential lenders are unable to obtain information about the cession from such a central register.

Security rights in aircraft and ships is governed by special laws for hypothecating rights to aircraft and ships. Hypothecating rights to aircraft and ships must be registered with governmental authorities and are real rights. In terms of the Convention on the International Recognition of Rights in Aircraft Act,[532] an aircraft or share therein may be mortgaged as security for a loan or other debt by a deed of mortgage executed in the prescribed form. The prescribed form is contained in the Mortgaging of Aircraft Regulations, 1997. The Mobile Equipment Act[533] has given the Convention on International Interests in Mobile Equipment 2001 and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment 2001 the force of law in South Africa. The effect of this is that security interests in aircraft have been made an *'international interest'*, which is a defined term that means an interest held by a creditor to which Article 2 applies. Article 2 provides for the *'constitution and effects of an international interest in certain categories of mobile equipment and associated rights'*, which includes an interest *'granted by the chargor under a security agreement'* in respect of aircraft.[534] Security interests in aircraft are then, on producing the deed of mortgage and payment of the prescribed fee, recorded

[529] On 23 February 2018 Strate responded to my query as to whether the electronic registration or flagging is sufficient to constitute the pledge, or if Strate requires any further statutory notices to be given. Strate requires no further statutory notices to be sent, other than that the pledge must be reflected in the statement to be sent by the central securities depositary participant to its clients at least every six months in terms of rule 5.8.5 read with rule 7.6.1.3 of the Strate Rules.
[530] Section 39(1)*(b)* and *(d)* of the Financial Markets Act.
[531] Section 39(1)*(e)* of the Financial Markets Act.
[532] Convention on the International Recognition of Rights in Aircraft Act 59 of 1993.
[533] Convention on International Interests in Mobile Equipment Act 4 of 2007.
[534] Ibid art 2(1), (2) and (3).

by the Commissioner for Civil Aviation in a register.

No statutory registration requirements exist to register rights *in rem* created by cessions *in securitatem debiti* of personal rights to accounts, debtors' books, unlisted shares, insurances and intellectual property (other than registered trademarks in terms of the Trademarks Act 194 of 1993), nor is the enforcement of such cessions prior to the cedent's insolvency governed by statute. As with unlisted shares, there is also no central, public register that lenders can consult to establish if rights to accounts, debtors books, insurances and intellectual property have been ceded *in securitatem debiti* or to whom they were so ceded. Lenders must therefore conduct due diligence exercises to identify security rights and risks and rely on the borrower to disclose existing cessions and security interests.[535] This is not ideal and is not conducive to creating an investment environment of certainty, and may even be disastrous if there are errors in the due diligence or the borrower's disclosures turn out to be false.

The terms of the security cession will have to be alleged and proven if they are to be enforced in a court.[536] However, the enforcement of security rights in listed securities appears to be easier and less burdensome than for unlisted securities, given that security rights in listed securities are registered in terms of the Financial Markets Act, which is at least *prima facie* evidence of the cession.[537] The registration assists in proving that a security cession exists. Enforcement of security rights in unlisted securities is somewhat more cumbersome, as the cessionaries or pledgees would need to allege and prove their rights by leading evidence as to the validity and enforceability of the obligationary agreement and the cession agreement, their security rights in the securities, the authenticity of the securities certificates, the securities register, and other matters, as opposed to relying on a statutory register as *prima facie* evidence of their security.

The Companies Regulations[538] contain a publicity or disclosure requirement in respect of loans and security rights held in a company. A company issuing a prospectus in terms of regulation 56 of the Companies Regulations[539] must, in that prospectus, describe any loans made to or by the company, and, in the case of loans made to the company, must provide details of any security interests. The disclosure obligation provides investors with material information about the company's borrowings, security interests granted, and loans advanced to enable investors to decide if they wish to

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[535] Hewko 'Foreign Direct Investment in Transitional Economies: Does the Rule of Law Matter' (2002) 11(4) *East European Constitutional Review* 71 at 72.
[536] Herbstein & Van Winsen *Civil Practice of the High Courts and the Supreme Court of Appeal of South Africa* 5 ed (2012) ch 34, section VII. The cessionary also relies on the cedent to assist it to prove its ceded rights: see Lubbe 'Cession' *LAWSA* (2013) 126 para 170.
[537] *Prima facie* evidence means evidence that, if uncontroverted, is sufficient to persuade a reasonable person in the position of the party who has the onus or burden of proving that position. See *Alli v De Lira* [1973] 4 All SA 547 (T) at 551; *Ex Parte Minister of Justice: In re Rex v Jacobson and Levy* 1931 AD 466 at 478. The case law does not appear to distinguish between the standard required for evidence to constitute *prima facie* evidence in civil matters and in criminal matters and for that reason the former civil case (*Alli*) approves of the latter criminal case (*Ex Parte Minister of Justice*) insofar as it defines the meaning of *prima facie* evidence.
[538] Companies Regulations, 2011.
[539] Ibid.

subscribe for equity in the company.

4.6 The accessorial principle

The accessorial principle applicable to security rights is integral to secured lending transactions. It determines the nature of security rights in relation to the secured debt. In Roman law times, the principle was expressed as *accessorium sequitur principale*, which can be translated as *'the security interest follows or depends on the obligation it secures'*.[540]

In South Africa, the accessorial and related principles were first applied by the Transvaal Provincial Division in 1921 in *Ex Parte The Master, Re Dutton and Seymour*,[541] and the Appellate Division in 1931 in *Kilburn v Kilburn ('Kilburn')*.[542] The principles were confirmed in a number of later judgments, including in the seminal 2009 judgment in *Grobler v Oosthuizen*[543] (*'Grobler'*) and, most recently, by the Supreme Court of Appeal in 2016 in *Panamo Properties 103 (Pty) Ltd v Land and Agricultural Development Bank of South Africa.*[544]

In South African law, a security right must be accessory or ancillary to a valid principal obligation (the secured debt), that is, the existence of a security right depends on the existence of a valid principal obligation; without a valid principal obligation, the security right does not, and cannot, exist.[545] Brits states that a limited real right must relate to a valid principal obligation, and that its effectiveness is dependent thereon. To illustrate the point in relation to mortgages, Brits states that an extinguished or invalid principal debt would likewise extinguish or invalidate the mortgage.[546] Scott states that the security right depends on a valid principal debt existing and, if there is no such debt or it was discharged, the security right is *ipso iure* cancelled.[547] Silberberg and Schoeman consider the effect of the accessorial principle on the cessionary's right of pledge by stating that it lapses automatically once the secured debt is discharged.[548] Tajti, in analysing whether Continental Europe would adopt a system similar to Article 9 of the Uniform Commercial Code in American law,[549] considers the position of the accessorial principle in civil-law systems. He contends that accessoriness can be framed in tripartite form. First, its existence means that a security interest is created, follows, extinguishes and is capable of

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[540] Tajti 'Could Continental Europe Adopt a Uniform Commercial Code Article 9-Type Secured Transactions System? The Effects of the Differing Legal Platforms' (2014) 35 *Adelaide Law Review* 149 at 169.
[541] *Ex Parte The Master, Re Dutton and Seymour* 1921 TPD 347.
[542] *Kilburn v Kilburn* 1931 AD 501.
[543] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[544] *Panamo Properties 103 (Pty) Ltd v Land and Agricultural Development Bank of South Africa* 2016 (1) SA 202 (SCA). Interestingly, the *Panamo* judgment also held that an act or contract that contravenes a statute may not necessarily be rendered invalid, but if recognising the act or contract will defeat the statute's purpose, the act or contract will be void. It is submitted that contravening a statute results in unlawful conduct, but that does not always render the conduct void.
[545] *Kilburn v Kilburn* 1931 AD 501; *Thienhaus NO v Metje & Ziegler Ltd and Another* 1965 (3) SA 25 (A) at 32 and 43; *Lipschitz NO v UDC Bank Ltd* 1979 (1) SA 789 (A) at 807; *Panamo Properties 103 (Pty) Ltd v Land and Agricultural Development Bank of South Africa* 2016 (1) SA 202 (SCA) para 28. This is the position in both our common law and statute. Regarding statute, see, for example, the definition of 'security' in s 2 (titled *Definitions*) of the Insolvency Act, s 66 (titled *Restrictions on borrowing, guarantees and other commitments*) of the Public Finance Management Act 1 of 1999, and s 48 (titled *Security*) of the Local Government: Municipal Finance Management Act 56 of 2003. In each of these sections, security is accessory to a principal debt. Also see Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 102.
[546] Brits *Real Security Law* (2016) 20.
[547] *Scott on Cession* (2018) 381–382 and 438 para 9.2.3.1.
[548] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.6.3(e).
[549] Article 9 of the American Uniform Commercial Code is analysed in chapter 7 *Cession of Personal Rights: Lessons from International Instruments, the United Kingdom and the United States of America.*

enforcement for as long as the underlying obligation exists. Second, its scope means that the amount of the obligation that it secures determines the amount of the security interest. Third, its identity means that the person entitled to claim the security interest is also the secured creditor.[550]

If the principal obligation is invalid, the security right cannot exist, but invalid security rights do not negate a valid principal obligation such as a loan.[551] The principle applies to real security rights created by agreement between parties and real security rights created *ex lege*.[552] The principal obligation can be claimable or contingent, present or future, as long as there is or will be an obligation to which hypothecation is accessory. For this reason, the principle has come to be known as the *'accessorial principle'*. The obligation need not exist when the security right is created, as long as the obligation exists when the creditor seeks to enforce its security right.[553] The security right may be created prior to, and in anticipation of, an obligation coming into existence. In practice, the security right is typically created to secure the fulfilment of an existing obligation.

The obligation must be a real and genuine obligation, not a simulated one parading as an obligation designed to defeat creditors' rights. A court will consider the true nature and substance of the transaction, not the veil in which it is wrapped. In the case of a loan, the debt must therefore be a real debt, whether claimable or contingent, present or future. In South African law, if the secured debt is invalid, the security right fails. The latter principle applies to notarial and mortgage bonds, but it can be applied to all security rights.

In contrast, a guarantee, on the other hand, operates on different principles. In South African law, a guarantee is a promise to pay the debt of a third person in case of its default. A guarantee creates a principal obligation, as opposed to an accessory obligation, that is independent of the main transaction and does not depend on the validity thereof to be enforceable. A guarantee is thus not accessory to another obligation but is itself a principal obligation.[554] The accessorial principle accordingly does not and indeed cannot apply to guarantees. A guarantee is typically coupled with an indemnity by the guarantor in favour of the lender,[555] whereby the guarantor indemnifies the lender on demand against any cost, liability or loss it may incur.[556] The guarantor's obligation to pay the lender its cost, liability

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[550] Tajti 'Could Continental Europe Adopt a Uniform Commercial Code Article 9-Type Secured Transactions System? The Effects of the Differing Legal Platforms' (2014) 35 *Adelaide Law Review* 149 at 169–170.
[551] Ibid. See also the judgment of the court *a quo* in *UDC Bank Ltd v Lipschitz NO* 1977 (1) SA 275 (W) at 286 para 6, with which the Appellate Division, in the appeal, concurred.
[552] As to the application of the accessorial principle to the landlord's tacit hypothec, a real security right is created *ex lege*. See Brits *Real Security Law* (2016) 437 para 6.9.2.
[553] *Kilburn v Kilburn* 1931 AD 501; Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 102.
[554] In *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd CTA* 2010 (2) SA 86 (SCA) the Supreme Court of Appeal held at para 20: *'The guarantee by Lombard is not unlike irrevocable letters of credit issued by banks and used in international trade, the essential feature of which is the establishment of a contractual obligation on the part of a bank to pay the beneficiary (seller). This obligation is wholly independent of the underlying contract of sale and assures the seller of payment of the purchase price before he or she parts with the goods being sold. Whatever disputes may subsequently arise between buyer and seller is of no moment insofar as the bank's obligation is concerned. The bank's liability to the seller is to honour the credit. The bank undertakes to pay provided only that the conditions specified in the credit are met. The only basis upon which the bank can escape liability is proof of fraud on the part of the beneficiary.'* Also see *First Rand Bank Limited v Brera Investments* CC 2013 (5) SA 556 (SCA); *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* (050/13) [2013] ZASCA 202. In *Nedbank v Procprops* (108/13) [2013] ZASCA 153 the Supreme Court of Appeal in November 2013 confirmed the judgments in *Lombard* and *First Rand*.
[555] The LMA's Term Facilities Agreement, clause 17 (*Guarantee and Indemnity*).
[556] The LMA's Term Facilities Agreement, clause 17 (*Guarantee and Indemnity*) (1)(c).

or loss arises when the lender incurs the liability for such amount(s), as opposed to when the lender pays it.[557]

It is necessary to understand the common law as it applies to the accessorial principle, given its importance in South African secured lending law. In the seminal case of *Kilburn v Kilburn*,[558] the Appellate Division held that, in South African law, security is accessory to a valid main obligation. Henry Kilburn, an electrical engineer, wished to marry Emma Lorimer, and agreed to pay her £500 prior to the marriage. As he did not have the funds, he acknowledged his indebtedness to her and caused a notarial bond to be registered over his movable property, which comprised book debts, cash in the bank, plants, machinery, fixtures and fittings, stock-in-trade, and all other business assets. After 22 years of marriage, he was sequestrated. The court *a quo* held that the spouses never considered the £500 to be a debt owed by the husband to the wife, but that the bond merely secured £500 for the wife out of the husband's estate should he become insolvent. Accordingly, his wife could not use the bond in a *concursus creditorum* as a secured creditor. Amongst her claims rejected by the Master of the High Court and the court *a quo* was a claim for £500 secured by the bond. On appeal against the decision of the Natal Provincial Division, the Appellate Division, responding to the wife's counsel's contention that her claim secured by the bond was a settlement by a right secured in the case of insolvency, held that it was meaningless to divorce security from the obligation which it secures. The court held further that it is possible to secure any obligation, claimable or contingent, present or future, and the security is accessory to the obligation. Although the security may be suspended until the obligation comes into existence, there must always be an obligation to which the security is accessory. The Appellate Division accordingly held that as the £500 was never intended by the spouses to be a debt owed by the husband to the wife, there was no obligation secured by the bond. The spouses had instead intended that, should the husband become insolvent, the wife would be entitled to £500 from his estate. The appeal was dismissed with costs.

In 2009, in *Grobler*, the Supreme Court of Appeal dealt with a number of important legal issues, including the legal effect of settling a fixed debt (the secured debt) on a claim ceded *in securitatem debiti* that constituted security. Thus, the court considered how settling a loan affects the security. It held that *'a claim ceded in securitatem debiti automatically reverts to the cedent once the secured debt is extinguished and that in such event a re-cession by the cessionary is not required'*.[559] *Grobler* was an appeal against a dismissal of a special plea of prescription that centred on the nature of the cession of insurance policies as security for the payment by the purchaser of the purchase price for a property, as the deed of sale was ambiguous on this issue. The Supreme Court of Appeal was clear about the fact that, once the secured debt is settled, no further act is required to fully restore the ceded claim, that is, the right of action, to its owner, the cedent. The ceded claim is,

[557] In *Taurog and Others NNO v General Accident Insurance Co of SA Ltd* [1978] 3 All SA 543 (W) the court held at 547 that, depending on the wording used in an agreement, the indemnified party could require the indemnitor to indemnify it before the indemnified party is itself required to pay the principal creditor.
[558] *Kilburn v Kilburn* 1931 AD 501.
[559] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.

according to the Supreme Court of Appeal, therefore automatically restored. The rationale is that the security was accessory to a principal obligation, and if the latter is extinguished by settlement, the ceded claim is automatically restored to the cedent.

4.7 The effect of indebtedness on continuing covering security

The parties often agree in the facility agreement or the security agreement that the security will be *'continuing covering security'* or *'continuing security'* or a *'continuing guarantee'*[560] notwithstanding any settlement of, or fluctuation in, the indebtedness.[561] The condition is ordinarily a lender requirement and applies to facilities where the debt fluctuates, such as a revolving credit facility,[562] or is fixed, such as a term facility.[563] The borrower may repay the loan through scheduled[564] or unscheduled repayments.[565] If, for example, the loan is an amortising loan, the borrower repays the capital and interest over time on scheduled repayment dates, resulting in a constantly reducing balance or fluctuating indebtedness.

What precisely is meant in law by *'continuing covering security', 'continuing security'* or a *'continuing guarantee'*? What is the legal position if the security is stated in an agreement as being *'continuing covering security', 'continuing security'* or a *'continuing guarantee'*, and the agreement contains a discharge clause?

These phrases are, as a matter of practice, used to describe the security, and, in the case of a continuing guarantee as *quasi*-security, employed to secure the repayment of both fluctuating debt and fixed debt. Continuing covering security, continuing security or a continuing guarantee are intended to secure repayment of the balance in a bullet loan or the reducing balance in an amortising loan so that, despite interim payments, the lender's claim to the balance owing is secured.

A provision in an agreement that security is continuing covering security or that a guarantee is a continuing guarantee is a contractually agreed *incidentale*[566] of the security agreement in terms of which the parties agree that, despite partial settlement or temporary extinction of the debt, the security or guarantee remain in force.

Our courts have held that, depending on the parties' intentions, continuing covering security or continuing security for a fluctuating debt, such as a revolving facility, means that the security remains valid and in force despite the partial settlement or temporary extinction

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[560] Although, as stated elsewhere, guarantees are not security for insolvency law purposes.
[561] The LMA's Term Facilities Agreement, clause 17.2 (*Continuing guarantee*), where the concept of a continuing guarantee is used. There are numerous cases where the concept *'continuing security'* is used, such as *Coopers & Lybrand and Others v Bryant* 1995 (3) SA 761 (A) at 766 and 768, where the respondent's banking facilities were secured by a deed of cession that served as continuing security, and *Pfeiffer v First National Bank of SA Ltd* 1998 (3) SA 1018 (SCA) at 1024, where a suretyship served as continuing security for a principal debtor's continuing and fluctuating indebtedness in respect of overdraft facilities.
[562] A revolving credit facility is discussed in section 3.1.1 *Availability of the loan* under the sub-heading *Revolving credit facility.* In that section I describe an overdraft facility as a revolving credit facility in nature.
[563] A term loan facility is discussed in section 3.1.1 *Availability of the loan* under the sub-heading *Term loan facility.*
[564] The LMA's Term Facilities Agreement, clause 6.1(a) and (b) (*Repayment of loans*).
[565] Ibid clause 7.4 (*Voluntary prepayment of loans*).
[566] The *incidentalia* of a loan agreement are the terms incorporated by the parties either by way of a departure from the *naturalia* (terms implied by law) that would ordinarily have applied to a loan, or for which the law does not make provision.

of the debt.[567] It seems that the continuing covering security is limited to the value of the debt, and the security would not secure future debt unless the security agreement expressly provides that the security secures future debt of, for example, an unspecified or unlimited amount.[568] Thus, even if all amounts drawn under a revolving facility have been repaid, the security can remain in force to cover future draws by the borrower from the facility. This reasoning can be extended to continuing guarantees as well, even though guarantees are not *security* for insolvency law purposes[569] in the sense that the guarantee can remain in place despite the partial settlement or temporary extinction of the debt.

In 1994, in *Shaw NO v Burger*[570] (*'Shaw'*), the court held that a continuing covering bond remained in force despite the indebtedness being decreased or even extinguished completely, as such temporary extinction does not affect the accessory nature of the bond. The accessorial principle –

> *does not require that the principal debt should exist when the bond comes into being. The bond becomes effective as security the moment an indebtedness covered by the bond comes into existence. See Voet 20.1.20; Van Zyl The Judicial Practice of South Africa 1923 ed vol 2 at 741. The right which the mortgagee enjoys until such an indebtedness arises is one entitling him, without more, to the security of the bond the moment he makes an advance of a kind stipulated in the bond.*[571]

However, a mortgage bond was different because, unless there is a principal obligation, there can be no mortgage as the mortgage is accessory in nature.[572] A covering bond, such as the one the court was considering, had different characteristics to a mortgage bond. It was a bond granted as continuing security for existing debts and future debts up to a maximum, and envisaged the debt decreasing or even being extinguished completely.[573]

African Consolidated Agencies (Pty) Ltd v Siemens Nixdorf Information Systems (Pty) Ltd[574] (*'African'*) and *Interland Durban (Pty) Ltd v Walters NO and Another*[575] may be considered authority for the proposition that a security cession given as continuing security remains operative, despite the non-existence of a principal debt at a given time, but in that time it is dormant. The court held that the non-existence of a principal debt at the time the cessionary sought to enforce the security cession did not invalidate the cession or render it inoperative, but merely rendered it *'dormant'* and it *'remained extant'*. The security continued in force despite the principal obligation becoming inoperative. The *African* principle can be relied on as authority for security remaining valid despite the fact that a borrower may not (yet) have drawn down under a facility.

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[567] *Airco Engineering (Pty) Ltd v Ensor NO* 1988 (2) SA 367 (N); *Interland Durban (Pty) Ltd v Walters NO and Another* 1993 (1) SA 223 (C); *Shaw NO v Burger* 1994 (1) SA 529 (C); Lubbe *Contract: General Principles* (2020) 539 para 13.62; Lubbe 'Die Aksessoriteitsbeginsel en die Sessie van Dekkingsverbande' 1987 *De Jure* 241.
[568] *Airco Engineering (Pty) Ltd v Ensor NO* 1988 (2) SA 367 (N).
[569] See section 4.3 under the sub-heading *Guaranteed parties as creditors.*
[570] *Shaw NO v Burger* 1994 (1) SA 529 (C).
[571] Ibid 532.
[572] Ibid 531–532.
[573] Ibid 531.
[574] *African Consolidated Agencies (Pty) Ltd v Siemens Nixdorf Information Systems (Pty) Ltd* 1992 (2) SA 739 (C) 746–747.
[575] *Interland Durban (Pty) Ltd v Walters NO and Another* 1993 (1) SA 223 (C).

PG Bison Ltd and Others v The Master and Another[576] (*'PG Bison'*) illustrates how one should exclude contractual limitations placed on a cessionary implementing a cession *in securitatem debiti* if the cessionary wishes to enjoy unhindered continuing covering security. The Supreme Court of Appeal held that a clause in a deed of cession of book debts given *in securitatem debiti* that the cessionary would not implement the cession unless the account was overdue by 30 days, and 7 days' notice of the intention to implement the cession was given, did not suspend the cession. The parties' intention was to unconditionally and immediately transfer the rights *in securitatem debiti*, and the said cession therefore provided the required security.[577] As a result of the requirements that the accounts had to be overdue and notice had to be given, the cessionaries' rights to implement or carry out the cession were suspended until the conditions were fulfilled.

It is submitted that the decision as to whether security was meant to continue in force, and was meant to be continuing covering, will depend on the parties' intentions evidenced in the contract.

A discharge clause, revolving credit facility and the lapsing of security rights

I now consider the effect of a discharge clause[578] and a revolving credit facility on continuing covering security in a contract where the debt is settled in full. Does security, *ipso iure* as set out in *Grobler*, automatically revert to the cedent if the agreement requires the cessionary, on application by the cedent, to take steps to cancel the security?

Applicable principles

It is a *naturale* of the security agreement that the security automatically reverts to the security provider on settlement of the secured debt. In the pledge of corporeal movable property, the pledgee who possesses such property must physically transfer possession back to the pledgor, on satisfaction of the secured debt.[579] Transfer by the pledgor of the corporeal movable property back to the pledgee must take place *pari passu* with the payment by the pledgor of its debt to the pledgee.[580] In the pledge of personal rights, *Grobler*'s principle is that the security rights revert automatically to the cedent on satisfaction of the debt, without the need for a re-cession. The rationale for this is that the security is accessorial to the principal obligation (secured debt), and if the principal obligation is extinguished by settlement, then the related security automatically lapses.

The principle that security automatically reverts to the security provider upon the settlement of the debt it secures does not apply to continuing covering bonds if the position

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[576] *PG Bison Ltd and Others v The Master and Another* 2000 (1) SA 859 (SCA).
[577] Ibid paras 8–17.
[578] A typical discharge clause reads as follows: *'At any time after the Facility Outstandings has been fully, finally and irrevocably paid and discharged in full, the Borrower shall be entitled to request the Lender to confirm, by the delivery of a written notice from the Lender to the Borrowers ("Discharge Notice"), that the Borrower obligations under the Finance Documents have been fully, finally and irrevocably discharged in full, provided that the obligations of the Borrower under the Finance Documents have been so fully, finally and irrevocably discharged in full. The Lender shall not unreasonably withhold or delay providing the Discharge Notice.'* A discharge clause typically found in a facility agreement is similar in concept to the discharge provisions in s 1(2) of the Security by Means of Movable Property Act 57 of 1993.
[579] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 431.
[580] Ibid.

in *Shaw*[581] is followed. In the case of continuing covering bonds, the bond does not lapse but remains registered if the parties agreed that the property over which the bond was registered will serve as security for existing and future debt. If not, the bond must be cancelled in the Deeds Office.

A discharge clause

A discharge clause contains a security cancellation mechanism that requires the borrower to request the lender's written confirmation, upon settlement of the secured debt, that the borrower has fulfilled all its obligations under the finance documents,[582] and that the security is henceforth cancelled and released. It can be contained in any type of agreement, whether it is a term loan facility agreement or a revolving loan facility agreement, or a security agreement. Until the cedent has complied with the discharge clause, and the cessionary has actively cancelled the security, the cession *in securitatem debiti* remains in place, despite the borrower having settled the secured debt. In these circumstances, on the authority of the *African* judgment, the security remains in place, but it is dormant as there is no debt to the extent that the parties intended the security rights to be continuing covering security.

A related issue is whether a future, contingent syndicated loan can be secured. It is possible for the lenders and the borrower to agree that the borrower will encumber specific assets or property as security for a contingent loan, provided that the loan will be a real and not a simulated loan at that time, whether claimable or contingent.[583] The legal basis is, as stated below, that the secured debt need not exist when the security right is created, as long as the obligation exists when the creditor seeks to enforce its security right.[584] In a syndicated loan, the encumbrances will be created in favour of the Security SPV.

If the cessionary in its capacity as a lender is satisfied that the cedent as borrower has repaid the loan plus interest and costs in full, the cessionary then cancels its security by releasing its hold on the pledged assets or ceded incorporeal rights by issuing a discharge and release letter.[585] The rights that were pledged and ceded *in securitatem debiti* are, once the cessionary cancels and releases the rights, restored in full to the cedent's patrimony or estate.

A revolving credit facility[586]

If a revolving credit facility is made available, and the parties agree that the security given will remain in place despite the temporary settlement of drawn amounts, the following questions arise. Do the security rights at the time of settlement revert to the cedent as there

[581] *Shaw NO v Burger* 1994 (1) SA 529 (C).
[582] Finance documents are defined as the facility agreement and the related security agreements or documents, such as a borrower security cession and pledge agreement, bond documents, an obligor guarantee, a security cession and pledge agreement, an indemnity agreement and a subordination agreement, amongst others.
[583] *Kilburn v Kilburn* 1931 AD 501. See the analysis in section 4.6 *The accessorial principle.*
[584] *Kilburn v Kilburn* 1931 AD 501; Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 102.
[585] The letter is sometimes referred to as a discharge letter or a release letter.
[586] A revolving credit facility is analysed in section 3.1.1 under the heading *Revolving credit facility* and this section must be read with that section.

is no principal debt (secured debt) at that time? And, if the cedent draws on the facility again, are the security rights then ceded (transferred) again to the cessionary? It seems unlikely to be so. In effect, what happens is that, on temporary settlement, the cession remains in force, and the security rights become dormant as the principal debt was settled, lying in wait to operate again when the cedent draws on the facility. This view, expressed to some extent in *African*, may however be challenged on the basis that describing a ceded right as dormant goes against the principle laid down in *Grobler* that settling the debt *ipso iure*, bar the parties' contrary intentions, reverts the security to the cedent. The parties may, however, intend the cession to continue in force in these circumstances. If so, the cession still being operative is predicated entirely on the parties' intentions to keep the security rights alive despite the debt having been settled, rather than because of the accessorial principle *per se*. A contrary view is that because *Grobler*'s facts did not deal with fluctuating debt like *African* did, the *Grobler* judgment is not at odds with the *African* judgment, with the result that both conceptual approaches to the continuation in force, or the automatic reversion of ceded rights, are acceptable.

The parties may vary the *naturale* or legal consequence that security, upon settlement of the debt, automatically reverts to the cedent or pledgor, by agreeing to the *incidentale* of discharge provisions. The contractual effect of the discharge provision is an agreement that the security remains in place despite the debt being settled, so that it may serve as security for future debt, unless intentionally cancelled by the cessionary on the cedent's application for discharge. Thus, the parties contemplate any settlement of the debt to be a temporary extinction of the cedent's liability given that the cedent may borrow further amounts from the same cessionary (lender).

The lender's obligation to lend and advance the monies is cancelled if, at the end of period for which the loan was available to be drawn down,[587] an unutilised portion of the loan amount remains so that the loan was not fully drawn.[588]

Discretionary rights

Having examined the legal meaning and effect of continuing covering security provisions that apply to fluctuating debt and fixed debt, I will now analyse the principles in accordance with which the lender is required to exercise its rights under these provisions. The circumstances in which the lender may exercise its continuing covering security rights are determined by the content and construction of the clause. Generally, however, the borrower must have actually defaulted on repaying the loan before the lender is entitled to exercise its security rights. The lender should not exercise its default rights against the borrower if it only anticipates that the borrower *may* default on its contractual obligations, but the borrower has not *actually* defaulted.[589] If there is a default, the lender may, if there is an acceleration clause, exercise its right to accelerate or bring forward the loan repayment to

[587] The LMA's Term Facilities Agreement, defined as the Availability Period, clause 1.1 (*Definitions*).
[588] Ibid clause 5.5 (*Cancellation of commitment).*
[589] See the analysis of acceleration notices discussed in section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims* under the heading *Acceleration notices.*

an earlier maturity date[590] or require that outstanding amounts be repaid on demand.[591] Should the borrower not repay the loan, the lender may realise its rights to the security.[592]

The rights granted to the lender on the borrower's default are usually written into the facility agreement in such a manner that the lender may exercise them if, in the lender's opinion, certain circumstances have arisen. The rights can be termed discretionary contractual rights,[593] and are more commonly known as unilateral rights, although that description is technically misleading as all rights are in some sense unilateral.

A distinction can be drawn between a discretionary substantive right and a discretionary incidental right.[594] A discretionary substantive right is a right to determine the performance required under a contract *ab initio* or to vary an agreed performance.[595] Van Huyssteen *et al* are unclear about whether this means that the party vested with the discretion determines what the performance will consist of or, alternatively, measures compliance with what performance was agreed to.[596] I assume it is the latter. A discretionary incidental right is a right to determine an incidental, as opposed to an essential, aspect of the agreement. The debate as to whether a discretionary contractual right may be abused by the party on whom the discretion is conferred, and leads to legal uncertainty, or should be prohibited as being contrary to public policy, is eloquently covered by Van Huyssteen *et al.*[597] In principle, the Supreme Court of Appeal has limited the prohibition on discretionary substantive rights to cases where the discretion is unfettered and unrestricted by objective considerations.[598] In other words, a discretionary substantive right that confers unfettered powers on a party, with no objective considerations to be observed when exercising that discretion, is invalid and unenforceable. The courts have also found that the prohibition against discretionary substantive rights is limited to contracts of sale and lease.[599] Van Huyssteen *et al*[600] state that the following types of discretionary rights are therefore acceptable: (i) clauses that limit a party to a range of alternative options; (ii) clauses that require a discretion to be exercised having regard to factual or objective criteria; and (iii) clauses that provide for disputes to be resolved objectively, where such disputes arise from exercising a power. In their review of *NBS Boland Bank Ltd v One Berg River Drive CC and Others; Deeb and Another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd*,[601] Van Huyssteen *et al*[602] state that the Roman-Dutch rule against substantive discretions was limited to clauses that entitled a

[590] The LMA's Term Facilities Agreement, clause 22.22(b) (*Acceleration*); see section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims* under the heading *Acceleration notices.*
[591] Ibid clause 22.22(c) (*Acceleration*).
[592] Ibid clause 22.22(d) (*Acceleration*).
[593] Lubbe *Contract: General Principles* (2020) 274 para D.
[594] Ibid 276 para 8.18 and 277 para 8.20.
[595] Ibid 276 para 8.18.
[596] Perhaps this is because the judgment in *NBS Boland Bank Ltd v One Berg River Drive CC and Other; Deeb and Another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 (4) SA 928 (SCA) did not distinguish between the power to vary agreed performance and the power to make the initial determination of performance unilaterally, as pointed out by Lubbe *Contract: General Principles* (2020) 276 para 8.18 and 281 n 155.
[597] Lubbe *Contract: General Principles* (2020) 276 para 8.18 – 284 para 8.31.
[598] Ibid 280–281 para 8.27.
[599] Ibid 280–281 para 8.27; *NBS Boland Bank Ltd v One Berg River Drive CC and Others; Deeb and Another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 (4) SA 928 (SCA).
[600] Lubbe *Contract: General Principles* (2020) 280–281 para 8.27.
[601] *NBS Boland Bank Ltd v One Berg River Drive CC and Others; Deeb and Another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 (4) SA 928 (SCA); [1999] 4 All SA 183 (A).
[602] Lubbe *Contract: General Principles* (2020) 280–281 para 8.27.

party to determine the rental in contracts of lease or the purchase price in contracts of sale. The authors infer from this that incidental discretions in contracts of lease and sale should therefore be valid, and substantive discretions in respect of other types of contract are permissible.

The ambit of a lender's discretionary contractual rights in a secured *mutuum* is generally to determine, without reference to the borrower,[603] but in accordance with objective criteria in the facility agreement, if a pre-agreed event of default has occurred. The LMA's South African facility agreements contain a set of events of default[604] that can be categorised broadly into objective, fact-based defaults, and subjective, opinion-based defaults. In both default types, if the borrower's conduct falls short of, or is not in compliance with, or worse still breaches, the standard set in that clause, the borrower will have committed an event of default. In fact-based defaults, the lender determines whether the borrower's conduct constitutes an event of default based on facts. Examples of fact-based defaults are the borrower's failure to pay an amount on the due date (unless its failure was due to an administrative or technical error, and payment is not made within three business days after its due date)[605] and the borrower's failure to satisfy the financial covenants,[606] which is determined by applying the agreed formula. In opinion-based defaults, the lender exercises a value judgment, based on information provided, to determine whether the borrower's conduct constitutes an event of default. An example of an opinion-based default is whether, in the lender's opinion based on its interpretation of the provisions of the Companies Act that deal with financially distressed companies, a member of the borrower group is deemed by such provisions to be financially distressed, which in turn is an insolvency event.[607] It is submitted that opinion-based defaults constitute discretionary substantive rights in favour of the lender as the lender is required to apply its discretion to determine if the borrower has performed adequately. The language of the events of default clause is such that only a borrower or other obligor can commit an event of default, and not the lender. If an event of default has occurred, the lender can accelerate the loan maturity date[608] and, failing repayment of the loan, can exercise its security rights or instruct the agent to do so.[609]

However, in the exercise of such rights, the lender's power to determine the borrower's compliance is fettered by both the common-law *naturalia* principles of reasonableness and *bona fides* and the provisions of the facility agreement that stipulate *inter alia* that the performance consists of (i) repaying the loan in legal tender,[610] and in the currency in which the loan was advanced unless the facility agreement stipulates otherwise; (ii) maintaining financial covenants; and (iii) fulfilling ongoing obligations. The standards with which the

[603] Often, facility agreements and security agreements will describe the lender's discretionary substantive rights by using the terms 'in its sole discretion' as a prefix to the lender's power in relation to a specific matter. *Ipso iure*, such a discretion must be exercised reasonably and in a *bona fide* manner.
[604] The LMA's Term Facilities Agreement, for example, lists 21 instances of default that a borrower could commit. See clause 22 (*Events of default*) of the LMA's Term Facilities Agreement.
[605] Ibid clause 22.1 (*Non-payment*).
[606] Ibid clause 22.2(a) (*Financial covenants and other obligations*).
[607] Ibid clause 22.6(b) (*Insolvency*).
[608] Ibid clause 22.22(b) and (c) (*Acceleration*).
[609] Ibid clause 22.22(d) (*Acceleration*).
[610] Section 17 of the South African Reserve Bank Act 90 of 1989 contains a definition of legal tender.

borrower must comply in respect of (i), (ii) and (iii) are detailed in the facility agreement.

At common law, a lender must exercise a discretionary right conferred on it (in a facility agreement or security agreement) reasonably and in a *bona fide* manner. The lender's exercise of such a right will be judged against the objective standard of reasonable behaviour in the circumstances. In 1993, in *Remini v Basson*,[611] the court had to decide whether it was lawful for Saambou to cancel a home loan it had approved, based on a clause that unilaterally entitled it to do so. The court held that Saambou's reason for doing so must be tested against the standard of reasonableness, or it should at least not be an unreasonable decision. This is based on the general common-law principle seemingly applicable to all classes of contract that a party must exercise a discretionary contractual power reasonably or *arbitrium boni viri*.[612] This common-law obligation protects borrowers from unreasonable lender action against borrowers.

In 2010, in *Bredenkamp v Standard Bank*,[613] the Supreme Court of Appeal considered whether the bank had exercised its unilateral contractual rights to cancel its contract with the appellants and close their accounts, reasonably and fairly. It heard an appeal against an order of the court *a quo* which granted an interim interdict preventing the bank from closing the appellants' accounts. The bank exercised its contractual right to close the appellants' accounts and notified the appellants, who applied for the interim interdict. The principal issue was a constitutional one, namely, the fairness of the contract; even if the contract was found to be fair and valid, its enforcement had to be fair to pass constitutional muster. The bank closed the accounts because Bredenkamp and his entities were listed as specially designated nationals by the US Department of Treasury's Office of Foreign Asset Control (OFAC) because he was said to be a 'crony' of President Mugabe of Zimbabwe. The bank alleged that it was an express, alternatively, implied term of its contracts that it could close accounts on reasonable notice. Without deciding the merits of the business decision to close the accounts, the court found that the bank had acted *bona fide* in its decision[614] and that the bank's motive was irrelevant. This finding accords with the common-law requirements that discretionary rights must be exercised reasonably and in a *bona fide* manner.

In 1999, in *NBS Boland Bank Ltd v One Berg River Drive CC and Others; Deeb and Another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd*[615] (*'NBS'*), the Supreme Court of Appeal had to decide one issue in the three appeals before it, namely, whether a clause in a mortgage bond that entitled the mortgagee to unilaterally increase the original interest rate payable by the mortgagor was valid. In the first appeal, the court *a quo* had held that, as the clause conferred on the mortgagee the unfettered discretion to vary the interest rate, the clause was void for vagueness as one party could determine the extent

[611] *Remini v Basson* 1993 (3) SA 204 (N).
[612] *Dharumpal Transport (Pty) Ltd v Dharumpal* [1956] 1 All SA 388 (A).
[613] *Bredenkamp v Standard Bank* 2010 (4) SA 468 (SCA).
[614] Ibid para 64.
[615] *NBS Boland Bank Ltd v One Berg River Drive CC and Others; Deeb and Another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 (4) SA 928 (SCA); [1999] 4 All SA 183 (A).

of his or the other party's performance. In the second appeal, the court *a quo* had held that the clause allowed the mortgagee to increase the interest rate when and by the amounts which it would do in the ordinary course of its business. In the third appeal, the court *a quo* had held that the discretion to increase the interest rate was not unfettered as it could be increased only in accordance with prevailing banking practices. The Supreme Court of Appeal canvassed foreign case law, South African case law and the Roman-Dutch authorities. The court concluded that the decisions that held that such a clause is invalid had a recurring theme, which was that a contract that empowered a party to *'fix a prestation is void for vagueness'*.[616] After reviewing foreign case law which recognised such clauses as valid, and Justinian's Digest which concerned only the power of a party to fix its own performance (not that of the other party), the court concluded that a clause that conferred on a party the right to determine a prestation was unobjectionable,[617] but qualified this by holding that the common law states that *'unless a contractual discretionary power was clearly intended to be completely unfettered, an exercise of such a discretion must be made arbitrio bono viri'*.[618] *NBS* adds depth to the common law regarding discretionary contractual rights by requiring such rights to be exercised *arbitrio bono viri* if the agreement does not confer an unfettered discretion on a party.

If the exercise by a lender of its discretionary rights reasonably and in a *bona fide* manner would yield a result unfavourable for the lender, the lender may be tempted to avoid complying with its common law obligations by exercising its rights in bad faith or capriciously so that it attains a more favourable result. A lender behaving in this manner breaches its common law obligations to exercise its discretionary rights reasonably and in a *bona fide* manner. Borrower's will need to diligently evaluate the lender's exercise of its discretionary rights to establish if the lender complied with its common law obligations.

4.8 ***Pari passu*** **ranking of security**

It is necessary to understand the principles that govern security rights, and how multiple claims with concomitant security rights rank in relation to each other.

The term *pari passu* has been used in different contexts in South Africa, such as shares ranking *pari passu*, lenders' claims ranking *pari passu*, payment obligations ranking *pari passu,* security rights ranking *pari passu*, and other rights or obligations ranking *pari passu*.

Facility agreements almost always contain a representation, undertaking and warranty given by the borrower that the obligations (including the debt) owed by the borrower to the lender rank at least *pari passu* with the claims of all its other unsecured and unsubordinated creditors.[619] The representation and warranty typically read as follows:

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[616] Ibid para 9.
[617] Ibid para 24.
[618] Ibid para 25.
[619] The LMA's Term Facilities Agreement, clause 18.13 (*Representations, Pari passu ranking*).

Pari passu ranking

Its payment obligations under the finance documents rank at least pari passu with the claims of all its other unsecured and unsubordinated creditors, except for obligations mandatorily preferred by law applying to companies generally.[620]

South African case law has interpreted the term *pari passu* to mean *'equally and without preference'*.[621] Thus, in *Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries*,[622] the court held:

As to the phrase, pari passu, it seems to me that it should be given the meaning ascribed to it in the Oxford Dictionary where, referring to the phrase in the legal sense, the following appears: 'On an equality, equally and without preference'.[623]

The *pari passu* clause recognises that the borrower has existing obligations but requires the borrower to represent and warrant that the borrower's obligation to pay the lender's claims (arising from the loan) rank at least equally with the borrower's obligations to pay its other unsecured and unsubordinated creditors. The *pari passu* clause gives the lender the comfort that legally, there is a parity of claims, and that no claim will be paid in preference to its claim.[624] Whether the *pari passu* principle applies to the claims of all the classes of creditors depends on the wording of the clause, although lenders under the same facility are typically treated *pari passu*.

Unsecured creditors derive comfort that applying the *paritas creditorum* (equality of creditors) principle will result in their claims being settled proportionately and equally.[625] It can be argued that the *paritas creditorum* principle results in unsecured creditors' claims ranking *pari passu.* Creditors who want their claims to rank ahead of other creditors' claims take security as is the case in, for example, English law.[626] The taking of security establishes a priority of claims between creditors which back-ranks the *pari passu* principle as between secured and unsecured creditors because secured creditors' claims are, in consequence of the secured creditors having security, paid in preference to the unsecured creditors' claims.

4.9 The realisation of security

Having analysed the principles that govern security rights, it is important to understand how the lender, as the holder of security rights, realises its security if the borrower defaults. The sections dealing with the security structure and the security rights of syndicated lenders[627] is the context within which this analysis of the principles that apply to realising security

[620] Ibid.
[621] See *Absa Bank Ltd v Moore and Another* 2017 (1) SA 255 (CC); *Nulliah v Harper* 1930 AD 141 at 151–152 and 155.
[622] *Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries* 1979 (3) SA 713 (W).
[623] Ibid 715B.
[624] The LMA's Term Facilities Agreement, clause 18.13 (*Representations, Pari passu ranking*).
[625] Brits *Real Security Law* (2016) 2.
[626] McCormack *Secured Credit under English and American Law* (2004) 5. The *pari passu* clause is particularly relevant in cross border loans where the lenders may be concerned that the claims of other lenders or even third party creditors rank in priority to their claims, a discussion of which is beyond the scope of this thesis.
[627] Section 4.11 *Security structure and security rights of syndicate lenders.*

interests is undertaken.

The realisation of security if the borrower defaults is a phase in the loan cycle that occurs in the sequence of events contemplated in a facility agreement. The borrower commits an event of default if, for example, it does not repay the loan on the maturity date,[628] or goes into business rescue,[629] or goes insolvent.[630] In respect of certain types of default, the borrower is typically given short time periods to remedy the default, and if it fails to do so, the agent on behalf of the lenders and the Security SPV can exercise their rights, whilst in other defaults, no such grace period is required before the lender exercises its rights. In section 4.6 (*The accessorial principle*) I analyse the distinction between fact-based defaults and opinion-based defaults,[631] which must be borne in mind when reading this section. If the borrower is granted the right to remedy the default[632] and fails to do so, or if the borrower is not granted such a remedy opportunity, the agent on behalf of the lenders in a syndicated loan may, if the facility agreement contains an acceleration clause,[633] cancel the lenders' commitments to fund,[634] and accelerate the maturity date on which the loan plus interest and costs should have been repaid to an earlier date.[635] After accelerating the maturity date, the agent may, if the borrower fails to repay the loan, claim against the Security SPV under the guarantee agreement and, simultaneously, the agent will instruct the Security SPV to exercise its security rights[636] by in turn claiming for a like amount under the borrower counter-indemnities.[637] If unsuccessful, the Security SPV then calls on guarantees issued by obligors (other than the borrower) and if no payment is received then it realises its security rights held in the obligors' assets and property.[638] The Security SPV or a lender in a bilateral loan may exercise its security rights by claiming performance from the principal debtor directly in its own name under the terms of the bond, the pledge or pledge and cession *in securitatem debiti* or it could dispose of the ceded rights and use the proceeds to settle the secured debt.[639] Lubbe states that this is only possible if the ceded claim is enforceable and the principal debtor will perform in a way that settles the secured debt.[640] Alternatively, the Security SPV in a syndicated loan or the lender in a bilateral loan could apply to court, in its own name, for judgment against the cedent in terms whereof the court would order (i) that the debt under the counter-indemnities (syndicated loan) or under the facility agreement (bilateral loan) is due; and (ii) the sale in execution of the ceded claim,[641] which is carried out by the appointed sheriff. The rights of the Security SPV or the lender

[628] The LMA's Term Facilities Agreement, clause 22.1 (*Non-payment*).
[629] Ibid clause 22.7 (*Insolvency and business rescue proceedings*); as contemplated in Chapter 6 (*Business rescue and compromise with creditors*) of the Companies Act 2008.
[630] Ibid clause 22.6 (*Insolvency*); as contemplated in the Insolvency Act.
[631] Section 4.6 under the heading *Discretionary rights*.
[632] The LMA's Term Facilities Agreement, clause 22.1 (*Non-payment*) (a) and (b).
[633] Ibid clause 22.22 (*Acceleration*).
[634] Ibid clause 22.22 (*Acceleration*) (a).
[635] Ibid clause 22.22 (*Acceleration*) (b) and (c).
[636] Ibid clause 22.22 (*Acceleration*) (d).
[637] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51 at 52.
[638] Ibid.
[639] Lubbe *Contract: General Principles* (2020) 549–551 para 13.76.
[640] Ibid.
[641] Ibid. In respect of realising movable property held under a pledge agreement, see Brits *Real Security Law* (2016) 159, para 3.4.1. However, at 329, Brits states the sale in execution is the pledgee's only right in these circumstances. Of course, the lender need not ask the court to order execution of the claim if *parate executie* legitimately applies, but the lender would still need a court order confirming the debt is due.

to institute legal action in its own name arises *ex lege* from the cession *in securitatem debiti*, but is also typically contained in the cession agreement in the form of a power of attorney conferred by the borrower on the Security SPV or the lender, as the case may be. The circumstances at the time of default, for example, the nature of the security or whether the claim is enforceable, will determine whether the Security SPV (as cessionary) or the lender (as cessionary) claims performance from the principal debtor or seeks judgment against the borrower (as cedent).[642] It appears from *Cohen's Trustee*[643] that the cessionary's entitlement at the time of default is to elect whether to institute action against either the principal debtor or the cedent.[644]

In English law, an acceleration notice must be issued on the basis that the loan is actually due and payable, and must not purport to give notice of an acceleration or a future acceleration conditional on future events, such as an anticipated default, as that gives rise to uncertainty.[645] In South African law, a court will not enforce a contractual claim if it is brought prematurely prior to the default occurring.[646] However, academic opinion is that anticipatory breach is an acceptable form of breach that consists of either repudiation or prevention of performance.[647] Anticipatory breach occurs before performance is rendered by predicting that a party will malperform (positive or negative) in relation to its obligation, or will continue its negative malperformance.[648] A distinction must be drawn between prematurely issuing a default notice (whether in respect of an anticipatory default or a default) where no default has occurred, and issuing a default notice (whether in respect of anticipatory default or default) where a default has occurred. It is established law that a term in an agreement or contract that imposes an obligation on a party to act in a particular manner by, for example, requiring that party to issue a notice, such as an acceleration notice, before it can exercise a right, can be exercised by that party only if it has carried out the required act.[649] In other words, the right (arising from the obligation) can be exercised only if the party complies with the prescripts of the contract.

An important factor to consider when deciding whether a court would enforce a prematurely issued default notice is that in a *mutuum,* the lender's loss arises only if the borrower actually fails to repay the loan on the agreed date,[650] not before. To claim, the

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[642] Lubbe *Contract: General Principles* (2020) 549 para 13.76; *Densam (Pty) Ltd v Cywilnat (Pty) Ltd* 1991 (1) SA 100 (A).
[643] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235.
[644] Ibid 251. Innes CJ said: *'The secured creditor, so far as the enforcement of the right is concerned, would seem to occupy a position practically equivalent to that of an owner. He alone can sue upon the ceded obligation: and he may do so for the full amount, however much in excess of the secured debt (Wetzlar vs General Insurance Co 3, J, p 86). Nor need he excuss the pledgor before taking steps to realise the security (Sande's Decis 3, 12, Def 25).'* (emphasis added)
[645] *African Export-Import Bank and Others v Shebah Exploration and Production Company Ltd and Others* [2016] EWHC 311, Queen's Bench Division, Commercial Court. See the discussion titled *Acceleration notices* under section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims*.
[646] In *Commercial Union Assurance Co of South Africa Ltd v Golden Era Printers and Stationers (Bophuthatswana) (Pty) Ltd* 1998 (2) SA 718 (B), the court would not uphold the plaintiff's claim against the defendant (obtained by a cession of the lessor's claim to the plaintiff) on the basis of contract because the lessor's claim against the lessee for the lessee to return the leased premises in the same condition of good repair had not yet arisen because the lease had not been terminated, and such termination was a condition precedent to the claim to return the property. The court effectively held that such a claim was premature because the lease had not been terminated, which would have founded the claim. The plaintiff could not have acquired a claim that the lessor did not have.
[647] Lubbe *Contract: General Principles* (2020) 390 para 11.36, 408 para 11.108 and 417 para 11.143.
[648] Ibid, 408 para 11.108.
[649] *Thiart v Kraukamp* 1967 (3) SA 219 (T); *Scott and Another v Poupard and Another* 1971 (2) SA 373 (A); *Design and Planning Service v Kruger* 1974 (1) SA 689 (T); *Blou v Lampert and Chipkin NNO and Others* 1970 (2) SA 185 (T); *Briscoe v Deans* 1989 (1) SA 100 (W*)* and *Van Wyk v Botha and Others* [2005] 2 All SA 320 (C).
[650] Usually defined in the facility agreement as the *maturity date* or *repayment date.*

lender must prove factual causation, namely, that its damages were caused by the borrower's default.[651] This requirement rests on the general principle that a plaintiff must prove that the damages that it suffered were caused by the breach of contract.[652] If the lender were to issue a default notice prematurely, that is, before it sustains or incurs damages, it will not be able to prove that borrower's non-payment caused its damages, that is, factual causation would not have occurred. The lender's rights against the borrower therefore only arise on the date that it can prove factual causation, not before. The English law position that the loan must be due and payable accords with South African contract law principles on damages in respect of a *mutuum.* If a lender can prove its damages were caused by the borrower's default, then default notices issued by the lender, whether in respect of anticipatory defaults or any other defaults, may be enforced.

Assuming that the default notice is issued when the borrower commits an event of default, a related issue is whether the lender can, in that default notice, recover damages in addition to the repayment of the loan. In South African law there are different theories and methods that are used to explain the law of damages and the computation thereof,[653] but these are not relevant to this thesis. In 1938, in *Oslo Land Co Ltd v The Union Government*,[654] the Appellate Division held that damages are not *'injury to the property injured, but the damnum, that is the loss suffered by the plaintiff by reason of the negligent act'*.[655] Damages arising from breach of contract are measured using the positive interest criterion,[656] in terms whereof one compares the plaintiff's patrimonial position after the breach against the position in which the plaintiff would have been had the contract been fulfilled.[657] The lender's patrimonial position (as plaintiff) after the borrower's failure to repay the loan, interest and costs must therefore be compared to the lender's patrimonial position had the borrower made the necessary payments. Then one must establish whether the facility agreement terms allow the lender to claim amounts in addition to the loan repayments. The LMA-styled facility agreements use the concept of *damages* in relation to agent's responsibilities[658] and *outstanding loans or amounts* in relation to the borrower's obligations under the finance documents.[659] When first interpreting the said wording, it seems that the LMA's South African facility agreements are not structured to permit the lender to claim damages in addition to the loan repayments. However, if the facility agreement or the other finance documents contemplate that the borrower will be liable for outstanding loans or amounts and damages, then the lender is contractually entitled to recover its damages. If the lender is unable to prove its damages, it cannot recover its damages. It would, however, be difficult for a lender to explain what damages it could have

[651] Lubbe *Contract: General Principles* (2020) 466 para 12.137.
[652] Ibid at 463 para 12.129.
[653] Lubbe *Contract: General Principles* (2020) 462ff; Dendy 'Damages' *LAWSA* vol 14(1) 3 ed (2018) paras 12ff.
[654] *Oslo Land Co Ltd v The Union Government* 1938 AD 584.
[655] Ibid 590 (sources omitted).
[656] However, this approach has been questioned, as mentioned by Lubbe *Contract: General Principles* (2020) 467–468 at para 12.144.
[657] Lubbe *Contract: General Principles* (2020) 467–468 at paras 12.144 and 12.145.
[658] As examples, see the LMA's Term Facilities Agreement, clause 4.1(b) (*Initial conditions precedent*), clause 24.2(c) (*Additional guarantors*) and clause 25.7(e) (*Rights and discretions*).
[659] As examples, see the LMA's Term Facilities Agreement, clause 1.1 (the definition of *Loans*), clause 6.1(a) (*Repayment of loans*) and clause 21 (*General undertakings*).

suffered if the full loan amount, including interest and costs, is already being claimed under the facility agreement. An alternative view is that the *Oslo* definition of damages means that it is the lender's loss arising from the borrower's failure to repay the loan, so that there is no distinction between damages and such a failure, notwithstanding the LMA's approach above. A related issue is whether a syndicate lender may recover damages for itself that were suffered by an assignee, novatee[660] or sub-participant of a loan by applying the *res inter acta*[661] principle.[662] The English courts have upheld such claims, but academic opinions differ.[663]

The parties to a facility agreement or security agreement typically agree that the lender may, upon the borrower's default, realise its security rights[664] as a juristic act to settle the unpaid debt by granting the lender the power to transfer ownership in the asset or incorporeal right (that constitutes the security) to itself, or to a third party, for value.[665] In either case, the lender's obligation is to credit the borrower for the value of the asset or incorporeal thing, thereby discharging the principal debt. Any surplus remaining after settling the principal debt must be paid to the borrower.[666] If, however, there is a deficit, the borrower remains liable to the lender for the deficit. Apart from these options, the lender could hold the security rights as a temporary repository until it decides whether to take ownership itself or to transfer ownership to a third party (for value).[667] As a temporary repository,[668] the lender must perform all the functions and duties, and is entitled to all the rights, of the owner, as if it was the owner. A lender who holds a defaulting borrower's shares as a temporary repository in terms of a security agreement, when called on by the company in which the shares are held to cast its votes on a matter, must do so, failing which the borrower will have breached the memorandum of incorporation or the shareholders' agreement.

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[660] A novatee (transferee) may suffer damages if, for example, the actual liabilities transferred to it by the novator (transferor) exceed the contracted liabilities.

[661] The Latin maxim is *res inter alios acta alteri nocere non debet*, which means that persons should not be prejudiced by the acts or words of others to which they were neither party nor privy, and which they consequently had no power to prevent or control.

[662] Goh 'Syndicated Loans and the Res Inter Alios Acta Principle: When Can an Arranger Claim for Loss it Did Not Suffer?' (2017) 1 *Journal of International Banking and Finance Law* 14.

[663] Ibid.

[664] The LMA's Term Facilities Agreement, clause 22.22(d) (*Acceleration*).

[665] The laws that apply to realising security rights are analysed in section 4.9.1 *Parate executie* to section 4.11 *Security structure and security rights of syndicate lenders.* If the borrower goes insolvent, the security rights must be realised by implementing the Insolvency Act and the common law, which vest all the insolvent's assets, movable and immovable property, however encumbered, in the trustee, who must acquire possession thereof, sell them, and pay the creditors in order of priority. See Mars *The Law of Insolvency in South Africa* 10 ed (2019) para 21.2; Moorcroft *Banking Law* (2021) ch 26; Silberberg and Schoeman's *The Law of Property* 6 ed (2019) chapters 16 and 17.

[666] *Graf v Buechel* 2003 (4) SA 378 (SCA) para 29, where the court stated this principle in respect of the pledgee realising its security through a conditional sale of the pledged article. See also Lubbe *Contract: General Principles* (2020) 550 para 13.76 and the authorities cited at n 725 and n 760.

[667] A lender may hold the security interests as a temporary repository because, for example, it has no business interest in owning assets or incorporeal rights of that kind and so wants to solicit offers to purchase the assets or incorporeal rights that form the subject of its security interests, or because market conditions are not ripe at that time to dispose of the security interests.

[668] The concept of a cessionary acting as a temporary repository holding pledged shares that are or were realised is used in practice in cession agreements in South Africa. Its origins are uncertain, but it is used in different contexts such as in early American trust law, where, in relation to trustees of estates who become bankrupt, the position seems to have been that the district court in those circumstances became the temporary repository of title in a qualified way, so that neither the court nor the judges attracted liability under a lease that was part of the trust property. See Simes, Fratcher & William 'Cases and Materials on the Law of Fiduciary Administration' 2 ed (1956) 249 at 257.

Realisation of security rights by a lender *prior to the obligor's insolvency* is governed by the common law discussed below and not by legislation because the Insolvency Act would not apply if the obligor is solvent. The common-law principles and the provisions of the Financial Markets Act govern the realisation of listed securities that are held in security, while the realisation of immovable property is governed by the common law and legislation.[669] However, realisation by a lender *on the obligor's insolvency* is governed by the common law applied with the Insolvency Act and, if applicable, legislation that governs the particular type of security. A lender may itself realise its security in terms of section 83(8) of the Insolvency Act, after obtaining the prior approval of the Master of the High Court or the insolvent estate's trustee in terms of section 83(8)*(c)* before the second meeting of the insolvent estate's creditors, and must realise its security *'within the limitations and subject to the conditions prescribed by that section'*.[670]

In the case of the cession *in securitatem debiti* of personal rights, realisation amounts to selling the claim or taking it over or enforcing the right of action to collect the principal (ceded) debt. This aspect of cession is covered more comprehensively in chapter 5. An analysis of the law on realising security requires a discussion of the principles regarding *parate executie*, perfection and the cessionary's common-law obligation to realise fair value for the security, which follows.

4.9.1 *Parate executie*

In realising the security, the lender must observe the common-law principle relating to *parate executie* (meaning summary execution). The lender cannot thereby take the law into its own hands by, for example, selling the security assets or rights or taking it over, such as immovable property held under a mortgage bond, without first obtaining a court order authorising the sale. The principle applies to contract and statute, and to all real security rights and personal security rights.

The origins and purpose

The origins of the principle prohibiting *parate executie* can be traced back more than a hundred years to *Nino Bonino v De Lange*[671] where Innes CJ stated as follows:

> *Under these circumstances, does a clause of this kind place the lessor in any better position than he would have occupied without it? In my opinion, it does not; and for the simple reason that the Court cannot recognise such a provision. It is an agreement which purports to allow one of the two contracting parties to take the law into his own hands, to do that which the law says only a court shall do, that is to dispossess one person and to put another person in the possession of property. It purports to allow the lessor to be himself the judge of whether a breach of contract has been committed, and having decided in his own favour to allow him of his own motion to prevent the lessee from having access to the premises. Only a court of law*

[669] Alienation of Land Act 68 of 1981 and the Deeds Registries Act 47 of 1937.
[670] *De Hart, NO v Virginia Land and Estate Co Ltd and Another* 1957 (4) SA 501 (O) at 507; Sharrock 'Secured Creditors and Realisation of Secured Property' *LAWSA* vol 11 2 ed (2008) para 325; s 83 (*Realisation of securities for claims*) of the Insolvency Act.
[671] *Nino Bonino v De Lange* 1906 TS 120.

> *can do those things. The parties cannot stipulate to do them themselves. To take a case not nearly so strong as this very often there is inserted in contracts of pledge a clause stipulating for the right of parate executie, the right of the pledgee under certain circumstances without obtaining the judgment of any court to realise and execute upon the pledged property. I have always understood that the weight of authority is against the validity of such a clause.*[672]

The purpose of prohibiting *parate executie* is to prevent a creditor from taking the law into its own hands by depriving a debtor of its lawful possession of its assets or property.[673] So, when a creditor wishes to take possession of pledged assets under, for example, a notarial bond, or otherwise in the debtor's possession, the creditor must seek the court's sanction.[674] The rationale for this is, I submit, to be found in constitutional law and in common-law fairness to the debtor, because the debtor may well have a defence to the creditor's claim against the debtor's property which claim arises from the security rights. A debtor's right to judicial process is enshrined in section 34 of our Constitution, which provides:

> *34. Access to courts*
>
> *Everyone has the right to have any dispute that can be resolved by the application of law decided in a fair public hearing before a court or, where appropriate, another independent and impartial tribunal or forum.*

So crucially important is the right of access to the courts that in 2021, in *Rikhotso v Premier, Limpopo Province and Others*,[675] the Constitutional Court held that the rule of law was a foundational value on which South Africa's constitutional democracy was built, and that access to courts was an aspect thereof.[676]

Against this constitutional backdrop, a creditor who takes the law into its own hands by depriving the debtor of its lawful possession of its own assets without a court's sanction infringes the debtor's section 34 constitutional right, and therefore quintessentially infringes the rule of law.[677] In 2000, in *Findevco (Pty) Ltd v Faceformat SA (Pty) Limited*,[678] the Eastern Cape High Court considered the applicant's application to grant an order that authorised it to take possession of the respondent's movables to perfect its security under a general notarial bond. After considering relevant superior court judgments, the court held that if legislation that allowed the attachment and sale of movable property without recourse to the courts was constitutionally invalid, then the common law should likewise not allow it. The court therefore could not sanction the applicant's order to authorise *'a private kind of execution for the debt owed to it by the respondent'* and held that the clause was unconstitutional. Findevco has been rightly criticised in *Bock and Others v Duburoro Investments (Pty) Ltd*[679] as being wrong in law

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[672] Ibid 123.
[673] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA) paras 13 and 14.
[674] Ibid.
[675] *Rikhotso v Premier, Limpopo Province and Others* 2021 (4) BCLR 436 (CC).
[676] Ibid para 16.
[677] Ibid.
[678] *Findevco (Pty) Ltd v Faceformat SA (Pty) Limited* [2000] 4 All SA 14 (E).
[679] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA).

because it not only wrongly equated perfecting notarial bond clauses with *parate executie* clauses in a pledge, but it also failed to draw distinctions between self-help clauses in pledge agreements, perfection clauses generally, and statute that empowers the state to seize a debtor's property without recourse to the courts.[680] The court in *Bock* endorsed Scott's criticisms of *Findevco*, affirmed the position in *Osry v Hirsch, Luubser & Co Ltd*[681] (discussed below), and held *inter alia* that it was not possible to extend the Constitutional Court's rationale[682] for declaring certain legislative provisions that entitled the state to seize a defaulting debtor's property as constitutionally invalid to contractual *parate executie* clauses in respect of movable property in the creditor's possession.

The substance and operation

In 1922, in *Osry v Hirsch, Luubser & Co Ltd*,[683] the court considered the validity of *parate executie* clauses in South African law, and, after reviewing the Roman-Dutch authorities, concluded as follows:

> *The conclusion at which I have arrived is that an agreement for the sale, by means of parate execution, of movables delivered to a creditor by his debtor is valid in law. It is, however, open to the debtor to seek the protection of the Court if, upon any just ground, he can show that, in carrying out the agreement and effecting a sale, the creditor has acted in a manner which has prejudiced him in his rights.*[684]

The court therefore endorsed *parate executie* in respect of movable property in the creditor's possession, provided that the debtor's rights are not prejudiced.

In 1995, in *Chief Lesapo v North West Agricultural Bank,*[685] the Constitutional Court considered the constitutionality of section 38(2) of the North West Agricultural Bank Act,[686] which empowered the bank to seize the property of a defaulting debtor and sell it by public auction without recourse to a court to settle the debt owed.[687] The applicant, a farmer, had borrowed ZAR60,000 to purchase farming equipment, but fell into arrears, and the bank consequently exercised its rights under section 38(2). Applying constitutional law principles, the court held that the bank's interest in the inexpensive and speedy realisation of its securities, as contemplated in section 38(2), had to be weighed against its debtors' interests in having disputes settled by courts and the importance of the principle against self-help. The bank had less restrictive and drastic powers than *parate executie* at its disposal to achieve its objectives and, accordingly, section 38(2), which made the bank a judge in its own dispute,[688] was not a justifiable

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[680] Schulze 'Parate Executie, Pacta Commissoria, Banks and Mortgage Bonds' 2004 *De Jure* 256 at 264–265; Scott 'Summary Execution Clauses in Pledge and Perfecting Clauses in Notarial Bonds: *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' 2002 *THRHR* 656.
[681] *Osry v Hirsch, Luubser & Co Ltd* 1922 CPD 531; Brits *Real Security Law* (2016) 173.
[682] The appellant in *Bock* argued that Nedcor had exercised its contractual *parate executie* rights unconstitutionally, given the appellant's s 34 constitutional right, which guarantees the right to have disputes settled by a court of law. It relied on the Constitutional Court's judgments in *Chief Lesapo v North West Agricultural Bank and Another* 2000 (1) SA 409 (CC) and *First National Bank of SA Ltd v Land & Agricultural Bank of SA*; *Sheard v Land & Agricultural Bank of SA* 2000 (3) SA 626 (CC).
[683] *Osry v Hirsch, Luubser & Co Ltd* 1922 CPD 531.
[684] Ibid 547.
[685] *Chief Lesapo v North West Agricultural Bank and Another* 2000 (1) SA 409 (CC).
[686] North West Agricultural Bank Act 14 of 1981.
[687] *Chief Lesapo v North West Agricultural Bank and Another* 2000 (1) SA 409 (CC) para 1.
[688] Ibid para 20.

limitation on debtors' section 34 constitutional rights of access to courts and was therefore unconstitutional.[689] In *First National Bank of SA Ltd v Land & Agricultural Bank of SA*; *Sheard v Land & Agricultural Bank of SA*[690] the Constitutional Court reached a similar conclusion.[691]

In 2003, in *Bock and Others v Duburoro Investments (Pty) Ltd*,[692] the Supreme Court of Appeal considered, among other things, a *pactum commissorium* and a creditor's rights to take over a pledged asset at a fair price. The court said the following about *parate executie*:

> *The principles concerning parate executie (immediate execution) are trite. A clause in a mortgage bond permitting the bondholder to execute without recourse to the mortgagor or the court by taking possession of the property and selling it is void. Nevertheless, after default the mortgagor may grant the bondholder the necessary authority to realise the bonded property. It does not matter whether the goods are immovable or movable: in the latter instance, to perfect the security, the court's imprimatur is required. It is different with movables held in pledge: a term in an agreement of pledge, which provides for the private sale of the pledged article and in the possession of the creditor, is valid but a debtor may*
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> > *'seek the protection of the Court if, upon any just ground, he can show that, in carrying out the agreement and effecting a sale, the creditor has acted in a manner which has prejudiced him in his rights.'*
>
> *Smalberger JA put the proviso in slightly different terms when he said that for validity the private execution clause should not prejudice, or be likely to prejudice, rights of the debtor unduly, meaning that the clause should not contain execution provisions that would be contra bonos mores.*[693]

The court set out the applicable principles, clearly describing how *parate executie* operates and its limitations. In summary, the court held that whilst self-help clauses permitting a creditor to dispose of a debtor's immovable property without a court order are void, a pledge agreement[694] that provides for *parate executie* by the private sale of movable property in the lender's possession without a court order is, however, valid, provided the borrower's rights are not thereby unduly prejudiced.[695] Silberberg and Schoeman state that after the mortgagor has defaulted, it may authorise the mortgagee to sell its property without a court order.[696] Schulze similarly distinguishes between a

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[689] Ibid para 29; Schulze 'Parate Executie, Pacta Commissoria, Banks and Mortgage Bonds' 2004 *De Jure* 256 n 10.
[690] *First National Bank of SA Ltd v Land & Agricultural Bank of SA*; *Sheard v Land & Agricultural Bank of SA* 2000 (3) SA 626 (CC).
[691] Wallis 'Courts and Tribunals' *LAWSA* vol 10 3 ed (2017) para 462.
[692] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA), which was quoted with approval in *Lamula Partnership v Masingita Group (Pty) Ltd and Another* [2008] 2 All SA 650 (W) para 3.
[693] Ibid para 7.
[694] The real right of pledge is created once the lender is in possession of the pledged movable property. If the pledge was done correctly by *inter alia* granting the lender physical possession of the movable property or a symbol of control, such as a key to a warehouse where the movable property is held, then the circumstances in which the borrower will be in physical possession of movable property are limited to situations where the borrower has given the lender constructive delivery of the movable property and retains physical possession, or the parties have agreed to apply the principles of attornment whereby a third party, such as an agent, holds constructive possession of the movable property on the lender's behalf.
[695] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA) para 7.
[696] Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.3.3(h), based on the authorities cited in n 158; Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) para 426.

clause in a loan agreement or mortgage document where the debtor, prior to defaulting, grants the creditor the right to *parate executie* which is invalid, and after default, grants the creditor the right to *parate executie* which is valid.[697] The debtor may apply to court for relief if the creditor prejudices the debtor's rights when it effects the sale.[698] The Appellate Division framed the position that a *parate executie* clause should not prejudice the debtor more widely, by holding that it should not prejudice nor be likely to prejudice the debtor's rights unduly.[699] Once the creditor settles the secured debt from the proceeds of realising the debtor's asset or property using the *parate executie* provisions in the agreement, the debtor is entitled to any surplus which can be claimed by means of the *actio pigneraticia directa*.[700] The principle against self-help applies whether the creditor wishes to sell the debtor's assets by public auction, as held in *Chief Lesapo*, or by private treaty, as held in *Bock*.

In the context of the pledge and cession *in securitatem debiti* of personal rights, the question arises whether a cessionary can, relying on its summary execution rights, claim the amount due to the cedent from its principal debtor without first obtaining a court order.[701] The question is particularly relevant where the rights to credit balances in bank accounts, debtors' books, shares and/or insurance policies are the subject of the cessionary's security rights. In *Graf v Beuchel*,[702] the court held that if the rights to shares and loan accounts are ceded with the object of securing a debt, the cession is in effect a pledge of the right.[703] In *Bock v Duburoro Investments (Pty) Ltd*[704] the court held that the cessionaries (banks) could either realise the pledged shares by disposing of them to third parties or take the pledged shares over at their fair value.[705] The court then explained the operation of *parate executie* in relation to *inter alia* a pledge agreement and held, as explained above, that *parate executie* by the private sale of movable property held under a pledge in the lender's possession without a court order is valid, provided the borrower's rights are not thereby unduly prejudiced. In *Millman NO v Twiggs and Another*,[706] a case which did not deal with *parate executie* but which is relevant to the issue under discussion, the court held that if a right is ceded with the object of securing debt, the cession is regarded as a pledge of the right.[707] Scott, interpreting the judgments in *Graf, Bock* and *SA Bank of Athens v Van Zyl*,[708] contends that a cessionary can, without a court order, instead of selling the personal right held in security under a cession, enforce it against the cedent's principal debtor for the purpose of using the proceeds to settle the secured debt.[709] It is submitted that Scott's conclusion is defensible given that the said judgments, especially *Graf* and *Millman,* treated the

[697] Schulze 'Parate Executie, Pacta Commissoria, Banks and Mortgage Bonds' 2004 *De Jure* 256 at 259–260.
[698] Ibid; *Osry v Hirsch, Luubser & Co Ltd* 1922 CPD 531 at 547; *Scott on Cession* (2018) 440.
[699] *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A) at 14D–E.
[700] *Scott on Cession* (2018) 440.
[701] Ibid.
[702] *Graf v Buechel* 2003 (4) SA 378 (SCA).
[703] Ibid para 8 n 1.
[704] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA).
[705] Ibid paras 4, 5 and 7.
[706] *Millman NO v Twiggs and Another* 1995 (3) SA 674 (A).
[707] Ibid 676.
[708] *SA Bank of Athens Ltd v Van Zyl* 2005 (5) SA 93 (SCA).
[709] *Scott on Cession* (2018) 440–441.

pledge and cession *in securitatem debiti* of personal rights as analogous to the pledge of movable property under which such action is possible.[710] As *parate executie* clauses are valid in a pledge of movables (provided the debtor is not prejudiced) they are, by extension, valid in a pledge and cession *in securitatem debiti* of personal rights given that the latter security is analogous to the former security.[711] An additional factor to bear in mind is that the pledge and cession *in securitatem debiti* of personal rights vests the cessionary with *locus standi* to collect the principal debt,[712] which fortifies the cessionary's reliance on its summary execution rights, although the two concepts must be distinguished. The *locus standi* right arises *ex lege* while the summary execution right arises *ex contractu.* It may also be argued that the lender's summary execution rights vest it with *locus standi* contractually.

If, after exercising permissible rights to self-help, the lender acquires ownership of the security assets or rights by retaining them, the price that the lender owes the borrower therefor can be set-off at common law against the principal debt. Set-off is possible because there are two liquidated amounts owed by the same parties to each other. A liquidated amount or debt is a debt the amount of which is certain or objectively ascertainable. If the lender sells the security assets or rights on the open market, the sale proceeds are used to settle the principal debt.

4.9.2 ***Perfection***

Perfection, as a crucial step in realising security rights, is the process whereby a creditor takes possession, prior to the advent of the *concursus creditorum*, of the pledged assets (or personal rights), by which act it acquires the status of a secured creditor under the Insolvency Act. A creditor already in possession of the pledged assets does not need to perfect its rights prior to executing them,[713] because its rights are already perfected. A secured creditor may, on the debtor's default (subject to a court order unless the *parate executie* principle applies), dispose of the assets, the proceeds of which will be used to settle the secured debt. Most perfection cases that have come before our courts involved perfecting a creditor's rights in terms of a general or special notarial bond.[714]

In the case of movable property pledged in security, the perfection requirement is satisfied by the pledgee being in possession of the pledged article, since pledge law requires such possession to constitute the pledge.[715] Sometimes the contract in a

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[710] As to cession *in securitatem debiti* of personal rights being analogous to the pledge of movable property, see the analyses of *Standard General Insurance Co Ltd v SA Brake CC* 1995 (3) SA 806 (A) in section 6.4 *A review of the case law* and section 6.6 *The pledge theory.*

[711] In practice, security cession and pledge agreements often contain *parate executie* clauses.

[712] See section 6.7.5 *Enforcing the ceded rights: Locus standi.*

[713] *Arctocel (Pty) Limited v Firstrand Bank Limited* [2016] JOL 36842 (GJ) para 29.

[714] For example, *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* [2003] 1 All SA 267 (SCA); *Firstrand Bank Ltd v Land and Agricultural Development Bank of South Africa* [2014] 4 All SA 425 (SCA) which held that on insolvency of the mortgagor the holder of a general notarial bond over movables enjoys a preference out of the free residue of the estate, but only up to the value of the assets hypothecated; *Land and Agricultural Development Bank of South Africa v Factaprops 1052 CC and Another* [2015] 3 All SA 319 (GP), and many other judgments.

[715] *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* [2003] 1 All SA 267 (SCA) para 6. A consideration of our case law is to the effect that the delivery requirement for pledge is satisfied only once the pledgee is in possession, actual or constructive, of the pledged property. If, for example, in the case of actual delivery, it would take the pledgor a number of days or weeks to physically hand over the movable property to the pledgee, then the pledge is valid on the date on which the

notarial bond[716] contains a perfection clause. In 2003, in *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others*,[717] the Supreme Court of Appeal held that in a bond document, *'[a] perfection clause entitles the holder of the bond to take possession of the movables over which the bond has been registered. Such a clause amounts to an agreement to constitute a pledge and will be enforced at the instance of the bondholder, whereupon the creditor obtains a real right of security.'*[718] In 2014 and 2015, the Supreme Court of Appeal confirmed the position in *Contract Forwarding*.[719]

In the case of incorporeal rights ceded *in securitatem debiti*, the perfection requirement is satisfied by *'delivery'*. However, as physical delivery is impossible given that the right is incorporeal, the delivery requirement is satisfied by placing the cessionary in *'possession'* of the incorporeal right by cession (transfer) of the right.[720] Cession therefore vests the lender with what would amount to possession of corporeal property if that were the subject of the security, the right of action. In cession *in securitatem debiti,* delivery of the document evidencing the ceded right is not required to create a valid cession.[721] The position is the same where the debtor has *in securitatem debiti* ceded its incorporeal rights to funds held in a bank account as security for the obligation to repay a loan(s) drawn from credit facilities. In such a case, the creditor does not need to *'perfect its security prior to executing it for the security is already in its possession. This is different from a notarial bond which first requires to be perfected to enable the creditor to take possession. In the present case the pledged security is already in the possession of the respondent.'*[722]

Lenders ordinarily, as a condition for the loan, require delivery of documents both evidencing and constituting incorporeal rights,[723] and the security agreements typically contain lengthy perfection clauses.[724] In strict legal terms, as is apparent from the analysis above, a lender need not acquire possession of a document that evidences a

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pledgee receives possession of the movable property, not the date on which the last of the parties signed the pledge agreement nor the date on which the pledgor commenced the delivery process.

[716] The nature of a notarial bond is discussed in section 4.5 *Personal and real security, and the registration of security rights* under the sub-section *Real security rights.*

[717] *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* [2003] 1 All SA 267 (SCA).

[718] Ibid para 4.

[719] In *Firstrand Bank Ltd v Land and Agricultural Development Bank of South Africa* [2014] 4 All SA 425 (SCA), the court held at para 4: *'Under the perfection clause that is a common feature of such bonds, the bondholder will be entitled to take possession of the movables and thereby constitute a pledge over the movables. When that happens the bondholder acquires a real right of security over the movables.'* In *Land and Agricultural Development Bank of South Africa v Factaprops 1052 CC and Another* [2015] 3 All SA 319 (GP) the court held at para 42: *'In Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and others, the Supreme Court of Appeal ("the SCA") expressed the principle that the holder of a general notarial bond hypothecating movable property, does not enjoy a real right of security in the assets subject to the bond. There is therefore nothing to prevent the owner from dealing with and disposing of assets subject to the bond. The rights of the bondholder are of importance mainly upon insolvency. However, a perfection clause, if applicable, entitles the bondholder to take possession of the movables over which the bond has been registered. Such a clause amounts to an agreement to constitute a pledge enforceable at the instance of the holder of the bond.'*

[720] See section 5.1.1 *Cession as a bilateral juristic act of transfer*. Also see *Muller NO v Trust Bank of Africa Ltd and Another* [1981] 1 All SA 321 (N).

[721] The role that delivery plays in cession is discussed in section 5.2 *Legal requirements for a valid cession in securitatem debiti.*

[722] *Arctocel (Pty) Limited v Firstrand Bank Limited* [2016] JOL 36842 (GJ).

[723] The LMA's Term Facilities Agreement, clause 4.1(a) (*Initial conditions precedent*).

[724] Lenders are very conservative in this regard in that they are not willing to rely merely on an enforceable cession *in securitatem debiti* without delivery of the documents that constitute or evidence the security.

right to perfect its security over that right, as it is already perfected through cession.[725]

4.9.3 *A lender's common-law obligation to realise fair value for the security*

In this section an analysis of the fair price principle is provided, followed by an analysis of *pacta commissoria* and conditional sales. The fair price principle is, like perfection, a crucial principle that lenders must observe when realising their security rights. It can be applied equally to conditional sales and disposal of security rights to third parties as both deal with the same issues, namely, settling the secured debt whilst treating the borrower fairly.

Whether the lender realises the security by taking over the ceded right or pledged asset or sues the principal debtor is a decision to be made by the lender in the default circumstances then prevailing. In *South African Breweries v Levin*[726] the Appellate Division, in holding that the pledgee is under a duty to protect the pledgor's interests, must take timeous action to preserve the pledge and must act according to the standard of a *bonus paterfamilias* or a reasonably careful man,[727] also held that the facts of that case did not oblige the pledgee to sue the principal debtor in order to fulfil those duties.[728] Instead, because the principal debtor (one Greenberg) was also the pledgee's debtor arising from a separate transaction, the pledgee had the basis on which to determine the most appropriate course of action against the principal debtor, which was to manage the principal debtor so that repayments due were made, rather than to sue him.[729] However, if the lender decides to dispose of or acquire the ceded right or pledged asset, the fair price principle is triggered.

In our common law, a lender is obliged to realise a fair price for the ceded right or pledged asset[730] it possesses when in law the lender controls the disposal thereof to a third party or acquires ownership thereof through a conditional sale[731] by exercising its *parate executie* rights.[732] In all other instances where the realisation of security rights occurs through a judicial process, the price is determined by the sale in execution process.[733] The lender may not realise the ceded right or pledged asset for less than its fair value as this would prejudice the borrower. The requirement to realise the ceded right or pledged asset at a fair price is driven mainly by case law dealing with conditional sales,[734] and, to a lesser extent, by the disposal by the lender of the ceded right or pledged asset to third parties. If the realised ceded right or pledged asset yields a

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[725] *Botha v Fick* 1995 (2) SA 750 (A). However, this judgment requires delivery of documents that constitute the ceded right to perfect the security so held.
[726] *South African Breweries v Levin* 1935 AD 77.
[727] Chapter IV of the UN Model Law titled *Rights and obligations of the parties and third-party obligors*, Art 53, adopts a similar approach in that a grantor or secured creditor in possession of the encumbered asset must exercise reasonable care to preserve the asset. Similarly, Art 9-207(a) imposes a duty on a secured party to preserve the collateral in its possession.
[728] *South African Breweries v Levin* 1935 AD 77 at 84.
[729] Ibid.
[730] Hereafter referred to as the *fair price principle.*
[731] Conditional sales are dealt with in section 4.10 *Pacta commissoria and conditional sales.*
[732] *Parate executie* is dealt with in section 4.9.1 *Parate executie.*
[733] See the methods by which a lender can realise its security in section 4.9 *The realisation of security.*
[734] *Mapenduka Appellant v Ashington Respondent* 1919 AD 343 at 351; *Graf v Buechel* 2003 (4) SA 378 (SCA) at 382–388. See the analyses in section 4.10 *Pacta commissoria and conditional sales.*

surplus, the lender must pay the excess to the borrower.[735] If the realised ceded right or pledged asset yields less than the debt at the date on which the debt falls due, the borrower is liable for the difference.[736]

The following questions arise: How is the fair value of an asset or incorporeal right established? What are the lender's legal duties when realising its security? Is the lender obliged to realise its security at a surplus over the debt owed or is it sufficient to realise an amount equal to the debt, and what happens if the lender realises its security at a value less than the debt?

A lender, when realising its security rights, must do so within the prescripts of the principal agreement with the obligor, and consequential prejudice suffered by such obligor is the obligor's risk. This principle was laid down in *Bock and Others v Duburoro Investments (Pty) Ltd*,[737] where the Supreme Court of Appeal heard an appeal for the release of sureties from their obligations. Although the judgment is principally about suretyship law, it sets out important principles regarding realising security at a fair price. The appellants were part of the controlling structure of a listed company. Two other entities in that structure borrowed from banks and pledged shares in the company to the banks as security. When the borrowers defaulted on repaying the loans, the banks called up the loans and took over the pledged shares. The borrowers were credited with the share value and the banks sought to recover the balance from the sureties. The share pledge allowed the banks to either dispose of the shares to a third party or retain the shares for themselves. In either case, the qualification was that it must be 'at a fair price'. The sureties alleged that by crediting the borrowers with the share value, the banks acted to their prejudice, which released them from the suretyships. The Supreme Court of Appeal held that the creditor's rights, duties and obligations are sourced primarily from the principal agreement and its agreement with the surety, and if such surety suffered prejudice caused by the creditor having acted within the prescripts of the principal agreement or the deed of suretyship, then such prejudice is what the surety agreed to suffer.[738] The fair price is calculated as at the default date when the debt fell due and not the pledge date when the agreement was concluded.[739] However, in that case, the pledges allowed the banks to determine, at their discretion, when to realise the pledges.[740]

The case law is abundantly clear that in the case of the pledgee or cessionary taking over the ceded right or pledged asset, the fair price must be determined, not as at the date of the agreement being concluded, but at the date of the borrower's default.[741] It is insufficient that the borrower was willing, on the date on which the agreement was concluded, for the lender to acquire ownership of the ceded right or pledged asset if it

[735] *Mapenduka v Ashington* 1919 AD 343 at 354.
[736] Ibid.
[737] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA).
[738] Ibid para 20.
[739] Ibid para 28.
[740] Ibid para 29.
[741] Ibid para 28; *Mapenduka v Ashington* 1919 AD 343 at 353.

defaulted. The borrower must be willing for the lender to acquire ownership at the time that the borrower defaults.[742] According to Cloete JA in *Graf*,[743] the origin of the fair price principle is to be found in D 20.1.16.9.[744]

The method to calculate a fair price has not been determined in South African law, although case law has made observations as to such methods. Thus, in 1924, in *Sun Life Insurance Co of Canada v Kuranda*,[745] the Appellate Division held, in the context of a conditional sale, that an asset's value for which there is a free market is, on the face of it, the value that it will fetch on the market on the day (of the sale) in question. The court held that one must establish if there is a market for the commodity.[746] Furthermore, as there was no market for the sale of life policies in South Africa at that time, the surrender value of the policy was its value.[747] The *Sun Life* approach is complemented by the International Financial Reporting Standards ('IFRS') Valuation Guide's definition of fair market value: *'Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.'* I submit that it would be useful if lenders were to apply both the *Sun Life* approach and the IFRS guide when realising ceded rights or pledged assets. In 2003, in *Bock*[748] the court stated that the parties there, on the facts of that case, had agreed to agree on the fair price, and failing agreement, an expert had to determine the fair price.[749] Whether the common-law principle requiring the cessionary or pledgee to take over the ceded right or pledged asset at a fair price is sufficient to protect a debtor remains to be determined. As an extension of this common-law principle, it could be useful to impose a duty of care on the cessionary when it realises the security to achieve a fair price. The standard used to judge a duty of care would be the standard typically applied in South African law. Such a duty of care can be coupled with the parties agreeing that the cessionary will, on an arm's length basis, determine the fair price in a private treaty sale or public auction of the ceded right or pledged asset,[750] but that if the cessionary wishes to take it over, the fair price will be agreed and, failing agreement, an expert will determine the fair price. In practice, the parties often agree on the latter mechanisms in the relevant security agreement.

A party cannot imply that the lender is obliged to realise its security at a surplus over the debt owed, as the defendant did in *Nedbank Ltd v Moffett*[751] ('Nedbank'). Nedbank

[742] Ibid *Mapenduka*.
[743] *Graf v Buechel* 2003 (4) SA 378 (SCA).
[744] Ibid para 27.
[745] *Sun Life Insurance Co of Canada v Kuranda* 1924 AD 20.
[746] Ibid 27.
[747] Ibid 28.
[748] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA).
[749] Ibid para 17.
[750] If the value of the ceded right or pledged asset is declining because, for example, the default has come to the market's knowledge, the cessionary and cedent agreeing a fair price may take so much time that further value depreciation is inevitable. This reduces the amount that the cessionary will recoup on its disbursed loan. An obstinate cedent, determined to frustrate the disposal process, could worsen the crisis. In these circumstances, where time is of the essence in determining the value that the market is willing to pay, the scenario that will enable the cessionary to achieve the maximum value from the ceded right or pledged asset is if it determines the fair price.
[751] *Nedbank Ltd v Moffet* 2005 JDR 0579 (T).

sued three defendants on a deed of suretyship given as security for a loan made by Nedbank's predecessor, BoE Bank Ltd ('BoE') to a close corporation, Steven James Moffet Marketing CC. The court per Botha J held that it was problematic to imply, as the second defendant contended, a tacit term into the agreement that BoE was obliged to realise its security at the highest possible price, so that a surplus over the R2.2 million bond should be achieved.[752]

It is submitted that lenders should use their best endeavours to obtain a fair price, by leaving no stone unturned and taking all reasonable steps they can that are within their powers, to obtain a fair price,[753] when they realise ceded rights or pledged assets given in security for a debt. A fair price or fair value is what interested purchasers would be willing to pay for an asset on the open market on the day of sale that will hopefully, equal the debts owed to the lenders. If the lender disposes of the ceded rights or pledged assets for less than their fair value because the lender failed to take reasonable measures to obtain a fair value, the borrower cannot be held liable for the shortfall and the lender must carry the loss. If, however, the lender disposes of the ceded rights or pledged assets for less than their fair value because the market would not pay more, then the borrower remains liable for the shortfall.

A related issue that arises is whether the lender is obliged to dispose of the ceded right or pledged asset on the open market, inviting all prospective purchasers to bid for the asset or personal right, or if an offer to a closed group of purchasers will suffice. It is submitted that this will have to be determined with reference to the following factors: the terms of the principal agreement, the method that will discharge the lender's obligation to realise fair value for its security in the circumstances then prevailing, the circumstances of each case, and whether that method will raise proceeds sufficient to settle the debt. For example, if only a selected group of purchasers will be interested in purchasing the pledged asset, then it need only be offered to that group. If the ceded right or pledged asset is not realised at a fair price, the borrower may successfully challenge the disposal (to a third-party purchaser) or retention (by the cessionary) on the grounds that the disposal or retention at a lower than fair price prejudiced its interests, and hence its ability to repay the debt in full was compromised. It is further submitted, based on the *Nedbank* decision, that the law does not require a lender to realise its security for more than the amount of the debt owed as lenders are under no legal duty to achieve a surplus over the debt, subject to the qualification that if the realisable fair value is more than the debt, the lender cannot sell the asset for less than the debt. If the agreement permits the lender to take over or retain the ceded right or pledged asset as its own, I submit that the fair price should be determined by the value of the debt and a market valuation of what purchasers would pay for it. It is submitted that lenders who dispose of or retain ceded rights or pledged assets on borrower default at less than a fair price violate the fair price common-law principle and thus act

[752] Ibid 9.
[753] In *Daimler Fleet Management South Africa (Pty) Ltd v Telkom SA (Soc) Ltd* 2015 JDR 0811 (GP), the court appears to have adopted this meaning of *best endeavours* as expounded in English law, at paragraph 23 of the judgment.

unlawfully. The consequence is that any such disposal or retention could, on application to a court, be declared unlawful by a court and set aside, resulting in restitution of the ceded right or pledged asset and repayment of the price. If this happens, the lender will have to start afresh by disposing of or retaining the ceded right or pledged asset for a fair price.

4.10 *Pacta commissoria* and conditional sales[754]

The mechanisms to realise a ceded right or pledged asset held as security are governed by South African law. In law, a distinction is drawn between an agreement whereby a lender acquires, from the owner (the borrower), ownership in a ceded right or pledged asset, however great its value may be, that is given in security for a debt, however small it may be, and one where the lender acquires the ceded right or pledged asset for its fair value or a fair price is given. The former agreement is a *pactum commissorium* and is invalid in South African law because it is unduly oppressive to debtors.[755] The latter is a conditional sale and is a valid agreement in South African law.[756] In 1919, in *Mapenduka v Ashington*,[757] the Appellate Division, relying on the authority of Voet and the Digest, held that such a sale is not a real sale because it retains its character as a pledge, and the debtor can claim his property back once he pays the debt. The borrower's value in its ceded right or pledged asset is protected by the prohibition against illegal *pacta commissoria* and under the law applicable to conditional sales because of the fair price principle.

In the case of the lender exercising its *parate executie* rights, the unpaid debt is settled by the lender either disposing of the ceded right or pledged asset on the open market and using the proceeds to settle the debt, or acquiring the ceded right or pledged asset. The amount that the lender owes the borrower for the ceded right or pledged asset is set-off at common law against the secured debt.

The concept of credit bidding, commonly used in Canada and the USA in insolvency proceedings, is not known in South African law. In a credit bid, a creditor, or a group of creditors, uses the debt owed to it or them as currency to competitively bid to acquire the debtor's assets that are the subject of the security.[758] The price for the asset is then set-off against the debt owed to the creditor(s), and that settles the debt. In a facility agreement governed by South African law, a lender cannot use credit bidding to shield its loan and

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[754] Kariem 'A Fair Price for Pledged Assets' *Finance and Banking Alert*, Cliffe Dekker Hofmeyr Inc., 27 July 2016.
[755] *Mapenduka v Ashington* 1919 AD 343 at 351; *Sun Life Insurance Co of Canada v Kuranda* 1924 AD 20; *Graf v Buechel* 2003 (4) SA 378 (SCA) at 382–388.
[756] *Mapenduka v Ashington* 1919 AD 343 at 352; *Graf v Buechel* 2003 (4) SA 378 (SCA) at 388–389.
[757] Ibid 352.
[758] Huff, Rogers, Bartner & Culbert 'Credit Bidding – Recent Canadian and U.S. Themes' 2010 *Annual Review of Insolvency Law* 1. Credit bidding is distinguishable from a so-called 'loan to own' strategy where the investor purchases distressed debt at a discount, not with the intention of maintaining the business's value in the long-term but rather to achieve a high return in the short-term by, for example, on a default, either converting its debt to equity under the threat of exercising its foreclosure rights or actually foreclosing. Loan to own funds may also, after purchasing the borrower's distressed debt, encourage the distressed borrower to enter into insolvency (bankruptcy) so that they can acquire managerial control or equity over the borrower. Secured creditors, keen to avoid having their claims dealt with in the insolvency (bankruptcy) proceedings, can use credit bidding to obtain the maximum value for the secured assets. See Kirkham and Taylor, 'Working through a workout: A practitioner's guide from the perspective of private equity sponsors, venture capital funds and other significant equity investors' (2009) 5(2) Hastings Business Law Journal 355 at 358 and DiNizo Jr., 'Cause for credit bidding: Utilizing secured debt to obtain property during a bankruptcy auction' (2019) 19(1) *Houston Business and Tax Law Journal* 84 at 108–110.

have it repaid. Huff *et al* liken a credit bid to a foreclosure, but state that in large commercial insolvencies a normal foreclosure is neither possible nor appropriate.[759]

In 2003, in *Graf v Buechel*,[760] the Supreme Court of Appeal considered, among other things, a *pactum commissorium* and a conditional sale. The respondent was the sole shareholder of a company and borrowed money from the appellant to fund the purchase of a property on which to develop a hotel, against the security of a mortgage bond registered over the property. If property development conditions were not met by an agreed date, the loan was repayable. The conditions were not met, and the repayment date was extended by agreement. As further security, the respondent pledged its shares. Pursuant to the pledge, the respondent agreed to leave its share certificates, share transfer forms and a cession of loan claims in trust with attorneys. The company failed to repay the loan, was wound up, and the pledged shares were transferred into the creditor's name. The respondent sought to undo the transfer on the basis that the agreement permitting it constituted a *pactum commissorium* and was therefore invalid. The Supreme Court of Appeal held that the common-law principles were as follows. A *pactum commissorium* is an agreement that if the pledgor defaults, the pledgee may keep the security as its own. The court confirmed the principle that an agreement whereby a creditor retains for itself a pledged asset given in security for a debt of less value is a *pactum commissorium* and is invalid and unenforceable, because it is unduly oppressive to debtors. An agreement whereby a creditor realises a pledged asset given in security for a debt by disposing of or retaining the pledged asset at a fair price is a conditional sale and constitutes a valid and enforceable agreement. The fair price is calculated as at the default date and not the pledge date when the agreement was concluded.[761] However, in that case, the pledges allowed the banks to determine, at their discretion, when to realise the pledges.

A few months later, in 2003, in *Bock and Others v Duburoro Investments (Pty) Ltd*,[762] the Supreme Court of Appeal again considered, among other things, a *pactum commissorium* and a creditor's rights to take over a pledged asset at a fair price. The court in *Bock* confirmed the principles discussed in *Graf.*

4.11 Security structure and security rights of syndicate lenders

4.11.1 *General remarks*

Commercially, real security rights[763] place syndicate lenders in a less risky position than if they had no security because if the borrower fails to repay the loan, they can realise the encumbered asset or property and use the proceeds to settle the loan. The *pari*

[759] Huff, Rogers, Bartner & Culbert 'Credit Bidding – Recent Canadian and U.S. Themes' 2010 *Annual Review of Insolvency Law* 1 at 2 *A.- Foreclosure and Credit Bidding.*
[760] *Graf v Buechel* 2003 (4) SA 378 (SCA).
[761] Ibid para 28.
[762] *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA); 2004 (2) SA 242 (SCA). The facts of this case are discussed in section 4.9.3 *A lender's common-law obligation to realise fair value for the security.*
[763] See section 4.5 *Personal and real security, and the registration of security rights* for an analysis of the nature of real security rights.

passu ranking of security[764] and the realisation of security rights[765] are affected by the contractual arrangements agreed to by the syndicate lenders.

What is the legal effect of syndicated lending on the lenders' claims and security? The senior lender typically holds first ranked personal and real security through the Security SPV[766] as it lends most of the capital and is repaid first in the payment waterfall from incoming repayments. The mezzanine lender, who also holds personal and real security through the Security SPV,[767] lends subordinated debt, so its claims and security rank after those of the senior lender.[768] The legal effect of the subordination is that it renders the cause of action of the subordinating mezzanine lender's claim temporarily incomplete so that its claim cannot be enforced[769] and it effectively has no enforceable claim until the senior lender's claims have been paid in full.[770] The claims of the senior lender, including its claims to its security rights, rank *pari passu* with the claims of any other senior lenders who hold security, but rank in preference to the claims of the mezzanine lender. Similarly, the claims of the mezzanine lender, including its claims to its security rights, rank *pari passu* with the claims of any other mezzanine lenders who hold security.

4.11.2 ***The security structure***

The security structure typically used in a syndicated facility transaction governed by South African law is a Security SPV[771] incorporated in terms of the Companies Act 2008.[772] However, security rights can be held directly by a senior lender and a mezzanine lender in their names, although this is unlikely.[773] The security rights and structure are typically effective prior to draw down because that is when the lender(s) will be at risk.

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[764] See the discussion in section 4.8 *Pari passu ranking of security.*
[765] See the discussion in section 4.9 *The realisation of security.*
[766] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–53.
[767] Ibid.
[768] See the discussion in section 3.2.7 *The contractual and economic relationship between the syndicate lenders.*
[769] See the discussion in section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims*, which explains the principles of subordination in South African law in the section *Subordination.*
[770] *Ex Parte De Villiers and Another NNO In Re Carbon Developments (Pty) Ltd (In Liquidation)* 1993 (1) SA 493 (A) at 505.
[771] The LMA, in its *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–53, recognises that in South Africa in multiple lender transactions, the Security SPV structure is used and that its use is driven by the restrictions in the Deeds Registries Act 47 of 1937. It refers to s 54 whereby neither a mortgage bond nor a notarial bond can be passed in favour of an agent acting for a principal. As a result, obligors undertake principal commercial obligations in favour of the Security SPV as discussed in this section. See Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008) at 43 for an analysis of Security SPVs in the context of securitisation transactions, and Hatzilambros *Determinants of the Cost of Credit for Project Finance Debt in Africa* (MCom Finance (Financial Management), UCT, August 2016) for a broad non-legal discussion of Security SPVs in the context of project finance transactions. Major law firms in South Africa use the Security SPV structure in syndicated lending transactions; I have used the Security SPV structure as lender's counsel in many transactions. The term *'Debt Guarantor'* is often used in transactions instead of Security SPV. Apart from these referenced sources, and the Boshoff article in n 724, there is no South African academic or common-law authority for the use of the Security SPV structure in syndicated lending transactions.
[772] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–53; Boshoff 'One Way or Another' (2016) 35(9) *International Financial Law Review* 45–46.
[773] See the discussion in section 6.7.1 *The divisibility of personal rights* regarding the senior lender and the mezzanine lender holding security directly in their names.

The Security SPV is mandated by the lenders to hold and realise their security interests if the borrower defaults,[774] is placed under business rescue,[775] or goes insolvent.[776] The Security SPV is established as an insolvent remote entity by limiting its main business in its Memorandum of Incorporation[777] to holding the security interests bonded, ceded and pledged in its favour. The LMA indicates that the Security SPV is (i) ring-fenced so as to ensure that it only acts as a special purpose vehicle company under the relevant transaction;[778] and (ii) tax-neutral. If the Security SPV's business is restricted in this manner, it is unlikely to trade itself into insolvency by either its liabilities exceeding its assets or by being unable to pay its debts when they fall due. The lenders derive comfort from this security structure as their security rights are unlikely to be prejudiced by insolvency. The cost of setting up and administering the Security SPV is borne by the borrower.[779]

The shares in the Security SPV are owned and held by a trust established in terms of the Trust Property Control Act,[780] known as the owner trust. The owner trust is managed by independent trustees[781] who owe fiduciary duties to the beneficiaries to administer the trust property in their interests. The independent trustees are usually a fiduciary services company,[782] whose business it is to manage Security SPVs. The owner trust's trustee enters into a management agreement with the Security SPV whereby the Security SPV appoints it to administer the Security SPV.[783] The beneficiaries of the owner trust are the finance parties.

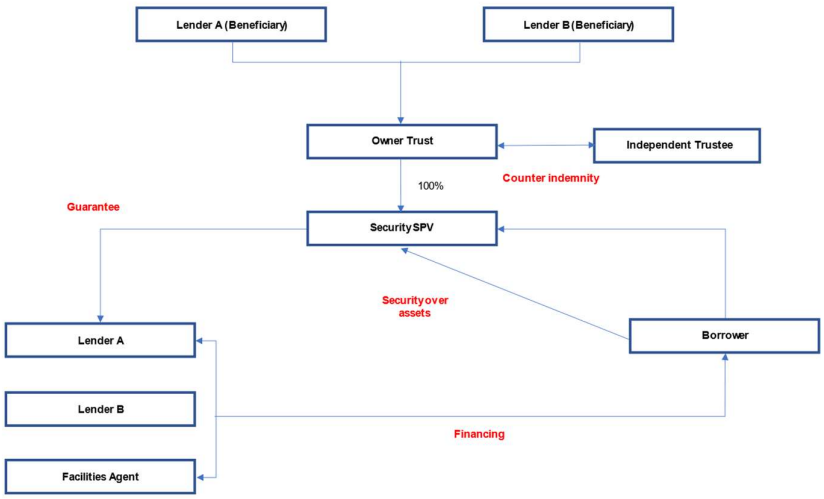
If the borrower defaults on its loan repayment obligations or goes insolvent,[784] and the lenders have elected to take enforcement action, the agent on behalf of the lenders will claim against the Security SPV under the guarantee agreement. Simultaneously, the agent will instruct the Security SPV to in turn claim for a like amount under the borrower counter-indemnities.[785] If the borrower fails to make payment thereunder, the Security SPV is entitled to realise its security rights held in the obligors' assets and property.[786] The Security SPV will use the proceeds received from its claim under the enforced counter-indemnities or of its realised security rights to make payment due to the lenders under the guarantee, either directly or by paying these monies to the owner trust, which in turn, will distribute the monies to its beneficiaries, the finance parties (that

[774] The mandate is sometimes an informal arrangement between the lenders and the independent trustees who manage the owner trust.
[775] As defined in s 128(1)*(b)* of the Companies Act 2008.
[776] As contemplated in the Insolvency Act.
[777] Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008) at 43.
[778] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–52.
[779] Ibid 53.
[780] Trust Property Control Act 57 of 1988.
[781] The LMA's Term Facilities Agreement, clause 1.1 (definition of *Owner Trust*); Boshoff 'One Way or Another' (2016) 35(9) *International Financial Law Review* 45–46 at 45.
[782] Ibid. Fiduciary services companies commonly used in South Africa are GMG Trust Company (SA) Proprietary Limited or Maitland Group South Africa Limited.
[783] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–52; the LMA's Term Facilities Agreement, clause 1.1 (definition of *Debt Guarantor Management Agreement*). The term *Debt Guarantor* is often used instead of *Security SPV*.
[784] As contemplated in the Insolvency Act.
[785] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–52.
[786] Ibid.

includes the lenders). Such payment discharges the Security SPV's obligations under the guarantee agreement entered into with the lenders.[787]

A typical Security SPV structure that incorporates this structure is depicted schematically below.

The Security SPV Structure



An important aspect of the syndicate lenders' contractual relationship is the enforcement action that may be taken by the lenders against the obligors which arises from the borrower's default or insolvency.[788] Enforcement action ordinarily includes accelerating the loan liabilities by demanding payment thereof; making a demand under any guarantees; realising any security, any composition or compromise permitted; and instituting any insolvency or analogous proceedings. As the focus of this thesis is on bilateral and syndicated loans and security, the enforcement analysis will be limited to the enforcement of security.

A distinction is made between the rights of senior lenders and those of mezzanine lenders to undertake enforcement action. A decision to take enforcement action is typically voted for by senior lenders holding a majority percentage of the value of loans, often 66,6 per cent.[789] After the senior loans have been fully settled, the mezzanine lenders may vote for enforcement action by a majority percentage of the value of loans, often 66,6 per cent. Any intended enforcement action by mezzanine lenders may be made subject to contractual provisions in the facility agreement that oblige them to cure senior loan defaults before, for example, acquiring collateral.[790] Payment by the

[787] Ibid 53.
[788] The term 'obligors' is defined in section 1.3 *The research question* as being, individually or collectively, the borrower or any third party who or which has given security for the borrower's loan obligations.
[789] The percentage could be set higher by agreement between the lenders.
[790] See the discussion of *Bank of America, N.A. v PSW NYC LLC* 918 N.Y.S.2d 396 (2010) under section 3.2.9 *Tranche wars among syndicate lenders*.

mezzanine lenders to cure senior loan defaults does in fact protect their interests in the loan and security structure because the senior lenders, having been repaid, will not need to realise their security rights.

Any enforcement action approved by a lenders' vote is implemented by the facility agent. Although the convention for sizeable financings in other jurisdictions may be to appoint a senior agent to represent the senior lenders and a mezzanine agent to represent the mezzanine lenders,[791] the South African practice is to appoint one facility agent to represent both senior and mezzanine lenders.[792] The appointment of separate facility agents for each class of lenders would occur if the lenders believe that their interests would be better served by separate, independent facility agents. The facility agent, despite exercising discretionary rights for the lenders, attracts no fiduciary duties to the lenders.[793]

Although bilateral loans and syndicated loans are transferable, the nature of security rights for these loans in South African law[794] make transferring security rights, when the loans for which they offer credit support are transferred, rather complicated. South African debt security structures are, it is submitted, not ideally designed to facilitate the transfer of, and sharing in, security rights to new lenders, as demonstrated below. This scenario is unlike the scenario where a secured loan is sold and assigned in its entirety to a new lender. The security rights attached to that loan are, by virtue of the *Pizani* principle, automatically transferred to the new lender without the need for further action.[795]

If new lenders acquire portions of the loan[796] through syndications, there are broadly two options available in South African law whereby the security can be shared between all the lenders. In the first option, if there is only one new lender, the original lender can retain the cession *in securitatem debiti* of the right of action[797] in the principal debt and the new lender can take a cession *in securitatem debiti* of the reversionary interests[798] therein.[799] However, if there is more than one new lender, then the second option will have to be used where the original lender's existing security rights must either (i) be cancelled and new security rights created in favour of the Security SPV so that the lenders (original and new) can share in it *pari passu* through the Security SPV structure; or (ii) be ceded out-and-out to the Security SPV, so that the lenders (original and new)

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[791] The LMA's Intercreditor Agreement for Leveraged Acquisition Finance Transactions (Senior/Mezzanine), 20 March 2020.
[792] The LMA's Term Facilities Agreement.
[793] Wright *International Loan Documentation* (2014) 272–277.
[794] See chapter 4 *Security for Loans*, chapter 5 *The Law of Cession* and chapter 6 *The Law of Cession in Securitatem Debiti*.
[795] The *Pizani* principle is analysed in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?*
[796] As to the methods for acquiring portions of a loan, see section 3.2.4 *The nature of syndication.*
[797] See section 6.6 *The pledge theory* for an analysis of the concept *'right of action'* under the heading *The theoretical nature of cession in securitatem debiti under the pledge theory.*
[798] See section 6.6 *The pledge theory*. However, pledge and cession security agreements often contain a standard clause that should it transpire that the initial pledge and cession *in securitatem debiti* in that agreement is invalid for whatever reason, such as there being a prior cession, the pledge and cession will then operate as a pledge and cession *in securitatem debiti* of the cedent's reversionary interest in the principal debt. See Lubbe *Contract: General Principles* (2020) 556.
[799] See chapter 6 *The Law of Cession in Securitatem Debiti*.

can share in it *pari passu*[800] with other secured lenders. The cancellation or out-and-out cession of existing security rights requires the parties to conclude agreements to that effect and comply with legislation governing certain types of security rights including, amongst others, the registration of bond cancellations or cessions[801] or the cancellation or cession of pledged, listed securities that were flagged in the central securities account or the securities account in terms of section 39 of the Financial Markets Act.[802] The out-and-out cession of existing security rights is a rather complicated matter because not only must there be a *causa* for such a cession,[803] but moreover, if the original cession *in securitatem debiti* was defective, then its purported out-and-out (onward) cession will be invalid. In order to avoid these complexities, the cancellation of the existing security rights is, it is submitted, the preferred option. The creation of new security rights in favour of the Security SPV has to follow the same legal and statutory (if applicable) process originally followed, except that the beneficiary of the security will be the Security SPV. Both the cancellation or out-and-out cession and creation of security rights come at significant legal and statutory (if applicable) cost. Furthermore, the new lenders must be made beneficiaries of the owner trust and parties to all the finance documents, including the intercreditor agreement. They will have to satisfy themselves that the terms and conditions of the finance documents protect their interests, and they may want to negotiate it before binding themselves.[804]

As the Security SPV holds all the security rights, the priority of claims is not a concern for the Security SPV since it does not compete with any lenders for security. The claims of the senior lenders rank and abate equally amongst themselves, as would the claims of the mezzanine lenders. Perfection of security rights would similarly not be a concern for the lenders because the Security SPV (not the lenders individually) is the only party holding security rights. Hardening periods only apply to mortgage bonds in limited circumstances. A general or special mortgage bond, passed for the purpose of securing the payment of a debt not previously secured, which was incurred more than two months prior to lodging the bond with the registrar of deeds for registration, or for the purpose of securing the payment of a debt incurred in novation of or substitution for any such aforementioned debt, confers no preference if the estate of the mortgagor (the debtor) is sequestrated within six months after lodging the bond document for registration, provided that a mortgage bond is deemed not to have been lodged if it was withdrawn from registration.[805]

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[800] *Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries* 1979 (3) SA 713 (W) 715B. See section 4.8 *Pari passu ranking of security*.
[801] Deeds Registries Act 47 of 1937.
[802] Financial Markets Act 19 of 2012.
[803] See section 5.2 *Legal requirements for a valid cession in securitatem debiti* under the heading *Causa or justa causa.*
[804] Banks negotiate terms and conditions with each other and the borrower when loans are syndicated, which forms part of the post-mandate phase, according to the LMA: see section 3.2.6 *The phases of syndication*.
[805] Section 88 (*Certain mortgages are invalid*) of the Insolvency Act.

4.11.3 *The security rights*

The contractual arrangements discussed here are created simultaneously so that the agent, lenders and Security SPV face no risks at any point.

The Security SPV unconditionally and irrevocably guarantees[806] to the lenders the fulfilment of the borrower's obligations, and indemnifies the lenders against any losses they may suffer should the borrower[807] fail to repay the loan. Effectively, the Security SPV thereby promises to pay the lenders the loan amount if the borrower fails to do so.[808] This agreement creates the principal obligation that binds the Security SPV to the lenders.[809] The borrower counter-indemnifies the Security SPV should it suffer a loss because it paid the lenders under the guarantee.[810] As the Security SPV is a non-trading entity, it has no revenue from which to pay the lenders under the guarantee if the borrower defaults. As a source of revenue, and as security for the borrower's counter-indemnity obligations, the borrower bonds its movable and immovable property, pledges its movable property, and pledges and cedes *in securitatem debiti* its personal rights[811] in favour of and to the Security SPV.[812] As further security, the obligors (other than the borrower) unconditionally and irrevocably guarantee the borrower's obligations in favour of and to the Security SPV and, as security for the obligors' guarantee obligations, they bond their movable and immovable property, pledge their movable property, and pledge and cede *in securitatem debiti* their personal rights to their bank accounts, debtors' books, shares and/or insurance policies in favour of and to the Security SPV.

The use of the Security SPV as the security rights holder, together with the syndicate lenders entering into an intercreditor agreement, ensures the orderly and structured settlement of the lenders' claims and the enforcement of security rights (created ultimately for the lenders, even though technically the Security SPV is entitled to exercise such rights for its own benefit).[813] Importantly, though, the Security SPV structure creates no agency relationship between the lenders and the Security SPV, as is evident from the arm's length agreements discussed above. If syndicate lenders have real security over the same assets or property directly, they may dispute each other's rights, resulting in tranche wars.[814] In such an instance, the South African common-law principle is that the right(s) created or registered (if applicable) first in time prevails over

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[806] See the discussion in section 4.4 *The meaning of 'security' in the Insolvency Act*, which explains the meaning of guarantees in South African law.
[807] The lenders sometimes require that the Security SPV guarantees the fulfilment of both the borrower's and the other obligors' obligations owed to the lenders and indemnifies the lenders in respect of any related risks.
[808] This could include the other obligors obligations if the lenders adopt the position in n 807.
[809] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–52.
[810] Ibid; Boshoff 'One Way or Another' (2016) 35(9) *International Financial Law Review* 45–46 at 45.
[811] See chapter 5 *The Law of Cession* and chapter 6 *The Law of Cession in Securitatem Debiti* for an analysis of the law of cession and cession *in securitatem debiti.*
[812] The LMA's *User's Guide to the Recommended Form of Documents for Use in the South African Market* (updated 21 December 2018) 51–52; Boshoff 'One Way or Another' (2016) 35(9) *International Financial Law Review* 45–46 at 45.
[813] See section 3.1.3 *The purpose of the loan* and following for discussions of the intercreditor agreement.
[814] As occurred in *Bank of New York Mellon (London Branch) v Truvo NV and Others* [2013] EWHC 136, Queen's Bench Division, Commercial Court, analysed in section 3.3.2 *English case law lessons regarding acceleration notices and the priority of claims*.

any subsequent right(s).[815]

If the borrower, or any other obligor, defaults on the finance documents[816] or goes into business rescue[817] or liquidation,[818] then, subject to the lenders voting in favour of enforcement action (if the terms of the intercreditor agreement so require),[819] the lenders' claims are settled by the agent and the Security SPV realising the security rights. The payment waterfall or order of priority of payments is regulated contractually in the intercreditor agreement.[820] Through this process the senior lender's claims are settled *before* the mezzanine lender's claims. Once the senior lender's claims are settled, the mezzanine lender's claims are settled from the balance of the realised security proceeds.

4.12 Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?

A lender, having entered into a facility agreement and a security agreement, acquires rights and incurs obligations (duties). For example, the lender has an obligation to advance the loan, a right to repayment thereof, and an obligation to receive payment when tendered. Similarly, a lender has a right to have the agreed security interests created, and an obligation to preserve the security given.[821] Having acquired these rights and obligations, and having advanced the loan, but having not yet been repaid, the lender may want to sell the loan for value to a new lender during the loan term. The substance of the transaction could be a straightforward disposal of a loan,[822] a factoring transaction, or a securitisation transaction.[823] In this scenario, it is assumed that the lender's ability to sell and cede the loan is not prohibited in the contract by a *pactum de non cedendo*.[824] The new lender becomes, pursuant to implementing the sale, either a co-lender with the original lender as a senior lender or a mezzanine lender,[825] or substituted as the lender under the original facility agreement and the security agreement, or a sub-participant in the loan.[826] Legally, this is achieved by the lender ceding its rights and delegating its obligations under the

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[815] Brits *Real Security Law* (2016) discusses the first in time principle generally (at 7) and then discusses it in relation to different security instruments such as: bonds over movable property (at 159), special and general bonds (at 196), security held under the Security by Means of Movable Property Act 56 of 1993 (at 258) and pledge of claims (at 322). Also see *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* 2003 (1) All SA 267 (SCA) para 6, where the court held that '[r]eal rights are stronger than personal rights and in the case of conflicting real rights the principle *prior tempore potior iure* applies.'

[816] The term 'finance documents' is defined in n 582.

[817] As contemplated in Chapter 6 (*Business rescue and compromise with creditors*) of the Companies Act 2008.

[818] As contemplated in the Insolvency Act.

[819] See the discussion on lenders voting in favour of enforcement action in section 4.11.2 *The security structure*.

[820] The LMA's intercreditor agreement for leveraged acquisition finance transactions (senior/mezzanine), 20 March 2020, clause 18 (*Application of proceeds*).

[821] With regard to a lender who holds security interests *in securitatem debiti* it was held in *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC) para 30 that *'the cessionary, like the pledgee, is under a duty to exercise due diligence with regard to the right and to protect the interests of the cedent, on pain of liability for damages sustained by the cedent should he fail to do so. He must deal with the ceded right as a bonus paterfamilias.'*

[822] A disposal of this kind is sometimes referred to as a sale in the secondary loan market. See, for example, Drucker & Puri 'On Loan Sales, Loan Contracting and Lending Relationships' (July 2009) 22(7) *The Review of Financial Studies*.

[823] Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008) describes securitisation as *'the pooling of a homogenous group of income-producing assets, the sale of these assets by the original holder (originator) to an insolvency-remote third party (a special purpose vehicle or SPV) and the issue by the SPV of marketable securities (typically debt instruments such as debentures) to finance the purchase of the assets. The transferred assets serve as security for the securities issued'* (at 15).

[824] I analyse this phenomenon in section 5.6 *Agreements prohibiting or restricting cession (pacta de non cedendo)*.

[825] See the analysis of syndicate lending in chapter 2 *The Law of Loans* and chapter 4 *Security for Loans.*

[826] See section 3.2.4 *The nature of syndication* for a discussion and analysis of sub-participants.

original facility agreement to the new lender for value, who accepts the cession and delegation. I will now explore the assignment in more detail.

In our common law, a right is transferred by cession[827] and an obligation (duties) by delegation. A lender (a cedent) cannot transfer both its rights and obligations to a new lender (a cessionary) by cession alone. Instead, the term 'assignment' is used to simultaneously denote the legal acts of both the cession of rights and the delegation of obligations.[828] The traditional perspective though is that only duties (which would include the duty to pay debts) can be transferred by *'a delegation involving a novation.'*[829] Lubbe explains, however, that *Botha v Van Niekerk en 'n Ander*,[830] which was supported in subsequent judgments despite academic criticisms,[831] is authority for a different view that, with the concurrence of the creditor, the debtor can transfer its duties (which would include the duty to pay its debts) to a third party through an assignment without a novation.[832] Thus, if the creditor, debtor and third party agree, such a transfer of duties is possible without the need to extinguish the debtor's obligations and replace it with new obligations owed by the third party to the creditor.[833] Again, traditionally, a novation can be used to transfer a current, valid obligation by extinguishing it and substituting it with a new obligation.[834] If one of parties is to be substituted by another, then novation is termed a delegation.[835] In order to cede a right, the concurrence of two parties is required, namely, the lender (the cedent) and the new lender (the cessionary).[836] The cession is valid whether or not the debtor has consented, and the debtor's consent to, or knowledge of, the cession is, in law, irrelevant.[837]

The debtor should, however, be informed of the cession so that the debtor renders its performance to the party entitled under the cession to receive the performance. A debtor who has not been informed of the cession, and who renders performance of its obligation to the cedent in accordance with the terms of its contract with the cedent, is immune from suit.[838] If, however, the facility agreement or the lender's terms and conditions under which a loan was advanced prohibits the cession,[839] or creates a prior cession *in securitatem debiti* in favour of the cessionary, and the existing lender wants to sell and assign only part of the loan while retaining a part of the loan, the debtor will have to consent to the cession because of the contractual prohibition on cession; without this consent, the purported

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[827] The concept of out-and-out cession is analysed in section 5.1.2 *Cession in security versus out-and-out cession.*
[828] Reinecke 'Insurance Part 2' *LAWSA* vol 12(2) 2 ed (2012) para 128.
[829] Lubbe *Contract: General Principles* (2020) 585 para 14.40.
[830] *Botha v Van Niekerk en 'n Ander* 1983 (3) SA 513 (W).
[831] Joubert '*Botha v Van Niekerk* 1983 3 SA 513 (W) Die koper of sy genomineerde' 1984 *THRHR* 234.
[832] Lubbe *Contract: General Principles* (2020) 585 para 14.41.
[833] Lubbe 'Law of Purchase and Sale' 1983 *Annual Survey of South African Law* 160.
[834] Reinecke *et al* 'Novation and Delegation' *LAWSA* vol 12 2 ed (2012) para 146; see the discussion of novation in section 3.2.4 *The nature of syndication.*
[835] Ibid para 129.
[836] Lubbe 'Cession' *LAWSA* (2013) para 128; De Wet & Van Wyk *Kontraktereg* (1992) 251; Sande *Cession of Actions* (1906) ch II, under the heading *In how many various ways cession may be correctly effected*, where Sande states that *'[w]ithout mandate actions are ceded in any other way by mere consent, provided there exist an antecedent title or cause, whence the intention to transfer the action may be gathered'*.
[837] Lubbe *Contract: General Principles* (2020) 505 para 13.15; *National Sorghum Breweries Ltd v Corpcapital Bank Ltd* 2006 (6) SA 208 (SCA) para 1; *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T) paras 28 and 29; Kariem 'Cession in Security: Notice to the Debtor' *Finance and Banking Alert* Cliffe Dekker Hofmeyr Inc., 18 May 2020.
[838] See section 5.1.3 *Notice of the cession to the principal debtor and performance including set-off.*
[839] The LMA's Term Facilities Agreement, clause 24.1 (*Cessions and delegations by obligors*).

cession will be void.[840]

To transfer an obligation, the concurrence of three parties is required, namely, the debtor, the lender (the cedent) and the new lender (the cessionary).[841] The parties must plainly have intended that the lender would transfer its rights and obligations to the new lender, who will be substituted in the lender's stead. Delegation is classified as a *'species of novation'*.[842] Our courts have clearly established these principles and consider it a misnomer and incorrect that cession transfers both rights and obligations.[843] The type of cession contemplated in this scenario is an out-and-out cession, which is a complete transfer of rights from one party to another.[844] The lender thereby transfers its claim for repayment of the loan to the new lender, for value. The transfer is achieved by the lender ceding all its rights and delegating its obligations.[845] The net effect of the assignment is that the lender is divested of its rights and obligations under the original facility agreement, which comes to an end when the assignment is agreed to be effective.

In this context, the vexed question that arises is whether the cession of the lender's rights and the delegation of its obligations under the loan agreement automatically, without the need for any further conduct, transfers the lender's security interests, or whether a separate transfer of the security interests is needed. It is submitted that, in South African law, the nature of the security rights determines whether delegation of the principal debt results in the automatic cession (transfer) and delegation of the associated security, or whether the security must be separately ceded.

In 1979, in *Pizani and Another v First Consolidated Holdings (Pty) Ltd*,[846] the Appellate Division heard an appeal against an order of the Witwatersrand Local Division upholding exceptions to a plea. The respondent had sued the appellants in the court *a quo* for the payment of monies under suretyships given by them for the obligations of the lessee (Grinding Wheels (Pty) Ltd) arising from an equipment lease agreement. The lessee was liquidated, resulting in the lease agreement being terminated, and the respondent was placed in possession of the leased equipment. The respondent then claimed arrear rental, interest and damages, and sued the sureties. Although the sureties acknowledged that they had signed the suretyships, they contended they were not liable on a number of grounds including that, unless the suretyships were ceded out-and-out simultaneously with

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[840] In a secured term loan transaction in which I advised a lender in 2018/2019, a condition precedent of the loan was the pledge and cession *in securitatem debiti* by the borrower of its rights to a bank account, and the acknowledgment by the bank at which the account was held of such cession. The bank refused to acknowledge the cession, citing its internal risks as the reason. The refusal raised the enforceability of the cession for, if there was a prohibition on cession, or a prior cession of the same account, the purported cession would be unenforceable. See also section 5.4 *Partial cession: Splitting the claim* for an analysis of the legal principles that must be complied with if a monetary claim is to be split between different creditors.

[841] *Froman v Robertson* 1971 (1) SA 115 (A) at 122C–H. In terms of clause 23.2 (*Borrower consent*) of the LMA's Term Facilities Agreement, the debtor's consent is not required for transfers as defined and the debtor's consent is deemed to be given within five business days after the lender requested it for any other transfers unless the debtor expressly refuses to consent.

[842] *Froman v Robertson* 1971 (1) SA 115 (A) at 122C–H.

[843] Ibid.

[844] The LMA's Term Facilities Agreement, clause 23.1 (*Cessions and delegations by the Lenders*), permits a lender to transfer *'any or all of its rights and/or obligations … to another bank or financial institution or to a trust, fund or other entity which is regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets.'*

[845] Ibid.

[846] *Pizani and Another v First Consolidated Holdings (Pty) Ltd* 1979 (1) SA 69 (A).

the cession of the lease rights, the sureties could not be held liable under the suretyships. The court noted that one school of thought held that cession of the principal debt automatically transferred the cedent's claims against the surety to the cessionary, while the other held that cession of the principal debt was not sufficient to transfer the cedent's claims against the surety to the cessionary, and that a separate cession was required. The former position arose from the nature of cession.[847] The court considered the views of Voet[848] on the subject, stating that although Voet supported the view that both the main action and the accessory actions had to be ceded, in the same paragraph Voet later accepted *'that privileges attached to the ceded right, or rights which cleave to the action ceded, pass to the cessionary by the cession of the main right'*.[849]

The court held that, in light of this position, the view that, without a separate cession of rights under the suretyship, the surety was discharged on cession of the principal debt could not be justified. The cession of the principal debt had the effect that the original creditor could no longer claim from the principal debtor or the surety as that right had passed to the cessionary, who had stepped into the original creditor's (the cedent's) shoes. The cessionary acquired the cedent's rights against the principal debtor and the cedent's rights in respect of the secured debt, which included the right to sue the principal debtor and the surety.[850] The court rejected the view that, as a matter of law, the cessionary could not acquire rights against the surety without a separate cession of such rights.[851] However, this did not apply in all cases, as the wording of the cession might confine it to a certain scope, and the terms of the suretyship might limit the surety's liability by, for example, the surety undertaking exclusive liability to that creditor only as a *delectus personae*.[852] The court held further that different considerations may apply to other forms of security where the law prescribed formalities, procedures and registrations to be observed.[853]

The *Pizani* principle was discussed and adopted in a number of judgments after 1979, the most recent being in 2014, in *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others*,[854] in the Kwazulu-Natal division of the High Court. The applicant applied to set aside a board of directors' resolution to place the company under business rescue.[855] The court, in deciding whether it was just and equitable to set aside the resolution under section 130(5)*(a)*(ii) of the Companies Act 2008, had to consider if the business rescue plan was not one envisaged under the Act, because it provided for the compulsory cession of 75.5 per cent of the applicant's claim, leaving the applicant unable to claim that portion against the directors who had provided suretyships for it. The court held that this submission depended on whether the business rescue plan deprived the applicant and other creditors

[847] Ibid 77B–C, where the court held: *'Such effect is that the cessionary veritably steps into the shoes of the cedent. Whatever claims could, but for the cession, have been enforced by the cedent may after the cession be enforced by the cessionary. This is of the essence of the cession.'*
[848] D 18.4.12 in Gane's translation.
[849] *Pizani and Another v First Consolidated Holdings (Pty) Ltd* 1979 (1) SA 69 (A) at 77G–H.
[850] Ibid 77H and 78A–B.
[851] Ibid 78E.
[852] Ibid 78F–H.
[853] Ibid 78D–E.
[854] *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP).
[855] As contemplated in Chapter 6 (*Business rescue and compromise with creditors*) of the Companies Act 2008.

from proceeding against the sureties. Citing the authority of *Pizani*, the court held that at common law the cession of a claim entitled the cessionary to claim against both the principal debtor and the surety. The cedent could no longer enforce these claims because *'it has perforce ceded its claim against the principal debtor, and suretyship is an accessory obligation'*.[856] Security was first held to be accessory in nature in 1931 in *Kilburn.*[857] The *Pizani* principle was, I submit, based on the perspective that the security in that case was accessory to the principal debt.

The *Pizani* principle can be applied to the pledge and cession *in securitatem debiti* of bank accounts, debtors' books, unlisted shares and insurances if these forms of real security are accessory to the secured debts that they secure and there are no contrary statutory conditions. The out-and-out cession of a principal debt that is secured by the pledge and cession *in securitatem debiti* of any of these rights has the effect in law that the accessory security rights are likewise ceded to the cessionary without the need for a separate cession. Given its accessory nature, this kind of security 'follows' the principal obligation into the hands of the new lender as its fate is bound to the principal obligation. If the principal obligation (the loan) is assigned, so is the security.

I submit that the *Pizani* principle does not apply to certain types of accessory security rights where legislation requires such rights to be registered in order to be legally effective. Accessory security rights that must still be separately ceded and registered are security rights in listed, uncertificated securities and bonds. The Financial Markets Act requires the registration of listed, uncertificated securities that are ceded or pledged in security. The name of the pledgee or cessionary, the number or nominal value of the uncertificated securities, the interest ceded or pledged, and the date of entry must be recorded in the central securities account or the securities account.[858] So, every time the cessionary or pledgee changes because of a new cession, the new party's name and details must be registered. This implies, I submit, that, despite the *Pizani* principle*,* a separate (from the cession of the loan) pledge and cession *in securitatem debiti* of listed, uncertificated securities is required every time new security is created, so that it can be registered as required by the Financial Markets Act.

In terms of sections 3(1) and 52 of the Deeds Registries Act,[859] the cession of mortgage bonds and notarial bonds must also be registered.

What is the effect of a no assignment clause on the principle that assigning the loan automatically assigns the security because the security is accessory to the loan? In terms of a no assignment clause, the obligors may not cede their rights nor delegate their obligations under the facility agreement to a third party.[860] If an obligor were to assign its rights and obligations it would be a breach of the no assignment clause. The no assignment

[856] *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP) paras 64 and 65.
[857] *Kilburn* is discussed in section 4.6 *The accessorial principle.*
[858] See section 4.5 *Personal and real security, and the registration of security rights.*
[859] Deeds Registries Act 47 of 1937.
[860] The LMA's Term Facilities Agreement, clause 24.1 (*Cessions and delegations by Obligors*).

clause does not apply to a novation of the loan, though, as assignment and novation are substantively distinct concepts. I submit that, although the *Pizani* principle would ordinarily result in the automatic transfer of accessory security rights to a new lender, a no assignment clause would, depending on its content, render the *Pizani* principle contractually ineffective. In other words, unless the assignment of the obligors' facility rights and obligations, and the accompanying security rights transfer is consented to by being reduced to writing and signed by the parties, the accessory security rights would, in those circumstances, not follow the assignment of the loan for which the security rights were given.[861]

While the no assignment clause prohibits the borrower and the other obligors from ceding their rights against the lenders or delegating their obligations under the finance document to third parties,[862] the lenders are allowed, subject to stipulated conditions, to transfer their rights and obligations against the borrower and the other obligors to new lenders,[863] which facilitates loan syndication. Once implemented, the obligors would be bound to new lenders to whom they will owe obligations originally owed to the initial lenders. The lenders are further allowed to encumber their rights under the finance documents to secure that lender's third party obligations.[864] The lenders can control, through the obligor no assignment clause, the obligors' abilities to trade their rights and obligations in the market because it poses a risk to the obligors repaying and securing the loan. It is submitted that the obligor no assignment clause, the lender transfer clause and the lender encumbrance clause would be acceptable under South African contract law principles as enforceable against the parties as it is aligned with such principles.

Sometimes intra-group assignments by the lender to companies within the lender group occur[865] because lenders often need the contractual flexibility to move the loan from its books of account to another group company for accounting reasons. It will only do so if the security can likewise be assigned.

New lenders would want certainty that when they 'purchase' the loan, the security originally given for the loan is likewise 'purchased', as this mitigates the risk of non-payment. The *Pizani* principle adequately covers this concern. However, where the law prescribes formalities, procedures and registrations that must be complied with in respect of security rights, these will have to be complied with to ensure that the security is legally effective, since legislative registration requirements override the common law.[866]

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[861] The LMA's Term Facilities Agreement, Schedule 2 (*Form of transfer certificate*) contains a note that it is the new lender's responsibility to ascertain whether any documents or formalities are required to perfect a transfer of a share in the existing lender's security.
[862] Ibid clause 24.1 (*Cessions and delegations by Obligors*).
[863] Ibid clause 23.1 (*Cessions and delegations by the Lenders*).
[864] Ibid clause 23.7 (*Security over Lenders' rights*).
[865] Ibid clause 23.1 (*Cessions and delegations by the Lenders*) can be utilised for this purpose.
[866] See ss 3(1) and 52 of the Deeds Registries Act, discussed in section 4.9 *The realisation of security*, which require cessions of bonds to be registered in the relevant Deeds Office; and s 39 of the Financial Markets Act, discussed in section 4.4 *The meaning of 'security' in the Insolvency Act*, which requires the pledge and cession *in securitatem debiti* of listed securities to be registered.

An interesting issue is whether a lender can, by novation, transfer its security to a new lender. The law of novation is discussed in section 3.2.4 (*The nature of syndication*) and in this section. It is stated there that novation not only extinguishes and substitutes obligations, but it also releases securities, pledges and sureties given for the extinguished obligation. It follows that if the secured debt is novated, all security rights held for that debt are thereby released. The probable reason for this construct is that security is accessory to the secured debt, and if that is extinguished, the security is extinguished. The other part of novation is the creation of a new obligation that substitutes the extinguished obligation. However, doing so does not automatically create new security rights as the South African law on personal security and real security has to be complied with to create new security rights. Doing so requires positive conduct by the parties. For example, if a debt is extinguished and replaced with new debt by novation, the accessory pledge and cession *in securitatem debiti* of personal rights is extinguished but is not revived when the new debt is created because the cedent must pledge and cede its rights to a new cessionary, the new lender, for the security to be effective. Additionally, if there are formalities to be complied with to create legally effective security,[867] then this must be complied with.

Assuming that the new lenders use a new Security SPV to hold the new security rights pursuant to the out-and-out cession of the principal debt, its effect on the ranking of claims, perfection and hardening periods is as follows. As the new Security SPV holds all the security rights, the ranking of security rights is not a concern for the Security SPV because it is the only party holding security rights. Perfection of security rights would similarly not be a concern for the lenders for the same reason, namely, that the Security SPV (not the lenders individually) is the only party holding security rights. The hardening period principles applicable to mortgage bonds discussed in section 4.11.2 (*The security structure*) apply equally to any new mortgage bonds.

4.13 Concluding remarks

In this chapter I analysed security for loans, the nature of security rights and related issues. I examined *inter alia* the principles that apply to all security rights, especially those that apply to security interests in personal rights and the security rights of syndicate lenders. The theoretical foundation for an analysis of cession and cession *in securitatem debiti* has now been laid.

[867] For example, s 39 of the Financial Markets Act requires the pledge and cession of listed securities to be registered.

5 Chapter Five: The Law of Cession

The general principles applicable to security rights have been examined and the theoretical foundation for an analysis of cession and cession *in securitatem debiti* has been laid. In this chapter, the South African law of cession is analysed in order to critique the security component of the research question, which is secured lending in South African law.

The following aspects will be examined next: the legal nature and requirements of a valid cession; cession as an act of transfer; the distinction between an out-and-out cession and cession *in securitatem debiti*; notice of cession to the principal debtor and performance including set-off; registration of cession; the legal requirements for a valid cession *in securitatem debiti*; the classification of cession as belonging to the law of obligations or the law of property; splitting a claim by cession; the cession of future non-existent rights; and agreements prohibiting cession (*pacta de non cedendo*). I will conclude by considering whether the fruits of a ceded right are transferred with the right.

Relevant historical aspects of the law of cession *in securitatem debiti* are also explored because South African legal principles on the subject are based on Roman-Dutch law, which is in turn based on Roman law.[868]

5.1 The legal nature of cession

5.1.1 *Cession as a bilateral juristic act of transfer*

Cession is a bilateral juristic act in terms of which, by mere agreement, a cedent transfers its incorporeal right(s) to a cessionary, who accepts the right.[869] At its core, cession is an act of transfer of an incorporeal right arising from an underlying *causa*.[870] The object of a cession is a right or a claim which originates from an obligation, and it is accordingly impossible to cede a contract.[871] Cession as a method to transfer incorporeal rights has been likened to delivery of a corporeal thing.[872]

The duty to cede is created by consensus in an obligatory or obligationary agreement such as a facility agreement, a contract of donation, a contract of exchange, a contract of sale, a contract of settlement, a payment or a security agreement.[873] In a *mutuum*, the lender in the facility agreement typically requires, as a condition precedent to the loan being advanced, that the borrower pledges and cedes *in securitatem debiti* agreed

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[868] Sande *Cession of Actions* (1906), ch II, under the heading *History of the subject.*
[869] Lubbe 'Cession' *LAWSA* (2013) para 128; De Wet & Van Wyk *Kontraktereg* (1992) 251; Sande *Cession of Actions* (1906) ch II, under the heading *In how many various ways cession may be correctly effected*, where Sande states that *'[w]ithout mandate actions are ceded in any other way by mere consent, provided there exist an antecedent title or cause, whence the intention to transfer the action may be gathered'.* Also see Kariem 'The Nature of Cession in Security' *Finance and Banking Alert* Cliffe Dekker Hofmeyr Inc., 20 September 2017.
[870] The concept of *causa* or *justa causa* is discussed in section 5.2 *Legal requirements for a valid cession in securitatem debiti.*
[871] Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 93. In section 6.1 *Rights as security for a debt*, I discuss the object of a cession and Scott's view of the matter.
[872] *First National Bank of SA Ltd v Lynn NO and Others* 1996 (2) SA 339 (A) at 345.
[873] *Johnson v Incorporated General Insurances Ltd* 1983 (1) SA 318 (A) at 331F–I; *Botha and Another v Carapax Shadeports (Pty) Ltd* 1992 (1) SA 202 (A) at 214.

personal rights as security for the borrower's obligation to repay the loan.[874] The agreement or duty to cede is known as the *pactum de cedendo*[875] and it is the *causa* for the cession. Cession of a personal right, such as the right to a principal debt, may be given to secure another debt,[876] such as the borrower's obligation to repay a loan under a *mutuum.*

The duty to cede is discharged or given effect to in a transfer agreement[877] and is known as the *pactum cessionis*.[878] The transfer agreement effectively transfers the incorporeal right[879] or a security interest therein, depending on the type of cession, to the cessionary. In order to do so the transfer agreement must comply with the principles applicable to agreements generally. One of these principles is the principle decided in *Legator McKenna Inc and Another v Shea and Others*[880] (*'Shea'*), where the Supreme Court of Appeal discussed the application of the abstract theory to the transfer of ownership of movable and immovable property. It is submitted that the abstract theory applies to the transfer of personal rights in respect of out-and-out cessions. Its application to the cession *in securitatem debiti* of personal rights is, however, more problematic because the accessorial principle also applies to such a cession, and one has to understand how the two concepts will be applied in relation thereto.[881]

The agreement giving rise to the duty to cede and the discharge of that duty by cession are distinct or discrete juristic acts, and the two juristic acts should not be conflated.[882] The cession is independent of the underlying obligationary agreement.[883] The obligationary agreement (containing the duty to cede) and the act of transfer (cession) remain two discrete juristic acts despite the fact that both acts may be contained in one agreement or be subject to the fulfilment of the same conditions precedent.

5.1.2 *Cession in security versus out-and-out cession*

There are two types of cession, namely, an absolute cession, more commonly known as an out-and-out cession, and cession *in securitatem debiti*. In both cases, cession is a bilateral juristic act that transfers rights between two persons. Whether a cession is

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[874] The LMA's Term Facilities Agreement, clause 4 (*Conditions of Utilisation*) read with clause 3 (*Finance Documents*) of Part I (*Conditions Precedent to initial Utilisation*) of Schedule 2 (*Conditions Precedent*). It is market practice in South Africa for lenders to also require other group companies to similarly provide security in one or more of the accepted forms of security.
[875] *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68 para 15.
[876] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA); *Millman NO v Twiggs and Another* 1995 (3) SA 674 (A) at 676G–I.
[877] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *LTA Engineering Co Ltd v Seacat Investments (Pty) Ltd* 1974 (1) SA 747 (A) at 762; *Johnson v Incorporated General Insurances Ltd* 1983 (1) SA 318 (A) at 331F–I; *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* 1992 (1) SA 867 (A) at 873; *First National Bank of SA Ltd v Lynn NO and Others* 1996 (2) SA 339 (A); *Headleigh Private Hospital (Pty) Ltd t/a Rand Clinic v Soller & Manning Attorneys and Others* 2001 (4) SA 360 (W) at 366; *Lynn & Main Inc v Brits Community Sandworks CC* 2009 (1) SA 308 (SCA) para 6; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[878] *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68 para 15.
[879] The issue as to whether an incorporeal right can be owned is a controversial one. I examine this aspect elsewhere in the thesis. I use the terms 'own' or 'ownership' of an incorporeal right because it is convenient to do so, but I am mindful of the controversy.
[880] *Legator McKenna Inc and Another v Shea and Others* 2010 (1) SA 35 (SCA).
[881] This aspect is discussed in detail in section 5.2 *Legal requirements for a valid cession in securitatem debiti* under the heading *The abstract theory, the accessorial principle, and the causa.*
[882] *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68 para 15.
[883] Ibid. See also *Grobbelaar v Shoprite Checkers* [2011] ZASCA 11 para 18.

one type or the other is determined by the parties' intentions, evidenced in the obligationary agreement.

An out-and-out cession is a complete and permanent divestiture of rights from one person to another. In this case, title and all ancillary rights are transferred by the cedent, usually for value, to the cessionary. The legal effect is that, after the cession, the cedent ceases to own the right and the cessionary acquires the right. Title is ordinarily transferred against payment, although payment can be delayed by consensus or be made in instalments with title still passing.

A cession *in securitatem debiti* is the transfer by the cedent (i) on the pledge construction,[884] of part of a personal right, namely, the right to enforce the debt due to the cedent; or (ii) on the *pactum fiduciae* construction,[885] of the entire personal right, to the cessionary, to secure the secured debt. In a cession *in securitatem debiti* of personal rights, consensus between the parties as to the essential aspects of the cession occurs if the cedent intends to transfer its rights (on the pledge construction, it transfers the right of action in the principal debt to the cessionary, and on the *pactum fiduciae* construction, it transfers the entire right) as security for the secured debt, and the cessionary intends to acquire the transferred rights.

5.1.3 *Notice of the cession to the principal debtor and performance including set-off*

Notice to the principal debtor of the cession is not a requirement and there is no publicity or publication requirement.[886] I submit that this is a systemic deficiency because potential lenders are unable to access information about personal rights ceded by the cedent, which may impair the potential lenders' risk assessments.[887]

However, notice of the cession to the principal debtor is typically given so that the debtor renders performance to the party entitled to performance under the cession. A principal debtor who was not informed of the cession, and who renders performance to the cedent instead of the cessionary, has fulfilled its obligations under the contract between the cedent and the principal debtor, and is consequently immune from suit.[888] In *Van Staden* it was held *obiter* that the onus of proving knowledge of the cession rests with the cessionary, that the knowledge could be either actual or constructive, and that *'[a] court will impute constructive knowledge to a debtor where it has reasonably shut its eyes to the truth by not heeding indicators of that truth'*.[889] If the principal debtor is not informed of the cession (whether it is *in securitatem debiti* or an out-and-out cession), and the principal debtor, in ignorance of the cession, renders performance to

[884] The pledge theory is analysed in section 6.6 *The pledge theory.*
[885] The *pactum fiduciae* theory is analysed in section 6.5 *The pactum fiduciae theory.*
[886] Lubbe *Contract: General Principles* (2020) 505 para 13.15; *National Sorghum Breweries Ltd v Corpcapital Bank Ltd* 2006 (6) SA 208 (SCA) para 1; *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T) paras 28 and 29; Kariem 'Cession in Security: Notice to the Debtor' *Finance and Banking Alert* Cliffe Dekker Hofmeyr Inc., 18 May 2020.
[887] The systemic deficiency arising from the lack of a publicity or registration requirement is discussed elsewhere in this thesis. See The Law Commission of England and Wales 'Registration of Security Interests: Company Charges and Property Other Than Land – A Summary of the Consultation Paper' (2002) 14(1) *Bond Law Review* para 13.
[888] *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T) para 28.
[889] Ibid para 29.

the cedent, then the risk is the cessionary's, who will have no claim against the principal debtor.[890] Furthermore, if the cedent becomes insolvent, and the principal debtor pays into the cedent's insolvent estate,[891] the liquidator must, if the cessionary is a secured creditor, hold such moneys for the cessionary's benefit. The innocent principal debtor, ignorant of the cession, will have discharged its payment obligation. Conversely, if the principal debtor, despite receiving notice of the cession (whether it is *in securitatem debiti* or an out-and-out cession), still renders performance to the cedent and not the cessionary, then the principal debtor may face the risk of a valid claim by the cessionary for payment, despite the principal debtor having already paid the cedent.[892] The principal debtor may have a claim against the cedent for the return of the money paid to the cedent, on the basis that the cedent had no *locus standi* to receive the payment and was unjustifiably enriched.

The question whether the principal debtor's claim against the cedent can be set-off against a debt owed by the cedent to the principal debtor has come before the South African courts. Set-off applies *ipso iure* in respect of debts owed between the same parties, where such debts are both due and liquid.[893] The issue can be addressed in three different scenarios. First, can set-off operate *prior* to effecting the cession *in securitatem debiti* of personal rights? Second, can set-off operate *after* the cession *in securitatem debiti* of personal rights but *prior* to the principal debtor receiving notice of the cession? Third, can set-off operate *after* the cession *in securitatem debiti* of personal rights and *after* the principal debtor receives notice of the cession? In each of these scenarios, whether set-off can be applied is an issue because cession transfers the debt.

In the first scenario, set-off of the principal debt against the cedent's debt owed to the principal debtor can be applied.[894] In the second scenario, most South African case law accepts that set-off of the principal debt against the cedent's debt owed to the principal debtor can be applied before the principal debtor is notified of the cession, in which event the principal debtor is not liable to the cessionary[895] and the principal debtor can raise set-off as a defence against the cessionary.[896] This is because the cession is ineffective against the principal debtor until it is notified of the cession[897] and there is a mutuality of debts between the same parties. In scenarios one and two, the exercise of the principal debtor's set-off rights would extinguish the cessionary's security rights in the principal debt. Ideally, to preserve the cessionary's security rights in the principal debt, such set-off rights should be prohibited in the cession agreement. In the third

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[890] Nienaber 'Security Cessions of Life Insurance Policies' (2004) 16 *South African Mercantile Law Journal* 83 at 86 para 7.2. Nienaber mentions this principle in relation to the cession in security of the rights to a life insurance policy, and states that if the insurer as the principal debtor, unaware of the cession in security, in good faith pays its policyholder (as cedent), then it is *'protected against a claim for payment by the true creditor, the cessionary, who failed to inform him of the prior cession'.*
[891] As occurred in *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T).
[892] Nienaber 'Security Cessions of Life Insurance Policies' (2004) 16 *South African Mercantile Law Journal* 83 at 86 para 7.3.
[893] *Scott on Cession* (2018) 329 at para 7.4.2.4.
[894] Ibid; *Smith v Howse* (1834) 2 Menz 163.
[895] *Agricultural & Industrial Mechanisation (Vereeniging) (Edms) Bpk v Lombard en Andere* 1974 (3) SA 485 (O).
[896] *Scott on Cession* (2018) 329–330at para 7.4.2.4.
[897] *Agricultural & Industrial Mechanisation (Vereeniging) (Edms) Bpk v Lombard en Andere* 1974 (3) SA 485 (O).

scenario, set-off of the principal debt against the cedent's debt owed to the principal debtor cannot be applied,[898] because cession *in securitatem debiti* of personal rights vests *locus standi* in the cessionary, who is entitled to receive payment of the principal debt from the principal debtor.[899] The effect of such vesting of *locus standi* is that one of the requirements for set-off, namely, a mutuality of claims between the same parties, is absent because the cedent's right to receive payment of the principal debt is ceded (transferred) to the cessionary.[900] It is therefore in the cessionary's interests to insist that the cedent serves a notice of the cession on the principal debtor as it preserves the principal debt and hence the cessionary's security rights therein.

5.1.4 *Registration of cession*

There are generally no mandatory registration requirements for cessions, and there is no central, public database or register in South Africa in which cessions are recorded that investors can check to establish if a cedent disposed of its assets or property by an out-and-out cession or encumbered its assets or property by pledge and cession *in securitatem debiti*.

The pledge and cession *in securitatem debiti* of listed uncertificated securities is an exception because the cedent and the cessionary must comply with the registration requirements of the Financial Markets Act.[901] Prior knowledge of encumbrances over the cedent's assets or property, whether by cession or any other security form, obtained from a central database administered by governmental authorities, would aid investors' decisions as to whether to lend money to a company. The absence of a coherent and uniform registration system that applies equally to all types of security is, I submit, a serious systemic deficiency.

5.2 Legal requirements for a valid cession *in securitatem debiti*

Although no formalities must be complied with to create a valid cession *in securitatem debiti*, except in certain cases,[902] general principles must be complied with. A valid cession *in securitatem debiti* means a cession to which the law attaches legal consequences so that it may be enforced in a court of law.

At common law, a contract comes into existence only if there is consensus between the parties about the contract, that is, the parties are *ad idem* as to the nature and the terms of the contract.[903] So too, cession requires the concurrent intention of the parties to transfer and take transfer of the right. In a cession in *securitatem debiti* the parties must be *ad idem*

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[898] *Smith v Howse* (1834) 2 Menz 163 at 165; *Porterstraat 69 Eiendomme (Pty) Ltd v PA Venter Worcester (Pty) Ltd* 2000 (4) SA 598 (C) at 611J–612C; *Scott on Cession* (2018) 331 at para 7.4.2.4.
[899] See section 6.7.5 *Enforcing the ceded rights: Locus standi.*
[900] Nortje 'General Principles of Contract' 2000 *Annual Survey of SA Law* 204–205.
[901] The registration requirements are discussed in section 4.5 *Personal and real security, and the registration of security rights* and elsewhere in this thesis.
[902] See ss 3(1) and 52 of the Deeds Registries Act, discussed in section 4.10 *Pacta commissoria and conditional sales*, which require cessions of bonds to be registered in the relevant Deeds Office; and s 39 of the Financial Markets Act, discussed in section 4.4 *The meaning of 'security' in the Insolvency Act*, which requires the pledge and cession of listed securities to be registered.
[903] Lubbe *Contract: General Principles* (2020) 31 para 2.21.

that the cedent transfers its right of action to the principal debt owed to the cedent (or, on the *pactum fiduciae* theory, the entire right owed to the cedent on an out-and-out basis coupled with a re-cession thereof if the secured debt is repaid),[904] to the cessionary, to secure fulfilment of the underlying obligation. In a *mutuum,* that obligation is to repay the loan advanced, which is the so-called secured debt. There would be dissensus if, for example, one party intended the cession to be in the nature of a cession *in securitatem debiti* and the other party intended it to be an out-and-out cession.[905] Similarly, there would be dissensus if one party to the cession intended to apply the pledge theory, and the other party intended to apply the *pactum fiduciae* theory to the cession *in securitatem debiti*. Such mistakes will be regarded in law as material mistakes that exclude consensus, resulting in there being no binding contract. A material mistake is one that has a bearing on the parties' obligations under the contract or on the identity of the parties.[906] In other words, the contractual undertaking to cede would be invalid, as would the cession itself. Similarly, a material mistake that excludes consensus, resulting in there being no binding contract, could be made in relation to the cession (transfer) agreement.

The cedent must have the legal capacity to transfer the rights,[907] the rights must be legally capable of transfer, and there must be certainty as to what is being transferred. The cession must be for a lawful purpose, may not be used for an unlawful purpose, and must not prejudice the debtor.[908] The repayment of a valid loan is an example of a lawful purpose. The parties' intentions are important in determining if cession was contemplated, and the type of cession contemplated. I will now examine the parties' intentions.

Animus transferendi

A requirement in the law of cession, for both cession *in securitatem debiti* and an out-and-out cession, is that the cedent must intend to transfer its right or claim against another to the cessionary.[909] However, the content of what is transferred as between the two types of cession differs drastically.

An area of controversy in a cession *in securitatem debiti* is what rights the cedent retains, and what rights the cedent transfers to the cessionary. Academic writers and the courts have long held differing views on what precisely is transferred in a cession *in securitatem debiti,* and these differences have been, and still are, the subject of substantial controversy in this area of South African law, as examined in this thesis.[910] In this section, I focus on the cedent's intention to transfer part of a right, or a right, for the purpose of

[904] The *pactum fiduciae* theory is discussed in section 6.5 *The pactum fiduciae theory*.
[905] Lubbe *Contract: General Principles* (2020) 31para 2.22. The differences between a cession *in securitatem debiti* and an out-and-out cession are discussed in section 5.1.2 *Cession in security versus out-and-out cession*. The lawyers representing the parties must obtain clear instructions from the parties as to the nature and purposes of the cession and must ensure that the contract reflects these instructions.
[906] Lubbe *Contract: General Principles* (2020) 33 paras 2.28 and 2.29.
[907] Lubbe 'Cession' *LAWSA* (2013) 113 para 157(b). This is discussed in the section titled *Capacity to cede* below.
[908] Prejudice to the debtor may occur in different forms. South African courts generally do not support principles or forms of behaviour that prejudice debtors. See, for example, *Bock and Others v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 (SCA) and *Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd* 2015 (3) SA 479 (CC).
[909] Lubbe *Contract: General Principles* (2020) 497 para 13.5. The terms 'right' and 'claim' are examined in section 6.1 *Rights as security for a debt*.
[910] In section 6.7 *Theoretical issues arising from the pledge theory,* I analyse the rights that are transferred in a cession *in securitatem debiti*.

constituting a security interest in the cessionary's favour. In order to address the issue of *animus transferendi*, it is necessary to understand that the extent of the rights that are transferred *in securitatem debiti* are determined by whether the pledge theory or the *pactum fiduciae* theory[911] applies. In terms of the pledge theory, the cedent must intend to divest itself of a component of the principal debt and vest it in the cessionary, to constitute the security interest, and the cessionary must intend to acquire that component of the principal debt.[912] In terms of the *pactum fiduciae* theory, the cedent must intend to divest itself of the entire principal debt, and vest it in the cessionary, to constitute the security interest.[913]

The parties to the cession *in securitatem debiti* must choose which theory to apply to their cession, failing which the default position in law is that the pledge theory applies.[914] In the case of either theory, it is submitted that the cedent must intend to transfer its rights to the cessionary.

The content of what the cedent transfers to the cessionary to constitute the security interest is underpinned not only by the choice of theory, but also by the maxim *nemo plus iuris ad alium transferre potest quam ipse haberet.* The maxim, which forms part of South African law, means that the holder of a right cannot transfer greater rights than what he or she has.[915] The rights held by the cedent are determined by the consequences assigned by the law and, if applicable, prior contractual undertakings. A cedent who, in a prior contractual undertaking, ceded its personal rights *in securitatem debiti* to a cessionary as security for a debt can, for example, only cede its reversionary interests in that principal debt in a subsequent cession to another cessionary.[916]

Capacity to cede

A cedent's *animus transferendi* is affected by its legal capacity and authority. A cedent who holds a right may be incapable of ceding it if it lacks the capacity or authority to do so.

Capacity and authority are different legal concepts. Capacity is the legal ability to cede.[917] An insolvent, a minor and a person who is not the holder or owner of the right are some examples of cedents who lack the capacity to cede their rights in security.

Authority is the approval given by a governing body of an entity,[918] a curator or a liquidator to cede.

It is important that a cedent observes the laws applicable to it insofar as capacity and authority are concerned. A few examples follow. A company that has not passed section

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[911] The theories are examined in detail in sections 5.1.2 *Cession in security versus out-and-out cession*, 6.2 *Notice to the principal debtor and performance*, 6.5 *The pactum fiduciae theory*, 6.6 *The pledge theory* and 6.7 *Theoretical issues arising from the pledge theory*.
[912] This is because of the nature of the pledge theory, which is explained and analysed in section 6.6 *The pledge theory.*
[913] This is because of the nature of the *pactum fiduciae* theory, which is explained and analysed in section 6.5 *The pactum fiduciae theory.*
[914] In section 6.6 *The pledge theory,* I discuss the application of the default theory in a cession *in securitatem debiti* as set out in *Grobler.*
[915] Lubbe 'Cession' *LAWSA* (2013) 126 para 171.
[916] For the meaning of reversionary interests, see the analysis in section 6.6 *The pledge theory.*
[917] Lubbe 'Cession' *LAWSA* (2013) 113 para 157(b).
[918] The entity could be a company, close corporation, trust or common-law partnership.

45 financial assistance board and shareholder resolutions, as required by the Companies Act 2008, lacks the authority to grant financial assistance as defined in the Companies Act 2008. A section 45 resolution is required because the cession *in securitatem debiti* of incorporeal rights by a company in favour of a lender as security for a borrower's payment obligations, where that company is related or inter-related[919] to the borrower, is defined as the granting of financial assistance as contemplated in that section.[920] In the case of trusts, trustees must unanimously decide to cede the rights of the trust *in securitatem debiti*, because a decision by a majority of trustees does not bind the trust, even if the trust deed provides for majority rule.[921] The Pension Funds Act,[922] read with the regulations promulgated thereunder, and the rules of the pension fund define the limits of a pensioner's and a pension fund's[923] contractual capacity to cede. Section 37A(1) of the Pension Funds Act[924] prohibits a pensioner and a pension fund from ceding the pensioner's right to his or her pension.

Animus acquirendi

Another requirement in law is that the cessionary must intend to acquire, from the cedent, the ceded right to a claim against another.[925] This means that the cessionary must intend that the right will vest in it. In the case of cession *in securitatem debiti*, on the pledge construction, the *dominium* or the reversionary interest remains vested in the cedent and is not transferred by the cession, and therefore the *dominium* or the reversionary interest is not received. Instead, the right of action, or framed differently, the right to enforce the claim, is ceded and the cessionary must intend to acquire it. This entitles the cessionary to control the economic value of the personal right for as long as the secured debt remains unpaid.

Causa or justa causa

The cession of a right arises from an underlying obligation to transfer that right, known as the *causa.* The agreement creating the duty to cede is known as the *pactum de cedendo*[926] and is the *causa* for the cession. The *causa* is therefore the obligation that the cedent undertakes to cede its right to the cessionary. In *Froman v Robertson*,[927] the Appellate Division quoted *Conradie v Rossouw* with approval,[928] holding that a *causa* in respect of the contract underlying the issue of a cheque meant *'the particular transaction out of which*

[919] The terms 'related' and 'inter-related' are defined in the Companies Act 2008.
[920] Section 45 of the Companies Act 2008 must be read with *inter alia* s 65 (titled 'Shareholder resolutions') of the Companies Act 2008, which requires that s 45 resolutions be passed as special resolutions. The Companies Amendment Bill, 2021 contemplates that s 45 will not apply to the provision by a company of financial assistance to its subsidiaries because it *'gives rise to an unnecessary compliance burden.'* (Companies Amendment Bill, 2021, Background Note and Explanatory Memorandum on the Companies Amendment Bill at 340).
[921] *Ex parte Davenport* [1963] 1 All SA 507 (SR); *Nieuwoudt NO and Another v Vrystaat Mielies (Edms) Bpk* [2004] 1 All SA 396 (SCA); *Johannes Marthinus van der Merwe NO and Others v Hydraberg Hydraulics CC and Others; Johannes Marthinus van der Merwe NO and Others v Quinton Petrus Johannes Bosman and Others* 2010 (5) SA 555 (WCC).
[922] Pension Funds Act 24 of 1956.
[923] As to a pension fund's contractual capacity to cede, see *ABSA Bank Ltd v SACCAWU National Provident Fund* [2012] 1 All SA 121 (SCA).
[924] Pension Funds Act 24 of 1956.
[925] Lubbe 'Cession' *LAWSA* (2013) 433 para 12.5.
[926] *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68 para 15.
[927] *Froman v Robertson* 1971 (1) SA 115 (A) at 121.
[928] *Conradie v Rossouw* 1919 AD 279.

the obligation is said to arise, be it sale, hire, donation or any other contract or handeling'.

Cession is the execution and fulfilment of the duty or obligation to cede. As Lubbe states, the *causa* and the cession ought not to be confused, and *'they are conceptually and functionally distinct'*.[929] The duty to cede is created by consensus in an obligationary agreement such as a contract of donation, a contract of exchange, a contract of sale, a contract of settlement, a payment[930] or a debtor's undertaking to cede its claim against another as security for satisfying a debt.[931] However, the duty to cede may also arise *ex lege*.[932] The relationship between the *causa* and cession has been likened to the relationship between an agreement to deliver a corporeal thing and the delivery thereof.[933]

I now consider the position in Roman-Dutch law. Sande was a seventeenth-century judge of the Supreme Court of Friesland, on whose works authors like Voet, Huber, Noodt and other Roman-Dutch authors relied.[934] He tended to reflect on Roman law to a greater extent than the Dutch writers of Holland. In Roman-Dutch times, Sande required the *causa* to be *iusta,* that is, legally valid. In other words, the obligationary agreement had to contain a legally valid obligation to cede as security for satisfying a debt, if the cession *in securitatem debiti* was to be valid.[935] Sande[936] stated:

> *2. … It is necessary that this causa be lawful and genuine, according to C.2,13,9, where the following words occur, 'he has exercised the actions assigned to him upon a proper and suitable preceding cause.' For an illegal cause is inapt for the purpose of transferring an action for instance a motive to harass a debtor or injure his business.*
>
> *3. Again the causa required must be such as is proper and sufficient for the transfer of corporeal as well as incorporeal things: for example purchase; the giving of dowry; payment; donation; and the like.*
>
> *4. A further requirement is that the causa of cession shall be real, and not fictitious or imaginary.*

In modern times, Lubbe has expressed the view that a legally valid *causa* is no longer required for the cession *in securitatem debiti* to be valid, because one can divorce the efficacy of a cession from the validity of the *causa* by means of the abstract theory.[937] Based on this view, a cessionary can enforce a cession *in securitatem debiti* even if the *causa* contained in the obligationary agreement is invalid (by reason of any legally recognised ground on which to escape contractual liability, such as lack of consensus, duress, fraud or undue influence). I submit below that one cannot simply apply the abstract theory without simultaneously applying the accessorial principle when determining the validity of a cession *in securitatem debiti.* It is necessary to apply both constructs, as this

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[929] Lubbe *Contract: General Principles* (2020) 497 para 13.5.
[930] *Johnson v Incorporated General Insurances Ltd* 1983 (1) SA 318 (A) at 331F–I; *Botha and Another v Carapax Shadeports (Pty) Ltd* 1992 (1) SA 202 (A) at 214.
[931] Lubbe *Contract: General Principles* (2020) 497–498 para 13.6; *Holzman NO and Another v Knights Engineering and Precision Works (Pty) Ltd* 1979 (2) SA 784 (W).
[932] Lubbe *Contract: General Principles* (2020) 497 para 13.5.
[933] Ibid.
[934] Sande *Cession of Actions* (1906) preface.
[935] Lubbe 'Cession' *LAWSA* (2013) 111 para 155; *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 at 252.
[936] Sande *Cession of Actions* (1906) ch II (*In how many ways cession may be correctly effected*), clauses 2, 3 and 4.
[937] See the discussion of the abstract theory in section 5.1.2 *Cession in security versus out-and-out cession.*

determines the validity of the cession.

The abstract theory, the accessorial principle, and the causa

I now consider the legal position regarding the abstract theory that governs the transfer of ownership. The abstract theory is relevant as it applies to an out-and-out cession that transfers ownership, and to the *pactum fiduciae* theory whereby a cedent is divested of its personal right completely, as if it had transferred that right as an out-and-out cession to the cessionary. A condition is imposed on the cessionary to re-transfer its acquired right to the cedent once the cedent settles the secured debt. The abstract theory that governs the transfer of ownership is relevant to both types of cessions. In *Shea*[938] the Supreme Court of Appeal considered an appeal against the judgment of the court *a quo.* In the court *a quo* an agreement of sale of Shea's immovable property signed by Shea's curator *bonis* at a time when she was incapacitated was held to be illegal and invalid, and she was entitled to the return of the house. The court had to consider the nature of a condition written into the agreement of sale, which was that it was subject to the Master's consent. The court held that a seller executing conveyancing documents could not cure the lack of acceptance that conformed to statutory requirements. The court also held that it was a trite principle that a binding contract comes into existence only if the acceptance corresponds with the offer in all material aspects.[939] The court also confirmed that the abstract theory applies to the transfer of ownership in respect of movable property, and that the time had come to accept that it also applies to immovable property. In terms of the abstract theory, the validity of the transfer of ownership does not depend on the validity of the underlying contract. Also, the transfer of immovable property requires the conclusion of a so-called real agreement, and the delivery is achieved by the registration of the transfer of the property in the Deeds Office.[940] Lubbe's view, based on the judgment in *Grobbelaar v Shoprite Checkers*,[941] is that the Supreme Court of Appeal has approved the position that, based on the abstract theory, one can divorce the efficacy of a cession from the validity of the *causa*.[942] He holds that the validity of a cession must be determined by establishing if the rules of the law of cession have been complied with, regardless of the validity of the *causa.* He states that one can therefore have a valid cession, even if the *'underlying contract to cede is void or defective'*.[943]

I now consider the relationship between the abstract theory's principles and the accessorial principle applicable to security held for a *mutuum*, given that the former does not require a valid underlying contract while the latter does.[944] As stated in section 4.6 (*The accessorial principle*), the accessorial principle provides that a security right must be accessory to a valid principal obligation. Although a cession *in securitatem debiti* is given

[938] *Legator McKenna Inc and Another v Shea and Others* 2010 (1) SA 35 (SCA).
[939] Ibid para 17.
[940] Ibid paras 20, 21 and 22.
[941] *Grobbelaar v Shoprite Checkers* [2011] ZASCA 11.
[942] Lubbe *Contract: General Principles* (2020) 500 para 13.8. In this judgment, the court held that the agreement to cede and the real agreement of cession were discrete, distinct acts that often coincide. The cession itself was 'independent of the underlying, obligationary, agreement' (at para 18).
[943] Lubbe *Contract: General Principles* (2020) 500–501 para 13.9.
[944] The accessorial principle is discussed in section 4.6 *The accessorial principle.*

as security for a principal debt (secured debt), the *causa* is not the principal debt as it does not create the duty to cede. Nothing in the nature of the principal debt creates the duty to cede as it is the debt owed by the principal debtor to its creditor, the cedent. What creates the duty to cede is the obligation undertaken by the cedent to cede, in security, its personal rights, which is the *causa.* In terms of the abstract theory, the invalidity of the *causa*, that is, the duty to cede, does not affect the efficacy of the cession. I submit that if the principal debt is valid but the *causa* of the cession *in securitatem debiti* is invalid, the cession *in securitatem debiti* remains valid because of both the abstract theory (under which the validity of the cession agreement can be divorced from the efficacy of the cession) and the accessorial principle (under which a principal debt must be valid for the security to be valid). If, however, the principal debt is invalid, the cession *in securitatem debiti* fails because the cession is not accessory to a valid obligation. The abstract theory would not, in these circumstances, apply to the cession *in securitatem debiti* because the validity of the cession agreement is not in question, but the principal debt is. I submit that the abstract theory and the accessorial principle must be applied simultaneously to a given set of facts as the obligationary agreement (containing the principal obligation) and the cession agreement (containing the security rights) are intertwined. It is therefore inappropriate to arbitrarily decide whether to apply the abstract theory or the accessorial principle.

Lubbe discusses the legality of a cession that is created by an invalid *causa*. His view is that although the resultant transfer brought about by the cession will be legally effective, it may be *'liable, perhaps, to be reversed'*,[945] if the cession is rendered inoperative because its conclusion, implementation or purpose is *inter alia* prohibited by common law, is *contra bonos mores*, is contrary to public policy, is prohibited by statute or was occasioned or tainted by duress, fraud or undue influence.[946] In fact, such reversal is not limited to a cession created by an invalid *causa*, but will extend to any transfer *sine causa.* I submit that this approach makes sense, for how can one be a beneficiary of a cession if the underlying obligation (*causa*) is unlawful or *sine causa*?

In a *mutuum*, the *causa* for a pledge and cession *in securitatem debiti* is typically the obligation to provide security for the loan.

Delivery

The Supreme Court of Appeal has held that the real right of pledge of movable property is established by means of, and perfected by, taking possession of the movable property, not by an agreement to pledge.[947] In a cession *in securitatem debiti* of rights, physical delivery is not possible, and possession is achieved differently.

As a general principle, consensus is sufficient to create a valid cession *in securitatem debiti.*[948] The right is transferred by means of consensus – the concurrence of *animus*

[945] Lubbe 'Cession' *LAWSA* (2013) 111 para 155.
[946] Ibid 113–114 para 158.
[947] *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* [2003] 1 All SA 267 (SCA) para 6.
[948] Lubbe *Contract: General Principles* (2020) 31 para 2.21.

transferendi and *animus acquirendi*. The subject matter of cession *in securitatem debiti* is the right, not the document evidencing the right, except if the right is constituted by a document so that it cannot exist independently. As an intangible, a right cannot be possessed or physically delivered by either the cedent or the cessionary. For this reason, the right is transferred by mere agreement between the parties and delivery of the document evidencing the right is therefore not required to create a valid cession.[949] If, however, the rights are constituted by the document of title in that the right cannot exist without the document, as opposed to the right being evidenced by it, then delivery is needed.[950] In 1968, in *Trust Bank of Africa Limited v Standard Bank of South Africa Limited*[951] (*'Trust Bank'*), Ogilvie-Thompson J held in a minority judgment that a cessionary in *securitatem debiti* should retain the instrument evidencing a right ceded in security in order to maintain effective security, just as a pledgee is required to retain the corporeal property pledged to it to preserve its security.[952] However, the majority of the bench was silent on this issue.

In 1995, in *Botha v Fick*[953] (*'Botha'*), the Appellate Division held that consensus is sufficient to create a valid cession *in securitatem debiti* and that delivery of the document evidencing the claim was no longer a requirement to create a valid cession.[954] The court reached this conclusion after reviewing the Roman-Dutch authorities and important cases on the subject.[955] The court distinguished between a claim that is constituted by a document and cannot exist independently of it (such as a negotiable instrument), and a claim that is proved (not constituted) by a document and exists independently of the document (such as a share certificate). The court held that it was not a requirement to create a valid cession that the share certificate be delivered to the cessionary.[956]

General requirements

A cession *in securitatem debiti* must furthermore be for a lawful purpose and cannot be *contra bonos mores* or contrary to public policy.[957] If the cession *in securitatem debiti* is tainted by duress, fraud or undue influence, it will be inoperative.[958]

Legislation prescribes formalities that must be complied with in order for certain types of personal or real security rights to be valid.[959]

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[949] Lubbe 'Cession' *LAWSA* (2013) 115 para 160, but see the qualification discussed in *Botha v Fick* 1995 (2) SA 750 (A).
[950] Ibid 115 para 160.
[951] *Trust Bank of Africa Limited v Standard Bank of South Africa Limited* 1968 (3) SA 166 (A).
[952] Ibid 187C–F.
[953] *Botha v Fick* 1995 (2) SA 750 (A).
[954] Scott 'Representation, Cession *in Securitatem Debiti* and Notice: Bankers and Insurers Beware! *Van Staden NO & Another v Firstrand Ltd & Another*' (2008) 20 *South African Mercantile Law Journal* 530–545 at 536. It appears that Scott may have changed her mind in the period between the 1992 *Roman Catholic* judgment and the 1995 *Botha* judgment.
[955] *Botha v Fick* 1995 (2) SA 750 (A) at 765E and 765F–776C. Howie J came to the conclusion that *'geen oorwoë beslissing ooit gegee is waarvolgens lewering 'n vereiste vir die geldigheid van 'n sessie is nie'.*
[956] See also Scott's criticism of the *Botha* judgment in 'Delivery of Document as Validity Requirement for Cession' 1995 *Journal of South African Law* 760 at 767–770.
[957] In *Sasfin (Pty) Ltd v Beukes* [1989] 1 All SA 347 (A) 350, the court held that the classifications *contra bonos mores* and *'contrary to public policy'* were interchangeable.
[958] Lubbe 'Cession' *LAWSA* (2013) para 158.
[959] See the legislative requirements discussed in section 4.5 *Personal and real security, and the registration of security rights* under the heading *The registration of security rights.*

5.3 Classification of cession *in securitatem debiti*: The law of obligations or the law of property

Conceptually, cession straddles two inter-related aspects, namely, an obligationary aspect and a property aspect. Cession straddles the law of obligations because it effects a substitution of creditors (in the case of an out-and-out cession), and the law of property because it involves the transfer of an asset. The transfer is temporary in the case of cession *in securitatem debiti*, and permanent in the case of an out-and-out cession or the *pactum fiduciae* theory. The contract that contains the obligation to hypothecate creates a security interest in the cedent's assets or property, in the cessionary's favour. The property aspect defines or identifies the cedent's assets or property over which the security interest is created.

According to Scott, a claim or a personal right has a dual nature because it is an asset in a person's estate, and is capable of transfer from that estate to another estate, and it is a claim against a person for performance.[960] Scott explains that, in recent times, the dual nature of a personal right lies in the fact that an aspect thereof relates to the law of property (presumably because it is an asset in a person's estate), and another aspect thereof relates to the law of obligations (presumably because performance is owed).[961] My view is that while Scott is correct that a claim or a personal right has a dual nature, a claim or a personal right is an asset in a person's estate because performance by the debtor will yield measurable, tangible results that mostly sound in money.

The matter of classifying cession *in securitatem debiti* is not made any simpler by the courts having found that the doctrinal foundation of cession *in securitatem debiti* is the pledge theory[962] because, even in terms of that theory, both the hypothecary and the property aspects exist.

I submit that cession *in securitatem debiti* falls, as a judicial construct, within both the law of obligations, given that the obligations that arise from its hypothecary nature, and the law of property, given that what is hypothecated is property. An agreement to cede creates the obligation on the cedent to hypothecate its rights, which in turn leads to creating a security interest in property.

Scott offers an excellent view on classifying the law of cession, stating that:

> *The theoretical classification of cession is, therefore, determined to a large extent by the nature of the object of cession (claim), as well as by the meaning and relative importance assigned to the term 'property'. Depending on whether one emphasises the transfer-of-property aspect of cession or the substitution-of-creditors aspect, one can classify it as pertaining either to the law of property or to the law of obligations. One can also regard both aspects as equally important*

[960] Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 93; *Scott on Cession* (2018) 15 para 1.3.2.
[961] *Scott on Cession* (2018) 16 para 1.3.2.
[962] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).

and treat cession as falling within both the law of property and the law of obligations.[963]

I conclude that cession *in securitatem debiti* falls within both the law of obligations and the law of property for the reasons discussed above. Furthermore, personal rights can be classified as constitutional property that is worthy of protection under section 25(1) of the Constitution.[964]

5.4 Partial cession: Splitting the claim

A creditor who sells part of its secured claim against a debtor in order to syndicate the loan must comply with the common law on splitting claims. A claim to payment of a debt arises from a cause of action, which consists of the facts on which a claim is founded, such as the loan of money in a *mutuum.* I now consider whether it is permissible in law for a creditor to split its claim to payment of a debt against its debtor, by cession, between other creditors.

A claim to a debt is split if a creditor cedes (transfers) a part of the claim out-and-out to another creditor.[965] The debt itself remains owing, except that it is now owed to two creditors instead of one. The legal effect of the cession of part of the claim is to entitle the second creditor to rely on the same cause of action that the first creditor relies on to found its claim against the debtor, even though the second creditor was not a contracting party to the original agreement or contract (such as a *mutuum* or goods sold and delivered) between the first creditor and the debtor.

In 2003, in *Van der Merwe v Nedcor Bank Bpk*,[966] the Supreme Court of Appeal considered the question of whether a cession constituted splitting one cause of action between two creditors. The court confirmed the principle that a right cannot be ceded in part, except with the debtor's consent. The reason for the principle is to protect the debtor from facing a multiplicity of creditors.[967] The cession was accordingly invalid.

In 2009, in *Proflour (Pty) Ltd v Grindrod Trading (Pty) Ltd*,[968] the High Court held that the principle that partial cession of a debt is prohibited applied when a single debt is split by cession between two creditors.[969] The court had to decide *inter alia* if the cession of book debts by the second applicant in favour of the second respondent was valid. The court considered the wording of the cession clause, which read *inter alia* that the second applicant ceded in favour of the second respondent *'[a]ll present and future debtors only to the value of OD facility at that time'*. The court reasoned that the wording of the cession limited the cession to a value of the book debts that could not exceed the current overdraft limit, and that the clause was not directed at the debtors' identities but at the value of the debt. The court distinguished between the partial cession of the debt of a single debtor,

[963] Scott 'Evaluation of Security by Means of Movables: Problems and Possible Solutions, Section C: Codification of the Law of Cession' (1997) 60 *THRHR* 633–649 at 641.
[964] See section 7.5 *The reform of South African law* and section 8.4 *The objectives, principles, international instruments, and harmonisation* for a discussion of s 25(1) of the Constitution.
[965] *Van der Merwe v Nedcor Bank Bpk* 2003 (1) SA 169 (SCA).
[966] Ibid.
[967] Ibid 175.
[968] *Proflour (Pty) Ltd v Grindrod Trading (Pty) Ltd* 2009 JDR 1402 (KZD).
[969] Ibid para 26.

and that of numerous debtors.[970] The court held that a number of book debts of numerous debtors may be ceded and that perhaps one debt out of the bundle will be partially ceded. The court also held that the possibility of the partial cession of one debt was hardly a reason to invalidate the cession and that the cession was valid. The court did not offer a clear reason or reasons why the rule against splitting a single debt without the debtor's consent should not also apply to splitting multiple debts. I submit that if the court's position was that it is permissible to cede one debt partially out of a number of debts without the debtor's consent, then this position is, with respect, not acceptable, as the debtor whose claim has been split will potentially face two or more lawsuits from different creditors, which will be prejudicial to that debtor. The distinction drawn by the court between obtaining the debtor's consent to split a single debt and not doing so to split multiple debts is arbitrary and without legal foundation.

Unless the debtor consents, splitting a claim between more than one creditor is unacceptable in South African law because it will cause harm or prejudice to the debtor.[971] The LMA Term Facilities Agreement, for example, includes a conditional consent by the borrower to the splitting of claims that arise from a transfer allowed under the agreement.[972] If the debtor consents to splitting the claim between multiple creditors, the split is valid and may be enforced, because the debtor has agreed to potentially face multiple lawsuits instituted by different creditors, possibly in different jurisdictions. If, however, a creditor has multiple claims against different debtors, it can cede some of those claims to another creditor or creditors without the consent of the various debtors, provided it cedes entire claims without seeking to split them.

5.5 The cession of future rights

I now consider whether it is possible in South African law to cede *in securitatem debiti* rights that are non-existent at the time of cession but that may come into existence and, at that future time, will constitute an asset in the cedent's estate. A cedent may, for example, cede its current and future personal rights to book debts or shares to a cessionary as security for a loan.

A distinction is drawn in law between a *spes*, a contingent right and a vested right. In order for the law to attach consequences to a right, the right must have come into existence, which occurs when title to it comes into existence. A *spes* is an expectation or a hope that a right may come into existence in the future; there is a chance or possibility of a right coming into existence, but no investitive facts required to create the right have occurred. A contingent right is a right where title is incomplete, inchoate and conditional, in that only some investitive facts sufficient to create the right have occurred and others have not and may never occur. The contingency of a right is evidence that title of the right coming into existence is conditional. A vested right is a right where title is complete and unconditional

[970] Ibid.
[971] In facility agreements that permit the lender to assign the loan or a part thereof to a new lender, a standard consent by the borrower to the splitting of claims that may arise from such an assignment is typically included.
[972] The LMA Term Facilities Agreement, clause 23.1 (*Cessions and delegations by the Lenders*).

in that all investitive facts required to create the right have occurred.[973] Cowen distinguishes between two classes of vested rights. Vested rights with a present enjoyment are known in English law as *'vested in possession'*. In Roman law, the equivalent was a vested right in respect of which *dies venit* has occurred: the date of enjoyment has arrived. Vested rights where enjoyment is postponed to a future time are known in English law as *'vested in interest but not in possession'*. In Roman law, the equivalent was *dies cedit sed non venit*: vesting has occurred but the date for enjoyment of the rights has not yet arrived.[974] *Dies venit* and *dies cedit* may or may not be simultaneous events or occurrences. According to Roman law, a right could vest in a person and, at the time when the right vested, it could be enjoyed immediately. Alternatively, a right could vest in a person but the ability to enjoy the right may occur only later in time. Cowen states that it is important to distinguish between, and not confuse, the contingency of a right and the fact that enjoyment thereof may be postponed to the future. Postponing the enjoyment of a right does not make the right conditional.[975] Cowen also states that contingent rights are transmissible on death to heirs and legatees, although one must distinguish between contingent rights that are personal to the holder and those that are not, which affects the transmissibility of the right.[976] Smit notes that rights subject to conditions may be either contingent or vested.[977] A right subject to a condition precedent is a contingent right because, while title has been created, it is incomplete until the condition precedent is fulfilled.[978] A right subject to a resolutive condition is a vested right because title is complete, but may be undone if the future condition occurs.[979]

Three notable judgments confirm that contingent rights are transferable by cession.[980] In 1987, in *Bank of Lisbon and South Africa Ltd v The Master and Others*,[981] the court held *inter alia* that the effect of the relevant clause in the deed of cession was that, as Nedbank held the first cession *in securitatem debiti* of book debts, the appellant held a cession *in securitatem debiti* of the reversionary right to the book debts. The reversionary right had a money value and was not a mere *spes* or expectation, but an existing contingent right that constituted the appellant's security. Accordingly, the appellant was a secured creditor, as the security had been created by the cession.

In 1995, in *Standard General Insurance Co Ltd v SA Brake CC*,[982] the court appeared to accept that future rights were capable of cession in security *in anticipando*, but that the

[973] Cowen 'Vested and Contingent Rights' 1949 *SALJ* 404 at 405; Price '*Spei*, Contingent and Vested Rights: Towards the Clear and Consistent Regulation of Future Uncertainty' 2005 *Responsa Meridiana* 71; Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 at 81.
[974] Cowen 'Vested and Contingent Rights' 1949 *SALJ* 404 at 412.
[975] Ibid 411; Price '*Spei*, Contingent and Vested Rights: Towards the Clear and Consistent Regulation of Future Uncertainty' 2005 *Responsa Meridiana* 71; Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 and the authorities cited therein.
[976] Cowen 'Vested and Contingent Rights' 1949 *SALJ* 404 at 417–418.
[977] Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 at 81; *Cape Produce Co (PE) (Pty) Ltd v Dal Maso NO and Another* [2002] JOL 9674 (A) para 6.
[978] Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 at 81.
[979] Ibid 81.
[980] Ibid 82.
[981] See the analysis of *Bank of Lisbon and South Africa Ltd v The Master and Others* 1987 (1) SA 276 (A) elsewhere in this thesis.
[982] See the analysis of *Standard General Insurance Co Ltd v SA Brake CC* 1995 (3) SA 806 (A) elsewhere in this thesis.

rights in the insurance policy were not future rights but contingent rights that could be transferred by the insured ceding the rights *in securitatem debiti* for a debt. The contingent rights in an insurance policy come into existence as soon as the insurance policy is concluded, and the rights vest when the insured event occurs.

In 1996, in *First National Bank of SA Ltd v Lynn NO and Others*[983] (*'Lynn'*), the majority of the court held that the right to retention monies under the road construction contract was a contingent right, which was capable of being transferred to another by cession *in securitatem debiti*, even though it was subject to a condition. The condition *in casu* was the completion of a maintenance period. The majority held that *'[t]here is nothing in logic that militates against acceptance of the notion that an extant right may be transferred to another forthwith despite its being subject to a condition'*.[984]

A *spes* is an expectation or a hope of a future right and is not a right as such. It is expected to come into existence and, at that time, will constitute an asset in the cedent's estate. Lubbe notes that a *spes* is not recognised by legal theory as a concept,[985] and does not form part of a person's patrimony (that is, it is not recognised as an asset or a right in a person's estate), although earning capacity has been recognised by our courts as an asset.[986] Lubbe notes further that our courts have held that the expectation of a future right (*spes actionis*) can be ceded, but points out that this position cannot be supported if it means that the expectation is transferred before the right itself comes into existence (he uses the word 'materialises') in the cedent's estate. He distinguishes between a future right, which is capable of cession, and the expectation of a future right, which is not capable of cession. It is, however, unclear what Lubbe means by a future right. Is it a contingent right or a vested right to be enjoyed by the holder sometime in the future?

In *Lynn*[987] the majority held that cession involves the transfer of rights and therefore the mere expectation of a right that had not yet come into existence could not be transferred by cession.[988] The minority was of the same opinion. In 1981, in *Muller NO v Trust Bank of Africa Ltd*,[989] the court dealt with the purported cession of future rights. SCG Construction Co (Pty) Ltd ceded in security to Trust Bank of Africa Ltd on 4 February 1975 its current and future rights to claim retention monies from the employer under construction contracts between the company and municipalities when such monies became due. On 12 August 1975, the company was wound up, but the contracts had not been completed by the company. The liquidator caused the works to be completed, resulting in engineering certificates being issued, which entitled the company to certain progress payments. The court had to decide whether the bank acquired a vested right or claim to these payments evidenced by the certificates, which payments became due to the company after its winding up. The court relied heavily on the 1906 judgment of Innes CJ in *Mears v Pretoria Estate*

[983] *First National Bank of SA Ltd v Lynn NO and Others* 1996 (2) SA 339 (A).
[984] Ibid 352.
[985] However, it is recognised around the world as a concept.
[986] Lubbe *Contract: General Principles* (2020) 464 para 12.131 n 266 and 514 para 13.25.
[987] *First National Bank of SA Ltd v Lynn NO and Others* 1996 (2) SA 339 (A).
[988] Ibid 349I–J. Also see Lubbe *Contract: General Principles* (2020) 514 para 13.25.
[989] *Muller NO v Trust Bank of Africa Ltd* 1981 (2) SA 117 (N).

and Market Co Ltd[990] where he reasoned that a *spes* was not capable of attachment as it would be difficult to know where to stop.[991] Using this concept as a premise, the court held that by parity of reasoning, a *spes* was incapable of being ceded, entitling the cessionary to a right against the cedent's creditors enforceable before the *spes* materialised.[992] As the retention monies had not become due to the company before its winding up, they did not form part of the future rights ceded by the company to the bank as security.[993] Therefore, the bank did not acquire a right to the certified retention monies due to the company after its winding up. These amounts were excluded from the bank's preferential claim and the liquidator had to include these amounts for the benefit of the general body of creditors.[994]

In 1998, in *Smit v Carniasaad en Andere*[995] (*'Smit'*), the court stated *obiter* that a future right such as a *spes* could be validly ceded, but on the facts it was unnecessary to decide whether the *spes* when it materialised vested in the cedent and then passed to the cessionary, or whether it vested immediately in the cessionary. It was significant, said the court, that such a future right could be ceded.[996] Smit notes, however, that the concept of anticipatory transfer, although accepted by the court in *Smit*, was not applied as the facts of the case did not require it. [997]

Leading academics also support the position that anticipatory cession is permissible in South African law. Lubbe holds the view that anticipatory cession can be useful in South African law.[998] He states that, as there are no fundamental theoretical objections to anticipatory cession, it has been accepted by leading academics.[999] He notes the requirements for cession *in anticipando*: the subject matter of the cession must be certain or ascertainable, the transaction must not be contrary to public policy, and the transfer agreement operates when the right comes into existence only if all the formalities for the transfer have been observed.[1000]

If a cedent cedes its future rights to book debts or shares *in securitatem debiti* for a loan, then, according to *Lynn*, there is a present intention to transfer *in anticipando* not the expectation of the right but the future right itself when it comes into existence. The cession must be contained in an obligationary agreement and is given effect to in a transfer (cession) agreement. The obligationary agreement and the transfer (cession) agreement may be contained in one document and may even be subject to the same conditions precedent. The conclusion of the transfer (cession) agreement is a completed juristic act in that both parties are bound to it, and neither party can renege on it. The personal rights

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[990] *Mears v Pretoria Estate and Market Co Ltd* 1906 TS 661.
[991] The learned Chief Justice is quoted by Judge Thirion in *Muller NO v Trust Bank of Africa Ltd* 1981 (2) SA 117 (N) at 127.
[992] Ibid.
[993] See also Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 at 93.
[994] *Muller NO v Trust Bank of Africa Ltd* 1981 (2) SA 117 (N) at 127–128.
[995] *Smit v Carniasaad en Andere* 1998 (4) SA 877 (A).
[996] Ibid 883.
[997] Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 at 94.
[998] Lubbe 'Die Oordrag van Toekomstige Regte' (1980) 43 *THRHR* 117 at 129; Smit 'The Cession of Future Rights in SA Law: Denying the Transfer of Mere Expectations' 2009 *Responsa Meridiana* 77 at 94.
[999] Lubbe *Contract: General Principles* (2020) 515 para 13.26.
[1000] Ibid 517–518 para 13.29.

to future book debts or future shares are therefore ceded *in anticipando* and are effective when the book debts arise or come into existence (which may be before they are due and owing), or when the shares come into existence. It is therefore necessary to understand how shares come into existence in South African company law.

The rights to shares subscribed for come into existence when the shares are issued in terms of section 38 of the Companies Act 2008. A decision by a company to allot shares must be distinguished from the issue of the shares, and such a decision is not the issue of the shares. Shares are issued when the title of the offeror (the incumbent shareholder) becomes complete, which is when the company notifies the offeror that it has allocated shares to it, because at that stage the rights comprising the shares come into existence and are exercisable against the company.[1001] Title in issued shares that are sold passes to the purchaser on the date agreed to, which is usually against payment of the price.

Although the same principles apply to the pledge and cession *in securitatem debiti* of future listed shares, the position regarding the execution of such pledge and cession *in securitatem debiti* differs because of legislation. In terms of the Financial Markets Act read with the Strate Depository Rules, an *'entry'* (as defined)[1002] must be made against pledged shares to publicise the pledge.[1003] This can of course occur only when the share is actually pledged, which in turn occurs only when the share exists. So, although a cedent may purport to cede, *in anticipando*, *in securitatem debiti* future listed shares (which creates the mechanism to transfer the right when it comes into existence), the entry or flagging, as it is known, can occur only when ownership of the shares occurs. Until then, the cession *in securitatem debiti* or pledge of future listed shares is a promise to create a real security claim that the cessionary has against the cedent, not recognised by the Johannesburg Securities Exchange Limited prior to the future listed shares coming into existence, as no entry or flagging in respect of such shares could have occurred. Such a purported cession *in anticipando* is merely a promise to pledge and cede in security as one cannot pledge and cede listed shares *in anticipando* until all the formalities in the Financial Markets Act have been complied with, because these formalities create and give effect to the pledge and cession.

5.6 Agreements prohibiting or restricting cession (*pacta de non cedendo)*

In this section, I examine contractual restraints on cession in order to critique their application to security interests created by cession.

A distinction has been drawn between a restraint imposed on the transfer of an existing right, and one imposed on a new right being created in an agreement. The creditor and debtor may agree, as a term in their agreement, that the creditor of the principal debt (who

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[1001] *Henochsberg on the Companies Act 2008*, November 2011, updated August 2021, Commentary on section 38.
[1002] Section 1 of the Financial Markets Act defines an *'entry'* as *'an electronic recording of any issuance, deposit, withdrawal, transfer, attachment, pledge, cession in securitatem debiti or other instruction in respect of securities or an interest in securities'*.
[1003] The requirements of the Financial Markets Act to electronically register cessions *in securitatem debiti* and pledges are analysed in section 4.5 *Personal and real security, and the registration of security rights.*

may also be a debtor in respect of the secured debt), will not cede its rights to the principal debt *in securitatem debiti* or out-and-out.[1004] A restraint on cession raises two issues: whether it is valid between the parties to the restraint, and whether it is effective against third parties. Conceptually, the common-law rule that the cession of an existing right is invalid unless the party in whose favour it is created has an interest in the restriction is, according to Scott, based on the property law principle that *res in commercio* should not be withdrawn from commerce by such an agreement, whilst an agreement that restricts the cession of a right created as a non-transferable right being valid *ab initio* is based on the private law principle that the parties have the freedom to contract as they wish, and requiring the debtor to have an interest therein is not necessary.[1005] I now consider whether the one principle trumps or limits the other.

In the one scenario, the *pactum de non cedendo* is agreed between the creditor and the debtor when a right that was purportedly ceded is being constituted or created. The creditor and the debtor agree that the creditor cannot transfer the right to a third party. The only limitations on such an agreement are discussed below. Lubbe states that, in this scenario, *'the restraint is a characteristic of the right itself. From its inception the right lacks the attribute of transmissibility.'*[1006] Here the personal right is created, and has the characteristic of not being capable of transfer and the debtor need not show an interest in the prohibition.[1007] In the other scenario, the *pactum de non cedendo* is agreed between the cedent and the cessionary in respect of an existing right when an obligationary agreement is concluded.[1008] Lubbe states that, in this scenario, *'the restriction is superimposed on the right and should in principle be enforceable, like any contractual term, by the cedent in whose favour it was inserted into the contract'*.[1009] Here the party in whose favour the prohibition is created must show an interest in the prohibition.

Our courts have held that such a *pactum* is enforceable in respect of a prohibition on the cession of existing rights if it serves some functional purpose or the interests of the party in whose favour it was created.[1010]

In 1919 in *Paiges v Van Ryn Gold Mine Estates Ltd*,[1011] the leading judgment on *pacta de non cedendo,* the Appellate Division heard an appeal against the judgment of the Transvaal Provincial Division where a resident magistrate, sitting as a court of appeal, had given judgment for a plaintiff who sued a company for £24 1s 9d. Mr Klein had, on 23 June 1919, before entering into the employment of a company, ceded his salary (present and future) and his other future legal claims, as security for a debt of £24 1s 9d he owed the plaintiff (the respondent) and for any future debt. The security was not to exceed £24 1s 9d. On 5 September 1919, the plaintiff gave notice of the security cession to the company,

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[1004] Lubbe 'Cession' *LAWSA* (2013) para 164.
[1005] *Scott on Cession* (2018) 204–205.
[1006] Lubbe 'Cession' *LAWSA* (2013) para 164.
[1007] Sunkel '*Pactum De Non Cedendo*' 2010 *Stellenbosch Law Review* 465.
[1008] Lubbe 'Cession' *LAWSA* (2013) para 164(a) and (b).
[1009] Ibid.
[1010] Ibid para 164.
[1011] *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600.

but it refused to recognise the cession, insisting that Klein personally received his wages. The plaintiff then successfully sued the company for payment of £24 1s 9d, which was Klein's debt. On appeal, the Appellate Division examined the interests of both Klein and his employer in the restraint against the cession. The court held that the employer would want to legitimately protect itself from competing claims against its employees' wages by such a restraint on cession.[1012] The company would want to know whether it was liable to only its own workers or strangers to pay the wages due. The court held, based on the authority of Sande[1013] and Voet,[1014] that a stipulation that is useful to a debtor is valid and binding on the parties.[1015] In other words, if the debtor can demonstrate an interest in the prohibition against the cession, the personal right cannot be transferred, and if it is transferred in contravention of the prohibition, the transfer is void. Lubbe, discussing the judgment in *Paiges*, states that a contractual restraint must serve *'some or other functional purpose or interest of the party, be it the debtor or the cedent, in whose favour it was stipulated'*.[1016] The court in *Paiges* also considered whether other principles in South African law could, when applied, render the restraint (against cession) invalid. The court considered whether the restraint was contrary to public policy[1017] and whether a trader who provides credit in reliance on the common law of cession would be prejudiced by a contract to which he was not a party.[1018] Scott criticises the *Paiges* judgment on a number of grounds,[1019] including that the court relied on Sande and Voet, Frisian and Roman-Dutch jurists, to decide on the validity of the *pactum*, whilst the court relied on the views of Bernhard Windscheid, a German jurist and a member of the Pandectist school of law, to discuss the effect of such agreements. Scott states persuasively that the court should have followed Sande and Voet regarding not only the validity of the *pactum* but also its effect.[1020] Perhaps the point is that the court should have adopted a consistent methodology in the use and application of legal sources.

In 1968, in *Trust Bank*, Botha J held that circumstances would determine the effect of a *pactum de non cedendo.* Voet[1021] and Sande,[1022] held Botha J as part of his *ratio*, were of the view that an agreement whereby an owner deprived himself of the right to deal freely with his property was without effect unless the restriction served an interest of the other party. However, the learned judge drew a distinction between a right upon which this restriction was imposed (an existing right), and a right created with a restriction against alienation (a right created as a non-transferable right). The so-called interest requirement discussed here applied only in the former case, not the latter. Lubbe states that the restriction can be made subject to qualifications.[1023]

[1012] Ibid 615.
[1013] *De Prohibita rerum Alienatione* 4.1.1, 4.2.1.
[1014] *Commentarius ad Pandectas* 2.14.20.
[1015] *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600.
[1016] Lubbe 'Cession' *LAWSA* (2013) para 164.
[1017] *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600 at 615.
[1018] Ibid 616.
[1019] *Scott on Cession* (2018) 198–202 para 5.3.2.
[1020] Ibid 201 para 5.3.2.
[1021] Voet 2.14.20.
[1022] Sande *Restraints* 4.1.1 and 4.2.1.
[1023] Lubbe 'Cession' *LAWSA* (2013) para 164.

In 1980, in *Vawda v Vawda and Others*,[1024] the Transvaal Provincial Division of the High Court, in considering a deed of cession, held that if no advantage accrues to the other party from an agreement that takes away the owner's free right to deal with his property, then the agreement is of no effect. If, however, one can demonstrate that the agreement serves a useful purpose to the debtor, then it is valid. Absent a useful purpose, an agreement that restricts the owner from dealing with his property was useless. The court held that such an agreement had no *causa* that supported the agreement. The court stated that utility demanded that parties could not conclude agreements that *'impede all commerce and take away from us without consideration the use of our property'*.[1025] The court in *Vawda* relied on *inter alia* the works of Sande, *Paiges v Van Ryn Gold Mines Estates Ltd*[1026] and *Trust Bank*[1027] for this conclusion.

The court in *Capespan*, relying on the *Paiges* judgment,[1028] upheld the distinction between a voluntary cession and the vesting of a right in an insolvent estate in a trustee, stating that the latter must not be treated as a cession. The right had vested in the trustee by the operation of insolvency legislation.[1029]

In *Paiges* the court held that the interest requirement meant that if the interest stipulation *'can be shown to serve a useful purpose to the debtor, it is valid and binding upon the parties to the contract'*.[1030] The court failed to explain the depth or scope of such interest that the debtor must be able to demonstrate. The rationale that an agreement that restricts the cession of an existing right is invalid unless the party in whose favour it is created has an interest in the restriction is, according to Scott, based on the property law principle that *res in commercio* should not be withdrawn from commercial transactions unless the interest aforesaid exists.[1031] I submit that Scott's view makes sense. The view that an agreement that restricts the cession of a right created as a non-transferable right is valid *ab initio* is based on the principle of freedom of contract.[1032]

The *Paiges* interest requirement has been criticised by academic writers. De Wet and Van Wyk hold that the contracting parties can agree that the personal right that originates from the contract cannot be ceded. However, they hold that there is no convincing authority that justifies the interest requirement in *Paiges*.[1033] Scott analyses Sande and Voet, on whom the *Paiges* decision relies heavily, and concludes that the debtor must have an interest in the restriction against cession, and then tests the conclusion in *Paiges* that the debtor must have such an interest. She contends that Sande opined on prohibiting the disposal of things and *'an agreement, which hinders the dealing in res in commercio without*

[1024] *Vawda v Vawda and Others* 1980 (2) SA 342 (T).
[1025] Ibid 346.
[1026] *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600 at 615.
[1027] *Trust Bank of Africa Limited v Standard Bank of South Africa Limited* 1968 (3) SA 166 (A).
[1028] *Paiges v Van Rhyn Gold Mines Estates Ltd* 1920 AD 600. This judgment is regarded by many subsequent judgments and academic writers as the *locus classicus* on the subject of *pacta de non cedendo.*
[1029] *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C) at 513.
[1030] *Paiges v Van Rhyn Gold Mines Estates Ltd* 1920 AD 600 at 615.
[1031] *Scott on Cession* (2018) 204; *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C). In *Capespan* the court also approved of Scott's views on a *pactum de non cedendo.*
[1032] Ibid.
[1033] De Wet & Van Wyk *Kontraktereg* (1992) 254 and n 16, where the learned authors hold that, in respect of the qualification that the debtor must have an interest in the limitation, *'bestaan daar geen oortuigende gesag nie'.*

cause and deprives the owner of the use of their property, does not have a binding effect'.[1034] Voet held that an agreement that deprives an owner of its control and discretion over its property had no effect.[1035] Scott states that Sande and Voet were in fact referring to restraints on the alienation of corporeal property, not incorporeal property. They were therefore referring to the *pacta de non aliendo* and not the *pacta de non cedendo*.[1036] Sunkel endorses Scott's criticism that *Paiges* was based on an incorrect interpretation of Sande and Voet,[1037] and criticises the law governing *pacta de non cedendo* as *'convoluted and out of touch with modern trends and in need of a fresh perspective'*.[1038] Hutchison criticises the distinction between a *pactum de non cedendo* restraint imposed on created rights and existing rights as being artificial and misleading.[1039] The preferred distinction, states Hutchison, is the one drawn between a debtor and creditor, and between a cedent and cessionary. Hutchison further criticises the law on restraints on cession as being *'unsatisfactory and out of line with developments in other jurisdictions'* because prohibiting the transferability of claims impedes commerce.[1040] This view is in line with the views expressed by Sande. In this regard, Hutchison notes that because agreements that restrain cession are so problematic, Article 9 of the Uniform Commercial Code in American law has outlawed such restraint in respect of the assignment of book debts, which are used in factoring and securitisation transactions.[1041] However, I do not intend to deal with the numerous valuable proposals by different authors about how to reform the law on *pacta de non cedendo* here. Rather, I will examine its application to the security interests typically created in respect of a *mutuum.*

I will now consider the application of the *pactum de non cedendo* to a secured *mutuum.* It is significant that the judgments analysed do not stipulate the nature of the interest that the other party must have in the restriction or prohibition on existing rights.[1042] Provided that the other party can demonstrate a clear interest in the restriction or prohibition on an existing right, the requirement is met, and the *pactum* in respect of existing rights is valid.

The *pactum de non cedendo* in a secured *mutuum* typically consists of the parties agreeing that the cedent (the borrower) is prohibited from ceding its rights constituted in the finance documents to third parties.[1043] The constituted rights include the cedent's right to borrow money and the right to require the cessionary (the lender) to receive repayment of the loan. In terms of the common law, if the prohibition against cession applies to rights constituted in agreements, then such rights are incapable of transfer since the prohibition operates *ab initio*, and the cessionary in whose favour the prohibition is created is relieved

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[1034] *Scott on Cession* (2018) 198 para 5.3.2.
[1035] Ibid.
[1036] Ibid.
[1037] Sunkel '*Pactum De Non Cedendo*' 2010 *Stellenbosch Law Review* 465 and n 25.
[1038] Ibid.
[1039] Hutchison 'Agreements in Restraint of Cession' 2016 *Stellenbosch Law Review* 273 and 288.
[1040] Ibid 290.
[1041] Ibid 274. For a comprehensive academic treatise on securitisation in South African law, see Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008).
[1042] However, the court in *Capespan* noted that the court in *Vawda* had held that the seller of immovable property had a *'material and reasonable interest in the prohibition against cession, a requirement which goes further than Professor Scott's proposition, but which, for the purposes of the present case, it is not necessary to consider'* (at 517).
[1043] The term *'finance documents'* is defined in n 582.

from needing to demonstrate an interest therein for it to constitute a valid prohibition. The rationale for the interest requirement not applying is presumably that since the constituted rights are inherently incapable of transfer, there is no point in requiring the party in whose favour the restriction applies to fulfil the interest requirement by demonstrating a clear interest in the restriction or prohibition.

The *pactum* will typically, in agreements creating security interests to secure the repayment of a loan, prohibit the cedent (the borrower) from ceding its existing personal rights in the principal debt ceded in security to third parties. Given that the cedent would, in the security agreements, already have ceded its rights in the existing principal debt as security for the secured debt, the prohibition against cession effectively means that the cedent cannot cede what remains, namely, its reversionary interests therein.[1044] These include the cedent's reversionary rights in its book debts, credit balances, shares and insurance policies. The cessionary in whose favour the prohibition is created must demonstrate an interest in the prohibition for it to be valid. Our courts have not explained the depth, nature or scope of such interest. The cessionary's interest, and the reason for the prohibition, is that the cession agreement typically states that if the cession *in securitatem debiti* of the principal debt fails for some reason, the cession will operate as a cession *in securitatem debiti* of the cedent's reversionary rights in the principal debt.[1045] The prohibition against the cedent ceding its reversionary interests reserves the reversionary interest for future use by the cessionary as security in case the original cession fails, and prevents other creditors from becoming secured creditors in respect of the same principal debt in which the cessionary holds its security. I submit that these reasons constitute sufficient interest, as required under present law, to render the restriction on the cession of existing rights in this context valid.

Does one principle trump or limit the other? In current South African law, the common-law position that a restriction on the cession of an existing right is invalid unless the party in whose favour it is created has an interest in the restriction limits the principle that the parties are free to contract as they wish, because an external condition is imposed on their freedom to contract. This does not trump the freedom to contract, but imposes a condition on it, which, if complied with, binds the parties to the *pactum.* In a *mutuum* secured by a cession *in securitatem debiti* of personal rights, the effective restriction on the cedent ceding its reversionary interests impedes commerce by removing the reversionary interests from the market for the duration of the cession. In other words, the cedent is effectively contractually prohibited from ceding its reversionary rights to raise capital. Therefore, a cedent is deprived of the opportunity to raise capital and a prospective lender is deprived of the opportunity of lending. However, the *pactum* protects the cessionary's (the lender's) interests in the ceded personal rights.

[1044] A purported subsequent cession in security by a cedent of a personal right previously ceded would be legally ineffective as the right of action would already have been transferred in security.

[1045] The nature of reversionary interests is analysed in section 6.6 *The pledge theory*, under the heading *The theoretical nature of cession in securitatem debiti under the pledge theory.*

5.7 The fruits of a ceded right

I now consider whether the fruits of rights ceded *in securitatem debiti* are ceded along with the right when the right is ceded, and who in law is responsible to account for, collect and preserve the fruits arising from the right. These issues are often neglected in academic works even though they are significant in both theory and in practice.

In South African law fruits are divided into natural fruits and civil fruits.[1046] Natural fruits are created from fruit-bearing things such as animals or the earth.[1047] Fruits should be distinguished from rights that are accessory to the core right.[1048] Civil fruits are born of ownership of things or transacting with it. Fruits can be separated from the principal thing and have a legal existence that is independent of the principal thing.[1049] Once the fruits can be distinguished from the principal thing, the owner (of the principal thing) acquires ownership of the fruits.[1050] A dispossessed owner can use the *rei vindicatio* to reclaim possession.[1051] Fruits are, in my opinion, therefore a *specie* of property separate from the principal thing as they are distinguishable from it and have an identity of their own. It is market practice in South Africa to require a security cession of not only the incorporeal rights but also the fruits. Absent a bond over, or pledge and cession *in securitatem debiti* of, fruits, in theory at least, fruits of the thing are free of the encumbrance over the original right. Practically though, it is difficult to separate the encumbrance over the original right from its fruits.[1052] The UN Guide in fact indicates that many countries laws protect fruits from *'automatic re-encumbering under the security agreement'* which helps the grantor to use such fruits to raise additional funding.[1053] On the other hand, other countries automatically encumber the fruits under the original encumbrance as the parties would expect it to be included.[1054]

In the case of accounts and debtors' books the fruit is usually interest, whilst shares bear economic benefits such as dividends and voting rights. The fruits of insurance policies are the benefits arising from the policy, such as the right to, or the claim for, the payment of insurance proceeds on the occurrence of an insurable event, and sometimes a claim for cash payment if no claim was filed for a stipulated period of time. Scott states that the person entitled to enforce the right to claim the proceeds of a life insurance policy on the death of the insured is (i) the insured's estate if the insured and the insured life are the same person and no beneficiary was appointed; (ii) the insured if the insured and the insured life are not the same person and no beneficiary was appointed; or (iii) the beneficiary if one was appointed and that beneficiary accepted the benefit. In this latter case, Scott indicates that, in terms of case law, the right to claim the proceeds of the policy

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[1046] Van der Merwe 'Things' *LAWSA* vol 27 2 ed (2014) para 58.
[1047] Ibid. Further legal distinctions in respect of natural fruits are not relevant to this thesis.
[1048] Lubbe *Contract: General Principles* (2020) 513–514 para 13.23 and n 152 where Lubbe cites as examples of accessory rights, *inter alia,* a right to determine performance or a power to cancel a contract on account of breach.
[1049] Van der Merwe 'Things' *LAWSA* vol 27 2 ed (2014) para 58.
[1050] Ibid.
[1051] Ibid.
[1052] This is based on the fact that fruits acquire their own independent legal existence.
[1053] UN Guide, Chapter VI, Rights and obligations of the parties to a security agreement, A. General remarks, 5. Typical non-mandatory pre-default rules (c) Non-mandatory rules where the grantor is in possession at 251–252 para 62.
[1054] Ibid.

did not form part of the insured's estate.[1055] In law, the fruits accrue to the owner of the personal rights, who will, in the case of insurance policies be the insured and, possibly, the persons in (i), (ii) and (iii) above.

In 2008, in *Bisnath NO v ABSA Bank Ltd; ABSA Bank Limited v Bisnath and Another*,[1056] the Supreme Court of Appeal dealt with this issue in the context of a rental enterprise. The principle may be applied to rights in incorporeals. The appellants' case was that the bank as mortgagee, being in possession of the trust's fully let student residence after executing against the residence in fulfilment of debt owed under a default judgment, should have collected the rental income. If the bank had collected the rent, the judgment debt would have been settled, and the property was therefore incorrectly declared executable. The legal question that arose was whose obligation it was to collect the rent, or the fruits of the (mortgaged) property. The court quoted with approval the statement of law by Innes CJ in *Freeman Cohen's Consolidated Ltd v General Mining and Finance Corporation Ltd*:[1057]

> *The pledgee is bound not only to take care of the pledged property, but to render an account of any fruits or profits derived from it. The rule is thus expressed in the Code (4, 24, 1): Ex pignori percepti fructus imputantur in debitum, et si sufficiunt ad totum debitum, tollitur actio et reditur pignus. The profits received from the pledged thing are to go in account against the debt. If they are sufficient to wipe out the whole of the debt the action is at an end, and the pledge must be returned. In commenting on that rule Grotius (Introduction, 3, 8, 5) says: 'With respect to the fruits or profits of the property pledged, the pledgee must give them up or carry them to account in reduction of the debt' and Pothier, in his treatise on Namptissements (sec. 35, p. 680), is to the same effect.*

The court held that a mortgagee does not bear the same responsibility as a pledgee in respect of the fruits of the mortgaged property, as the mortgagee is ordinarily not in possession of the mortgaged property. In contrast, as a pledgee is ordinarily in possession of the pledged property, it is the pledgee's obligation to account for the fruits. If it is alleged that the mortgagee was in possession of the mortgaged property, then this must be proven on the facts. On the facts of the case, the court concluded that the appellants failed to prove that the bank (as mortgagee) was in possession of the property. The appeal on this issue accordingly failed. The implication is that if the appellant had led evidence to prove that the bank was in possession of the let student residence, the appeal may well have succeeded, as the bank would then have been in a position to collect the rent, and would therefore have been obliged to collect the rent. The court held that the onus of proving that the bank as mortgagee was in possession of the property and thus obliged to collect the rent (fruits)

[1055] Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 95–96.

[1056] *Bisnath NO v ABSA Bank Ltd; ABSA Bank Limited v Bisnath and Another* [2008] 3 All SA 219 (SCA).

[1057] *Freeman Cohen's Consolidated Ltd v General Mining and Finance Corporation Ltd* 1907 TS 224 at 226. The court also quoted with approval the statement of Ward J in *Judes v SA Breweries Ltd* 1922 WLD 1 at 8:

> *'Under the Roman-Dutch law the pledgee has to take care of the property pledged and he must account for the fruits (Grotius 3.8.4; Voet, XIII. 7.4) ... According to the [C]ode IV. 24.3 the creditor is bound to account for the fruits gathered and those which should have been gathered. Donellus De Pignoribus et Hypothecis IX. 1. (Vol. VI., page 998) says: "Quin etiam judicio pignoratitio percipere eos cogitur ex fide bona, ne res apud eum otiosa et sine fructu maneat, et debitori vacet." ... I take the law to be that the onus is on the plaintiff [the successor in title to the rights of the debtor] to show that there has been loss incurred.'*

was borne by the party alleging it.[1058]

Voet included in the law governing the pledge of movable property the fruits that accrue to the pledged article, and also things accessory to the pledged article (for example, a usufruct subsequently accreted to a mortgaged proprietary right). He also included what is made from the pledged article, provided it is possible to reduce the new form to its original material (for example, goblets made of pledged gold or silver).[1059] Thus, according to Voet, the scope is wider than only the fruits, and includes things accessory to or made from the pledged article. The pledgee's duty to preserve and account for the fruits will therefore extend to things accessory thereto and what is made from the pledged article. Although one could try to apply the same principle to cession, it is difficult to see practically what could be *'accessory to'* or *'made from'*, as opposed to being *'fruits of',* personal rights to accounts, debtors' books, shares and insurances.

It is submitted that the question as to whether the cessionary of personal rights acquires a duty to account for, collect and preserve the fruits arising from the right can be answered in one of two ways.

In a cession *in securitatem debiti* the cessionary of accounts, debtors' books, shares (sometimes) and insurances is, like the mortgagee, but unlike the pledgee, typically not in physical possession of any documentation constituting or evidencing the personal right for the duration of the cession, unless the parties have agreed otherwise. However, as far as shares are concerned, it is market practice in South Africa for lenders who take security over shares that are evidenced in certificates to hold the original share certificates and blank securities transfer forms in trust, until the secured debt has been repaid. On this basis, the cessionary can be liable to account for, collect or preserve the fruits of the object of the cession. This is the position even if the obligationary agreement states (as it usually does) that, despite the cession, the cedent will be entitled to the benefits arising from the shares.

It has furthermore been held that a cession *in securitatem debiti* of a personal right establishes the cessionary as the *quasi*-possessor of the right as soon as the cession is effective, much in the same way as the pledgee acquires possession of the pledged article on its delivery.[1060] This is a fiction since it is clearly not possible to possess a right. However, as the cessionary is the *quasi*-possessor of the right, it can be contended that the cessionary, like the pledgee in possession of the pledged article, thereby attracts a duty to account for, collect and preserve the fruits arising from the right in its 'possession'. This is the position even if the obligationary agreement states (as it usually does) that, despite the cession, the cedent will be entitled to the benefits arising from the shares. *Bisnath*

[1058] *Bisnath NO v ABSA Bank Ltd; ABSA Bank Limited v Bisnath and Another* [2008] 3 All SA 219 (SCA) para 25.
[1059] Berwick *Commentary on the Pandects* (1902) 266–304 in the chapter titled *Lib. XX Tit.I. Of Pledges and Hypothecs;- How they are Contracted;- And of the Pacts Annexed to Them.* Voet distinguishes between the scenario where the fruits have been *'gathered'* before or after *litis contestatio,* saying that if they are gathered after *litis contestatio* the fruits are security if the thing pledged is worth less than the debt. If they are gathered before *litis contestatio* the fruits do fall within the pledge save if they are extant and the thing pledged is less than the debt (the words used are *'principal thing is insufficient'*).
[1060] *Gunman and Another v Latib* 1965 (4) SA 715 (A) at 722C–E.

established that the party who alleges that the other party should have collected the fruits of the property held in security because it was in possession of the pledged property must prove such possession, based on the principle that he or she who alleges must prove.[1061] Therefore, a cedent alleging that a cessionary was the *quasi*-possessor of the right and should consequently have collected the principal debt (that was the subject of the right) will have to prove the cessionary's *quasi*-possession and consequential duty to collect the principal debt. This may prove to be somewhat difficult given that in a cession *in securitatem debiti*, the cessionary is by the cession itself already in *quasi*-possession of the right. It seems then that the cedent will have to prove that the cession was legally valid and will thereby automatically prove the *quasi*-possession. The UN Model Law adopts a similar approach in that a grantor or secured creditor in possession of the encumbered asset must exercise reasonable care to preserve the asset.[1062]

The security rights that secure a secured *mutuum* in the form of a term loan facility, or a revolving loan facility, are often in practice held for lengthy periods over a number of years. It is inevitable that in that time, fruits will accrue from the principal thing ceded *in securitatem debiti* in favour of the Security SPV or lenders directly. For this reason the lenders as cessionaries ought to be aware of the law governing the cession *in securitatem debiti* of the fruits of rights, and their obligations in respect of such fruits.

[1061] *Bisnath NO v ABSA Bank Ltd; ABSA Bank Limited v Bisnath and Another* [2008] 3 All SA 219 (SCA). The pledged property in *Bisnath* was a student residence that was let.
[1062] Chapter IV of the UN Model Law titled *Rights and obligations of the parties and third-party obligors*, Art 53.

6 Chapter Six: The Law of Cession *in Securitatem Debiti*

The general principles applicable to cession, its legal nature, the legal requirements for a valid cession *in securitatem debiti*, the difference between out-and-out cession and cession *in securitatem debiti*, and related issues were discussed and analysed in chapter 5.

I will now examine the concept that rights can be used as security for debt, followed by a discussion of notice to the principal debtor, an introduction of the competing theories that underpin cession *in securitatem debiti*, and a review of the case law to demonstrate the nature of the competing theories and the courts' vacillation between the theories, which continued until a watershed 2009 judgment settled the vacillation. The *pactum fiduciae* theory, the pledge theory, the intricacies of their operation, the criticisms, and the theoretical problems that arise from the pledge theory will be analysed in detail. I will establish which of the two theories is theoretically sound as a form of security generally, and specifically as security for a *mutuum*.

6.1 Rights as security for a debt

The discussion of rights as security for the obligation to repay a debt is in effect a discussion of the object of cession *in securitatem debiti.*

In South African law, the general principle is that rights can be freely ceded as security unless common-law, statutory or contractual restrictions apply.[1063] Personal rights such as rights against debtors in respect of book debts, rights to bank accounts, rights to shares or rights in insurance policies (all classified as the principal debt) can be ceded as security for the obligation to repay a debt.[1064] A cedent's personal rights in book debts, bank accounts and insurance policies are effectively the right to require payment of money, and are the object of the security. In the case of a bank account, it is the cedent's claim, in its capacity as the account holder, against a bank to pay the cedent the credit balance in its account. In the case of book debts, it is the cedent's claim, in its capacity as the creditor, against its debtors to pay the cedent the amounts due for services rendered or goods sold and delivered. In the case of insurance policies, it is the cedent's claim, in its capacity as the insured, against its insurer to an insurance pay-out.

However, a cedent's personal rights to a share in a company is different to a cedent's right to require payment of money. A share was judicially defined in the 1983 leading case of *Standard Bank of SA Ltd v Ocean Commodities Inc* as a *'bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends'*.[1065] The origin of this description is to be found in the 1909 judgment in *Randfontein Estates Ltd v The Master*[1066] where Innes CJ described shares as *'simply*

[1063] De Wet & Van Wyk *Kontraktereg* (1992) 415–416; Lubbe 'Cession' *LAWSA* (2013) para 179; Lubbe *Contract: General Principles* (2020) 513 para 13.23, 518 para 13.30, 520 para 13.34 and 539 para 13.62.
[1064] Sande *Cession of Actions* (1906) ch II under the heading *In how many various ways cession may be correctly effected* 14–16; *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 at 246; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA); De Wet & Van Wyk *Kontraktereg* (1992) 415–416; Lubbe 'Cession' *LAWSA* (2013) para 179; Lubbe *Contract: General Principles* (2020) 539–540 para 13.62; Scott 'Object of Cession' 1996 *Journal of South African Law* 812; Brits *Real Security Law* (2016) 273–274; Silberberg and Schoeman's *The Law of Property* 6 ed (2019) para 16.6.1.
[1065] *Standard Bank of SA Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A) at 288H.
[1066] *Randfontein Estates Ltd v The Master* 1909 TS 978.

rights of action – jura in personam – entitling their owner to a certain interest in a company, its assets and dividends'.[1067] This approach was adopted in later judgments, where the courts distinguished between the right of action in a share and passing ownership in a share by cession of that right of action.[1068] The cedent's *jura in personam* in the shares entitles the cedent, in its capacity as a shareholder, to a claim against the company (the issuer) to pay the cedent the amounts due to it by virtue of its shareholding in the company and to voting rights attached to shares. A cedent who wishes to use its rights to shares in a company as security for a *mutuum* must therefore cede its right(s) of action in the shares to the cessionary.

In *Grobler v Oosthuizen*[1069] the Supreme Court of Appeal confirmed the longstanding practice that one debt, the principal debt, could be used to secure another, the secured debt. The court in *Grobler* did not discuss what type of debt can be used to secure another debt. The case law on the meaning of *'debt'* is not of much help in deciding what type of debt the court in *Grobler* meant can secure another debt. In *Glen Anil*,[1070] for example, the Appellate Division defined *'debt'* in section 88 of the Insolvency Act narrowly as a firm obligation to pay, whether now or later, and held that it excluded a conditional liability, whilst in *Barnett*[1071] the Appellate Division defined *'debt'* as having a general and wide meaning, which may include an obligation to do something or to refrain from doing something.[1072] Since the dispute in *Grobler* was about a pay-out under an insurance policy that was ceded to the seller to secure payment of a purchase price for immovable property, it is safe to assume that when the court stated that one debt (the principal debt) can be used to secure the payment of another debt (the secured debt), it used the term *'debt'* as meaning a monetary debt.[1073]

A personal right gives rise to a claim. Scott, in her discussion of the cession of rights to life insurance policies and later in her 2018 book,[1074] states that the object of a cession is a claim or a personal right. A claim or a personal right, according to Scott, originates from an obligation, which in turn arises from a contract, delict or other cause. An abstract personal legal tie between a creditor, who is entitled to a particular performance against a debtor, who is under a duty to render performance, is the source of an obligation.

Unfortunately, South African case law does not have a consistent technical description of the object of cession *in securitatem debiti* of personal rights, and it is therefore described in different ways. Scott provides a summary of the different descriptions used by our courts

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[1067] Ibid 981.
[1068] *Scott on Cession* (2018) 225 para 6.2.3.2 and the authorities cited in n 111; *Farrar's Estate v Commissioner for Inland Revenue* 1926 TPD 501 at 508; *Liquidators Union Share Agency v Hatton* 1927 AD 240 at 251; *Richter NO v Riverside Estates (Pty) Ltd* 1946 OPD 209 at 224; *Suid-Afrikaanse Vroue Federasie, Transvaal v Thackwray NO en Andere* 1968 (1) SA 168 (T) at 175.
[1069] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 15. See also Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 100, para 3.4 where she states that all claims (personal rights) can be ceded unless such cession is prohibited by statute or agreement.
[1070] *Joint Liquidators of Glen Anil Development Corporation Ltd (In Liquidation) v Hill Samuel (SA) Ltd* 1982 (1) SA 103 (A).
[1071] *Barnett and Others v Minister of Land Affairs and Others* 2007 (6) SA 313 (SCA).
[1072] In chapter 4 *Security for Loans*, in the discussion on debt and security, I analyse the different meanings of *'debt'*.
[1073] In law, the term *'debt'* could mean, for insolvency law purposes, a monetary debt owed, or, for prescription law purposes, an obligation to do or refrain from doing something. See the analysis of the term *'debt'* in section 4.3 *Debt*.
[1074] *Scott on Cession* (2018).

in this regard up until 1996.[1075] The different descriptions used by our courts are *'cession of actions', 'cession of rights of action', 'cession of rights', 'cession of incorporeal things'* and *'cession of incorporeal rights'*.[1076] The indiscriminate use of terms to describe the object of cession may lead to legal uncertainty about what is ceded and has been criticised for a number of reasons, including *inter alia* that it blurs the distinction between the competing theories and does not contribute to clarity in the law.[1077] In English law, a similar problem exists in relation to security over a debt or fund, where the terms *'charge'* or *'mortgage'* are used interchangeably.[1078]

Describing the cession *in securitatem debiti* of personal rights in very wide terms, as happens in practice, may also result in the parties to the cession disputing the ambit of the cession. *Coopers & Lybrand and Others v Bryant*[1079] is a case in point, where the cession by the cedent, Mr Bryant, of his rights, title and interest to all book debts, other debts and claims of whatsoever nature, present and future, resulted in a dispute as to whether this included his claims against his auditors for breach of contract. I submit that lawyers in practice should avoid describing the cession *in securitatem debiti* of personal rights in very wide terms without providing examples of the types of claims ceded if all debts are ceded in security.[1080]

Incorrectly describing the object of a cession *in securitatem debiti* as the cession *in securitatem debiti* of book debts or insurance policies has also been criticised.[1081] Scott states that, in the former case, the correct description is a *'transfer of the claims to payment of the debts or book debts'*[1082] whilst in the latter case the correct description is the *'right to the proceeds of the policy',* and that neither the policy itself nor the contract is capable of cession, but the rights or claims to the proceeds of the policy are cedable.[1083] Recently, Scott described the cession of these as the cession of personal rights to book debts, shares or insurance policies.[1084] To this may be added the cession of personal rights to bank accounts or credit balances in bank accounts, which in practice are often ceded *in securitatem debiti*. I submit that Scott's descriptions are correct in law.

A *mutuum*, however, cannot be secured by pension annuities and benefits as these may not be ceded or pledged generally, which includes as security for a debt.[1085] Similarly, a debt cannot be secured by a statutory pension or right to a pension which may also not be ceded or pledged.[1086] A spouse's right to an accrual claim is, during the subsistence of a

[1075] Scott 'Object of Cession' 1996 *Journal of South African Law* 812.
[1076] Ibid 812–813.
[1077] Ibid 812. Also see Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 489, where he states: *'Die gebruik, ook deur die appèlhof, van onpresiese terminologie wat neig om die skeidslyn tussen die twee konstruksies te vervaag, dra ook nie tot helderheid omtrend die stand van ons regspraak by nie.'*
[1078] Gullifer *Legal Problems of Credit and Security* (2013) 37 para 1-56.
[1079] *Coopers & Lybrand and Others v Bryant* 1995 (3) SA 761 (A); Scott 'Object of Cession' 1996 *Journal of South African Law* 812 at 815.
[1080] A lawyer acting for a lender as cessionary is often caught between casting a cession *in securitatem debiti* as wide as possible to net all the cedent's rights, and being specific enough so that the terms of the cession are not found to be unenforceable due to vagueness.
[1081] Scott 'Object of Cession' 1996 *Journal of South African Law* 812.
[1082] Ibid 814.
[1083] Scott 'Cession of Insurance Rights' 2003 *Stellenbosch Law Review* 93 and 101.
[1084] *Scott on Cession* (2018) 139–141 para 5.2.1.
[1085] Section 2(1) and (2) of the General Pensions Act 29 of 1979.
[1086] Section 2 of the Statutory Pensions Protection Act 21 of 1962.

marriage, not capable of cession, including as security for a debt.[1087] The legal position regarding the cession of future rights has been discussed above.[1088]

Theoretical constructs differ as to both the basis on which personal rights are used as security, and which aspects of personal rights are ceded in security. I will briefly describe the two theories of cession *in securitatem debiti* to demonstrate the common factor that both theories are based on personal rights used as security for an obligation to repay a debt. The detailed descriptions of the theories are dealt with elsewhere in this chapter.

In terms of the *pactum fiduciae* theory of security cession, personal rights cannot be pledged in security but are ceded by the cedent out-and-out to the cessionary to secure repayment of the debt owed by the cedent to the cessionary (the secured debt). The cessionary thereby acquires legal title to the ceded personal rights and hence is substituted as the new creditor, subject to a condition that, once the secured debt is repaid, the cessionary must re-cede the personal right to the cedent. In terms of this theory, the entire right is ceded or transferred from the cedent's estate to the cessionary's estate, subject to the recession condition. The position is based on *inter alia* the assertion by De Wet and Van Wyk that a real right of pledge in a personal right, on which the pledge theory is based, was unknown in both Roman law and Roman-Dutch law.[1089]

In terms of the pledge theory of security cession, the cedent pledges to the cessionary its right of action in its personal right to secure repayment of the debt owed by the cedent to the cessionary (the secured debt), and the pledge is given effect to by cession *in securitatem debiti.* In terms of this theory, only the procedural aspect of the right, and not the entire right, is ceded or transferred from the cedent's estate to the cessionary's estate. The cedent retains the *dominium* or the reversionary interest in the right. The position is based on the authority of Voet, and is cited with approval in *Cohen's Trustee*.[1090]

The parties' intention in a cession *in securitatem debiti*, on both theoretical constructs, is for the cedent to provide credit support or security to the cessionary for its obligation to repay the secured debt, by the cedent conferring on the cessionary a limited right in the proceeds arising from its personal right. The proponents[1091] of both theories therefore advocate that a right can be used as security for the obligation to repay a debt, although they differ as to whether the entire right, or a component of the right, is used as security.

An important difference in the legal effect of the theories is that the cessionary, if the cessionary is the lender,[1092] is left in substantially different positions. In the *pactum fiduciae* theory, the lender as cessionary acquires the *dominium* in the personal right, whereas the

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[1087] Section 3(2) of the Matrimonial Property Act 88 of 1984.
[1088] See section 5.5 *The cession of future rights*.
[1089] The *pactum fiduciae* theory is analysed in detail in section 6.5 *The pactum fiduciae theory*. See De Wet & Van Wyk *Kontraktereg* (1992) 416.
[1090] The pledge theory is analysed in detail in section 6.6 *The pledge theory*. See Voet 20.3.1. Also see *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 at 246. *Cohen's Trustee* is analysed in section 6.4 *A review of the case law.*
[1091] Such as Scott and Lubbe, amongst others.
[1092] It is often the case in practice in a syndicated loan that a Security SPV company is used to house the security interests of the syndicate lenders. In this case, the Security SPV company, and not the lenders, is the cessionary in the security agreements.

pledge theory confers on the lender, as cessionary, a limited right in the ceded personal right proceeds.

The intention of the parties to a cession *in securitatem debiti* is different from their intention in an out-and-out cession, where the parties intend that the cedent will divest itself entirely of the right and all the components thereof and transfer the right in its entirety to the cessionary, for value received.

In a syndicated loan, the Security SPV holds all the security rights on behalf of the lenders, which include senior lenders and mezzanine lenders.[1093] The Security SPV as a cessionary would thus, under the *pactum fiduciae* theory, hold the entire personal right which it must re-cede to the cedent on settlement of the secured debt, whereas under the pledge theory it would hold the right of action in the ceded right. The number of senior lenders or mezzanine lenders that are parties to a loan does not alter this legal position of the Security SPV.

Controversial issues that arise from the pledge theory are whether personal rights can be owned, and whether personal rights are divisible, and if so, whether a component thereof can be transferred by cession *in securitatem debiti.* These and other aspects are analysed in section 6.7 (*Theoretical issues arising from the pledge theory*) below.

6.2 Notice to the principal debtor and performance

The principles regarding notice to the principal debtor of the cession and publicity are analysed in section 5.1.3 (*Notice of the cession to the principal debtor and performance including set-off*). In this section, the application of such principles to cession *in securitatem debiti* is analysed.

Notice to the principal debtor and its consent to the cession *in securitatem debiti* are typically conditions precedent of the security agreement.[1094] The obligation to notify the principal debtor and to obtain its consent to the cession *in securitatem debiti* is the cedent's, presumably because the principal contract is between the cedent and the principal debtor.[1095] The principal debtor typically consents to make payment to, or to perform non-monetary obligations in favour of, the cessionary on receipt of the cessionary's notice that the cedent has defaulted on a finance document.[1096] The principal debtor's consent ensures that the cessionary as the party entitled to payment in these circumstances will receive payment of the principal debtor's debt due to the cedent. However, banks as principal debtors may decline to accept the terms of a cession *in securitatem debiti* if doing so places the bank's interests at risk because, for example, the rights to the bank account held at that bank were already ceded *in securitatem debiti* to that bank by the cedent for its obligations

[1093] See section 4.11 *Security structure and security rights of syndicate lenders*.
[1094] The LMA's Term Facilities Agreement, clause 4 (*Conditions of utilisation*) read with clause 3(h) (*Finance documents*) of Part I (*Conditions precedent to initial utilisation*) of Schedule 2 (*Conditions precedent*). The security agreement typically has standard-form notices attached to it, which inform the principal debtor of the cession *in securitatem debiti* and which require its consent, which the cedent must dispatch to the principal debtor, and which the principal debtor must acknowledge, within stipulated time frames.
[1095] Ibid.
[1096] Ibid. This arises from the notice of acknowledgement of the cession *in securitatem debiti* signed by the principal debtor.

to the bank.[1097]

The fact that the right to enforce the principal debt (on the pledge construction), or that the entire right (on the *pactum fiduciae* construction) was by the cession *in securitatem debiti*, transferred to the cessionary, does not affect or absolve the principal debtor from performing its obligations. On the pledge construction, the principal debtor must render performance to the cedent according to the terms of its contract with the cedent, unless it receives a default notice from the cessionary, in which case the principal debtor must render performance to the cessionary. On the *pactum fiduciae* construction, the principal debtor must render performance to the cessionary as the effect of this construction is to assign the contract between the cedent and the principal debtor to the cessionary so that the cessionary takes over the cedent's position as creditor.[1098]

6.3 The competing theories of cession *in securitatem debiti*: The *pactum fiduciae* theory versus the pledge theory

The pledge theory and the *pactum fiduciae* theory each seek to explain the operation of cession in *securitatem debiti* in relation to the parties' rights and obligations.

The theoretical basis on which one debt can be ceded in *securitatem debiti* for another debt has been disputed by courts and academic writers for a very long time. Our courts have, over time, up until a watershed 2009 judgment, vacillated between the theories, with some courts preferring the pledge theory and other courts preferring the *pactum fiduciae* theory.[1099]

The opposing theories have remained the mainstay of differences of opinion and vacillation by the courts for almost 167 years (possibly longer), from *Sutherland v Elliot Bros*[1100] in 1842 (*'Sutherland'*), to *Rothschild v Lowndes*[1101] (*'Rothschild'*) in 1908 and *Grobler* in 2009. Importantly, in 2009, the Supreme Court of Appeal in *Grobler* laid this vexed debate to rest by ruling that the doctrinal foundation of cession in *securitatem debiti* is the pledge theory. However, the Supreme Court of Appeal did not abandon the *pactum fiduciae* theory altogether, and ruled that the parties to a security cession may choose this theory to construct their cession, and thus left the choice open.

Scott contends that the differences between the *pactum fiduciae* theory and the pledge theory are as follows. In the *pactum fiduciae* theory, the general principles of contract law determine the parties' legal positions, the right is transferred subject to the fiduciary agreement that determines the parties' contractual rights, and the fiduciary security agreement is the *causa* for the cession.[1102] The source of Scott's position for the latter two

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[1097] See the views expressed in *Van Staden* regarding these matters, which are analysed in section 5.1.3 *Notice of the cession to the principal debtor and performance including set-off.*
[1098] *Scott on Cession* (2018). The contrary view might be that, under the *pactum fiduciae* theory, the principal debtor must render performance to the cedent until the cessionary notifies the principal debtor to render performance to it (the cessionary) because the cedent is in default of a finance document.
[1099] Nienaber 'Security Cessions of Life Insurance Policies' (2004) 16 *South African Mercantile Law Journal* 83 at 84 para 2.1.
[1100] *Sutherland v Elliot Bros* (1842) 2 Menz 349.
[1101] *Rothschild v Lowndes* 1908 TS 493.
[1102] *Scott on Cession* (2018) 410 para 9.1.

aspects of the *pactum fiduciae* theory is German law, about which Scott writes extensively.[1103] In the pledge theory, the general principles of property law determine the parties' legal positions, *quasi*-possession (of a component part of the right) is transferred to the cessionary or pledgee, and the pledge is accessory.[1104]

6.4 A review of the case law

I will review the case law dealing with the two competing theories in chronological order to analyse the nature of the theories, and to lay the foundation for considering theoretical issues in the pledge theory. The theories form the bedrock upon which security interests in personal rights are founded in South African law, and thus directly affect the lenders' interests. The commercial and legal value of the theories as forms of security as expounded in the case law is considered, after the technical analysis of the case law, in sections 6.5 (*The pactum fiduciae theory*), 6.6 (*The pledge theory*), 6.7 (*Theoretical issues arising from the pledge theory*) and 6.8 (*Commercial considerations*).

Sutherland v Elliot Bros

In 1842, in *Sutherland v Elliot Brothers*,[1105] the Supreme Court of the Cape of Good Hope heard a claim for an order dealing with the cession *in securitatem debiti* of bonds. Sutherland loaned money to the Elliot Brothers, who placed Sutherland in possession of certain bonds due to them and endorsed a cession *in securitatem debiti* thereon in Sutherland's favour. In terms of the cession, the Elliot Brothers ceded their right, title and interest in the bond of J.N. Wood for the sum of £130 with interest thereon from 9 October 1839 and bound themselves as sureties and principal debtors *in solidum* for the payment of any deficiency if J.N. Wood became insolvent. The court held that the cession had the effect of vesting all rights and title to the bonds in the cessionary, and Sutherland, subject to an equitable right in favour of the Elliots' trustees, could use the sums realised to settle the Elliots' debt. Once the debt was settled, held the court, Sutherland had to re-transfer the remaining bonds to the trustees.[1106] This approach was adopted in *Rothschild* in 1908 and refined.

Rothschild v Lowndes

In 1908, in *Rothschild v Lowndes*,[1107] the Supreme Court of the Transvaal heard an appeal against an order setting aside two petitions involving the attachment of proceeds arising from the disposal of certain mining rights on the basis that there had been a cession by one Sharp to Lowndes of Sharp's rights against one Hollins. The court considered the nature of a disputed out-and-out cession by Sharp of his rights to one-quarter of Hollins' net proceeds in return for an undertaking by Lowndes to discharge a bill of exchange, payment of which Rothschild was demanding, it being contended that it was in truth a pledge given

[1103] Ibid. See 410 nn 9 and 10 where Scott's German sources are referenced.
[1104] Ibid.
[1105] *Sutherland v Elliot Bros* (1842) 2 Menz 349.
[1106] Ibid 350.
[1107] *Rothschild v Lowndes* 1908 TS 493.

in security. If it was a security cession, then Sharp would have a legal claim against Hollins that could be attached. In considering the nature of cession in *securitatem debiti,* the court held that in the case of mortgage or pledge of corporeal property, *dominium* in the pledged asset remained with the mortgagor or pledgor, although it conferred rights on the pledgee to have his claim satisfied out of the proceeds of the pledged asset.[1108] In the case of pledge of incorporeal property, legal ownership of the ceded debt vested in the cessionary without the need to notify the debtor.[1109] The court also held:

> *The title of the cedent has passed away from him; and while the cession stands, the cessionary is the dominus of the right. There is ample authority for these propositions (Voet, 18, 4, 15; Sande, Cession of Actions, c. 9, sec. 1; Burge, vol. 3 p. 548, &c.).*
>
> *…*
>
> *The matter, therefore, stands in this way. The cession of a right of action in securitatem debiti transfers that right to the cessionary as completely, so far as third parties are concerned, as an absolute cession would do. While the cession stands no right remains vested in the cedent which he can enforce against the debtor. His remedy is against the cessionary for payment of the balance, or for cancellation of the cession*.[1110]

The court held that the effect of the security cession was that Sharp had transferred his rights against Hollins to Lowndes, and Sharp therefore had no rights to cede. The attachment, and the attachment granted in execution, were rightly set aside by the court *a quo.* The court noted, though, that if the cession was in *securitatem debiti*, *'he possessed … very real rights against Lowndes … but those rights were not attached nor could they have been because the person against whom alone they were enforceable was not within the jurisdiction of the Court.'* In *Rothschild*, the court therefore held that in a cession *in securitatem debiti* the cedent's ownership in the ceded right passed completely to the cessionary, and the cedent's rights against the cessionary were for payment of the balance or cancellation of the cession.

National Bank of South Africa Ltd v Cohen's Trustee

In 1911, in *National Bank of South Africa Ltd v Cohen's Trustee*,[1111] Cohen had, as security for any indebtedness that the defendant might incur with its bank, passed a covering bond in favour of its bank for £450. The defendant specially bound property in Nylstroom and agreed to insure the buildings thereon for their full value, and to cede the insurance policy to the bank as collateral security for any debts due by the defendant to the bank. A fire occurred and, prior to payment of the loss, the insured became insolvent. Three days after insolvency, the insurer paid £800 to the bank. Lord de Villiers considered the *Rothschild* judgment that a person who cedes his right of action retains no attachable interest and noted that this position was formulated on the assumption that it was a *'simple cession and not a pledge'*. Lord de Villiers noted that Innes CJ in *Rothschild* had stated that mortgage

[1108] Ibid 498.
[1109] Ibid 499.
[1110] Ibid 499, 501.
[1111] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235.

or pledge does not transfer *dominium* in the pledged asset, and implied that, had the cession in *Rothschild* not been viewed as an out-and-out cession as it was, the court would not have held that *dominium* had gone out of the cedent, as it did. Lord de Villiers criticised *Rothschild* by stating that *'too much importance was attached to the form, and too little to the substance of such a transaction'*.[1112] The court then held as follows:

> *That a right of action can be pledged does not admit of a doubt (see Voet, 20, 3, 1). To make such a pledge effectual, the right of action is frequently ceded to the pledgee, but if the cession is made with the avowed object of only securing a debt owing by the cedent to the cessionary, it is, in my opinion, impossible to hold that the cession, whatever its form, takes the dominium out of the cedent.*[1113]

The court in *Cohen's Trustee* took a diametrically opposed view to the court in *Sutherland* and *Rothschild*, holding that *dominium* remained vested in the cedent until his insolvency, while the right of action was ceded in security to the cessionary.[1114] The court held that *'cession by way of pledge'* did not change the *'essential character of the transaction'*, namely, that it is a pledge.[1115]

The cornerstone of the *pactum fiduciae* theory is formed by *Sutherland* and *Rothschild*, which held that the cedent is divested of *dominium*, which vests entirely in the cessionary and that the cedent can claim payment of the balance of or cancellation of the cession. The cornerstone of the pledge theory is the judgment in *Cohen's Trustee*, which held that *dominium* remained vested in the cedent while the right of action was ceded in security to the cessionary.

Lief NO v Dettmann

In 1964, the Appellate Division in *Lief NO v Dettmann*[1116] heard an appeal against a judgment of the Witwatersrand Local Division dismissing exceptions taken in respect of six claims and alternative claims. The South African Board of Executors and Trust Co Limited ('the Board') was liquidated. The Board had acted as a lender using its clients' money to advance loans secured by mortgage bonds over immovable property, or the Board required loans on such security. The Board granted an investor a participation in a bond that was either registered or to be registered in the Board's name. Sometimes the Board would issue a certificate of participation that contained conditions attached to the grant. Using this method, the Board loaned money to a party secured by a mortgage bond, but a dispute arose. The court considered *inter alia* whether a mortgage bond was capable of cession without registration. The court held that a mortgage bond creates real rights in favour of the mortgagee over the mortgaged property, which are accessory to the debt and cannot be separated from the debt. This confirms the accessorial principle. The court held that the cession of real rights under a bond needed to be registered, but cession of the debt due

[1112] Ibid 246.
[1113] Ibid.
[1114] Ibid.
[1115] Ibid 253.
[1116] *Lief NO v Dettmann* 1964 (2) SA 252 (A).

under a bond requires no more than an agreement to cede. As no bond cessions were registered (in the Deeds Office) the plaintiff's claim to *'real rights'* in the bonds, or *'secured claims'* in respect of the proceeds thereof, could not succeed. Put differently, the court considered whether the cession of security (participation rights in the bond) without registration (in the Deeds Office) vitiates the cession of the debt.[1117] The court further held that a right of action could be furnished as security for a debt, the effect of which is to completely divest the cedent of any rights, which are vested in the cessionary. The cedent relies on his agreement with the cessionary that the right of action will be ceded back to him when his debt is discharged.[1118] The court in *Lief,* in what appears to be an *obiter dictum,* like the courts in *Sutherland* and *Rothschild,* thus preferred the *pactum fiduciae* theory over the pledge theory.

Trust Bank of Africa Limited v Standard Bank of South Africa Limited

In 1968, in *Trust Bank of Africa Limited v Standard Bank of South Africa Limited*,[1119] the Appellate Division heard an appeal against an order of the Transvaal Provincial Division given in favour of the respondent that, on presentation of eight deposit vouchers, the respondent was entitled to the appellant paying it ZAR3,400. The deposit vouchers had originally been ceded and pledged in security, and subsequently delivered, by one Mrs Davidoff, in favour of appellant, for credit facilities granted to her. She then fraudulently obtained possession of the deposit vouchers from the appellant and purported to again cede and pledge in security the very same deposit vouchers in favour of the respondent for further banking facilities granted to her. In the majority judgment delivered by Botha AJA, with whom Steyn CJ and Potgieter JA concurred, the court held that a right of action may be ceded to a creditor to secure a debt, coupled with an agreement that the cessionary is obliged to re-cede the right of action to the cedent on payment of the secured debt. The court then went on to hold that the effect of such a cession in *securitatem debiti 'is in all respects the same as that of an ordinary cession, but coupled with the agreement mentioned'*.[1120] The court clearly preferred the *pactum fiduciae* theory. Therefore, the court held that a cession in *securitatem debiti* takes the *dominium* out of the cedent completely, and vests it in the cessionary, coupled with the agreement mentioned. This had been the conclusion of the courts in *Sutherland* and *Rothschild* more than 60 years earlier.

The courts' vacillation about whether the *pactum fiduciae* theory or the pledge theory constitute the doctrinal foundation of cession in *securitatem debiti* is evident from the judgments discussed. In a minority judgment, Ogilvie-Thompson JA[1121] emphasised that the cessionary must retain possession of the written document evidencing the ceded right to *'preserve the efficacy of his cession against any possible subsequent competing*

[1117] Ibid 259–260.
[1118] Ibid 271.
[1119] *Trust Bank of Africa Limited v Standard Bank of South Africa Limited* 1968 (3) SA 166 (A).
[1120] Ibid 189. The court then went on to consider the legal effect of the deposit vouchers being endorsed *'neither transferable nor negotiable'* and concluded that these words had to be given their ordinary grammatical meaning, namely, that the rights under the vouchers could not be transferred in the only way they were capable of being transferred in law from one person to another, that is, by cession under the common law (at 191).
[1121] The other minority judgment was penned by Van Blerk JA.

cession'.[1122] In discussing the role of delivery or possession in a security cession, Ogilvie-Thompson JA noted the two competing theories of cession in *securitatem debiti*. He held that a pledgee of corporeal property loses his rights if he loses possession of the pledged property, and, in a cession of an incorporeal right, once the cedent has ceded the right of action he is divested of any rights so he has no rights to cede, whereas the pledgor of corporeal property retains ownership of the pledged property. He went on, however, to acknowledge the considerable authority (citing *inter alia* the *Cohen's Trustee* judgment) that a cession in *securitatem debiti* of an incorporeal right is distinct from an out-and-out cession in that South African law recognises that the cedent has residual *dominium* that approximates to the position of a pledgor. He noted that such residual *dominium* was tenuous and ill-defined.[1123]

Leyds NO v Noord-Westelike Kooperatiewe Landboumaatskappy Bpk en Andere

In 1985, in *Leyds NO v Noord-Westelike Kooperatiewe Landboumaatskappy Bpk en Andere*,[1124] the Appellate Division heard an appeal against the judgment of a full bench of the Transvaal Provincial Division that the cession *in securitatem debiti* of the respondents' claim for unpaid share capital to the Land Bank had divested the respondents thereof, that the claim had vested in the Land Bank, and that the respondents were therefore not liable to make a contribution. The Appellate Division held that in *Cohen's Trustee* the trustee of an insolvent estate of a cedent who had ceded his claim *in securitatem debiti* was entitled to recover and administer such claim on the basis that the *dominium* remained vested in the cedent. Accordingly, held the court, the respondents' claim ceded *in securitatem debiti* to the Land Bank remained vested in them as the *dominium* remained vested in them, consequently they were obliged to contribute share capital. The court held that the position in *Cohen's Trustee* was a *'useful approach which had been applied consistently for more than 70 years and which had not given rise to any practical problems or injustice'*.[1125] Whilst the full bench had adopted the *pactum fiduciae* theory, the Appellate Division adopted the pledge theory, and reversed the decision of the full bench. The appeal was upheld.

Marais en Andere NNO v Ruskin NO

Later in 1985, in *Marais en Andere NNO v Ruskin NO*,[1126] the Appellate Division heard an appeal against the judgment of a full bench of the Transvaal Provincial Division against the appellants as trustees of the Christiaan Lodewyk Moll Trust to pay ZAR88,730.40, with interest, to the respondent as curator of the insolvent estate of Christo Theo Moll. Moll had lent the trust the aforesaid amount for an indefinite period. In April 1982, Moll borrowed ZAR16,000 from one of the trustees, Marais. As security Moll ceded all rights to his loan account in the trust. In October 1982, Moll and his wife were divorced and in the divorce consent paper Moll ceded all his rights against the trust to his wife. On 19 April 1983, Moll

[1122] *Trust Bank of Africa Limited v Standard Bank of South Africa Limited* 1968 (3) SA 166 (A) at 185.
[1123] Ibid 186–187.
[1124] *Leyds NO v Noord-Westelike Kooperatiewe Landboumaatskappy Bpk en Andere* 1985 (2) SA 769 (A).
[1125] Ibid 770.
[1126] *Marais en Andere NNO v Ruskin NO* 1985 (4) SA 659 (A).

was declared insolvent. In September 1983, Ruskin repaid ZAR20,418.63 to Marais, being the ZAR16,000 capital Marais had loaned Moll plus interest. At Ruskin's request, Marais then re-ceded the claim Moll had ceded to Ruskin in his capacity as trustee of Moll's insolvent estate. Ruskin then asked the appellants to pay to him (Ruskin) ZAR88,730.40. The opinion of the trustees (the appellants) was that since Moll had ceded such claim to Mrs Moll in the divorce settlement, Ruskin was not entitled thereto. As appellants, the trustees contended that Moll had retained the *dominium* in his claim against the trust when he ceded it to Marais. The appellants contended that the reversionary right was capable of cession, and Moll had so ceded it to Mrs Moll as part of the divorce settlement. When Ruskin paid Moll's debt to Marais in September 1983, Mrs Moll had, by virtue of Moll's 3 October 1982 cession in her favour, become entitled to payment of the ZAR88,730.40. The appellants contended, in the alternative, that if it was found that Moll's cession to Marais was a complete cession of his claims against the trust, Moll acquired the right to a re-cession of such claims under the *pactum fiduciae* theory*,* which right arose at the time of the cession. Moll had ceded this right to the re-cession to Mrs Moll. The court *a quo* held that, on payment of the debt, a cedent's reversionary right arose, and that as Ruskin had repaid Moll's debt to Marais only in September 1983, Moll had no reversionary right on 3 October 1982 which he could have ceded to Mrs Moll. The Appellate Division held, without deciding, that even if the reversionary right was capable of cession, it was not so ceded because Mrs Moll had no knowledge of Moll's cession of his claims against the trust to Marais, and had no knowledge of Moll's reversionary right. The court held that Moll's reversionary right was a claim against Marais to claim re-cession of the claim he had ceded to Marais upon repayment of the debt; it was not a claim Moll had against the trust; and the rights that Moll ceded to Mrs Moll were rights against the trust, not Marais. I submit that this is incorrect in law, given the court's understanding of reversionary interest in *Grobler*.[1127] Ruskin, therefore, after payment of Moll's debt to Marais, became entitled to enforce Moll's claims against the trust. The appeal was dismissed, and the decision of the Transvaal Provincial Division was confirmed for different reasons.

Bank of Lisbon and South Africa Limited v The Master and Others

In 1987, in *Bank of Lisbon and South Africa Limited v The Master and Others*,[1128] the Appellate Division heard an appeal that required it to opine on *inter alia* the nature of a pledge and cession *in securitatem debiti* of the rights to book debts. The appellant was the creditor of a company in liquidation and relied for its claim on a cession of book debts *in securitatem debiti* (the second cession). However, prior to this, the company in liquidation had also ceded the same book debts *in securitatem debiti* to another creditor, Nedbank Limited (the first cession). The clause purporting to give effect to the second cession stated that, if the company had already ceded its rights to book debts *in securitatem debiti*, the second cession would operate as a cession of the company's reversionary interests therein. The appellant and the respondent disputed whether the costs of realising the

[1127] See the discussion of the *Grobler* judgment below.
[1128] *Bank of Lisbon and South Africa Limited v The Master and Others* 1987 (1) SA 276 (A).

appellant's security were costs occasioned by the liquidator's decision to complete the executory contracts to be deducted from sums due to the appellant. The liquidator initially viewed the appellant as a secured creditor, but then changed his mind, contending that the appellant was not a secured creditor because Nedbank, in its capacity as cessionary of the rights to book debts under the first cession, was in control of the book debts at the time of the second cession. The appellant then also conceded that it held no security, but still contended it was not liable for the costs occasioned by the completion of the executory contracts, as in its proof of claim it relied on its security; the costs of realising its security should not be confused with costs occasioned by the liquidator's decision to complete the executory contracts, which were costs of administration for which it was not liable. The Master thereupon ruled that, as the appellant conceded it did not have a secured claim, the appellant was a concurrent creditor in the insolvent estate, and it was therefore unnecessary for the Master to rule on whether or not he was liable as a secured creditor under the Insolvency Act. The appellant brought the Master's decision on review in the court of first instance, and in subsequent courts. The issue raised by the appellant regarding the second cession was this: the terms of the relevant clause 23 in the second cession rendered the bank a secured creditor, and therefore the Master's ruling could not stand. After reviewing the relevant case law, the court concluded as follows:

(i) the *Cohen's Trustee* decision was correct in law;

(ii) the *Rothschild's* position had been stated too widely, namely, that in a cession *in securitatem debiti* the cession of a right of action transferred the right as far as third parties are concerned as completely as an absolute cession would do, and that while the cession subsists, no right remains vested in the cedent, whose recourse is against the cessionary;

(iii) in the *Trust Bank* case the majority judgment was that a cession *in securitatem debiti* of incorporeal rights has the same effect as an out-and-out cession coupled with the cedent's right to claim that the cessionary re-cedes the right of action to him, but Ogilvie-Thompson's minority judgment acknowledged the position in *Cohen's Trustee* that *dominium* in fact remains in the cedent and that the cedent's right in a cession *in securitatem debiti* approximated to the rights of a pledgor in a pledge;

(iv) accordingly, based on the judgment in *Cohen's Trustee,* in a security cession of the rights to book debts the *dominium* remained vested in the company while Nedbank was vested with the exclusive right to claim and receive from existing and future book debtors the amounts owed by them which were to be credited to the cedent's account;

(v) the effect of clause 23 was that, since Nedbank held the first cession *in securitatem debiti*, the appellant held a cession *in securitatem debiti* of the reversionary right to the book debts;

(vi) the reversionary right had a money value and was not a mere *spes* or expectation, as the court *a quo* had held, but an existing right that constituted the appellant's security; and

(vii) accordingly, the appellant was in fact a secured creditor and not a concurrent creditor, as the court *a quo* had held.[1129]

The appeal was therefore upheld, and the appellant's claim was declared a properly proved secured claim for the purposes of the Insolvency Act.

Sasfin (Pty) Ltd v Beukes

In 1989, in *Sasfin (Pty) Ltd v Beukes*,[1130] the Appellate Division heard an appeal against the dismissal by the court *a quo* of Sasfin's application for an interim interdict to interdict Beukes, an anaesthetist, from collecting debts due by Beukes' patients and medical aids to him. Sasfin and Beukes had entered into a discounting agreement whereby, if Beukes wanted to sell any book debts due to him by his patients, he would offer them to Sasfin to be purchased. He also entered into a deed of cession with Sasfin and two other creditors, whereby he ceded in security all present and future claims, rights of action and receivables due to him to his creditors, as continuing security for present or future debts that he owed or might owe to his creditors. At some point, Sasfin alleged that Beukes had breached certain warranties in the discounting agreement and cancelled it. Sasfin alleged that Beukes owed Sasfin ZAR108,575.80 and that Sasfin was entitled to enforce its rights under the security cession. Beukes disputed that he had breached the agreement and alleged instead that Sasfin had breached the discounting agreement and cancelled it. The appeal turned on the validity and enforceability of the deed of cession as Beukes alleged that the deed of cession offended public policy. The court held, in the majority judgment delivered by Smalberger JA, that a cession *in securitatem debiti* of claims was in the nature of a pledge that was accessory to a principal obligation. Once the principal obligation is discharged, the pledge is *ipso iure* extinguished. The cessionary's rights continue only for as long as the debt that it intended to secure remains unpaid, and no claim can be made if there is no indebtedness. The court found the deed of cession to be contrary to public policy, and therefore void *ab initio.* The court also found that provisions in the deed of cession that entitled Sasfin to retain any excess over Beukes' debt to it rendered the deed of cession a *pactum commissorium*, which was therefore invalid.[1131] The court dismissed the appeal and held that the court *a quo* was correct in its judgment. Unfortunately, the majority judgment did not deal with either the pledge theory or the *pactum fiduciae* theory.

Millman NO v Twiggs and Another

In 1995, in *Millman NO v Twiggs and Another*,[1132] the Appellate Division heard an appeal by the liquidator of Continental Foods (Pty) Ltd ('Continental') against the court *a quo*'s

[1129] Ibid 291–295.
[1130] *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A).
[1131] Ibid 14.
[1132] *Millman NO v Twiggs and Another* 1995 (3) SA 674 (A).

dismissal of the liquidator's claim. The court *a quo* granted a declaration of rights order in favour of Twiggs, holding that he was a secured creditor in respect of two claims. Continental had a claim that it ceded to Twiggs as security for a debt of ZAR200,000 owed by Continental to Twiggs and a debt of ZAR300,000 owed by an outsider Brian Harry Cohen. Tuna Marine Foods (Pty) Ltd ('Tuna') owed Continental ZAR500,000. As security for its debt to Twiggs, Continental ceded *in securitatem debiti* to Twiggs its rights to two-fifths of its claim against Tuna for ZAR500,000, and three-fifths of its claim against Tuna for ZAR500,000. When Continental was wound up by court order in September 1991, the liquidator admitted Twiggs' secured claim of ZAR200,000 against the insolvent Continental. However, he declined Twiggs' claim that he was a secured creditor for ZAR300,000 against the insolvent Continental even though the security cession on which Twiggs based his claim was virtually identical to the security cession on which Twiggs based his other claim of ZAR200,000. The court *a quo* agreed with Twiggs that he was a secured creditor for R300,000 against the insolvent Continental. The liquidator appealed against that order. The issue on appeal was whether Twiggs was a secured creditor in respect of his claim of ZAR300,000. Twiggs discovered, while his application for a declaration of rights was pending in the court *a quo* (the Cape Provincial Division), that Tuna had paid its debt to the liquidator. The liquidator's case, and his reason for disputing that Twiggs was a secured creditor for ZAR300,000, was that the relevant clause of the cession, clause 2, secured Cohen's debt and created no obligation on Continental's part towards Twiggs. Clause 2 read as follows:

> *Continental Foods hereby cedes, assigns and makes over to Twiggs in securitatem debiti all Continental Foods' right, title and interest in and to 3/5ths of the claim for the sum of five hundred thousand rand (R500 000) which is so payable by Tuna Marine to Continental Foods on 30 June 1992.*

The court held that Continental's security cession to Twiggs of its claim against Tuna to three-fifths of ZAR500,000 was an effective pledge as if Tuna had delivered to Twiggs in pledge a corporeal asset that belonged to it. Twiggs thereupon acquired *'a ius in re aliena, equally effective as against creditors as against the owner in respect of both debts'*.[1133] The court held that the liquidator rightly admitted Twiggs' ZAR200,000 claim as a secured debt for this reason, and that there was no reason to treat Twiggs' ZAR300,000 claim any differently, given that there was no distinction between the security cession clauses. The court held that the court *a quo* had correctly admitted Twiggs as a secured creditor in respect of his ZAR300,000 claim and dismissed the appeal.

Standard General Insurance Co Ltd v SA Brake CC

In 1995, in *Standard General Insurance Co Ltd v SA Brake CC*,[1134] the Appellate Division heard an appeal against the order of the court *a quo* that Stangen, the insurer, had failed to prove that SA Brake CC, by cession *in securitatem debiti* of its rights in a Stangen

[1133] Ibid 678.
[1134] *Standard General Insurance Co Ltd v SA Brake CC* 1995 (3) SA 806 (A).

insurance policy to the Bank of Lisbon and South Africa Ltd ('the Bank'), had divested itself of such rights, and so divested itself of the *locus standi* to litigate to enforce those rights against Stangen. The issue on appeal was whether SA Brake (the respondent) had *locus standi* to sue Stangen (the appellant), notwithstanding that SA Brake had ceded its insurance policy rights *in securitatem debiti* to the Bank. After a fire destroyed SA Brake's assets, it claimed under a ceded insurance policy, and Stangen repudiated its claim. The parties differed on whether delivery of the insurance policy was necessary to complete SA Brake's pledge of its insurance policy rights. The trial judge held that, although there was uncertainty regarding this issue, he was bound by judgments[1135] that held that delivery to the cessionary of the document evidencing the ceded right was necessary to properly complete the cession. The court held that, as no delivery of the insurance policy document had taken place, Stangen had failed to prove that SA Brake had no *locus standi* because it had failed to prove that SA Brake had divested itself of its insurance policy rights. This judgment was delivered before the seminal judgment in *Botha v Fick*,[1136] where the court held that if a right exists independently of the document recording it, the cession can be given effect to without physical delivery of the document or proof that the cedent had *'exerted "all effort" to divest himself of the right'*.[1137] The appeal court therefore held that the *Botha* judgment undercut the trial judge's grounds for his judgment which had rendered it unnecessary to consider the content of the cession or the tacit term that the cession would include any replacement policy covering substantially the same risk, and if so, whether it constituted both an obligationary agreement and a transfer agreement, the effect of which was that SA Brake divested itself of its right to claim from Stangen. The court held that cession of a debt *in securitatem debiti* was analogous to pledging an incorporeal asset. Stangen argued therefore that the cession could not deliver what was not yet in existence; SA Brake's claim against Stangen came into existence only when the fire occurred; and SA Brake and Stangen could thus not have agreed on a transfer agreement, resulting in SA Brake divesting itself of the claim and hence of *locus standi.*

The court held that even future rights are capable of cession in security *in anticipando*. However, held the court, the rights in the insurance policy were not future rights but contingent rights that could be transferred. The appeal succeeded.

The following principles can be extrapolated from this judgment: (i) cession *in securitatem debiti* is analogous to pledge; (ii) insurance policies give rise to contingent rights that the insured can cede *in securitatem debiti* for a debt, which contingent rights already exist but vest when the insured event occurs; (iii) until the cedent settles his or her debt, he or she cannot enforce the claim; (iv) there is no distinction between a claim that has a present cash value and one that does not, such as a contingent right, in that the

[1135] The learned trial judge cited *Nezar v Die Meester en Andere* 1982 (2) SA 430 (T), which was seemingly supported by *Roman Catholic Church (Klerksdorp Diocese) v Southern Life Association Ltd* 1992 (2) SA 807 (A), as judgments that required delivery of the document evidencing the ceded right to complete the cession.
[1136] *Botha v Fick* 1995 (2) SA 750 (A).
[1137] *Standard General Insurance Co Ltd v SA Brake CC* 1995 (3) SA 806 (A) at 812.

cession in security of both[1138] has the effect that the cedent is divested of the right and hence does not have the *locus standi* to enforce it.

Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO

In 2002, in *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO*,[1139] (*'Development Bank'*) the Supreme Court of Appeal heard an appeal against the court *a quo*'s order whereby it*,* after granting an *ex parte* rule *nisi* authorising the appellant, the Development Bank of Southern Africa Ltd ('DBSA'), to take possession of all movable property and assets covered in a notarial bond so that the DBSA could perfect its security under the notarial bond, discharged the said rule *nisi.* The court did this because, after it granted the rule *nisi*, a provisional winding-up order was granted against the cedent, Serious Mills (Pty) Ltd ('Serious Mills'). In his minority judgment, Nienaber JA elaborated on this by saying that the issue was whether the court *a quo*'s interim order of attachment prevails over the same court's provisional order of liquidation of Serious Mills prior to the return day of the interim order of attachment. This issue went to the nature of the appellant's entitlement. Nienaber JA went on to state that the second issue in the appeal was whether the appellant as cessionary *in securitatem* of the notarial bond was entitled to take action against the debtor even though the cedent was not in default of its obligations owed to the appellant. This issue went to the *locus standi* of the appellant. I analyse the latter issue as the effect of the provisional liquidation order on the provisional attachment order is not relevant to the thesis, except in one respect. The appellant had lent ZAR7.2 million to the Agricultural Bank, which in turn lent it to Serious Mills. As security for its repayment obligations, Serious Mills granted the Agricultural Bank a power of attorney to register a notarial bond over its property and assets. Then, as security for its repayment obligations, the Agricultural Bank pledged and ceded to the appellant its rights to the notarial bond. Serious Mills defaulted on payments due to the Agricultural Bank and it came to the appellant's attention that an application would be made for its winding-up the next day. The appellant then urgently, on that day, sought an application to perfect its rights under the notarial bond, which was provisionally granted, as explained above. The majority judgment delivered by Streicher JA held *inter alia* that, as the appellant obtained possession by court order of Serious Mills' property and assets before the winding-up order was granted, it had thereby perfected its security under the notarial bond and was a secured creditor at the start of the winding-up proceedings. The court held that, although the appellant had rights under the notarial bond, these did not entitle the appellant as mortgagee to be a secured creditor. To be a secured creditor under the bond, the appellant would need possession of the property and assets under the bond. The court held that the court *a quo* erred in discharging the rule *nisi* and that it should have confirmed the rule *nisi*. The court therefore upheld the appeal.

[1138] The court did not directly compare a claim that has a present cash value and one that does not, such as a contingent right, insofar as the effect of a security cession on *locus standi* is concerned, as these issues were discussed in different paragraphs (at 814–815). The comparison, based on the court's ruling, is however made in this thesis.
[1139] *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA).

In his minority judgment in *Development Bank*, Nienaber JA held that a cessionary *in securitatem debiti* of a notarial bond could, *qua* mortgagee, for as long as the secured debt remained unpaid, perfect its security, in other words collect the debt, irrespective of whether the cedent was in breach. If, however, the agreement states that the cessionary cannot perfect its security until the cedent is in breach, then the cessionary clearly cannot do so until the breach occurs. Whether a cessionary who is not a mortgagee has the right to collect the ceded debt if the cedent is not in breach is a factual and not a legal issue, to be determined by the terms of the obligationary agreement. Nienaber JA also held that, ever since *Cohen's Trustee*, it has been held that cession *in securitatem debiti* resembled pledge, notwithstanding the underlying doctrinal difficulties. As in pledge, the cedent is not *'wholly divested of an interest in the asset he surrenders to the cessionary'* but retains the bare *dominium* or reversionary interest. The reversionary interest is the cedent's interest in the satisfaction of the principal debt by the debtor, not the cedent's claim against the cessionary for re-cession of the ceded debt. For this reason, *Marais* is wrong on this point of law. *Ex contractu*, the cedent had a claim against the cessionary for re-cession once the secured debt was repaid. The reversionary interest vests in the trustee upon the cedent's insolvency, which the trustee must administer in all creditors' interests, having due regard to the pledgee's interests. The reversionary interest can itself be ceded in security and, according to Nienaber JA, vests the cedent with (i) the ability to sue or be sued;[1140] (ii) the *locus standi* to apply for the debtor's sequestration; and (iii) the ability to perfect the cession to protect the ceded rights in appropriate circumstances. The cedent cannot, however, recover performance from the debtor unless there is a stipulation to that effect in the agreement; only the cessionary may enforce the principal debt if and when the cedent defaults on the secured debt. If the principal debtor is in breach of its obligations and the cedent is not in breach of its obligations, the question as to who is liable to take action to avoid, for example, prescription, will be determined by the obligationary agreement, contended Nienaber JA. Therefore, one cannot assert, held Nienaber JA, that the cessionary is precluded from taking action pursuant to the cession for as long as the cedent is not in default, because the obligationary agreement will determine this issue. Nienaber JA dismissed the appeal for reasons not discussed here.

6.5 The *pactum fiduciae* theory

In *Grobler* the court held that, in terms of the *pactum fiduciae* theory, a cession *in securitatem debiti* divests the cedent completely of the personal right, and vests it in the cessionary, so that it is in effect an out-and-out cession. The rights are transferred from the cedent to the cessionary for the purpose of creating a security interest in favour of the cessionary.[1141] An undertaking or *pactum fiduciae* is superimposed thereupon, which is that, on satisfaction of the secured debt by the cedent or by a third party for the cedent's benefit, the cessionary will re-cede the rights acquired by it under the cession to the

[1140] The question arises whether, if the cedent's debtor wanted to sue the cedent, it would have to cite both the cedent as the defendant and the cessionary as co-defendant, since the latter has *locus standi* to be sued. Lubbe's view, though, is that a cessionary is not a creditor: see Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 486.
[1141] Scott 'A Footnote to Nienaber's Analysis' 2012 *South African Mercantile Law Journal* 325.

cedent.[1142] All aspects of the ceded right are vested in the cessionary, leaving the cedent with a personal right against the cessionary for re-cession after the cedent has settled the secured debt. Scott describes this type of cession as *'a conditional cession subject to the resolutive condition that the cedent cedes his/her book debts only to cover the principal debt'*.[1143] If this is so, the right would be automatically transferred back to the cedent when the resolutive condition is fulfilled. The cedent's personal right against the cessionary for re-cession arises from the *pactum fiduciae.*[1144] According to Scott, this type of security is not accessory in nature but *'is an abstract form of security'*.[1145] It is not clear what these words mean: for example, do they mean that the validity of the cession is not dependent on the validity of the transfer (cession) agreement? The right leaves the cedent's estate and vests in the cessionary's estate for the duration of the cession, until the re-cession is effected if the secured debt is repaid, which transfers the right from the cessionary's estate back to the cedent's estate.[1146]

The decisions in *Sutherland*, *Rothschild*, *Lief* and *Trust Bank* adopted the *pactum fiduciae* theory. In fact, in *Trust Bank*, the court likened the effect of a cession *in securitatem debiti* to an ordinary cession where the cedent is divested of its ownership.[1147] The court's approach is, in a sense, not surprising if one considers that cession is the transfer of a right, and that proponents (academic writers and judges) of the pledge theory have, according to the proponents of the *pactum fiduciae* theory, failed to satisfactorily explain how in law it is possible to split a right into a right of action and a reversionary right, or to have a real right in a personal right.

If, according to proponents of the *pactum fiduciae* theory, a right cannot be split, and cession is the transfer of a right, then surely it is a reasonable conclusion that cession transfers the whole right, albeit in security, for the fulfilment of an obligation. I submit that although the cessionary 'owns' the ceded right pursuant to the cession, it cannot exercise the ceded right as a true owner because it holds the ceded right as security and is bound to re-transfer the right once the secured debt is repaid. The cessionary's acquired (ceded) rights, and its ability to use and enjoy such rights, are therefore, in a sense, suspended, pending the cedent's default of its obligations under the obligationary agreement. In a secured *mutuum*, the cedent's default is typically its failure to repay the loan, which entitles the cessionary to exercise the ceded rights as a true owner.[1148]

Settlement of the secured debt by the cedent or by a third party for the cedent's benefit does not *ipso iure* cancel or release the cession, and the obligation to re-cede the ceded

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[1142] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 17; Nienaber 'Security Cessions of Life Insurance Policies' (2004) 16 *South African Mercantile Law Journal* 83 at 84. Hutchison indicates that this type of arrangement was analogous to the *fiducia cum creditore*, a form of security known in Roman law, whereby a debtor transferred the full ownership of an asset to its creditor, subject to the creditor having to restore ownership to the debtor as soon as the debt was paid. See Hutchison 'Memorandum' 2003 para 4.1 (24 June 2003). Scott indicates that, in addition to the *fiducia cum creditore,* the other form of the *pactum fiduciae* known in Roman law was the *fiducia cum amico* (a fiduciary agreement with a friend). See Scott 'One Hundred Years' 2013 *South African Mercantile Law Journal* 515.
[1143] *Scott on Cession* (2018) 477 para 9.3.2.2.2.
[1144] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 17.
[1145] Ibid.
[1146] I discuss this aspect below.
[1147] See the discussion of the *Trust Bank* judgment in section 6.6 *Pledge theory.*
[1148] The concept of 'ownership of personal rights' is examined in section 6.7.4 *Ownership of personal rights*.

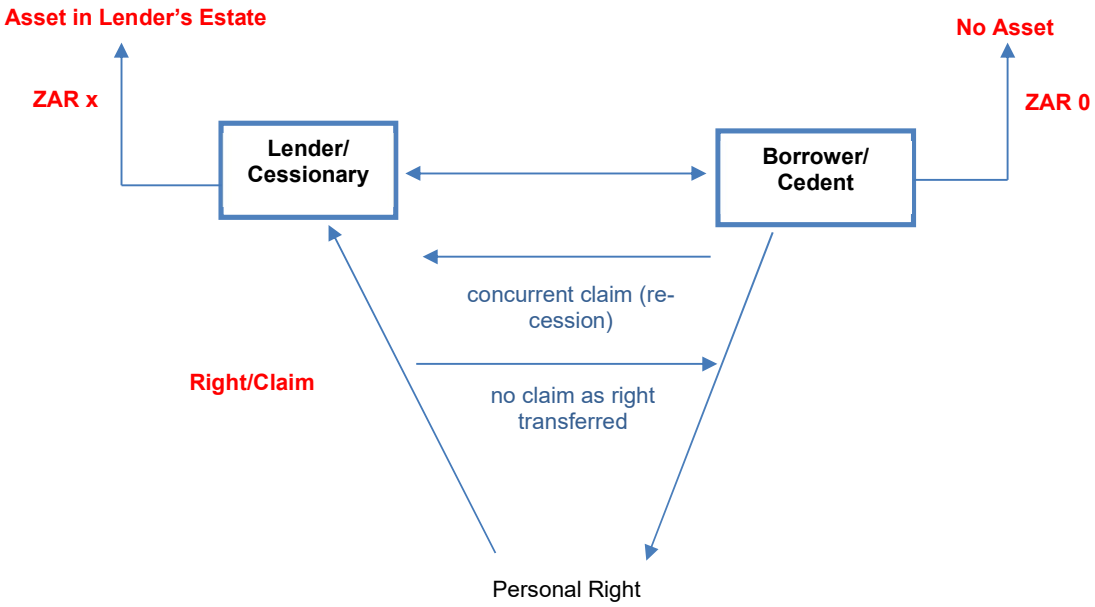
right must be carried out to transfer the ceded right back to the cedent's estate.[1149] Scott's explanation of the re-transfer of the ceded right is that, once the debt is settled, by operation of law, the ceded rights *'fall back into the estate of the cedent'* because, in her view, the cession is subject to a resolutive condition, on fulfilment of which the right automatically reverts to the cedent.[1150] But, if the ceded rights are, by operation of law, transferred back into the cedent's estate, why should the parties agree to a re-cession and what is its purpose? The alternative is that Scott means that the re-cession is given contractual effect by operation of law once the secured debt is repaid.

Nienaber states that, although one could argue the issue both ways, namely, that the ceded right reverts automatically to the cedent or that an act of re-cession is required, the *obiter dicta* (as at 2004) *'favour the view that an act of re-cession is not required'*.[1151] Scott, in her analysis of Nienaber's article, states that in these circumstances there is no need to cede the claim back to the pledgor because the claim is a security object that was transferred by agreement. She states that this is so because, on the pledge construction of cession *in securitatem debiti*, the *'dominium remains with the pledgor and on discharge of the debt the limited real right of the pledgee automatically terminates'*.[1152]

The issue as to whether, on settlement of the secured debt, the ceded right reverts automatically to the cedent or an act of re-cession is required was answered by the court in *Grobler* in respect of the pledge theory, where the accessorial principle applies, not in respect of the *pactum fiduciae* theory presently under discussion. In *Grobler* the court held that the ceded right, on settlement of the secured debt, automatically reverts to the cedent.[1153] I have discussed the effect of discharge clauses in facility agreements on this common-law position elsewhere in this thesis.[1154] Schematically, the *pactum fiduciae* theory can be represented as follows:

[1149] Scott 'A Footnote to Nienaber's Analysis' 2012 *South African Mercantile Law Journal* 325.
[1150] *Scott on Cession* (2018) 477 para 9.3.2.2.2.
[1151] Nienaber 'Security Cessions of Life Insurance Policies' (2004) 16 *South African Mercantile Law Journal* 83 at 91–92 para 11.2.
[1152] Scott 'A Footnote to Nienaber's Analysis' 2012 *South African Mercantile Law Journal* 333 para 2.4.
[1153] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.
[1154] See section 4.7 *The effect of indebtedness on continuing covering security*.

Cession *in securitatem debiti*: *Pactum fiduciae* theory



The proponents of the *pactum fiduciae* theory criticise the pledge theory, contending that it is impossible for a cessionary to acquire a real right in a personal right because of the nature of these rights; a personal right is the right to enforce conduct by another, whilst a real right is a right to a thing. De Wet and Van Wyk hold that, in South African law, one cannot have real rights in personal rights (*saaklike regte op vorderingsregte*).[1155] The authors contend that this is based on the better view that such a concept did not exist in Roman law or Roman-Dutch law. In support of the Roman-Dutch law position, the authors cite Voet, who contended that there can be no *rei vindicatio* in a personal right.[1156] We assume that the authors rely on the *rei vindicatio* example to infer that, in South African law, real rights in personal rights are non-existent because an owner would usually reclaim its ownership of an asset by the *rei vindicatio*. The authors contend that the cedent transfers its personal right (*vorderingsreg*) to the cessionary, who becomes the creditor in the cedent's place, and consequently there is no legal relationship between the cedent and the debtor after the cession. The cession is accompanied, so the authors contend, by an agreement between the cedent and the cessionary that the cession serves only as security for the secured debt owed by the cedent to the cessionary. In terms of this agreement, named a *pactum fiduciae*, the cessionary is obliged to re-cede the personal right to the cedent when the latter pays its debt and the cessionary must account to the cedent. If the cessionary refuses to accept the payment, it will be in *mora.* The agreement between the cedent and the cessionary does not bind third parties.[1157] According to Scott, De Wet further criticises the pledge of claims as being legally impossible and suggests, relying on the German Pandectists, that a fiduciary security cession is the only construct that can be used to create security rights.[1158] Its nature and effect are described above. Scott, responding to

[1155] De Wet & Van Wyk *Kontraktereg* (1992) 416 read with n 165.
[1156] Ibid n 165. The authors rely on Voet 1.8.19 and 6.1.26.
[1157] Ibid 416–417.
[1158] Scott 'One Hundred Years' 2013 *South African Mercantile Law Journal* 516, citing De Wet & Van Wyk *Kontraktereg* (1992).

De Wet's criticisms of a pledge of claims, states that *'[i]f one is a slave to theory, one can sympathise with his view'*.[1159] It is ironic that Scott makes such a criticism given that she is in fact a proponent of the *pactum fiduciae* theory, although she accepts the pledge theory as a possible option. Clark and Van Heerden state that it is impossible for a cessionary to acquire a real right in what is essentially a personal right against a debtor, and that the concept that a cedent retains ownership in the personal right after the cession is unacceptable, without advancing reasons. However, they rely on De Wet and Yeats as authority for these conclusions.[1160] Hutchison indicates that proponents of this theory also criticise the pledge theory on the basis that it implies ownership of a personal right, and if accepted, one would have to accept the ownership of real rights, which invites confusion into the understanding of rights.[1161] Hence, according to these proponents, one is dealing with a complete rights transfer coupled with a conditional re-cession.

The origin of the view that it is legally impossible to have a real right over a personal right is that, in early Roman-Dutch law, the transferability of claims was not recognised. One could not transfer the claim to a real right to another, so that that person held a real right over a third party's personal right. The transferability of claims and the ownership thereof are of course two different issues, and here I am dealing with the former issue. The reason for early Roman-Dutch law holding that it was legally impossible to transfer a claim is because it endorsed the Roman law position that the cedent's obligations were so personal in nature that any rights (claims) arising from that obligation could not be vested in or transferred to the cessionary so that the cessionary acted in the stead of the cedent. Zimmermann, referring to early and classical Roman law, states as follows:

> *'Nomina ossibus inhaerent' said the medieval lawyers in their metaphorical way: the action arising from the obligation hinges on the bones and entrails of the creditor and can no more be separated from his person than the soul from the body. … [T]he claims were taken as being inseparably related to the one individual creditor-debtor relationship.*[1162]

Anders, in his foreword to a translation of Sande's seminal work, *Cession of Actions*, states:

> *The early Roman law did not permit the transfer or assignment of an obligation (except as part and parcel of the universal succession), for the reason that the character of an obligation was an essentially personal relation, and that the parties thereto could not be changed without destroying the existence of such obligation.*[1163]

The corollary of a duty is of course a right, and the personal relation discussed by Sande applies equally to rights. An obligation is the legal bond between a cedent (the borrower) and a cessionary (the lender) that gives rise to a duty. According to Sande, if the parties to the obligation are changed, the obligation is destroyed. In later Roman-Dutch law,

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[1159] Ibid.
[1160] Clark & Van Heerden 'Cession *in Securitatem Debiti*' (1987) 104 *South African Law Journal* 238 at 242. The authors rely on De Wet & Yeats *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 4 ed (1978) 365ff.
[1161] Hutchison 'Memorandum' 2003 para 9.1.
[1162] Zimmermann *The Law of Obligations* (1990) 58–59.
[1163] Sande *Cession of Actions* (1906), under the heading *'History of the subject'*.

according to *Cohen's Trustee* citing Voet as authority, it was accepted that personal rights could be freely pledged.[1164] The legal position therefore developed from personal rights being incapable of cession in early Roman law and early Roman-Dutch law, to personal rights being capable of pledge and cession in later Roman-Dutch law, which was the position adopted in South African law.

The effects of the *pactum fiduciae* theory for the cedent are potentially detrimental if the cessionary goes insolvent. If the cessionary goes insolvent prior to the cedent settling the secured debt and the re-cession of the principal debt, the ceded right is accounted for in the cessionary's insolvent estate. The cedent, having transferred its rights in security to the cessionary without having taken security for the cessionary's obligation to cede the right back to the cedent on satisfaction of the secured debt, will rank as a concurrent creditor of the cessionary's insolvency estate. The cedent is, in such circumstances, left to fight the cessionary's other creditors to enforce its concurrent claim to the re-cession or its value. As a concurrent creditor, the cedent's claim for the re-cession of the principal debt or its value will rank after the cessionary's secured creditors and preferent creditors have been paid. It is conceivable that the other creditors' claims may well be paid, or partially paid, from the proceeds of the ceded principal debt. If any amount remains after the cessionary's secured creditors and preferent creditors have been paid, and the cedent's debt has been paid so that the balance forms part of the free residue, the cedent as a concurrent creditor will be entitled to such proceeds.

The proponents and the critics of the *pactum fiduciae* theory both acknowledge the cedent's precarious legal position in these circumstances as a fundamental shortcoming. De Wet and Van Wyk contend that if the cessionary goes insolvent the ceded right falls into the cessionary's estate and the cedent has, arising from the *pactum fiduciae,* merely a concurrent claim in the cessionary's insolvent estate for the re-cession of the surplus (if any), after the proceeds of the right are used to settle the secured debt.[1165] Scott states that *'a fiduciary security agreement enjoys no third-party operation and … the security cedent therefore has no protection if the security cessionary is insolvent'*.[1166] Scott goes further by calling for statutory intervention to remedy a cedent's lack of protection.[1167] Clark and Van Heerden state that, in these circumstances, *'the cedent bears the additional risk of being reduced to the "cold comfort of a concurrent claim"'*.[1168]

The cessionary may not want to be saddled with the effects of the *pactum fiduciae* theory either, which are *inter alia* that it acquires the principal debt and has obligations to fulfil in relation thereto, which include fulfilling all the obligations and responsibilities of an owner or *dominus*.[1169] For example, a cedent who owns a shopping centre borrows money from a bank to finance its operations. The cedent's business is to lease floor space in its

[1164] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 at 250.
[1165] De Wet & Van Wyk *Kontraktereg* (1992) 417.
[1166] Scott 'One Hundred Years' 2013 *South African Mercantile Law Journal* 517–518.
[1167] Ibid.
[1168] Clark & Van Heerden 'Cession *in Securitatem Debiti*' (1987) 104 *South African Law Journal* 238 at 242.
[1169] Kariem 'Cession in Security: A Cessionary's Obligations' *Finance and Banking Alert* Cliffe Dekker Hofmeyr Inc., 23 April 2020.

shopping centre to tenants in consideration for rental payments under lease agreements. As security for its obligation to repay the loan, the cedent cedes *in securitatem debiti* its rights under the lease agreements that it concluded with its tenants, but retains its lease obligations. If the parties intend the *pactum fiduciae* construct to apply to the cession, the cedent effectively thereby cedes out-and-out all its rights under the lease agreements to the bank, who acquires said rights. An undertaking is superimposed on the bank to re-cede the lease rights to the cedent once it has repaid the loan. The cession *in securitatem debiti* on a *pactum fiduciae* construct constitutes the bank as creditor, vesting the landlord's rights to the rental payments in the bank. However, accompanying the rights to the rental payments are bad debts, interest on bad debts, write-offs of bad debts, defaulting tenants, and other ills. The argument could be made that the bank will act on its acquired rights only if the cedent defaults on the loan repayment. However, this does not alter the fact that the cession is effective so that the lease rights are transferred (in security) to the bank immediately.[1170] The bank may therefore not want to be burdened with the obligations that accompany the right to rental payments. The effects of the *pactum fiduciae* construct are, in this example, undesirable for the bank.

Theoretically, the *pactum fiduciae* theory is a sensible conceptual approach to security rights because it treats rights in absolute terms in that the cedent cedes the entire right out-and-out to the cessionary who, once the cedent settles the secured debt, cedes the right back to the cedent. So, the right in its entirety passes from one estate to the other estate. The theory, purely as a theory not considering the above commercial risks, steers clear of the murky waters created by the pledge theory, where aspects of rights are ceded.

However, as a form of security, the *pactum fiduciae* theory is inadequate on a number of levels.[1171] I submit that the *pactum fiduciae* theory, by providing the cessionary with the full right, provides the cessionary with far more than what it needs at that point. If, for example, the cedent owes the cessionary ZAR10,000 but has ceded to the cessionary out-and-out its book debts in security valued at ZAR50,000, the cessionary holds ZAR40,000 as surplus security. In fact, it may even be contended that there is no basis in law on which to hold the ZAR40,000 in security because there is no principal obligation that is secured by the ZAR40,000. At that point, all that the cessionary needs is a limited security interest in the right, namely, security worth ZAR10,000, but it has five times as much security. Scott, an ardent proponent of the *pactum fiduciae* theory or fiduciary security cessions, as she calls them, recognises that the cessionary in this type of cession acquires more than what it needs for security purposes, but then states that the cessionary's rights to deal with the acquired right can be restricted contractually.[1172] I submit that restricting the cessionary's rights does not alter the fact that the cessionary owns (by cession) more than it actually needs as security. The out-and-out cession (transfer) of the right furthermore deprives the cedent of the right and, with it, the ability to trade or use the right as a source of revenue.

[1170] The scenario described above, where there was an immediate transfer of the obligations to the cessionary, is similar to that in *Picardi*, where the court, in interpreting a rental cession in a mortgage bond, held that the cession by the cedent of its rental income was an effective and unconditional transfer of rights given effect to when the cession was executed.
[1171] Hutchison 'Memorandum' 2003 para 6.
[1172] *Scott on Cession* (2018) 476 para 9.3.2.2.2.

Furthermore, the cedent is at risk of ranking as a concurrent creditor in the cessionary's insolvent estate if the cessionary becomes insolvent[1173] during the term of the cession.[1174] This is particularly problematic if the cedent honoured its obligations to repay the loan. In the case law and academic opinions that support the *pactum fiduciae* theory, the legal, operational and practical consequences of this theory, including whether the cedent can continue to exercise the rights of an owner when in fact it is no longer the owner, are neglected (other than in Scott's works). However, Scott has proposed solutions to the cedent's insolvency risk, as mentioned. Lubbe takes a far more decisive approach to the feasibility of the *pactum fiduciae* theory as security, stating that *'[a]s a security measure it is accordingly flawed'*.[1175]

6.6 The pledge theory

The pledge theory of cession *in securitatem debiti* is so named because it is regarded as analogous to the law of pledge.

As our courts have repeatedly held that cession *in securitatem debiti* is analogous to, or resembles, the pledge of corporeal property, I will compare the pledge of movable property and the cession *in securitatem debiti* of personal rights, to understand in what respects the latter is analogous to, or resembles, pledge. Next, I will analyse the theoretical nature of cession *in securitatem debiti* under the pledge theory, the *Grobler* decision, the rights that the cedent retains, and the rights that are transferred to the cessionary.

A comparison between the pledge of movable corporeal property and cession in securitatem debiti

In *Lief*[1176] it was held that there is a difference between determining the rights and obligations of a pledgor and a pledgee of movable property, and those of the cedent and the cessionary of rights ceded in a registered mortgage bond. The pledge of rights in a mortgage bond and applying the legal principles applicable to the pledge of movable property *'were brought to bear upon the "pledge" of incorporeal rights of action'*, because the parties were unaware of the differences between determining the rights and obligations in a pledge of movable property, and a cession of mortgage bond rights.[1177] With this in mind, I will examine the law of the pledge of movable corporeal property.

At common law, ownership in corporeal property consists of a bundle of competencies such as control, possession, the power of alienation, and the right to compromise a claim.[1178] In a pledge of corporeal property, ownership of the property is retained by the

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[1173] As contemplated in the Insolvency Act.
[1174] *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP). De Wet & Van Wyk *Kontraktereg* (1992) 417 state that, arising from the *pactum fiduciae*, the cedent becomes a concurrent creditor in the cessionary's insolvent estate.
[1175] Lubbe 'Cession' *LAWSA* (2013) 140 para 180.
[1176] *Lief NO v Dettmann* 1964 (2) SA 252 (A).
[1177] Ibid at 276–277.
[1178] Van der Merwe 'Things' *LAWSA* (2014) 27 paras 134–139; *MEC for Local Government & Finance, KwaZulu-Natal v North Central and South Central Local Councils, Durban and Others* [1999] 3 All SA 5 (N); *Mondi South Africa Ltd v Martens and Another* [2011] JOL 28057 (KZP): at common law, ownership consists of *'unrestricted and exclusive control and possession of the res, together with the power of alienation'.*

pledgor and possession granted to the pledgee; this implies that some rights are retained by the pledgor *qua* owner and some are transferred to the pledgee *qua* holder of rights as a creditor.

In Roman law and Roman-Dutch law, pledge (*pignus*) was one of four contracts *re.* If there was no delivery of possession, as in the case of immovable property, the term *hypotheca* was used. So important was delivery that the *'real right seems to have been acquired upon delivery'*.[1179] Voet described pledge as *'[a] right created in [another's] property, whereby it is allowed to one to possess it in security of a debt; and to sell it in order to recover the debt from the price'*.[1180]

The pledgor and the pledgee enter into a contract of pledge where there is a meeting of the minds on the *essentialia* of pledge. The parties intend to create a real right as a security interest in corporeal property to secure fulfilment of the secured debt. The pledgor is obliged *ipso iure* to grant the pledgee possession of the pledged property by delivering it to the pledgee, which constitutes[1181] and perfects the real right of pledge. The Supreme Court of Appeal has held that the real right of pledge is established by means of taking possession, not by an agreement to pledge.[1182] Delivery therefore both creates and perfects the pledge, and if a creditor's pledge is not so perfected, that creditor will not enjoy a preference on the debtor's insolvency.[1183] However, De Wet and Van Wyk state that Roman law recognised pledge without possession, and that the creditor and debtor could by agreement create a real right of pledge in respect of movable property while the property remained in the debtor's possession.[1184] Since the Supreme Court of Appeal has accepted delivery as an essential requirement to constitute a pledge, the Roman law position is no longer applicable.

The legal position where a contract of pledge was entered into without actual delivery was also considered by cases such as *Stratford's Trustees v The London and South African Bank* and *Goosen's Trustee v Goosen*,[1185] which held that:

(i) delivery could be actual or constructive, and either form of delivery was acceptable to perfect the pledge;

(ii) a contract of pledge not by public instrument, without actual or constructive delivery, does not create a real right but entitles the pledgee to a claim (right of action) against the pledgor to obtain possession of the pledged movable. In effect, the absence of delivery renders the contract of pledge a mere personal right of the pledgee to claim

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[1179] *Goosen's Trustee v Goosen* (1883–1884) 3 EDC 368 at 446–447.
[1180] Berwick *Commentary on the Pandects* (1902) in the chapter titled *Lib. XX Tit.I. Of Pledges and Hypothecs;- How they are Contracted;- And of the Pacts Annexed to Them* 269.
[1181] According to South African case law, the delivery requirement is satisfied only once the pledgee is in possession, actual or constructive, of the pledged property. If, for example, in the case of actual delivery, it would take the pledgor a number of days to physically hand over the movable property to the pledgee, then the pledge is valid on the date on which the pledgee receives possession of the movable property, not the date on which the pledge agreement was effective, or the date on which the pledgee commenced delivery.
[1182] *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* [2003] 1 All SA 267 (SCA) para 6.
[1183] Dendy 'Mortgage and Pledge' *LAWSA* vol 29 3 ed (2020) paras 405ff but specifically paras 420, 421 and 422.
[1184] De Wet & Van Wyk *Kontraktereg* (1992) 417.
[1185] *Stratford's Trustees v The London and South African Bank* (1883–1884) 3 EDC 439; *Goosen's Trustee v Goosen* (1883–1884) 3 EDC 368.

delivery from the pledgor;

(iii) a contract of pledge (or hypothec or mortgage) by public instrument duly registered, without actual or constructive delivery of the movable property, creates a real right in the pledgee's favour; and

(iv) a valid pledge, compliant with all the legal requirements including delivery of the pledged movable, is destroyed by re-delivery of the pledged movable to the pledgor, for whatever reason.

The context of both cases was whether the debtors had created undue preferences for certain creditors. The importance of delivery was discussed by the Appellate Division in *Zandberg v Van Zyl*:[1186]

> *The possession which is essential to the preservation by a creditor of his right over a pledged article is natural possession only (Voet, 41, 2, 3). He must retain the physical custody or control of the thing with the object of securing the benefit of his pledge. If he parts with that control to some other person, who holds the article for his own purpose, then he loses his pledge.*[1187]

Having briefly analysed the law of pledge of movable corporeal property, I explore in what respects it is analogous to, or resembles, the cession *in securitatem debiti* of personal (incorporeal) rights. South African courts have likened the cession *in securitatem debiti* of personal rights to the pledge of corporeal property because of the similarities between these legal concepts, and practical considerations. Each construct can be used to secure repayment of the secured debt, which provides the pledgee or cessionary with credit support in the form of ring-fenced assets or rights it can realise to settle the secured debt. The rights used in each construct have divisible features if one adopts the pledge theory of cession *in securitatem debiti*. In the pledge of corporeal property, one can distinguish between *dominium* in the property and possession thereof. In the cession of personal rights applying the pledge theory, one can distinguish between the *dominium* in a personal right (effectively, the residual interest, that is, the principal debtor performing or the proceeds remaining after the secured debt has been settled) and the right of action.

The theoretical nature of cession in securitatem debiti under the pledge theory

In a cession *in securitatem debiti* of a personal right based on the pledge theory, the conventional approach adopted by the South African courts, as expounded in *Cohen's Trustee,* is that the cedent pledges its personal right to the cessionary as security for its obligation to repay the secured debt, and gives effect to the pledge by ceding the right to the cessionary because it is not possible for the cedent to physically deliver a pledged right of action to the cessionary, as the cedent would have done had movable property been pledged. So, delivery is effected by cession of the right. The pledge and cession acting together create an encumbrance over the personal right that acts as security for the

[1186] *Zandberg v Van Zyl* 1910 AD 302.
[1187] Ibid 313–314.

secured debt. The legal effect is that the cedent retains the *dominium*[1188] or the reversionary interest in the principal debt, but transfers to the cessionary in security the right to claim performance from its debtor, typically described by South African courts as the right of action. The pledge of a personal right is perfected by its cession, whilst in comparison, the pledge of movable property is perfected by the actual or constructive delivery of the movable property to the pledgee.[1189]

In 2009, the Supreme Court of Appeal handed down a seminal judgment in *Grobler*[1190] that laid to rest the doctrinal debate that had raged for 167 years. The court heard an appeal against a judgment of the lower court upholding a plea of prescription of a claim. Grobler and Mothibi Crushers & Transport (Pty) Ltd ('Mothibi') entered into an agreement of sale whereby Grobler purchased immovable property from Mothibi situated in Mothibistat, Bophuthatswana for ZAR300,000 plus 15 per cent interest capitalised monthly. Grobler was required to acquire an insurance policy guaranteeing payment of ZAR1.2 million on 30 June 2001, to be ceded to Mothibi. Grobler in fact acquired three policies from Sanlam Limited, which cumulatively fulfilled the requirement of the agreement of sale, which he ceded to Oosthuizen instead of Mothibi. Oosthuizen was the sole shareholder and director of Mothibi. Oosthuizen died, the executors caused the policies to be paid up as they had fallen into arrears with the premiums, and ceded two of the policies to Oosthuizen's wife as the only heir in the deceased estate. She claimed the surrender value of ZAR741,677.24 from Sanlam, who paid the money to her. Grobler claimed this amount from Mrs Oosthuizen, to which she pleaded that his claim had prescribed. It must be mentioned that the agreement of sale was in fact void as ministerial consent to the sale of land in Bophuthatswana was required but was never obtained. Grobler's answer to the prescription plea was that the cession was not an out-and-out cession but a cession in security, to secure his obligation to pay the price. Mrs Oosthuizen contended that the cession itself constituted payment and must therefore be construed as an out-and-out cession for value. The cession documents supported the latter intention. However, the court cited *Cohen's Trustee*, where in response to similar reliance on cession wording, the court held that form should not override substance if, on an analysis of the transaction, it is clear that the cession was made for the purpose of securing a debt. The court in *Grobler* held that the *'true character of the cession therefore depends on the intention of the parties'*.[1191]

The court confirmed the principle that one debt can be used to secure another debt. The principle was first stated in *Cohen's Trustee*[1192] as follows: *'That a right of action can be pledged does not admit of a doubt (see Voet, 20, 3, 1).'* Implicit in the quotation from *Cohen's Trustee* is the understanding that a *'right of action'* is the right to take legal action to recover the principal debt. The court then considered the opposing theories that underlie

[1188] However, note the judicial criticism of the term *dominium* discussed elsewhere in the thesis.
[1189] In section 5.1.2 *Cession in security versus out-and-out cession* I discuss delivery as a requirement for a valid cession *in securitatem debiti* and the *Botha* judgment, which lays down the principles that apply when documents must be delivered to complete a pledge and cession *in securitatem debiti.* The court in *Botha* distinguished between documents that evidence the personal right and documents that constitute the personal right.
[1190] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[1191] Ibid para 11.
[1192] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 at 246.

this principle. The alternative theory, the *pactum fiduciae* theory, is dealt with below. After discussing the *pactum fiduciae* theory, the court stated that it had, in a series of prior judgments for pragmatic reasons, accepted the pledge theory in preference to the *pactum fiduciae* theory. Accordingly, held the court, *'[i]n light of these decisions, the doctrinal debate must, in my view, be regarded as settled in favour of the pledge theory'*.[1193] Scott states that it is important that in *Grobler* there was complete acceptance of the position in *Cohen's Trustee* for pragmatic reasons.[1194] The court in *Grobler* in fact used the word *'pragmatic'* as justification for the case law that used the pledge theory. It is significant that in *Grobler* the court's primary consideration in settling the doctrinal debate that had continued for more than 100 years was pragmatism, and not dogmatism or theory. However, it cannot be doubted that the court in *Grobler* considered the theoretical issues arising from the competing pledge theory and *pactum* fiduciae theory, as is evident from the judgment itself. Scott further lauds the decision by the court in *Grobler* as *'an excellent example of a strict adherence to the principle of stare decisis (system of precedents) that one expects from the courts'*.[1195]

The court held that the default position is that the pledge theory applies, unless perhaps the parties clearly expressed an intention to apply the *pactum fiduciae* theory. The court left open the question as to whether the parties can choose the *pactum fiduciae* theory to structure their cession. On the facts of the case, the court found no intention by the parties to mould their cession in any particular form; accordingly, the pledge theory applied.[1196] It is important to recognise that the court did not abandon the *pactum fiduciae* theory. Rather, the court held that the pledge theory is the default construction applicable where one debt is ceded in security for another debt, absent an express intention to apply the competing *pactum fiduciae* theory.

I will now consider the judicial meaning of the terms *'dominium'* and *'reversionary interest'*, which appear repeatedly in the reviewed case law. The *dominium* is the substantive right that is the cedent's reversionary right or residual interest in its debtor performing the principal debt, as confirmed by a number of judgments, including the Supreme Court of Appeal's judgment in *Grobler*. The entire substantive right is the right as it exists before the cession. In *Grobler* the court criticised the concept of *dominium* and held that it is –

> *ill-suited to describe the cedent's remaining interest. But the description of that interest as ownership becomes virtually nonsensical in a case such as this where the principal debt had been discharged before action was instituted. When Sanlam paid out the policies, the principal debt was extinguished. Grobler would then be the owner of nothing and that could hardly constitute the underlying basis for his claim*.[1197]

[1193] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 17.
[1194] Scott 'One Hundred Years' 2013 *South African Mercantile Law Journal* 525.
[1195] Ibid.
[1196] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 24.
[1197] Ibid para 18.

The court cited the reasons given in *Moola v Estate Moola*[1198] as examples of why the term *dominium* was ill-suited. The concept of *dominium* has also been criticised by others.[1199] Consequently, the term *dominium* does not, according to *Grobler* and other judgments,[1200] accurately describe the nature of the cedent's interest in the principal debt after having ceded its right of action. Having criticised the term *dominium,* the court indicated its preference for the term *'reversionary interests'* to describe the rights retained by the cedent. The court then clarified the meaning of the cedent's reversionary interest and came to a diametrically opposite view to the court in *Marais* on this point. The court held that the 1990 judgment in *Incledon*[1201] that a cedent's reversionary interest is the cedent's (the owner's) interest to claim re-cession of the rights once the debt is paid did not constitute good authority as it –

> *would simply amount to a recapitulation of the outright cession-cum-pactum fiduciae-theory (see Lawsa, op cit, at paragraph 53 note 14). Secondly, it is, in my view, in direct conflict with those decisions which held that a claim ceded in securitatem debiti automatically reverts to the cedent once the secured debt is extinguished and that in such event a re-cession by the cessionary is not required (see for example National Bank of South Africa Ltd v Cohen's Trustee (supra) at 246247; Bank of Lisbon & South Africa Ltd v The Master (supra) at 294EF).*[1202]

The court held that the cedent's reversionary interest is its interest in the debtor satisfying the principal debt.

In *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO*[1203] the Supreme Court of Appeal held that *'reversionary interest'* meant the following:

> *In common with pledge the cedent as the security giver is not wholly divested of an interest in the asset he surrenders to the cessionary as the security receiver; he retains, notwithstanding the cession, what has variously been described as 'the bare dominium' and 'a reversionary interest' (cf Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd 1968 (3) SA 166 (A); Landen Landboubank van Suid Afrika v Die Meester en Andere 1991 (2) SA 761 (A) at 771D G). 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 re-cession of the principal debt on satisfaction of the secured debt which is a right ex contractu against the cessionary). It is that reversionary interest that vests in the cedent's trustee upon his insolvency, to be administered 'in the interests of all the creditors and with due regard of the special position of the pledgee' (Millman NO v H Twiggs and Another (supra at 676H I)); that can itself be attached or ceded; that invests him with the locus standi to*

[1198] *Moola v Estate Moola* 1957 (2) SA 463 (N). At 464B–D the court held: *'The word "dominium" is therefore out of place, and it does not help much to describe plaintiff as the "owner" of the ceded rights. Ownership of a right of action would seem to imply the right to sue, and if the right to sue has passed to the cessionary it is difficult to imagine what can remain with the cedent. The truth probably is that the cedent by way of security retains only his "reversionary right", that is to say his right to enforce the ceded right of action after the [secured debt] ... has been discharged (see also for example Barclay's Bank (D,C&O) v Riverside Dried Fruit (Pty) Ltd 1949 (1) SA 937 (C) at 946).'* However, I submit that this criticism may be misplaced, given that what is owned is not only the right to sue, but more importantly, the right to the proceeds paid or to be paid by the principal debtor or the balance remaining after the cessionary's claim has been settled.

[1199] Hutchison 'Memorandum' 2003 para 12.1 notes that the court in *Barclays Bank (DC&O) v Riverside Dried Fruit Co (Pty) Ltd* 1949 (1) SA 937 (C) at 946 held that the reversionary interest was *'almost nothing … which gives the owner of the dominium no right to exercise the rights of a dominus'.*

[1200] *Holzman NO and Another v Knights Engineering and Precision Works (Pty) Ltd* 1979 (2) SA 784 (W) at 789–790.

[1201] *Incledon* (*Welkom*) (*Pty*) *Ltd v Qwa Qwa Development Corporation Ltd* 1990 (4) SA 798 (A).

[1202] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.

[1203] *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA).

> *sue or be sued or apply for the debtor's sequestration; and may conceivably entitle the cedent, in an appropriate case and notwithstanding the cession, to perfect in order to protect the ceded security.*[1204]

Lubbe states that the reversionary interest is an *'interest in the object of the ceded right itself, namely, in the performance owing by the debtor, and [should] not [be] confused with a right to re-claim the ceded right from the cessionary on repayment of the secured debt'*.[1205]

It is therefore incorrect in law to refer to the cedent's reversionary interest as the cedent's right to claim from the cessionary a re-cession of the ceded claim once the secured debt is repaid. The cedent's right to claim a re-cession of the ceded claim once the secured debt is repaid is a right *ex contractu*[1206] that arises from its obligationary agreement. In practice, such a mistaken understanding is commonplace. Instead, the cedent's reversionary interest is the cedent's right to performance by its principal debtor of the principal debt. The terms *'reversionary interest'* or *'residual interest'* better describe the cedent's interests in the right. Reversionary interest emphasises the cedent's right to receive the balance of its debtor's performance after the cessionary's claim (the secured debt) has been settled. Residual interest emphasises that, after the cession *in securitatem debiti*, the cedent retains what is left of the ceded right.[1207] In law, the terms *'reversionary interest'* and *'residual interest'* mean the same thing. The terms *'dominium', 'reversionary interest'* or *'residual interest'* are therefore used interchangeably in this thesis.

The cessionary acquires a pledge or limited interest in the cedent's principal debt as security.[1208] During the term of the cession *in securitatem debiti* the cedent retains not only the *dominium* or the reversionary interest in the right but also the right to protect its reversionary interests,[1209] but cannot collect the principal debt as the cessionary is vested with *'the exclusive right to claim and receive … the amounts owing'*[1210] which gives or affords the *locus standi*[1211] to collect the principal debt.

The cessionary's limited security interest gives it the *locus standi* to collect the debt, which includes issuing legal notices and compromising the claim but carries with it the obligation to preserve the debt, which includes preventing prescription of the claim. The right of action is the control over the procedural aspect of the principal debt, or as one judgment put it, the procedural manifestation of the right. A cessionary has *locus standi* only in the procedural aspect of the substantive right (the principal debt), and therefore has

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[1204] Ibid para 50.
[1205] Lubbe 'Cession' *LAWSA* (2013) 140 para 180.
[1206] This was the position of Nienaber JA in his minority judgment delivered in *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA) at 447F–H. It seems, therefore, that the court in *Grobler* was following the view of Nienaber JA in *Development Bank*.
[1207] In section 6.7 *Theoretical issues arising from the pledge theory* I analyse and explore precisely what rights the cedent retains after a cession *in securitatem debiti*.
[1208] Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 486.
[1209] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC) para 30. See sections 4.10 *Pacta commissoria and conditional sales*, 5.7 *The fruits of a ceded right* and 6.7 *Theoretical issues arising from the pledge theory* above.
[1210] *Bank of Lisbon and South Africa Limited v The Master and Others* 1987 (1) SA 276 (A); [1987] 1 All SA 286 (A) at 298; Lubbe 'Cession' *LAWSA* (2013) 141 para 180, and the cases cited in n 18.
[1211] The cessionary's *locus standi* is addressed comprehensively in section 6.7.5 *Enforcing the ceded rights: Locus standi.*

no legal basis on which it could be constituted as a true creditor in the full sense of that term. In this confined and limited sense, the cessionary performs creditor-type functions against the principal debtor, although in strict legal terms the cessionary is not the creditor to whom substantive performance is due. In passing, the position of a cessionary in an out-and-out cession is markedly different to that of a security cessionary, because an out-and-out cessionary becomes the creditor, in the fullest legal sense, of the principal debtor by taking over all the cedent's rights and competencies (including all components of the cedent's rights).[1212] It seems there is nothing in the cessionary having acquired *locus standi* that entitles it to be elevated to the status of a creditor. Ordinarily, a creditor in a *mutuum* is one who loaned a sum of money to another, and to whom the sum is owed. The rights necessary to constitute a debtor–creditor relationship remain vested in the cedent and are known as the *dominium* or the reversionary rights.[1213] For example, Lubbe states: *'Alhoewel die sessionaris se pandreg of sekuriteitsbelang omvattende bevoeghede met betrekking tot die reg inhou, word hy volgens hierdie siening nie as skuldeiser van die skuldenaar beskou nie.'*[1214]

If the cedent settles the secured debt, the cession *in securitatem debiti* automatically lapses and the right of action reverts to the cedent. If the cedent fails to settle the secured debt or becomes insolvent, the cessionary can realise its security rights, by retaining or disposing of them, and must credit the cedent for their fair value[1215] in settlement of the secured debt. The cessionary's security rights become operative only on the cedent's default or insolvency, even though the right of action (the right to collect the principal debt) vests in the cessionary immediately upon its creation. In these circumstances, it is important that the cessionary determines the fair value of the assets held in security. If there is a surplus remaining after the secured debt has been settled, the cedent is entitled thereto.

Whilst I do not intend to embark on a full historical analysis of the origins of South African law on this aspect, it is submitted that the cessionary's right to retain or dispose of the security rights is derived from the later Roman law of pledge. In early Roman law, the pledgee was seen as part-owner of the pledged property, which was simply forfeited to the pledgee if it was not timeously redeemed by the pledgor settling the secured debt.[1216]

Zimmermann states that once the pledgee's position *'had begun to be conceptualised as ius in re aliena, the situation was no longer that straightforward'*.[1217] The pledgor remained the owner, and to avoid the anomalous situation where the pledgee could keep the pledged article indefinitely without using it to satisfy the debt it secured because the pledgor was not in default, the parties came to an arrangement whereby there was a conditional ownership transfer on the basis of *datio in solutum* or sale. However, *'[i]f the*

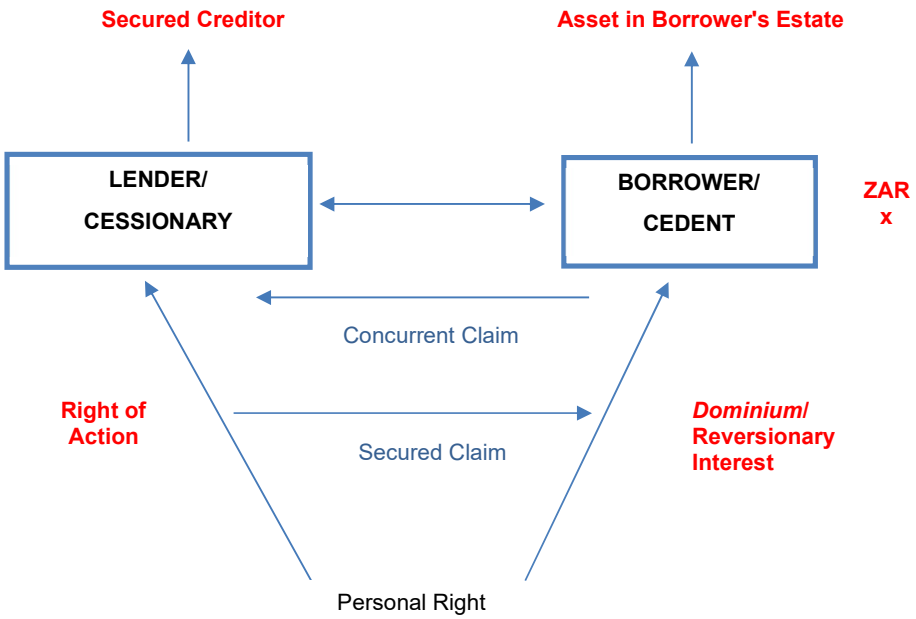
[1212] *Pizani and Another v First Consolidated Holdings (Pty) Ltd* 1979 (1) SA 69 (A) at 77–78.
[1213] The *dominium* or the reversionary rights are analysed elsewhere in the thesis.
[1214] Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 486.
[1215] I discuss fair value in section 4.9.3 *A lender's common-law obligation to realise fair value for the security.*
[1216] Zimmermann *The Law of Obligations* (1990) 223–224.
[1217] Ibid 224.

debt remained undischarged, the pledgee was to be taken to have bought the pledge or to have received and accepted it in lieu of fulfilment. Such clauses represent the contractual variant of the old forfeiture regime."[1218]

The legal position in *Sutherland* and *Rothschild*, and indeed in any similar judgments, that in a cession *in securitatem debiti* the *dominium* leaves the cedent and vests in the cessionary must, pursuant to *Grobler*, which held that the pledge theory is the doctrinal basis of a cession *in securitatem debiti*, be considered to have been abandoned, unless the parties to the security cession specifically opt to apply the *pactum fiduciae* theory.

Schematically, the pledge theory can be represented as follows:

Cession *in securitatem debiti*: Pledge theory



6.7 Theoretical issues arising from the pledge theory

At the time when judgments such as *Leyds*,[1219] *Marais*,[1220] *Illings*[1221] and *Bank of Lisbon*[1222] endorsed the pledge theory, Lubbe stated in 1989 that such judicial endorsement of the pledge theory did not end the perceived problems with the pledge construction. The central issue, argued Lubbe, was not the nature of the relationships that arose from the pledge construction, but rather the theoretical explanation therefor and the dogmatic acceptance thereof.[1223] The theoretical issues arising from the pledge theory alluded to by Lubbe are complex, and I will now examine some of them, together with other theoretical issues raised by the author.

[1218] Ibid.
[1219] *Leyds NO v Noord-Westelike Kooperatiewe Landboumaatskappy Bpk en Andere* 1985 (2) SA 769 (A).
[1220] *Marais en Andere NNO v Ruskin NO* 1985 (4) SA 659 (A).
[1221] *Illings (Acceptance) Co (Pty) Ltd v Ensor NO* [1982] 1 All SA 185 (A).
[1222] *Bank of Lisbon and South Africa Ltd v The Master and Others* [1987] 1 All SA 286 (A); 1987 (1) SA 276 (A).
[1223] Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 487.

The theoretical issues have arisen mainly out of the practical application of the pledge theory, and can be summarised as (i) whether personal rights are divisible; (ii) whether it is legally possible to have real rights over personal rights; (iii) whether the reversionary interest and the right of action constitute security under the Insolvency Act; (iv) whether it is conceptually correct that one can own personal rights; and (v) the enforcement of the ceded rights: the issue of *locus standi.* The Roman-Dutch authorities did not consider these issues apart from distinguishing between the *dominium* of a personal right and its enforcement, the right of action.

6.7.1 *The divisibility of personal rights*

Whether personal rights are divisible is an issue that arises from the structure of the pledge theory. Neither our courts nor academic writers, apart from Lubbe in his ground-breaking works, have expressly considered whether personal rights are divisible. The judgments reviewed in section 6.4 (*A review of the case law*) demonstrate that the courts that support the pledge theory of cession *in securitatem debiti* accept the conceptual distinction between *dominium*, reversionary interest or residual right (the terms are used interchangeably), and the right of action or the enforcement right. Such judicial acceptance must mean that courts recognise conceptually that personal rights can be divided or split into component parts.

I submit that the pledge theory is based *inter alia* on the innate basis that a personal right consists of a bundle of competencies that together constitute the right. I submit further that those personal rights are divisible as between the *dominium*; the reversionary interest or residual right; the right of action (*locus standi* to enforce performance); and the ability to compromise a claim, to novate a claim or to transfer a claim, together with the competencies contemplated elsewhere in this chapter. These competencies can be separately held or possessed by different parties as security. The transfer of components of a right is achieved by cession. This distinction would not fit comfortably with certain types of personal rights, such as the right to information.

Although De Wet and Van Wyk do not address the issue of the divisibility of rights, their unequivocal position that a real right of pledge over a personal right is impossible is, I submit, a clearly implied statement that a personal right cannot be separated into component parts; hence the entire right must, according to them, be ceded.[1224] However, Lubbe is of the view that personal rights can be split or divided, with only some of its component parts being transferred by cession.[1225] He bases this view on Dutch law, where a creditor's claim is viewed as a bundle of components, such as the ability to release a debtor, to compromise a claim with the debtor, to novate the claim, or to transfer the claim. Such a view is not, Lubbe argues, in conflict with South African law. Nienaber, on the other hand, is of the view that the procedural right to claim cannot

[1224] De Wet & Van Wyk *Kontraktereg* (1992) 415–424.
[1225] Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 492–493.

be separated from the right itself.

The issue of ownership being divisible can be used by analogy to address the divisibility of personal rights. It is, however, not a new issue in law. As a comparator, in property law, ownership as a legal concept is capable of divisibility. English common law and US law on the ownership of property holds interesting lessons for South African law. A high-level review of some of the literature on the ownership of property demonstrates these lessons and I undertake this review only to address the divisibility of rights. The review is not intended as a comprehensive analysis or critique of the international debate on the ownership of property that has continued unabated for decades. In the mid-eighteenth century, William Blackstone,[1226] an English jurist and judge, influenced the common-law concept of ownership by propagating the idea that the right of property was the *'sole and despotic dominium'* of the owner. This became known as the *'absolutist concept of ownership'*.[1227] Blackstone's concept of ownership was used not only in England but also in the USA.[1228] Clarry, in his analysis of ownership in the common-law tradition and the civil-law tradition, which was undertaken for the purpose of analysing trusts, states that in the common-law tradition, Blackstone's absolutist concept of ownership was irreconcilable with *'the multifarious threads of proprietary interests that had been woven into the fabric of the common law tradition since feudal times: ownership itself could be encumbered and fragmented amongst many people in a variety of ways'*.[1229]

Johnson, discussing the history and meaning of property law, states that ownership as a physicalist approach could not be applied to, and was outdated in relation to, new forms of property that were coming into existence, such as intangible rights to business goodwill, shares, trade secrets and trademarks.[1230] It was necessary to move away from conceiving of ownership of property in a physical sense, to a metaphysical concept that ownership in property was a set of legal or juridical relations in relation to property.[1231] By the turn of the twentieth century, academics who came to be known as legal realists and legal pragmatists criticised the Blackstonian absolutist concept of ownership as being inaccurate, because it failed to account for the harm that the exercise of absolute freedom in relation to property could cause others. Also, the Blackstonian absolutist concept of ownership *'masked the political function of property as power'*.[1232] In this context, the *'bundle of rights'* concept was born,[1233] which established ownership of property as a set of legal or juridical relations in relation to property. However, Johnson states that *'the concept works to illustrate both tangible and intangible property equally well – for example, 100 acres of land or 100 shares in a corporation'*.[1234] My review of

[1226] Sir William Blackstone (1723 to 1780), Wikipedia.
[1227] Clarry 'Fiduciary Ownership' 2014 *International & Comparative Law Quarterly* 903.
[1228] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 250.
[1229] Clarry 'Fiduciary Ownership' 2014 *International & Comparative Law Quarterly* 904.
[1230] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 250.
[1231] Ibid. Also see Clarry 'Fiduciary Ownership' 2014 *International & Comparative Law Quarterly* 904.
[1232] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 250–251.
[1233] Johnson indicates that the origin of the concept 'bundle of rights' is not known; see Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 252–253.
[1234] Ibid 247.

some of the literature on ownership reveals, however, that most of it was written in respect of tangible property. Penner contends that in fact there is no actual theory of a bundle of rights in a *'canonical formulation'* nor does it have a *'clear methodology'* with which to approach property issues, but that the Hohfeld–Honoré concept of a bundle of rights is merely *'an association of views of two legal philosophers'*.[1235] Wesley Newcomb Hohfeld[1236] pioneered work in this area in 1913, contending that property did not consist of things but rather legal relations between people.[1237] Hohfeld's theory was essentially that the holder of a right had a relationship with one who had no right, with the legal relationship between the two characterised by claims and entitlements in tension with each other. Individuals therefore had legal relations with each other that were interdependent in relation to things. Hohfeld believed there were four basic legal rights, which he classified as immunities, rights, powers and privileges. The rights, powers, privileges and immunities held by a person in respect of a thing may vary in time and place due to changes in the common law and statute, but *'a person who holds complete property in a thing is deemed the owner'*.[1238] Other academics built on Hohfeld's theory. Hohfeld's pioneering work was so significant that the American Law Institute ('ALI'), an association of academics, judges and lawyers, adopted the bundle of rights concept in its Restatements. Courts in the USA, in turn, rely on the Restatements issued by the ALI.[1239]

The next significant contributor to the ownership debate was Anthony Maurice Honoré,[1240] a British lawyer and jurist, who in the 1960s authored an article on ownership in which he listed 11 constituent incidents of ownership.[1241] Honoré stated that ownership consisted of the right to possess, the right to use, the right to manage, the right to income, the right to capital, the right to security, the incident of transmissibility, the incident of absence of term, the prohibition of harmful use, the liability to execution and the residuary character.[1242] In *Prinsloo and Another v Ndebele Ndzundza Community and Others*[1243] the Supreme Court of Appeal, in a judgment dealing with the restitution of land rights, noted that Honoré viewed these incidents of ownership as standard and that it was unnecessary to hold them individually to be designated as an owner.[1244] According to Johnson, it is not necessary to hold all 11 of Honoré's constituent incidents to be an owner, but she states that some incidents are

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[1235] Penner 'The Bundle of Rights Picture of Property' (1996) 43 *University of California Law Review* 711 at 714.
[1236] A professor at Stanford Law School, California; Wesley Newcomb Hohfeld (1879 to 1918), Wikipedia.
[1237] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 251. Johnson cites Hohfeld's seminal article titled 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' as the source of Hohfeld's ground-breaking views on property ownership.
[1238] Ibid 252.
[1239] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 249.
[1240] Anthony Maurice Honoré (1921 to 2019), Wikipedia.
[1241] Clarry 'Fiduciary Ownership' 2014 *International & Comparative Law Quarterly* 904; Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 253–254; Penner 'The Bundle of Rights Picture of Property' (1996) 43 *University of California Law Review* 711 at 731ff.
[1242] Clarry 'Fiduciary Ownership' 2014 *International & Comparative Law Quarterly* 904–905.
[1243] *Prinsloo and Another v Ndebele-Ndzundza Community and Others* [2005] 3 All SA 528 (SCA); Lewis 'The Modern Concept of Ownership of Land' 1985 *Acta Juridica* 241–266 discusses *inter alia* Honoré's hypothesis of ownership and its incidents.
[1244] *Prinsloo and Another v Ndebele-Ndzundza Community and Others* [2005] 3 All SA 528 (SCA) para 33 and the authorities cited at n 2.

clearly more important than others.[1245]

I submit that some, but not all, of Honoré's constituent incidents of ownership applicable to property may be applied to personal rights. Already, without Honoré's categorisation of the incidents of ownership rights, one can distinguish between *dominium* and the right of action, which has been judicially accepted and analysed at length elsewhere in this thesis. The right to possess intangibles has been described by Clarry as the right to exclude others from using, or benefiting from, the right.[1246] Similarly, in terms of South African law, the cessionary holds the exclusive right to enforce the ceded claim, while the cedent holds the exclusive right to use and benefit from the ceded claim. The latter point also addresses Honoré's right to use as a component incident. The right to manage, which is the right to decide how and by whom a thing will be used, is partly applicable to personal rights as the cedent decides to whom it will cede its rights. The right to income, which is the right to the benefits of the personal right, applies to personal rights such as the right to book debts, credit balances, shares and insurance policies, as income can be derived from each of these rights. The right to capital, described as the right or power to alienate, or to consume, waste and so on, applies to personal rights as these can also be alienated. The right to security, described as immunity from expropriation, applies to personal rights as the state cannot expropriate personal rights. The power of transmissibility, which is the power to bequeath, applies to personal rights as the holder can bequeath them to a beneficiary. The absence of term, described as indefinite ownership, applies to personal rights that can be owned indefinitely.[1247] The prohibition on harmful use, which is a person's ability to refrain from using the thing in harmful ways, is not applicable to a personal right for it is not possible for a cedent to use its right in a harmful way. Liability to execution, which is where the thing can be used to repay a debt, definitely applies to personal rights as the cessionary can sell the personal right or take it over, in settlement of the secured debt. The residuary character, understood as rules that govern the reversion of lapsed ownership rights, would not apply to personal rights.[1248]

In light of the judicial acceptance by the South African courts of the distinction between the *dominium* and the right of action of a personal right, having analysed Lubbe's view that personal rights are divisible and having applied Honoré's constituent incidents of real rights ownership to personal rights, it is reasonable to conclude that personal rights can be divided into component or constituent parts. This conclusion is significant in and for itself and enhances the soundness of the pledge theory by laying a proper theoretical foundation for contending that the holder of a personal right can in law temporarily vest an aspect of its personal right, namely, the right of action, in another person (the cessionary) to serve as security, whilst the holder remains the owner of the substantive right. As in the Hohfeld–Honoré scheme of property ownership, one need

[1245] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 253–254 n 620.
[1246] Ibid 253.
[1247] The concept of 'ownership of personal rights' is analysed in section 6.7.4 *Ownership of personal rights*.
[1248] Johnson 'Reflections on the Bundle of Rights' 2007 *Vermont Law Review* 253.

not have, or exercise, all the constituent incidents of ownership of personal rights at all times to be an owner, although holding the *dominium* or reversionary interest is clearly essential to owning a right.[1249]

The divisibility of personal rights is a significant finding in respect of syndicate lenders who hold security. Elsewhere it is concluded that it is possible in law to cede *in securitatem debiti,* in respect of a single asset or right, the right of action to one cessionary, and the *dominium* or reversionary interest to a different cessionary. In syndicated loans that do not use the Security SPV structure, this construct works well as the senior lender may hold the right of action in security and the mezzanine lender may hold the reversionary rights in security, in respect of the same right.[1250] If this construct is used, the mezzanine lender's ability to exercise its security rights is always contractually subject to the senior lender exercising its security rights first, and its claims being satisfied first. However, if the senior lender's claims and the mezzanine lender's claims are secured through the Security SPV, then it, and not the senior lender and the mezzanine lender, will hold the right of action to a principal debt ceded in security. The mezzanine lender can also hold security rights in assets or property not held by the senior lender as security. If so, the mezzanine lender could either hold security itself directly in its name, or under the Security SPV structure. In either instance, its claims will still be subordinated to the senior lender's claims and security rights. The mezzanine lender holding security independently of the senior lender does not, however, entitle it to exercise those rights prior to the senior lender's rights. The mezzanine lender cannot, for example, on its own, enforce its independent security rights outside of the enforcement process contemplated in the intercreditor agreement. Similarly, if the mezzanine lender holds security through the Security SPV, both it and the agent are contractually prohibited from enforcing the mezzanine lender's rights to settlement of its claims prior to the senior lender's claims being settled. The senior lender's security rights are therefore often described in the finance documents as *'first ranked'* or *'senior'* in relation to the mezzanine lender's security rights. The significance of the borrower retaining its reversionary rights (because the right of action was ceded in security to either a lender or a Security SPV) is discussed in section 6.7.5 (*Enforcing the ceded rights: Locus standi*). In summary, the reversionary right is an asset of value in the cedent's estate and can be protected by the borrower's reversionary *locus standi.*[1251] The borrower may cede its reversionary interests in security to raise additional loans from other lenders, unless the borrower is contractually restricted from doing so.

6.7.2 *Real rights over personal rights*

The issue being analysed is whether conceptually one can grant a real right over a personal right. In the pledge theory of cession *in securitatem debiti* of personal rights,

[1249] Ibid 253–254.
[1250] See, for example, *Bank of Lisbon and South Africa Limited v The Master and Others* 1987 (1) SA 276 (A) where one lender held a cession *in securitatem debiti* of the right of action to the cedent's book debts, and the other lender held a cession *in securitatem debiti* of the reversionary rights to the same book debts.
[1251] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC).

the cedent grants the cessionary a limited real right in its principal debt and the cedent holds the *dominium* in the right. Case law applying the *pactum fiduciae* theory has held that the right to the entire principal debt is ceded, whilst case law applying the pledge theory has held that only the right of action or procedural right is ceded. However, granting a limited real right in a personal right is, as explained by critics of the pledge theory, theoretically problematic, given the nature of a personal right; it is the right to enforce conduct by another whereas a real right is the right to a thing.

So, can a cedent confer a real right (a right to a thing) in a personal right (a right to enforce conduct) or is the real right conferred against the proceeds of the principal debt due by the debtor? There are examples in South African law of rights over rights and it can therefore be contended that the concept of rights over rights exists in South African law. One example is in insolvency law,[1252] where the effect of a pledge of incorporeal rights, such as the rights to or ownership of shares, a debtors' book or lease rights,[1253] is to confer on the holder the rights of a secured creditor. Another example is in property law, where an out-and-out cession by a mortgagee to a new mortgagee of its rights under a bond is permitted, subject to registering such cession in terms of the Deeds Registries Act because the new mortgagee's rights are created in respect of the transferred rights.[1254] A further example is in the law of landlord and tenant, where the sub-lease of lease rights is recognised because the sub-lessee has rights over or in respect of the lessee's rights to lease. Reid,[1255] for example, states that *'the idea of rights over rights is in fact found in most legal systems, whatever the theoretical status of rights as things'*. While the fact that rights over rights exist in other areas of South African law might perhaps be seen as justification for having a real right in a personal right, such justification does not in itself, I submit, deal with the longstanding criticism that it is impossible to have a real right in a personal right, nor does it explain what the cessionary's real right in a personal right is in respect of. The concept of rights over rights is, I submit for reasons that follow, innate in cession *in securitatem debiti* and does not affect the traditional distinctions between real security rights and personal security rights.[1256]

One can approach the issue as to whether one can have a real right over a personal right, in other words, a real right over the right to require another to perform, from a different perspective, by enquiring, as Lubbe[1257] does, how cession, which is traditionally a complete rights transfer, can be structured so that it displays the characteristics of pledge of a creditor's claim. Lubbe answers the question on two levels. First, it is necessary to shift the focus from a normal cession (a complete rights transfer) to a cession limited to aspects of the cedent's rights (an implicit premise is that personal rights are divisible as discussed above) in such a way that the cessionary acquires

[1252] Insolvency Act.
[1253] Reid 'Obligations and Property: Exploring the Border' 1997 *Acta Juridica* 225.
[1254] Deeds Registries Act 47 of 1937. See the discussion in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the cessionary, or must the security be separately ceded?*
[1255] Reid 'Obligations and Property: Exploring the Border' 1997 *Acta Juridica* 225 at 232.
[1256] See section 4.5 *Personal and real security, and the registration of security rights.*
[1257] Lubbe 'Components of the Creditor's Interest' 1989 *THRHR* 492–493.

control of the economic value of the right as security. Second, in Dutch law, a creditor's claim is viewed as a bundle of components, such as the ability to release a debtor, to compromise a claim with the debtor, to novate the claim, or to transfer the claim. Such a view is not, Lubbe argues, in conflict with South African law.

The component parts of rights are those recognised in English law, US law and Dutch law. A plausible solution to the criticism that it is impossible in law to have a real right over a personal right is the view held by Lubbe that the real right of pledge is held in respect of the proceeds of the principal debt due by the debtor to the cedent, rather than in the cedent's personal right to require performance (payment) by the debtor.[1258] The cessionary therefore acquires a real right to the economic value (the proceeds) of the personal right that serves as security for the secured debt, as opposed to acquiring a real right in the cedent's right to require its principal debtor to perform. If the real right of security is held in the proceeds that arise from the principal debt due, the need to justify the basis in law on which a cessionary can acquire a real right in a personal right falls away. On this construct, the real right operates classically against a thing, namely, the proceeds of the right to the payment of the principal debt. Applying this construct to a syndicate where the lenders hold their security directly and not through a Security SPV, the senior lender will therefore hold, as security, the right of action to the principal debt proceeds, while the mezzanine lender will hold, as security, the *dominium* or reversionary interest to the same principal debt proceeds. Practically, these security rights are held by the syndicate lenders against a sum of money. Both the senior lender and the mezzanine lender thus hold real rights (their security rights) against the same principal debt proceeds, not against the cedent's personal right to require its debtor to render performance of the principal debt. Here one must separate the right to require performance from the result of that performance, which are the proceeds, to make sense of the concept. However, if the syndicate lenders hold their security through a Security SPV, then it is the Security SPV and not the lenders that holds real security rights against the principal debt proceeds. The impossibility of the relationship between the real right and the personal right to require performance of the debtor has, through the decades, been the principal criticism of critics of the pledge theory, including Brits, De Wet, Scott and Nienaber.

I submit that the proposed divisibility construct whereby a right consists of component parts creates the legal basis on which the cedent can confer a real right in favour of the cessionary, not in its personal right to performance by the cedent's debtor, but rather directly in the proceeds that will result from the principal debtor rendering performance of its obligations. The cessionary acquires a real right in the sense of a right to a thing (the money), while the cedent retains its residual interest therein. I submit that this addresses the criticism that one cannot have a real right in a personal right and acknowledges the component parts of personal rights.

[1258] Lubbe *Contract: General Principles* (2020) 546–547 para 13.73.

6.7.3 *The reversionary interest and the right of action: Security under the Insolvency Act*

The Insolvency Act defines *'security'* as including a pledge. It is established law that personal rights are pledged in security, and that the pledge is given effect to by the cession of the rights. As cession *in securitatem debiti* of personal rights (the right of action) can constitute security for insolvency law purposes, a related issue is whether the cession *in securitatem debiti* of the *dominium* or the reversionary interest can similarly constitute security. The issue is relevant if a cedent wishes to cede *in securitatem debiti* both the right of action and reversionary rights to either the same or different cessionaries for different debts.[1259]

I submit that, based on the interpretation that *'pledge'* in the definition of *'security'* in the Insolvency Act includes cession *in securitatem debiti* at common law because it gives effect to the pledge, the pledge and cession of both the right of action and reversionary rights constitute *'security'* as defined in the Insolvency Act. The cessionary of the right of action and the cessionary of the reversionary rights are therefore both secured creditors for Insolvency Act purposes.

The liquidator may, on the cedent's insolvency, enforce the cedent's rights to the principal debt owed to it because the cedent retains its reversionary interests if it was not ceded in security, subject to paying the cessionary's claim. In *Cohen's Trustee*[1260] the court explained that the reason for imposing this duty on the liquidator[1261] is that, according to Voet,[1262] a creditor should not have the power to decide how much of the available money to take for himself and how much to leave for the other creditors.

6.7.4 *Ownership of personal rights*

I will now consider an aspect of the criticisms of the pledge theory, namely, whether it is possible to own personal rights. The courts have been critical of, and have noted academic writers' criticisms of, the concept of the cedent retaining *dominium* in a ceded personal right because, if the cession transfers the right of action from the cedent to the cessionary, what then remains with the cedent?

In section 6.6 (*The pledge theory*), I discussed the courts' criticisms in *Moola*[1263] and *Grobler*[1264] of the concept of *dominium.* In addition, in *Barclays Bank (D, C & O) and Another v Riverside Dried Fruit Co (Pty) Ltd*[1265] the court held that a statement that a cedent of rights *in securitatem debiti* had *dominium* in the right was misleading, unless one bears in mind that it is, as Watermeyer J said, *'a sort of reversionary interest'* and, as Stratford J said, an interest that gives the owner of the *dominium* no rights of a

[1259] Brits *Real Security Law* (2016) 322.
[1260] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 at 248.
[1261] Ibid. The word used in the judgment is *'trustee'.*
[1262] Ibid 248; *Voet* 42.7.7.
[1263] *Moola v Estate Moola* 1957 (2) SA 463 (N) at 464B–D.
[1264] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 18.
[1265] *Barclays Bank (DC&O) and Another v Riverside Dried Fruit Co (Pty) Ltd* 1949 (1) SA 937 (C).

dominus.[1266]

A personal right entitles the holder to require another person to perform an act and is generally freely transferable, unless it was created as being non-transferable,[1267] or common law or statute prohibits its transferability. Is it possible for the holder to own that right and, if so, what exactly does the holder own if the right of action has been transferred to the cessionary in consequence of the cession *in securitatem debiti*? Whatever the meaning of the cedent owning the *dominium* in the right may be, it is certain that commercially the right is an asset in the cedent's estate that ultimately has a money value in the period before and upon the insolvency of the cedent.[1268] In *Grobler* the court held that while the concept of *dominium* is ill-suited to describe the cedent's interests, the term *'reversionary interest'* better describes the cedent's interest in the right as being the debtor satisfying the principal debt.[1269] The court in *Grobler* held that to understand the cedent's reversionary interest as being its right to claim re-cession of the right of action from the cessionary once the secured debt is settled is not good law, as it would amount to a recapitulation to the *pactum fiduciae* theory and conflicts with the legal position that a claim ceded in security reverts automatically to the cedent once the secured debt is repaid.[1270] In this sense, I submit that it can be contended that a cedent does not, after a cession *in securitatem debiti*, own a personal right but rather has a reversionary interest therein. However, prior to a cession *in securitatem debiti* of a personal right, the holder enjoys the full right in the sense that he or she can burden or alienate the right.[1271]

6.7.5 *Enforcing the ceded rights: Locus standi*

The *locus standi* to enforce or collect the ceded principal debt from the principal debtor is governed by common-law principles. I will now discuss these principles and its legal effect on the parties' rights.

Ceded rights can be exercised prior to litigating, or through litigation, against the principal debtor. Enforcement may therefore occur in the ordinary course of business (without litigating), or by issuing legal process out of the courts. Whether the cedent wishes to follow one or the other route depends on how willing the principal debtor is to remedy its default.

Locus standi is the legal standing or legal capacity to litigate and seek appropriate relief from a court.[1272] As a procedural and substantive issue, *locus standi* –

> *concerns the sufficiency and directness of a litigant's interest in proceedings which warrants his or her title to prosecute the claim asserted. The applicant has to show that it is the rights-*

[1266] Ibid 946.
[1267] This aspect is discussed in section 5.6 *Agreements prohibiting or restricting cession (pacta de non cedendo).*
[1268] *Scott on Cession* (2018) 16 para 1.3.2.
[1269] See *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 22. The terms 'reversionary interest' and 'residual interest' are discussed in section 6.6 *The pledge theory*.
[1270] See *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.
[1271] *Scott on Cession* (2018) 16.
[1272] Harms 'Civil Procedure: Superior Courts' *LAWSA* vol 4 (Third Edition Replacement, 2016) para 71.

> *bearing entity, or is acting on the authority of the entity, or has acquired its rights. … It is for the party instituting proceedings to allege and prove that he or she has standing and the onus to establish this issue rests upon that party throughout the proceedings. … It is a requirement that a party to litigation must have a direct and substantial interest in the right, which is the subject matter of the litigation, and in the outcome of the litigation.*[1273]

If the cessionary wants to enforce the ceded rights, either because the cedent has defaulted on the secured *mutuum,* or because the cessionary must fulfil its obligations to protect the cedent's interests by preserving the ceded rights,[1274] it must have a direct and substantial interest in enforcing the principal debt and its outcome. The cessionary's direct and substantial interest in enforcing the principal debt arises, in the case of the cedent having defaulted on the secured *mutuum*, from the fact that its security interest in the principal debt enables it to recoup the secured debt, and in other cases, from its obligation to protect the cedent's interests therein by preserving the ceded rights. The cessionary's interest in the outcome of the litigation is to fulfil the said obligation.

A number of judgments that favour the pledge theory of cession *in securitatem debiti*, analysed in section 6.4 (*A review of the case law*), have held that the legal effect of such a cession is to *inter alia* vest the *locus standi* to collect (enforce) the principal debt exclusively in the cessionary. The cessionary may, for this reason, be obliged to exercise its *locus standi* rights to protect the cedent's interests in the ceded claim, for example, to prevent the ceded claim from prescribing, even though the cedent may not be in breach of its obligations arising from the secured debt.[1275] The reviewed judgments are replete with statements that the obligationary agreements must provide, when the cedent is not in default, whether the cedent or the cessionary must collect (enforce) the principal debt.

A seminal judgment that dealt specifically with *locus standi* was *Picardi Hotels Ltd v Thekweni Properties (Pty) Ltd*.[1276] The Supreme Court of Appeal examined a rental security cession in a mortgage bond and concluded that the cessionary had *locus standi* to collect the rental *ab initio.* The court held that the cession by the cedent of its rights to its rental income was an effective and unconditional transfer of rights, given effect to when the cession was executed. This means that, when executing the cession, the cedent immediately granted the cessionary a security interest in its rental income, but the cedent was still entitled to the rental income for as long as it was not in default of its obligations to the bank. It was therefore not a complete transfer by the cedent of its rights to the rental income to the cessionary. Accordingly, absent a re-cession by the bank, the cedent was divested of the power to sue its tenants for unpaid rentals. However, the court acknowledged that it was not unusual for a creditor to permit a debtor

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[1273] Ibid.
[1274] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC) para 30. Also see sections 4.10 *Pacta commissoria and conditional sales*, 5.7 *The fruits of a ceded right* and 6.7 *Theoretical issues arising from the pledge theory* above.
[1275] De Wet & Van Wyk *Kontraktereg* (1992) 416. Also see the minority judgment of Nienaber JA in *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA) para 27.
[1276] *Picardi Hotels Ltd v Thekweni Properties (Pty) Ltd* [2008] JOL 22588 (SCA).

to collect ceded debts. The court held that if the respondent itself wanted the right to sue for the unpaid rentals, it would have had to obtain a re-cession from the bank of the claims it ceded, in order to re-acquire *locus standi*.[1277] I submit that it is implied that the court drew a distinction between *collecting* unpaid rentals without *suing*, and *suing* for unpaid rentals. The position is, therefore, that a cession *in securitatem debiti* divests the cedent of *locus standi* to institute legal proceedings against the principal debtor, unless the cession agreement unequivocally provides to the contrary.

In holding that a cedent cannot recover performance from a debtor unless there was a stipulation to that effect in the agreement, Nienaber JA in *Development Bank* relied on the 1995 judgment in *Ovland Management (Tvl) (Pty) Ltd and Another v Petprin (Pty) Ltd*.[1278] In that case, the respondent sued the appellants for payment of monthly hire and service charges payable for the lease of office machines for February to April 1992. The appellants challenged the respondent's *locus standi* to sue them on the basis that all the appellant's rights were ceded to Bankfin as security for a loan advanced by Bankfin to the respondent, alternatively a third party whose identity was unknown to the appellants. Accordingly, contended the appellants, the respondent had no *locus standi* to enforce the lease agreements. The respondent contended it was entitled to collect rentals under the lease agreements until it was in default of its obligations to Bankfin or if Bankfin terminated its rights under the cession agreement. The court examined the relevant provisions of the cession agreement and held that Bankfin's rights to enforce payment of the debts arose only if the respondent as cedent defaulted on its obligations to Bankfin (in terms of clause 5.1). The court held, on its interpretation of the cession agreement, that the right to collect the rentals remained vested in the respondent (as cedent) unless the circumstances in clause 5.1 or clause 9 of the cession agreement occurred. The respondent therefore had the necessary *locus standi* to institute the present proceedings. It is therefore unclear what then was ceded. The court in *Ovland* came to a different conclusion to the court in *Picardi* regarding when the *locus standi* vested in the cessionary, because the facts were different.

The fact that a cession vests *locus standi* in the cessionary is aptly demonstrated by Van Heerden. In discussing legal proceedings that commence after the cession of personal rights, Van Heerden states that, if cession occurs before issuing summons, and legal proceedings are nonetheless issued in the cedent's name, the cedent would be the *'wrong plaintiff'* appearing before the court.[1279] She reasons that, at the moment of instituting legal proceedings, the cedent has no cause of action given that it would already have passed, by cession, to the cessionary.[1280] However, regard must be had to the position in *Retmil*[1281] (discussed below) that the cedent, for purposes of protecting its reversionary interests in the ceded claim, also enjoys limited *locus standi* and

[1277] Ibid paras 13 and 14.
[1278] *Ovland Management (Tvl) (Pty) Ltd and Another v Petprin (Pty) Ltd* 1995 (3) SA 276 (N).
[1279] Van Heerden 'Legal Proceedings after Cession of Personal Rights: Some Perennial Problems' (1995) 112 *South African Law Journal* 379 at 383.
[1280] Ibid. She proceeds (at 383) to consider whether this is fatal to the legal proceedings, or if the court has a discretion to allow the pleadings to be amended to substitute the cessionary as the plaintiff in the cedent's place.
[1281] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC).

therefore, by implication, must have a cause of action. The position also seems to be supported by the case law.[1282] Van Heerden's reference to cession could be to out-and-out cession or cession *in securitatem debiti.*

An interesting issue is whether cession *in securitatem debiti* of a personal right vests *locus standi* in the cessionary to institute legal proceedings against a third party, to fulfil its obligation to preserve the ceded right. In law, because cession *in securitatem debiti* of a personal right vests *locus standi* in the cessionary to enforce the principal debt, it likewise vests *locus standi* in the cessionary to protect the cedent's interests against third parties. How else will the cessionary acquire the *locus standi* to protect the cedent's interests?

Is the cedent completely divested of all its rights to deal with its principal debtor by reason of the cession *in securitatem debiti* vesting *locus standi* in the cessionary? In *Retmil*[1283] the principal debt, payment of insurance proceeds occasioned by the cedent's death, fell due and payment was duly made, but the secured debt, a loan, was not yet due. Davis AJ considered the effect of the cedent having transferred its right of action to collect the principal debt to the cessionary. He held that the cedent, by virtue of its reversionary interest in the ceded claim, *'also enjoys locus standi to protect his interest in the right by appropriate means, even if he cannot for the time being enforce the right'*.[1284]

Brits[1285] refers to Davis AJ's quoted view above as the cedent having *'limited' locus standi* or a *'reversionary' locus standi* to protect its reversionary interest. Davis AJ stated:

> A*lthough the cedent in securitatem debiti has divested himself of the ceded right, he is not wholly divested of an interest in the asset, for he retains the so-called reversionary interest. The reversionary interest forms part of the cedent's estate, has value, and can be protected by legal means (such as an interdict) even although the cedent cannot for the time being enforce the ceded right. As Nienaber JA observed in Development Bank:*
>
> > *'It is that reversionary interest that vests in the cedent's trustee upon his insolvency, to be administered "in the interests of all the creditors and with due regard to the special position of the pledgee" ... ; that can itself be attached or ceded; that invests him with the locus standi to sue or be sued or apply for the debtor's sequestration; and may conceivably entitle the cedent, in an appropriate case and notwithstanding the cession, to perfect in order to protect the ceded security.'*[1286]

[1282] See, for example, *Philotex (Pty) Ltd and Others v Snyman and Others; Textilaties (Pty) Ltd and Others v Snyman and Others* 1994 (2) SA 710 (T) at 715 and the authorities cited there. The appeal judgment, *Philotex (Pty) Ltd and Others v Snyman and Others; Braitex (Pty) Ltd and Others v Snyman and Others* 1998 (2) SA 138 (SCA), does not seem to have taken a different view of this narrow issue.

[1283] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC).

[1284] Ibid para 29.

[1285] Brits 'Right to Receive versus Right to Appropriate Proceeds of Insurance Policy Ceded *in Securitatem Debiti: Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others*' (2016) 28(2) *South African Mercantile Law Journal* 346–359.

[1286] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and Others* [2013] 3 All SA 337 (WCC) para 48.

In *casu,* it was the executor's right to engage Sanlam regarding its proposal to reduce payment on the ceded life insurance policy. I submit that the approach of Davis AJ would be at odds with a wide and literal interpretation of *locus standi* as including any dealings with the principal debtor regarding the ceded right. It is more in line with a narrower interpretation of *locus standi* such as enforcing the ceded right through, for example, a letter of demand or litigation against the principal debtor. The cedent is entitled to protect its reversionary interest by negotiating the relevant issues with its principal debtor. The issue in *Retmil* concerned the cedent's rights against its principal debtor other than the right to collect the principal debt, whereas *Development Bank* concerned the cessionary's rights to collect the principal debt. A claim is founded on an obligation, which in turn is founded on a cause of action. I submit that as the cessionary holds the exclusive right to enforce the principal debt by virtue of the cession *in securitatem debiti*, and the cedent has limited *locus standi* or a reversionary *locus standi* to protect its reversionary interest (as held in *Retmil*), both parties have a cause of action on which to institute proceedings for different relief that they may seek, such as collecting the principal debt (in the case of the cessionary), or obtaining an interdict to prevent damage or loss to the reversionary interest (in the case of the cedent).

The case law has established that the legal effect of cession *in securitatem debiti* of a principal debt is that it entitles the cessionary to *locus standi* to enforce it. The principal obligation naturally differs from right to right,[1287] but the common thread (between the rights) is that the cessionary holds the exclusive legal right to realise the economic value of the right through enforcement, and the proceeds are used to settle the secured debt. The legal effect is also to entitle the cedent to limited *locus standi* to protect its reversionary interests. The commercial practice has developed, where the cedent and the cessionary agree, in either the obligationary agreement (or the cession agreement) that, despite the cession, the cedent will continue to enforce the ceded right in the ordinary course of its business, that is, collect the debt due, until the cedent defaults. This is acceptable legally in respect of the pre-litigation stage.

The cedent, having (temporarily) parted with *locus standi* to enforce the principal debt, has, other than its limited *locus standi* arising from its reversionary rights, three options available to enforce its principal debt. First, it can require the cessionary, who is, pursuant to the cession, vested with the right of action in respect of the principal debt, to recover the principal debt. The cedent's right to do so arises *ex lege* since a consequence of the cession is that the cessionary is obliged to preserve the ceded right. If the cedent opts for this approach, the cessionary must institute legal action in its own

[1287] In a cession *in securitatem debiti* of accounts, it is the right of the cedent to receive payment from its bank of the credit balance in the ceded account in terms of the contract of mandate between the bank and the cedent. In a cession *in securitatem debiti* of book debts, it is the right of the cedent to receive payment from its customers or clients of amounts owed by them under the contracts of supply of goods or services concluded between the cedent and its customers or clients, for the supply of goods or services. In a cession *in securitatem debiti* of shares, it is the right to vote the shares and to collect declared but unpaid dividends or other economic benefits. In a cession *in securitatem debiti* of insurance policies, it is the insured's benefits due under the policies, especially payment of insurance proceeds. In a cession *in securitatem debiti* of rental income, it is the right of the cedent as landlord to receive rental payments from its tenants of amounts owed by them under the contracts of lease concluded between the cedent as landlord and its tenants.

name against the defaulting principal debtor.[1288] Not only does the right to institute legal action in the cessionary's name arise *ex lege* from the cession *in securitatem debiti*, but the right is also typically provided for contractually in the cession agreement in the form of a power of attorney. The cessionary need not join the cedent as a co-plaintiff in the action as long as it alleges and proves the contractual basis of the cession *in securitatem debiti* of the principal debt which in law confers on the cessionary the *locus standi* to institute the claim. A cessionary may well be hesitant to implement this option for a number of reasons, including if its core business is materially different to that of the cedent. Second, if the cedent wishes to recover the principal debt itself in its own name and for its own benefit, it could, on the authority of *Picardi*, with the cessionary's consent, acquire a re-cession of the right to recover the debt. The cedent and the cessionary will, when concluding the transfer agreement, need to agree to the re-cession of this right. This appears to be the more commonly practised commercial approach. However, re-ceding the right deprives the cessionary of its security in that right. To counter the loss of security, the cedent pledges and cedes *in securitatem debiti* to the cessionary its right to the proceeds of the pending litigation between it and its debtor, should it be successful.[1289] Third, if the cedent wishes to recover the principal debt itself in its own name but for the cessionary's benefit for purposes of fulfilling the cession, it could agree with the cessionary that it be appointed as the cessionary's agent to enforce the principal debt. The agency option has difficulties of its own, such as the nature of the relationship between the agent and principal; whether the cedent as agent is obliged to disclose that it is acting on behalf of the cessionary as its principal (if it sues in a representative capacity then the cedent must disclose it); the liability of the cessionary as principal for its agent's conduct; the time when the agency may be effected, whether before or after summons, during legal proceedings or after judgment; and related matters.[1290] These difficulties will no doubt militate against adopting this course of action.

The *Retmil* principle that a cedent has, arising from its reversionary rights, reversionary *locus standi* in respect thereof may not apply if a cedent pledged and ceded *in securitatem debiti* its reversionary rights to a cessionary. If so, the concomitant reversionary *locus standi* will likewise have been transferred. *Retmil* made it clear that the reversionary rights give rise to reversionary *locus standi*, so it is logically impossible to cede (transfer) the one without the other. In a syndicated loan where the lenders hold the security directly, a senior lender would hold the right of action to the principal debt proceeds as security, and a mezzanine lender would hold the reversionary interests with the reversionary *locus standi* to the same principal debt proceeds as security. In these circumstances, if the value of the principal debt equals the sum of the senior debt plus the mezzanine debt, the cedent will be left with nothing in the principal debt, other than the hope that, on settlement by it of the secured debt, the principal right will, on the

[1288] See also section 4.9 *The realisation of security*.
[1289] This is the cession of a future right; see section 5.5 *The cession of future rights*.
[1290] *Clark v Van Rensburg and Another* 1964 (4) SA 153 (O); *Waikiwi Shipping Co Ltd v Thomas Barlow and Sons (Natal) Ltd and Another* 1978 (1) SA 671 (A).

authority of *Grobler*,[1291] automatically revert to it and its ownership will be fully restored. Of course, if one takes the view that personal rights consist of a range of competencies or components such as those described in section 6.7 (*Theoretical issues arising from the pledge theory*),[1292] and not only the reversionary interests and the right of action, then the cedent will still retain the other competencies or components discussed in that section. It is possible that the value of the principal debt may exceed the sum of the senior debt plus the mezzanine debt, so that after the cedent cedes *in securitatem debiti* both the right of action and its reversionary interest to the senior lender and the mezzanine lender respectively, there is still unencumbered value in the principal debt. The cedent can then cede *in securitatem debiti* the unencumbered value (or part thereof) in the principal debt to a third lender as security for a different loan obligation.

6.8 Commercial considerations

A number of commercial considerations and factors influence or should influence the law of cession *in securitatem debiti* generally, and more specifically the choice of theory applicable to a given cession.

The cessionary requires adequate security to mitigate the risk that the cedent may not repay the loan and the value of the ceded rights must be sufficient to settle the secured debt. In practice, lenders achieve it by requiring the borrower to maintain a financial covenant in the form of a security cover ratio. The financial covenant measures the market value of the security[1293] to the total outstandings,[1294] which must be kept in a stipulated ratio at a measurement date[1295] until the secured debt is repaid. A failure by the borrower to maintain the financial covenant in this ratio on the measurement date(s) is an event of default of the facility agreement that entitles the lender to accelerate the loan repayment and/or enforce its security.

The cedent, on the other hand, needs to retain the ceded right, asset or property to trade it so as to produce the revenue to maintain its business, and to repay the loan, interest and costs according to the loan terms. The cedent must therefore be able to continue to exercise these rights for the duration of the cession; these rights include the right to sue delinquent debtors, compromise a claim if needed, and prevent claims from prescribing. Yet the exclusive right to enforce a claim ceded *in securitatem debiti* rests with the cessionary while the secured debt remains unpaid. The parties should therefore agree that, despite the cession *in securitatem debiti*, the cedent may require the cessionary to (i)

[1291] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.
[1292] In section 6.7.1 *The divisibility of personal rights*.
[1293] The standard definition of 'security value' in a facility agreement typically reads as follows:
'Security Value' means the aggregate market value of the Security contemplated in the Security Documents, determined by the Agent in accordance with clause 23.3 (Calculation of Security Value).
[1294] The standard definition of 'total outstandings' in a facility agreement typically reads as follows:
'Total Outstandings' means, on any day, the aggregate of all amounts (whether in respect of accrued interest, or otherwise) owing by any Group Company under any loan or Financial Indebtedness, including, without limitation, any claim for damages or restitution and any claim as a result of any recovery by any such Group Company or any other person of a payment or discharge on the grounds of preference, and any amounts which would be included in any of the above but for any discharge, non-provability or unenforceability.
[1295] A measurement date is a date on which the financial covenant ratios are measured, usually the end of a six-month or a twelve-month period.

enforce the ceded right; or (ii) appoint the cedent as its agent to exercise the ceded rights; or (iii) re-cede the ceded rights to the cedent to vest it with *locus standi* to enforce the ceded claim.

The insolvency law effects of the theories should also influence the choice of theory. In terms of the pledge theory, the ceded right remains an asset in the cedent's insolvent estate, to be administered by the liquidator, subject to the cessionary's right to payment. If the cessionary were to go insolvent, the cedent would suffer no harm as the ceded right vests in its insolvent estate. In these circumstances, the cedent would be no worse off.

The *pactum fiduciae* theory has very different consequences. In terms of this theory, the ceded right will have been transferred to the cessionary in consequence of the cession. It is accounted for in the cessionary's estate, both prior to and on the cedent's liquidation. The value of the cedent's business is therefore reduced by such transfer. The liquidator of the cedent's insolvent estate will have a claim against the cessionary for the re-cession of the ceded right once the secured debt is settled. Similarly, if the cessionary were to go insolvent, the cedent would have a claim against the cessionary's insolvent estate for the re-cession of the ceded right against payment of the secured debt, although such a claim may be considered, on payment of the secured debt, obsolete, since *Grobler*[1296] held that a claim ceded *in securitatem debiti* automatically reverts to the cedent on payment of the secured debt, rendering a re-cession of such claim unnecessary.

The pledge theory is more commercially feasible than the *pactum fiduciae* theory, for a number of reasons. It recognises the cedent's reversionary interests in the principal debt and simultaneously recognises the cessionary's security in its control of the economic value of the principal debt. The enforcement of the cessionary's security also works litigiously. If the cedent defaults on the secured debt, the cessionary may (i) retain the security assets or personal rights as beneficial owner and credit the cedent for the fair value[1297] of the assets or personal rights in settlement of the secured debt; or (ii) seek judgment against the cedent, requesting the court's sanction to dispose of the security assets for their fair value and apply the proceeds to settle the secured debt, assuming *parate executie* does not apply; or (iii) collect the principal debt from the debtor as it has *locus standi* to do so, and use the proceeds to settle the secured debt. The choice as to which course of action to follow is the cessionary's and will likely be informed by considerations such as the value of the ceded principal debt, and the cost and speed with which the secured debt can be repaid.

6.9 Concluding remarks

In South African law, the doctrinal foundation that one debt can be ceded *in securitatem debiti* for another debt is the pledge theory, unless the parties intend a complete transfer of the right, coupled with a re-transfer once the secured debt is settled, in which case the

[1296] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.
[1297] I discuss fair value in section 4.9.3 *A lender's common-law obligation to realise fair value for the security*.

pactum fiduciae theory would apply. The commercial feasibility in modern-day commerce of the pledge theory as opposed to the *pactum fiduciae* theory has been established.

Conceptually, can rights over rights be accommodated in the traditional classes of real rights and personal rights, or should these classes be expanded or modified to accommodate rights over rights? I submit that the traditional distinction between real rights and personal rights, insofar as security interests are concerned, is adequate to accommodate rights over rights because the cessionary's real security rights over the proceeds arising from the cedent's personal rights do not create a different or new class of rights that cannot be accommodated in the established classes of rights.

Having analysed and critiqued the law on loans for consumption, syndicated lending, security for loans, cession generally and cession *in securitatem debiti* of personal rights in South African law in considerable detail, I will now examine the international instruments that seek to standardise the law on security interests: the English law on charges, and Article 9 of the American Uniform Commercial Code.

7 Chapter Seven: Cession of Personal Rights: Lessons from International Instruments, the United Kingdom and the United States of America

In this chapter I will examine international instruments that seek to standardise the law on security interests, namely, the UNCITRAL Model Law on Secured Transactions, Vienna, 2019 ('UN Model Law'), the UNCITRAL Legislative Guide on Secured Transactions, New York, 2010 ('UN Guide'), the United Nations Convention on the Assignment of Receivables in International Trade, New York, 2004 ('UN Assignment of Receivables') and the Convention on International Interests in Mobile Equipment Act 4 of 2007 ('Mobile Equipment Act'). I will also consider the English law on charges and Article 9 of the American Uniform Commercial Code, and will compare them to South African security rights law and, more specifically, the South African law on cession in *securitatem debiti* of personal rights.

The purpose is to establish how the South African security rights law compares to international law on security interests in respect of its content and form, to determine if South African law accords with or conflicts with international trends. The international instruments provide a useful comparator for, specifically, the South African law on cession in *securitatem debiti* of personal rights because they allow us to benchmark this law against international standards. It enables us to establish the strengths and weaknesses of South African security rights law in relation to international law on security interests. The lessons learnt will aid in designing and mapping out the proposed substantive and structural reform of South African security rights law.

7.1 International instruments

Three international instruments and one South African instrument that enacts international law provisions into South African law affect the South African law on security rights.

The international instruments are the UN Model Law, the UN Guide and the UN Assignment of Receivables. South Africa has not enacted either the UN Model Law or the UN Guide into national legislation and is also not a contracting party to the UN Assignment of Receivables. The South African instrument is the Mobile Equipment Act, which incorporates provisions of international law in respect of security interests in aircraft into South African law, giving the provisions national force. These provisions are important because South African law is aligned with international law in this limited respect.

7.1.1 The UNCITRAL Model Law on Secured Transactions, 2019

The UN Model Law is a prime example of the international standardisation of security rights laws. The UN Model Law is the result of the work of Working Group IV of UNCITRAL,[1298] and was adopted by UNCITRAL on 1 July 2016. Its purpose is to help countries, especially countries with developing and transitional economies, to modernise and reform their laws on secured transactions for the purpose of reducing

[1298] Gullifer 'UNCITRAL Model Law on Secured Transactions Adopted' University of Oxford, at https://www.law.ox.ac.uk/business-law-blog/blog/2016/07/uncitral-model-law-secured-transactions-adopted.

the cost of credit and increasing access to credit to stimulate international trade.[1299] The UN Model Law can work in countries with any type of legal tradition, for example, the common-law tradition or civil-law tradition, as representatives of all legal traditions participated in its drafting.[1300] UNCITRAL recognised that the central problem with secured transactions laws globally is *'the multiplicity of regimes that creates gaps and inconsistencies'*.[1301] For this reason, the UN Model Law applies to a wide variety of transactions.[1302]

The UN Model Law applies if a country elects to apply it.[1303] South Africa has not enacted the UN Model Law into national legislation, nor has it influenced South African law. Only eight countries have to date adopted legislation modelled on the UN Model Law, namely, Australia, Colombia, Fiji, New Zealand, Nigeria, Papua New Guinea, the Philippines and Zimbabwe.[1304] If a country enacts the model law, it becomes part of the national law of that country and the model law will apply to security rights in movable assets.[1305] The UN Model Law defines a security right as follows:

> *'Security right' means:*
>
> *(i) A property right in a movable asset that is created by an agreement to secure payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right, and regardless of the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation; and*
>
> *(ii) The right of the transferee under an outright transfer of a receivable by agreement*[1306]

The definition of a security right envisages that it is a property right and that it will secure the fulfilment of an obligation regardless of whether the parties intended it to serve as security or not. Intention is therefore irrelevant as a criterion or a legal requirement to create a security interest. South African law differs fundamentally from the UN Model Law in this regard as intention to create a security interest, and intention to acquire a security interest, is a common-law requirement, even though the Insolvency Act's definition of security is silent on intention.[1307] In terms of the above definition, there are no limitations on the types of assets in which security rights can be created. A movable asset is defined in the UN Model Law as a tangible or intangible asset, other than immovable property.[1308] An intangible asset in turn is defined, rather circularly, as

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[1299] Ibid.
[1300] Ibid.
[1301] United Nations Information Service 'UN Commission on International Trade Law Adopts the UNCITRAL Model Law on Secured Transactions' Press Release, 4 July 2016, at http://www.unis.unvienna.org/unis/en/pressrels/2016/unisl233.html.
[1302] See the scope of application of the UN Model Law in the paragraphs that follow.
[1303] Chapter I *Scope of application and general provisions.*
[1304] See https://uncitral.un.org/en/texts/securityinterests/modellaw/secured_transactions/status.
[1305] Chapter I *Scope of application and general provisions*, Art 1.
[1306] Chapter I *Scope of application and general provisions*, Art 2*(kk)*.
[1307] The fact that South African common law requires intention to create a security interest and the Insolvency Act does not is yet another example of untenable differing approaches in South African law to the creation of security interests. However, in South African law, it is impossible to create a special mortgage, landlord's legal hypothec, pledge or right of retention (as in the definition of 'security' in the Insolvency Act) without the parties thereto having intended to create such security. Intention must therefore be read into, and be assumed to be included in, the Insolvency Act's definition of 'security'.
[1308] Chapter I *Scope of application and general provisions,* Art 2*(u).*

any movable asset other than a tangible asset.[1309] It can be contended that a movable asset includes a receivable, which is defined in the UN Model Law as *'a right to payment of a monetary obligation, excluding a right to payment evidenced by a negotiable instrument, a right to payment of funds credited to a bank account and a right to payment under a non-intermediated security'*.[1310]

The term *'receivables'* in this chapter includes book debts, credit balances, shares and insurance policies, given that these assets effectively constitute a right in favour of the holder to payment of a monetary obligation as is contemplated in the UN Model Law definition of *'receivable'*. Insofar as shares and insurance policies are concerned, the holder's rights thereto are generally conditional, and whilst shares include rights in addition to payment of a distribution (dividend), the main benefit of insurance policies is payment by the insurer of the sum insured. Traditionally, a receivable is understood to mean payment of a monetary obligation arising from goods or services sold. However, the UN Model Law definition of a receivable does not name the source of the right to payment of a monetary obligation and, as the source is irrelevant, the type of transaction from which the monetary obligation arises is cast wide.

The UN Model Law applies to a wide variety of secured transactions, including asset acquisition transactions, intellectual property rights transactions, retention-of-title, financial lease and secured loan transactions. However, it expressly states that it does not apply to certain types of security rights, such as the right to request payment under, or to receive the proceeds of, an independent guarantee or letter of credit.[1311] Similarly, in South African law, guarantees are not security for insolvency law purposes, although guarantees are viewed commercially as a form of *quasi*-security.[1312] Our courts have recognised letters of credit as a method of securing payment.[1313] A country that has enacted the UN Model Law can exempt the UN Model Law from applying to assets that are subject to specialised secured transactions and asset-based registration schemes that fall under other laws.[1314] The UN Model Law states that it does not:

(i) affect the rights and obligations of the grantor or debtor that are afforded to them under other laws that protect parties to transactions made for personal, family or household purposes;

(ii) override laws that limit the creation or enforcement of a security right, or the transferability of types of assets, except laws that limit the creation or enforcement of a security right, or the transferability of an asset on the sole ground that it is a future asset, or part of or an undivided interest in an asset.[1315]

[1309] Chapter I *Scope of application and general provisions,* Art 2*(p).*
[1310] Chapter I *Scope of application and general provisions,* Art 2*(dd).*
[1311] Chapter I *Scope of application and general provisions,* Art 1(3), which contains other exceptions as well.
[1312] See section 4.4 *The meaning of 'security' in the Insolvency Act.*
[1313] *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd CTA* 2010 (2) SA 86 (SCA) para 20.
[1314] Chapter I *Scope of application and general provisions*, Art 1(3)(e). For example, if South Africa adopted the UN Model Law, it could exempt the UN Model Law from applying to the pledge and cession *in securitatem debiti* of listed uncertificated securities that fall under s 39 and related sections of the Financial Markets Act.
[1315] Chapter I *Scope of application and general provisions,* Art 1(5) and (6).

> A future asset is defined as a movable asset that does not exist or which the grantor does not have rights in or the power to encumber at the time the security agreement is concluded.[1316]

So, for example, if South African law has principles or rules that achieve (i) or (ii), then such law would remain in force, despite South Africa adopting the UN Model Law.

In terms of the UN Model Law, a security right may secure an obligation of any type, present or future, determined or determinable, conditional or unconditional, fixed or fluctuating,[1317] and may be granted over any movable asset, a part of or an undivided right in a movable asset, a generic category of movable assets or all of the grantor's movable assets.[1318] A security right is created by a security agreement,[1319] provided that the grantor has rights in the asset that is to be encumbered, or alternatively, has the power to encumber it.[1320] This proviso accords with the position in South African law where, in terms of the maxim *nemo plus iuris ad alium transferre potest quam ipse haberet*, the holder of a right cannot transfer greater rights than he or she has.[1321] Thus, a borrower cannot grant a lender rights of any kind that are greater than those which the borrower has; this includes security rights. In South African law, a security right provides security for a secured obligation that can be claimable or contingent, present or future, as long as there is or will be an obligation to which hypothecation is accessory.

The security agreement must, in terms of the UN Model Law: (i) be signed by the grantor; (ii) identify the secured creditor and grantor; (iii) describe the secured obligation owed to the creditor; (iv) describe the encumbered asset in a manner that reasonably allows for its identification; and (v) state the maximum amount for which the security right may be enforced.[1322] In South African law these five items are typically contained in a security agreement, although it is not a requirement to state the maximum amount that the security secures. Typically, South African security agreements state that the security is given for all indebtedness, present and future, owed or that may be owed, by the borrower or obligors, arising from the facility agreement, without stipulating a maximum amount.

A security right is extinguished when all secured obligations have been discharged.[1323] The UN Model Law ends contractual limitations on creating security rights in receivables. For example, a security right in a receivable is effective notwithstanding any agreement between the initial or any subsequent grantor and the debtor of the receivable, or any secured creditor, limiting in any way the grantor's right to create a security right.[1324] The following feature is interesting:

[1316] Chapter I *Scope of application and general provisions,* Art 2*(n).*
[1317] Chapter II *Creation of a security right,* Art 7.
[1318] Chapter II *Creation of a security right,* Art 8*(a), (b), (c)* and *(d).*
[1319] Chapter II *Creation of a security right,* Art 6.
[1320] Chapter II *Creation of a security right,* Art 6(1).
[1321] Lubbe 'Cession' *LAWSA* (2013) para 171.
[1322] Chapter II *Creation of a security right,* Art 6 read with Art 9.
[1323] Chapter II *Creation of a security right,* Art 12.
[1324] Chapter II *Creation of a security right,* Art 13 generally, and Art 13(1).

> *A secured creditor with a security right in a receivable or other intangible asset or in a negotiable instrument has the benefit of any personal or property right that secures or supports payment or other performance of the encumbered asset without a new act of transfer. If that right is transferable under the law governing it only with a new act of transfer, the grantor is obliged to transfer the benefit of that right to the secured creditor.*[1325]

In South African law, the *Pizani* principle similarly states that, if a claim is ceded, the security given for that claim is automatically ceded with the claim, and the cessionary consequently may claim against both the debtor and the surety.[1326] The UN Model Law further contemplates that the enacting country will have a registry in which all security rights must be registered and it contains detailed provisions that apply to such a registry.[1327] The registry requirements of the UN Model Law are notice or publicity requirements. The effect of registering a notice of a security right in the registry is that it elevates the security right, from a security right in proceeds arising from an asset effective against the owner thereof, to the status of being effective against third parties.[1328] The rights of the security holder or creditor are therefore enforceable against the world at large, not only against the grantor, even though the security right was originally created as a personal right against the grantor. The position in South African law is discussed below.

Chapter V of the UN Model Law deals extensively with competing claims or security rights. The chapter regulates competing claims between lenders and is relevant to South African law as our jurisprudence in this regard can be compared. The chapter distinguishes between different scenarios, for example, competing security rights (i) created by the same grantor in the same encumbered asset;[1329] (ii) created by different grantors in the same encumbered asset;[1330] (iii) in the case of changing the method of third-party effectiveness;[1331] (iv) in proceeds[1332] and so forth. Third-party effectiveness can be achieved by registering the security right in a registry, or by physical possession in the case of movable property, or by a control agreement for the rights to bank account funds and non-intermediated securities in the case of intangible security rights.[1333] The rules on priority are furthermore set out in relation to the grantor's insolvency,[1334] security rights that compete with *ex lege* preferential claims,[1335] and security rights that compete with judgment creditors' rights.[1336] Competing security rights are subject to the following rules. First, the order of registration of security rights in the registry, not the

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[1325] Chapter II *Creation of a security right,* Art 14.
[1326] See the discussion of the *Pizani* principle in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?* However, there are exceptions to the *Pizani* principle, as discussed in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?*
[1327] Chapter IV *The registry system.* See the Model Registry Provisions in Chapter IV.
[1328] Chapter III *Effectiveness of a security right against third parties*, Art 18(1) read with Art 19(1).
[1329] Chapter V A. General rules *Priority of a security right*, Art 29.
[1330] Chapter V A. General rules *Priority of a security right*, Art 30.
[1331] Chapter V A. General rules *Priority of a security right*, Art 31.
[1332] Chapter V A. General rules *Priority of a security right*, Art 32.
[1333] UN Model Law Guide to Enactment Chapter III. *Effectiveness of a security right against third parties* A. General rules Article 18. *Primary methods for achieving third-party effectiveness*, sub-Art 123.
[1334] Chapter V A. General rules *Priority of a security right*, Art 35.
[1335] Chapter V A. General rules *Priority of a security right*, Art 36. Each country must determine the value for claim categories.
[1336] Chapter V A. General rules *Priority of a security right*, Art 37.

order of their creation, determines the priority between competing security rights.[1337] Even if a security right was created before other security rights, but was registered in the registry after the other security rights, it will rank after the other first registered security rights. Second, if competing security rights were made effective against third parties in a manner other than through registration in a registry,[1338] priority between competing security rights is determined by the order in which third-party effectiveness was achieved.[1339] Third, the order of registration or third-party effectiveness, whichever occurs first, determines priority between security rights made effective against third parties by registration in a registry and security rights made effective against third parties in some other manner.[1340] These rules also apply to and determine the priority between competing security rights in the same encumbered asset that were created by different grantors.[1341]

In terms of the UN Model Law, the debtor's obligation is to discharge a receivable by making payment in accordance with the contract from which the receivable originates, unless the debtor receives notification of a security right in that receivable.[1342] If the debtor receives such notification, the debtor discharges the receivable by paying the secured creditor,[1343] or as otherwise instructed in the notification or as subsequently notified by the secured creditor.[1344] The position in South African law is similar, although it is not regulated by law but by practice or the terms of the finance documents.[1345] Detailed provisions in Chapter VI of the UN Model Law deal with the debtor's obligations if it receives more than one payment instruction.

A person who has a security right or is a transferee under an outright transfer of a receivable is defined as a secured creditor.[1346] A secured creditor has substantial rights in terms of the UN Model Law. If insolvency proceedings are commenced against a grantor, the security right (of a secured creditor) remains effective against third parties and it retains its priority against other claims, unless those other claims have priority pursuant to the enacting country's insolvency laws.[1347] Enforcement procedures are regulated in detail in the UN Model Law.[1348] If enforcement procedures are implemented, secured creditors whose claims rank prior to or above the claims of other enforcing creditors who have commenced enforcement proceedings can usurp or take over such proceedings.[1349] A secured creditor also has other rights, such as the right to (i) obtain possession of the encumbered asset;[1350] (ii) dispose of an encumbered

[1337] Chapter V A. General rules *Priority of a security right,* Art 29*(a)*.
[1338] For example, by application of the common law or by legislation.
[1339] Chapter V A. General rules *Priority of a security right,* Art 29*(b)*.
[1340] Chapter V A. General rules *Priority of a security right,* Art 29*(c)*.
[1341] Chapter V A. General rules *Priority of a security right,* Art 30.
[1342] Chapter VI *Rights and obligations of the parties and third-party obligations*, Art 63(1).
[1343] A secured creditor is discussed below.
[1344] Chapter VI *Rights and obligations of the parties and third-party obligations*, Art 63(2).
[1345] See n 582 for a definition of the term 'finance documents'.
[1346] Chapter I *Scope of application and general provisions,* Art 2*(ff)*.
[1347] Chapter V *Priority of a security right,* Art 35.
[1348] Chapter VII *Enforcement of a security right.*
[1349] Chapter VII *Enforcement of a security right*, Art 76.
[1350] Chapter VII *Enforcement of a security right*, Art 77.

asset;[1351] (iii) distribute the proceeds of a disposed encumbered asset;[1352] and (iv) propose that the secured creditor acquires ownership of the encumbered asset in full or partial satisfaction of the secured obligation.[1353]

The UN Model Law is exemplary in its clarity of legal concepts, and in demonstrating the life cycle of a security right. It regulates in detail all aspects of security rights. While the South African law on security rights accords in some respects with the UN Model Law, it differs in other respects. For example, both legal systems adopt the principle that a party cannot confer greater security rights on another party than the rights that it has. The UN Model Law permits an agent who has the power to encumber an asset for the purpose of conferring a security right to do so. South African law also recognises such agency power, but it is governed by a set of common-law principles. The principles on notice or registration in the two legal systems differ. While the UN Model Law requires notice of security rights to be registered, South African law has a disparate and mixed system in which certain types of security rights (such as security rights in aircraft, property (movable and immovable), listed uncertificated securities or ships) must be registered, and others (such as security rights in moneys in bank accounts, book debts, insurance policies, movable property pledged but not held under a notarial bond and unlisted securities) need not be registered in order to be enforceable. The rules on priority (of competing security rights) in the two legal systems also differ. The UN Model Law has clear rules on priority that are determined by registration and third-party effectiveness, depending on whether the relevant security rights were made effective by registration or by third-party effectiveness. In contrast, the South African common-law principle is that, in the case of competing security rights, the rights created or registered (if applicable) first in time prevail over any subsequent rights.[1354] When one compares the legal position of the two legal systems on competing security rights, the UN Model Law has a more complex set of rules for priority, catering for different scenarios, whereas the South African approach is more simple, based on the first in time principle, which does not pay much attention to third-party effectiveness.

7.1.2 The UNCITRAL Legislative Guide on Secured Transactions, New York, 2010

The UN Guide, although not a model law or treaty, seeks to create modern, secured transactions laws.[1355] It consists of commentary and recommendations with its stated premises being that[1356] –

[1351] Chapter VII *Enforcement of a security right*, Art 78.
[1352] Chapter VII *Enforcement of a security right*, Art 79.
[1353] Chapter VII *Enforcement of a security right*, Art 80.
[1354] Brits *Real Security Law* (2016) discusses the first in time principle generally (at 7) and then discusses it in relation to different security instruments, such as bonds over movable property (at 159), special and general bonds (at 196), security held under the Security by Means of Movable Property Act 56 of 1993 (at 258) and pledge of claims (at 322).
[1355] Klein 'UNCITRAL Legislative Guide on Secured Transactions: An Introduction and Overview' (August 2009) XXVIII(6) *American Bankruptcy Institute Journal*.
[1356] Klein 'UNCITRAL Legislative Guide on Secured Transactions: An Introduction and Overview' (August 2009) XXVIII(6) *American Bankruptcy Institute Journal*; Dunn 'UNCITRAL Adopts Legislative Guide on Secured Transactions' (April 2008) 2(1) *Insolvency & Restructuring International* 40.

> *sound secured transactions laws can have significant economic benefits for States that adopt them, including attracting credit from domestic and foreign lenders and other credit providers, promoting the development and growth of domestic businesses … and generally increasing trade. Such laws also benefit consumers by lowering prices for goods and services and making consumer credit more readily available.*[1357]

Its comments and recommendations deal with the nature and methods to create, make effective, register, priority and enforcement of, security rights in *inter alia* intangible/incorporeal property (personal claims) such as rights to (i) bank account credit balances; (ii) proceeds under an undertaking; and (iii) intellectual property. Similarly, South African law permits the creation of security rights in intangible/incorporeal property (personal claims). As the UN Guide focusses on the use by businesses of their *'core commercial assets'*[1358] such as equipment, inventory, and trade receivables to raise finance and use it as security,[1359] many of its aspects are not directly applicable to the use of personal rights as security. However, the UN Guide does apply to the rights to credit balances in bank accounts, contractual non-monetary claims, and intellectual property rights,[1360] which are personal rights. The conceptual approaches of the UN Guide are therefore rather useful and are applied in chapter 8.

7.1.3 The United Nations Convention on the Assignment of Receivables in International Trade, 2004

The UN Convention on the Assignment of Receivables was adopted by the General Assembly of the United Nations by Resolution 56/81 on 12 December 2001, after the United Nations Commission on International Trade Law, known as UNCITRAL, had spent six years preparing and drafting the UN Assignment of Receivables.[1361] The Convention facilitates cross-border transactions that assign receivables.

The Secretariat of UNCITRAL states that –

> *[t]he main objective of the Convention is to promote the availability of capital and credit at more affordable rates across national borders, thus facilitating the cross-border movement of goods and services. The Convention achieves this objective by reducing legal uncertainty with respect to a number of issues arising in the context of important receivables financing transactions, including asset-based lending, factoring, invoice discounting, forfaiting and securitization, as well as transactions in which no financing is provided.*[1362]

Only three countries have to date become signatories to the UN Convention on the Assignment of Receivables, namely, Luxembourg, Madagascar and the USA.[1363]

[1357] UN Guide, Introduction, A. Purpose of the Guide at 1 para 2.
[1358] UN Guide, Chapter I, Scope of application, basic approaches to secured transactions and general themes common to all chapters of the Guide, A. General Remarks, 2. Scope of application, (a) Assets, parties, obligations, transactions and proceeds, (i) Assets at 32 para 5.
[1359] Ibid.
[1360] Ibid.
[1361] Sigman & Smith 'An Analysis of the UN Assignment of Receivables' 2002 *Business Lawyer* 727.
[1362] UNCITRAL Explanatory Note at 28. The reference to *Convention* in the quoted paragraph is a reference to the UN Assignment of Receivables.
[1363] See https://treaties.un.org.

Sigman and Smith state:

> *Among the more significant provisions of the Convention facilitating cross-border transactions involving the assignment of receivables are: (i) the validation of assignments of receivables in bulk; (ii) the validation of an assignment of future receivables by means of a present assignment; (iii) the validation of assignments of partial and undivided interests in receivables; (iv) the partial override of contractual anti-assignment provisions; (v) a choice of law rule looking to the internal law of the State in which the assignor is located to determine the priority of an assignee's interest in assigned receivables; and (vi) a limited substantive rule providing the assignee with a property right in proceeds of assigned receivables.*[1364]

A receivable is defined as a contractual right to payment of a monetary sum, and includes parts of, and undivided interests in, receivables from any class of contract.[1365] Claims from the following classes of contracts are covered by the definition of *'receivable'*: supply of construction services, goods and services, intellectual property licence royalties, loan receivables (arising from credit extension transactions), consumer receivables (arising from consumer transactions), sovereign receivables (arising from transactions with governmental authorities or public entities), monetary damage claims for contract breach, toll road receipts, interest and non-monetary claims convertible to money.[1366] UNCITRAL states that, in consequence, asset-based financing (such as revolving credit facilities) and project financing are covered.[1367] Claims that are excluded are the right to payment arising other than by contract, such as a tort claim or a tax refund claim.[1368]

The UN Assignment of Receivables applies in principle only to (i) international receivables, where the assignor and the debtor are, at the time of concluding the original contract (defined as the contract between the assignor and the debtor from which the receivable arises[1369]), in different countries; and (ii) international assignments, where the assignor and assignee are in different countries.[1370] The UN Assignment does not apply to domestic assignments, except in two instances.[1371]

In terms of Article 10, a personal or property right that secures the payment of a receivable is assigned to the assignee when the receivable is assigned, without the need for a new act of transfer, unless the law that governs the right requires an act of transfer, and then a new act of transfer is needed.[1372] In that case, the assignor is obliged to transfer that right and the associated proceeds.[1373] The position that an assignment of a receivable automatically assigns security rights given for that receivable

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[1364] Sigman & Smith 'An Analysis of the UN Assignment of Receivables' 2002 *Business Lawyer* 728. The reference to *Convention* in the quoted paragraph is a reference to the UN Assignment of Receivables.
[1365] UNCITRAL Explanatory Note para 9.
[1366] Ibid.
[1367] Ibid para 10.
[1368] Ibid para 9.
[1369] Chapter II *General Provisions*, Art 5*(a).*
[1370] Chapter I *Scope of Application*, Art 3; UNCITRAL Explanatory Note para 14.
[1371] UNCITRAL Explanatory Note para 15. See para 15 for a discussion of the exceptions.
[1372] Chapter II *General Provisions*, Art 10(1).
[1373] Ibid.

accords with the *Pizani* principle[1374] that assignment of a claim automatically assigns security rights given for a claim, and therefore a cessionary acquires not only the cedent's (the assignor's) rights against the principal debtor but also the cedent's (the assignor's) rights in respect of the secured debt, which includes the right to sue the principal debtor and the surety.

Section II of Chapter IV provides for the protection of the debtor, notification to the debtor of the assignment, and issuing a payment instruction to the debtor that may change the person to whom payment is to be made. Such an instruction may not, however, change the payment currency of the original contract, nor the country specified in the original contract in which payment is to be made.[1375] After notification, only the assignee may request payment from the debtor.[1376] It is not clear whether notification to the debtor of the assignment is compulsory or voluntary. In any event, the South African legal position is different, in that no notification to the debtor is required to create an enforceable pledge and cession *in securitatem debiti* of a right. However, as discussed in chapter 5,[1377] in practice, notice to the debtor, and an acknowledgement by the debtor, of the cession *in securitatem debiti* is typically a condition precedent of the security agreement. It assists the debtor in rendering performance to the party entitled to the performance.[1378] For example, in a pre-default period where the borrower is not in default of the finance documents, the debtor must render performance to the borrower. However, in a default scenario where the borrower is in default of the finance documents, the debtor must render performance to the cessionary or lender. In the case of a delegation of an obligation, though, the debtor's consent must, as a matter of law, be obtained.

The UN Assignment of Receivables is relevant to this thesis from an academic perspective only in the case of an assignor (a borrower) in one country who wishes to transfer its receivable (a principal debt) to an assignee (a lender) in another country as security for a secured debt, or in the case of an assigned receivable for which security rights were given where the assignment transfers the security right as well (unless the national legislation of the enacting country requires a separate act of transfer), as both scenarios deal with secured loans. In the former case, South African law differs from the UN Assignment of Receivables in that the method to create the security rights is the common-law pledge and cession *in securitatem debiti*, but the net effect is similar, namely, a transaction that results in the transfer of a right.[1379] UNCITRAL recognises this as a pledge-type transaction.[1380] In the latter case, the *Pizani* principle is similar in

[1374] See the discussion of the *Pizani* principle in section 4.12 *Does cession of a principal debt automatically transfer security given for the principal debt to the new cessionary, or must the security be separately ceded?*
[1375] Chapter IV *Rights, Obligations and Defences*, Art 16.
[1376] Chapter IV *Rights, Obligations and Defences*, Art 13.
[1377] See section 5.1.3 *Notice of the cession to the principal debtor and performance including set-off* and section 6.2 *Notice to the principal debtor and performance.*
[1378] See chapter 5 *The Law of Cession* and chapter 6 *The Law of Cession in Securitatem Debiti.*
[1379] Although, as discussed in chapter 6 *The Law of Cession in Securitatem Debiti*, the matter is more complex given the different doctrinal bases on which cession *in securitatem debiti* can be founded. If the pledge theory is the doctrinal basis, a part of the right, namely, the right of action, is transferred in security. If the *pactum fiduciae* theory is the doctrinal basis, the entire right is transferred in security, on the condition that it is re-transferred when the secured debt is repaid.
[1380] UNCITRAL Explanatory Note para 7.

substance and effect to Article 10 of the UN Assignment of Receivables.

7.1.4 The Convention on International Interests in Mobile Equipment Act 4 of 2007

The Mobile Equipment Act is discussed in section 4.5.2 (*The registration of security rights*). As noted there, the Mobile Equipment Act domesticated the Convention on International Interests in Mobile Equipment 2001 and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment 2001. The domestication of these international laws creates real security rights in favour of the creditor (a chargee). The effect is that security interests in aircraft have been made an *'international interest'*, which is a defined term that means an interest held by a creditor to which Article 2 applies. Article 2, titled *'The international interest',* provides for the *'constitution and effects of an international interest in certain categories of mobile equipment and associated rights'*, which includes an interest *'granted by the chargor under a security agreement'* in respect of aircraft.[1381] Security interests in aircraft are then, on producing the deed of mortgage and paying the prescribed fee, recorded by the Commissioner for Civil Aviation in a register.

7.2 English law on charges

I compare the English law on charges with the South African law on cession *in securitatem debiti* because, first, English law constitutes the national legal system in many common-law countries, including many African countries, and, second, a charge creates an encumbrance or security interest over *inter alia* personal rights,[1382] much like a pledge and cession *in securitatem debiti* over personal rights. For example, it is possible to create a security interest over a debt[1383] or a share[1384] using a floating charge or a fixed charge to secure the repayment of a loan. A comparison of the two legal constructs will provide lessons for the improvement of the law of pledge and cession *in securitatem debiti*.

7.2.1 The law on charges

As the English case law and literature on charges is extensive, the analysis is limited to the essential features of charges. The analysis does not deal with the advantages or disadvantages of the different types of charges, or criticisms thereof, except insofar as this is necessary for comparative purposes.[1385] The South African law of pledge and cession *in securitatem debiti* will not be compared with the English law of pledge because the latter applies only to movable property[1386] and not to personal rights.

[1381] Convention on International Interests in Mobile Equipment 2001, Art 2(1), (2) and (3).
[1382] To the extent that a floating charge creates a security interest over the borrower's assets or stock, it is comparable to a notarial bond in South African law. Notarial bonds are analysed in section 4.5 *Personal and real security, and the registration of security rights* under the heading *Real security rights.*
[1383] McCormack *Secured Credit under English and American Law* (2004) 226.
[1384] Ibid 262.
[1385] For the disadvantages of floating charges, see Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008) para 3.2.6 *Disadvantages of floating charges.*
[1386] Gullifer *Legal Problems of Credit and Security* (2013) 32 para 1-48 states that in practice pledges are used to create security interests in goods and documentary intangibles. The latter is a document that contains title to money, goods or securities such that it vests title thereto in the holder of the document. Title can be transferred by delivery. Although English

In English security law, the basic distinctions are between legal and equitable security interests, possessory and non-possessory security interests, and consensual and non-consensual security interests.[1387] A security interest such as a legal mortgage differs from an equitable mortgage or charge in that a legal mortgage enjoys priority over subsequent interests.[1388] An equitable security interest can be overridden by a disposition to a *bona fide* purchaser for value of the legal title without notice of the equitable interest.[1389] Security interests in English law are created mainly by mortgages, charges, pledges and *liens*.[1390] These four security types are consensual.[1391] Charges apply to both movable corporeal property and incorporeal rights.

McCormack states that, in English law, *'the workhorse of the secured credit industry has traditionally been the charge and, in particular, the floating charge'*.[1392] This is evidenced by the significant number of judgments that have come before the English courts since 1870 when the *Panama* case was heard.[1393]

A charge is an agreement between a lender and a borrower whereby an identified asset is appropriated by earmarking it to satisfy a debt if the borrower fails to do so.[1394] A charge has also been described as *'an umbrella expression to cover the right of recourse to property for security purposes'*.[1395] A charge is an encumbrance on an asset that does not transfer ownership or possession of the asset[1396] and does not depend on possession or title.[1397] A lender may hold a fixed charge or a floating charge or a debenture which combines fixed and floating charges[1398] over a company's undertaking or property. A fixed charge is equitable and may therefore be set aside by a sale of the asset or by a subsequent mortgage.[1399] McKnight *et al* contend that if the chargor has been completely deprived of the freedom to exercise its proprietary rights in the assets charged, it is a fixed and not a floating charge.[1400] Wright's view is that, in practice, the fact that legally a fixed charge may be set aside by a sale of the asset or by a subsequent mortgage because it is an equitable instrument is not relevant, given that the fixed charge is registered with the Companies Registry, which serves as notice to third

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law has never fully defined documentary intangibles, it includes negotiable instruments, negotiable securities and bills of lading. Documentary intangibles are distinguished from pure intangibles, which evidence but do not constitute the right.

[1387] McCormack *Secured Credit under English and American Law* (2004) 39; McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 815, ch 14.

[1388] Gullifer *Legal Problems of Credit and Security* (2013) 8 para 1-12.

[1389] Ibid.

[1390] McCormack *Secured Credit under English and American Law* (2004) 39; Gullifer *Legal Problems of Credit and Security* (2013); McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 816– 817 para 14.1.1.3.

[1391] Gullifer *Legal Problems of Credit and Security* (2013) ch 5.

[1392] McCormack *Secured Credit under English and American Law* (2004) 39. Orkun Akseli *International Secured Transactions Law* (2012) 24 states that *'[u]nder English law, a charge is a right of recourse against property to guarantee the payment of money or the due performance of some other obligation, and is a consensual security right according to which the chargor (debtor) retains possession of the asset used as collateral and established by agreement concluded between the chargor and chargee.'*

[1393] *Re Panama, New Zealand and Australian Royal Mail Company* (1870) 5 Ch App 318.

[1394] Gullifer *Legal Problems of Credit and Security* (2013) 36 para 1-55.

[1395] McCormack *Secured Credit under English and American Law* (2004) 40–41.

[1396] Gullifer *Legal Problems of Credit and Security* (2013) 36 para 1–55.

[1397] Wright *International Loan Documentation* (2014) 329.

[1398] Ibid 353. If security is given by way of a debenture, then the company provides *'comprehensive security … over all or substantially all of its assets'*, in favour of the lender; see McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 857 para 14.5.3.5. The debenture document may contain other types of security instruments in addition to the charges; see Wright *International Loan Documentation* (2014) 353.

[1399] Wright *International Loan Documentation* (2014) 331.

[1400] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 864–865 para 14.6.4.2.

parties, such as mortgagees and purchasers of the chargee's rights.[1401] In this scenario, registration is against the company granting the security, not against the asset, on the company's public records at the Companies Registry.[1402] Charges against certain types of assets, such as aircraft, land, ships and intellectual property, must be registered against the asset, not the company.[1403] One principal distinction between the two types of charges is that a fixed charge is a charge on specific assets of the company, whilst a floating charge is a charge on assets of the company in their varying condition,[1404] over a category of assets,[1405] or over the company's business operations. Gullifer holds that the distinction between a fixed charge and a floating charge is rather between a charge that leaves no control with the chargee (the lender), in other words, the chargor (the borrower) has the authority to operate the business, and one that leaves the chargee (the lender) in control.[1406] Gough refers to this arrangement as a business-dealing licence.[1407] McKnight *et al*[1408] state that the essential characteristic of a floating charge is the chargor's (the borrower's) freedom to deal with the assets charged in the ordinary course of its business, as described by Romer LJ in *Re Yorkshire Woolcombers Association.*[1409] In a floating charge, the chargor therefore has the freedom to deal with its assets in the proprietary sense, including to dispose thereof, in the ordinary course of its business.[1410] Wright frames the test differently, yet similarly, by stating that the chargor's degree of control to deal with its assets determines if the charge is floating; so, for example, can the chargor dispose of the assets in the ordinary course of its business?[1411] A floating charge hovers over the category of assets or business of the chargor, and crystallises if the chargor defaults on the secured debt or is liquidated.[1412] Gullifer describes the effects of crystallisation thus:

> *Crystallisation puts an end to the authority conferred on the debtor company to manage the assets comprising the security. In consequence, the charge becomes converted into a fixed charge, fastening on all assets in which the company then has or subsequently acquires an interest. Though crystallisation does not per say put an end to the company's ability to continue its business, it ceases to be able to dispose of the charged assets free from the charge without the consent of the chargee, who cannot give blanket permission without refloating the charge.*[1413]

English courts have, over the decades, wrestled with *inter alia* characterising charges as fixed or floating and the distinctions, dealt with the rights afforded to the chargor and the chargee, and dealt with the effects of charges on the right of the chargor

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[1401] Ibid 332.
[1402] Ibid 334.
[1403] Ibid.
[1404] Gullifer *Legal Problems of Credit and Security* (2013) 36 para 1-55.
[1405] Wright *International Loan Documentation* (2014) 329.
[1406] Gullifer *Legal Problems of Credit and Security* (2013) 131 para 4-08.
[1407] Locke *Aspects of Traditional Securitisation in South African Law* (LLD thesis, UNISA, November 2008) para 3.2.2.2 *Business-dealing licence.*
[1408] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 864 para 14.6.4.1.
[1409] In *Re Yorkshire Woolcombers Association* [1903] 2 Ch 284, discussed below.
[1410] Gullifer *Legal Problems of Credit and Security* (2013) 197 para 5-40; Pogue 'The Spectrum Plus Case: Fixed or Floating Charges over Book Debts in England' 2005 *Banking Inst.* 419 at 428.
[1411] Wright *International Loan Documentation* (2014) 331.
[1412] Gullifer *Legal Problems of Credit and Security* (2013) 156 para 4-35.
[1413] Ibid 154 para 4-32.

to operate its business in the ordinary course. In respect of floating charges, English courts have furthermore considered what is meant by the chargor having the freedom to deal with its charged assets.[1414]

Re Panama, New Zealand and Australian Royal Mail Company

The 1870 judgment in *Re Panama, New Zealand and Australian Royal Mail Company*[1415] (*'Panama'*) is considered by many leading academics to be the *locus classicus* on creating a charge as an English law security interest.[1416] The Court of Appeal had to consider the rights of debenture holders who held a charge on the undertaking of the company as security for the repayment of their debentures, in the context of the business being wound up and its property being realised. The company accordingly issued a prospectus wishing to borrow £100,000 against security of a charge, to which two debenture holders subscribed for five debentures of £100 each, entitling them to receive biannual interest payments. The company failed to pay the interest and an order was made to wind up the company before the debentures became repayable. The company's ships were sold in terms of the winding up, and the debenture holders claimed, in preference to the general creditors, the sale proceeds. Their claim was upheld by Vice-Chancellor Malins in the court *a quo.* The liquidators, acting on behalf of the general creditors, appealed against that order.

The Court of Appeal, in interpreting the debenture deed and dismissing the appeal, held that:

(i) the debenture deed constituted a charge against the undertaking of the company, in respect of all its property, both present and future;

(ii) the object and meaning of the debenture was that the word 'undertaking' used in the debenture deed meant that the company's business would continue (to operate) and that the debenture holder *'could not interfere until either the interest which was due was unpaid, or until the period had arrived for the payment of his principal, and that principal was unpaid'*;[1417]

(iii) the meaning and object of the security was that the company would continue to trade, and the debenture holder would not be entitled to any account of the mesne profits or deal with the company's property in their ordinary course of business;[1418]

(iv) the moment the company was wound up, and its property in consequence realised, the debenture holders' rights would attach.[1419]

[1414] McKnight, Paterson & Zakrzewski *The Law of International Finance (*2017) 866–867 para 14.6.5.
[1415] *Re Panama, New Zealand and Australian Royal Mail Company* 5 Ch App 318.
[1416] Gullifer *Legal Problems of Credit and Security* (2013) 125 para 4-02.
[1417] Ibid 322.
[1418] Ibid.
[1419] Ibid 322–323.

Re Yorkshire Woolcombers Association

In 1903, in *Re Yorkshire Woolcombers Association*[1420] (*'Yorkshire'*), the Court of Appeal had to determine the meaning of a floating charge as defined in section 14(1)*(d)* of the Companies Act 1900. Up until that point in England, the term 'floating charge' had been used, but not defined, in statutes and judgments. Yorkshire Woolcombers Association Ltd, in favour of the trustees of the debenture holders, mortgaged all its freehold and leasehold property to the trustees to secure its debenture stock; and charged, by way of a floating charge, its property and assets, both present and future, and its undertaking, but for uncalled capital. A year or so later, the company's directors and others gave the Bradford District Bank Limited ('the Bank') guarantees to secure the company's overdraft facility. The mortgage and the guarantees were obviously different forms of security, both given by the company. Both the mortgagee and the debenture holders appointed receivers who, by agreement, ensured that all moneys paid in settlement of debts owed to the company were paid into a joint account held at the Bank. The trustee applied in the debenture holders' action to enforce his security.

In considering the meaning of a floating charge, Romer LJ held:

> *I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1.) If it is a charge on a class of assets of a company present and future. (2.) If that class is one which, in the ordinary course of business of the company, would be changing from time to time; and (3.) If you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.*[1421]

Gullifer comments that the judgment describes a floating charge rather than defining a floating charge. He further states that the first two characteristics in the judgment are typical but not distinctive of a floating charge, whilst the third characteristic is the *'hallmark of a floating charge'*.[1422]

In 1897, in *Governments Stock Investment Co v Manila Railway Co*[1423] (*'Manila'*), Macnaghten L stated the following in relation to a floating charge:

> *A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes. His right to intervene may of course be suspended by agreement. But if there is no agreement for suspension, he may exercise his right whenever after default.*[1424]

[1420] In *Re Yorkshire Woolcombers Association* [1903] 2 Ch 284.
[1421] Ibid 295.
[1422] Gullifer *Legal Problems of Credit and Security* (2013) 127–128 para 4-04.
[1423] *Governments Stock Investment Co v Manila Railway Co* [1897] AC 81.
[1424] Ibid 86.

Evans v Rival Granite Quarries Limited

In 1910, in *Evans v Rival Granite Quarries Limited*,[1425] the Court of Appeal was asked to consider whether a garnishee order that was made absolute (final) in the court below should have been made at all,[1426] and to consider the ranking between the competing claims of an execution creditor and debenture holder.[1427] A creditor had obtained judgment against the company for an amount owing in the county court in November 1908. The company failed to pay, and the creditor obtained a garnishee order *nisi* against the company's bank account. A debenture holder opposed the application for the order to be made absolute on the grounds that the debenture included all the company's property, past and future, its undertaking, goodwill and all its possessions. The county court found for the plaintiff and made the garnishee order final. On appeal, the Divisional Court set the final garnishee order aside because it held that the plaintiff had not shown sufficient grounds. On a further appeal against the Divisional Court's decision, the Court of Appeal was asked to set aside the finding of the court below.

In separate judgments delivered by their Lord Justices, the Court of Appeal held that the garnishee order *nisi* be made final. The Court of Appeal reasoned as follows:

(i) The court held that a creditor who had a floating charge over the company's assets had such rights that if the company's goods were placed under execution (by court order), the execution would have to be ended. The execution creditor did not deny that the creditor (debenture holder) had such rights, but contended that after issuing the debenture, the company would have the right to manage its business (including the property that was the subject of the debenture) without the debenture holder interfering.[1428]

(ii) The debenture holder, having acknowledged the company's licence to continue to trade its business, and having done nothing to interfere therewith, could not intervene in making the garnishee order final, thereby preventing the company from paying one of its creditors. It could not select which of the company's creditors it should pay and which it should not.[1429]

(iii) The court cited with approval the decisions in the *Panama* case and the *Manila* case.

(iv) Earlier judgments concluded that this type of security, by its nature, was intended to leave the company *'free to carry on its business until the time arrived when the debenture-holders enforced their security upon the company's assets and undertaking'*, which was accepted in later judgments.[1430]

(v) In effect, their Lordships concluded that it was in the nature of a floating charge that the company was licensed to trade its business in the ordinary course,

[1425] *Evans v Rival Granite Quarries Limited* [1910] 2 Ch 978.
[1426] Ibid 985 (judgment of Vaughan Williams LJ).
[1427] Ibid 999 (judgment of Buckley LJ).
[1428] Ibid 986 (judgment of Vaughan Williams LJ).
[1429] Ibid 989 (judgment of Vaughan Williams LJ).
[1430] Ibid 993 (judgment of Fletcher Moulton LJ).

including paying its creditors, unless the debenture holder actually takes legal steps to enforce its security.

Agnew v Commissioners of Inland Revenue

In 2001, in *Agnew v Commissioners of Inland Revenue*[1431] (*'Agnew'*), the question on appeal from the decision of the New Zealand Court of Appeal was whether there existed a fixed charge or a floating charge over the uncollected book debts of Brumark Investments Limited (in receivership), given that the charge left the company free to collect such debts and use them in the ordinary course of business. The court had to characterise the charge. The court considered the judgment of Romer LJ in the *Yorkshire* case and held that Romer LJ's oft-quoted passage was a description of a floating charge and not a definition insofar as the charge on present and future class of assets was concerned, and if the class is one which the company would be changing. Romer LJ's third characteristic of a floating charge distinguishes it from a fixed charge, namely: if the charge contemplates that, until a future step is taken by the chargee, the company may carry on its business in the ordinary way as regards the particular class of assets.[1432] The court discussed the judgment of the UK Court of Appeal in *In re New Bullas Trading Ltd*[1433] (*'New Bullas'*). The question in *New Bullas* was also whether a fixed charge or a floating charge existed over the uncollected book debts of the company when the receivers were appointed. The Privy Council in the *Agnew* case criticised the position in the *New Bullas* case that the characterisation of a charge was simply a matter of construction, given that the parties were free to make whatever agreement they liked. Instead, the Privy Council held that the question was not one of construction. Deciding whether a charge was fixed or floating was a two-stage process. First, the charge instrument had to be construed to determine the nature of the rights and obligations that the parties intended to grant each other in respect of the charged assets. Second, using the aforementioned information, the charge had to be categorised, which is a matter of law. The Privy Council thus concurred with the decision of the Court of Appeal of New Zealand.

It is evident from this case law review that the charge is substantively different to a pledge and cession *in securitatem debiti* in content and form, even though both legal constructs create security interests in personal rights.

7.2.2 Reforming the English law on security interests

Charges have come under severe criticism from different quarters.[1434] The criticisms range from criticisms on priority issues in the case of competing claims, to charge enforcement, to the system of charge registrations, to the preference created for secured creditors. Other criticisms of floating charges include that they entitle the charge

[1431] *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28; [2001] 2 AC 710.
[1432] Ibid para 13.
[1433] *In re New Bullas Trading Ltd* [1994] 1 BCLC 449.
[1434] The Law Commission of England and Wales 'Registration of Security Interests: Company Charges and Property Other Than Land – A Summary of the Consultation Paper' (2002) 14(1) *Bond Law Review* paras 15–32.

holder to withdraw all or most of the assets from the scope of a liquidation, resulting in the liquidator being unable to pay preferential creditors, and the charge holder may, without warning, exercise its rights and obtain priority over the company's ordinary trade creditors.[1435]

These criticisms resulted in the UK's Department of Trade and Industry requiring the Law Commission to address the reform of the law relating to company charges. The process to reform the law in this regard commenced in 2002 and culminated in statutory amendments to the Companies Act some 11 years later in 2013. The Law Commission published a consultation paper in 2002,[1436] a consultative report in 2004,[1437] and a consultation paper in 2005.[1438] The Law Commission's recommendations included:

(i) *a new online system to register charges cheaply;*

(ii) *all charges are registrable unless specifically exempted;*

(iii) *lenders will only be required to send brief details of the charge in a statement of particulars – not the charge documents themselves;*

(iv) *Companies House should not issue a conclusive certificate of registration, as this requires staff to check through lengthy paperwork;*

(v) *removing the 21-day time-limit for registration, and making it possible to register in advance of the transaction;*

(vi) *removing the criminal offence of failing to register a charge;*

(vii) *a simpler system of priority, based on the 'first to register' principle; and*

(viii) *sharing of information between Companies House and the Land Registry, so charges over properties will need to be registered only once.*[1439]

The Companies Act 2006 (Amendment of Part 25) Regulations 2013 came into force in April 2013. The regulations amend the Companies Act 2006 relating to company security interests.[1440] Part 25 of the Companies Act 2006 regulates company charges in England, Wales, Northern Ireland and Scotland. Charges must be registered by the company that creates the charge, or may, on application, be registered by a person interested in it, such as the chargee.[1441]

[1435] *In re New Bullas Trading Ltd* [1994] 1 BCLC 449 paras 9 and 10. There has been a movement to provide ordinary trade creditors with more certainty that their claims will be paid. This includes a proposal by Macnaghten L in *Salomon v Salomon* [1897] AC 22 that *'ordinary trade creditors be given a preferential claim on the assets of an insolvent company in respect of debts incurred within a limited time before the winding up'.* See the *New Bullas* case at para 10.
[1436] CP No 164. The document is titled 'Registration of Security Interests: Company Charges and Property Other Than Land'.
[1437] CP No 176. The document is titled 'Company Security Interests'.
[1438] CP No 296. The document is titled 'Company Security Interests'.
[1439] See www.lawcom.gov.uk.
[1440] Ibid.
[1441] Section 860(1) and (2) of the Companies Act 2006.

7.2.3 South African law on cession *in securitatem debiti* and the English law on charges

The workhorse of security rights

The workhorse of the English secured credit system is the charge, whilst in South Africa it is the pledge of movable property, the pledge and cession *in securitatem debiti* of personal rights, or a bond.[1442] Formulated differently, in English law the charge as a right *in rem* is the foundation of security interests, whilst in South African law the pledge of movable property, or the pledge and cession *in securitatem debiti* of a personal right, or a bond respectively entitles the lender to a real right of pledge over the pledgor's movable property, or the proceeds arising from the personal right, or movable or immovable property.

The doctrinal bases

The English law on charges does not suffer from the doctrinal controversy that plagues the South African law on cession *in securitatem debiti.*[1443] The law on charges has been clearly and eloquently stated and restated by the English courts[1444] and all charges, bar a few, are statutorily registrable.[1445] Historically, the doctrinal foundation of the law on cession *in securitatem debiti* has been the subject of much academic and judicial controversy, as analysed in chapter 6.

The substance of security rights

Both a charge and a pledge and cession *in securitatem debiti* can be used to create encumbrances or security interests over or in personal rights in favour of lenders that create security for lenders' claims.

English charge law has a uniform approach to, and definition of, security interests, which are rights *in rem*.[1446] This means that English security rights are enforceable against third parties, and not only *inter partes*.[1447]

In South African law, security interests can take different forms prescribed by the common law or statute. Although the Insolvency Act has a standard meaning of *'security',* South African statutes have a disparate and mixed approach to security which consists of rights *in rem*, with some types of rights being statutorily registrable and others not. Even as between South African statutes, there are disparities in the treatment of security interests. Although the Insolvency Act does not expressly recognise the cession *in securitatem debiti* of rights as security, it is recognised by implication through the use of the term *'pledge'*.[1448] The Financial Markets Act uses both

[1442] A bond could be registered as a continuing covering, notarial, mortgage or a surety bond.
[1443] The doctrinal controversy is discussed and analysed in detail in chapter 6 *The Law of Cession in Securitatem Debiti*.
[1444] Gullifer *Legal Problems of Credit and Security* (2013) 35–36 para 1-55.
[1445] Ibid 81 para 2-19, 82 para 2-21 and 83 chapter 2.2 *Registration under section 859A of the Companies Act 2006.*
[1446] McCormack *Secured Credit under English and American Law* (2004) 46.
[1447] Ibid.
[1448] The legal reasoning for this conclusion appears in section 4.4 *The meaning of 'security' in the Insolvency Act* under the heading *Cessionaries as creditors*.

the terms *'pledge'* and *'cession in securitatem debiti'* where it requires the registration of a pledge or cession *in securitatem debiti* of uncertificated listed securities or an interest in uncertificated securities in the central securities account or the securities account.[1449] Furthermore, the Public Finance Management Act[1450] states that an institution to which the Act applies may not borrow money or issue a guarantee, indemnity or security or enter into any other transaction that binds or may bind that institution or the national or provincial revenue fund to any future financial commitment, unless certain stipulated conditions have been met, without defining security. Further still, the Municipal Finance Management Act[1451] defines security circuitously as *'any mechanism intended to secure the interest of a lender or investor, and includes any of the mechanisms mentioned in section 48(2)'*. And yet further still, the Income Tax Act[1452] uses the term *'security'* in relation to a debt but does not define it. However, despite these deficiencies, in a cession *in securitatem debiti*, the rights of the cedent, the cessionary and the principal debtor have been clearly elucidated by our courts.

Priority of claims

The priority of claims in English law is a matter of great complexity because of the absence of a coherent legal structure.[1453] In fact, the legal structure consists of a combination of the common-law 'first in time' principle, the development of equitable ownership and security interests, priority between competing equitable interests including interests in debts and intangibles, and a variety of statutory registration systems.[1454]

The rights of the chargor in English law and the cedent in South African law in respect of their businesses

In the English law on floating charges, the chargor's freedom to deal with its business or a class of assets in the business (which includes the right to control, manage, operate and freely dispose of the secured assets in the ordinary course of its business) over which the floating charge is registered is the distinctive feature and the hallmark of a floating charge.

South African law is silent on whether a cedent of rights in *securitatem debiti* may, after the cession in *securitatem debiti* and prior to its principal debtor defaulting, continue to control, manage, operate and freely dispose of the assets that comprise the ceded rights in the ordinary course of its business. These rights must be distinguished from the cessionary's *locus standi* to enforce the ceded rights if the principal debtor defaults.[1455] In practice, in my experience, it is accepted in the market that a cedent

[1449] See the discussion of s 39 and related sections of the Financial Markets Act in section 4.5 *Personal and real security, and the registration of security rights.*
[1450] Section 66(1) of the Public Finance Management Act 1 of 1999.
[1451] Local Government Municipal Finance Management Act 56 of 2003.
[1452] Income Tax Act 58 of 1962. See, for example, s 11*(j)(d).*
[1453] Gullifer *Legal Problems of Credit and Security* (2013) 175–176 para 5-01.
[1454] Ibid.
[1455] *Locus standi* issues are discussed and analysed in chapter 6 *The Law of Cession in Securitatem Debiti*.

retains these operational rights after the cession in *securitatem debiti*.

The similarities

Conceptually, in both legal systems (i) an asset is appropriated to the secured debt, and is consequently used to satisfy the secured debt if the chargor (the cedent in South African law) is unable to pay the secured debt; (ii) the claims of all creditors in the same class rank *pari passu*; (iii) security interests afford priority to secured creditors over preferent creditors and ordinary creditors on the insolvency of the chargor (the cedent in South African law); (iv) there is an absence of a coherent security registration system, including the absence of a coherent priority system; (v) charges and cession *in securitatem debiti* both confer real security rights over the assets of the chargor or cedent; and (vi) both rights are created contractually.

The differences

Charges and cessions *in securitatem debiti* are, despite the above similarities, fundamentally different in law, even though both instruments are used to create real security rights in personal rights. First, the object of a charge could be either an asset (movable property) or a right (for example, a receivable), or both. The object of a cession *in securitatem debiti* is always a personal right, never corporeal movable property. Second, although charges and cessions *in securitatem debiti* both confer present security rights over assets and rights, the chargee in a floating charge agrees not to interfere with the chargor's business, and the chargor has the authority and freedom to operate its business during the term of the charge. The chargee acquires no rights, against either the chargor or the debtor, to collect or enforce performance in respect of the assets held as security under the charge. On the other hand, the cessionary acquires the *locus standi* to collect or enforce the principal debt ceded in security, and the cedent is consequently deprived of such *locus standi* except for its reversionary *locus standi* to protect its reversionary interests.[1456] In practice, though, the obligationary agreement typically provides that, despite the cession *in securitatem debiti*, the cedent will, for as long as the cedent is not in default of the loan, continue to collect the principal debt in pre-litigation phases. Third, whilst the English courts have pronounced on the rights of the chargor to deal with its business during the existence of the charge, the South African courts have not done so in respect of the cedent's rights to deal with the ceded rights that constitute its business during the existence of the cession *in securitatem debiti.*

Attachment and perfection

In English law, attachment is the creation of a security interest in an asset entitling the creditor to real rights against the asset.[1457] A security interest attaches only if there is a

[1456] See the discussion of *locus standi* titled *Enforcing the ceded rights: Locus standi* in section 6.7 *Theoretical issues arising from the pledge theory*.
[1457] Gullifer *Legal Problems of Credit and Security* (2013) 63 para 2-02.

statutorily compliant security agreement, an identifiable asset in which the debtor has an interest or is able to confer security, the asset secures the debtor's extant obligation, possession (actual or constructive) has been given and taken if it is a pledge, and conditions for attachment have been fulfilled.[1458]

Perfection of security rights is a method of public notice to third parties that the lender has security interests in an asset.[1459] Perfection is not needed to render the security interest enforceable against the debtor because, when the security interest attaches, it is enforceable between the creditor and the debtor.[1460] Perfection differs depending on the type of asset in which a security interest is acquired. Charges created by companies must be registered in the Company Charges Register,[1461] while security interests granted by persons who are not companies must be registered in the Bill of Sales Act register. A failure to comply with these statutory requirements renders the security ineffective against other secured creditors and on the borrower's insolvency. Perfection and priority are distinct legal concepts in English law as a perfected security interest does not guarantee its priority over competing claims.[1462] A perfected security interest can be defeated by a security interest that ranks higher in law.[1463] McCormack describes the English perfection system as a transactional filing one, where transaction details must be filed with the registrar of companies. These details include filing the instrument of charge within 21 days of it being created, the parties thereto, the amount secured, the property charged, and the date of the charge.[1464]

In South African law, perfection of security rights addresses the enforcement or realisation thereof and is mostly used in relation to assets held in security under a notarial bond. The cession *in securitatem debiti* of personal rights transfers the rights (either a component thereof or entirely, depending on which theoretical construct is adopted by the parties[1465]) to the cessionary so that the perfection requirement is met by such cession, except if the right is constituted (not evidenced) by a document. In the latter case, the document itself must be delivered to perfect the security right.[1466] If the right is evidenced by a document but not constituted by it, then it need not be delivered. In South African security rights law, there is no concept equivalent to attachment in English law. Instead, a security agreement becomes enforceable in accordance with security law principles.

The mobility of secured assets and its effect on creditors' security interests

Are the security interests of the creditors (chargees in English law or cessionaries in South African law) terminated if the chargor in English law or the cedent in South African

[1458] Ibid 64 para 2-03.
[1459] Ibid 77–78 para 2-16.
[1460] Ibid 63 para 2-02 and 77 para 2-16.
[1461] See the discussion below under the heading *The system of registering security interests.*
[1462] LexisPSL at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document/391290/55KX-XBB1-F185-S0G7-00000-00/Perfecting_security.
[1463] Ibid.
[1464] McCormack *Secured Credit under English and American Law* (2004) 76.
[1465] The competing theories are analysed in chapter 6 *The Law of Cession in Securitatem Debiti*.
[1466] Perfection is discussed in section 4.9.2 *Perfection.*

law, in the ordinary course of business, disposes of assets forming part of the bundle of secured assets? And are the security interests made complete again if the chargor or the cedent acquires new assets that form part of the bundle of secured assets? Consider, for example, whether the security of a cessionary (as creditor) is, in relation to a cedent who grants that cessionary a cession *in securitatem debiti* over its book debts to secure the repayment of debt, terminated and then reinstated as clients settle their book debts and new book debts are incurred. The settlement and incurring of new book debts continually changes the composition of the secured assets.

Are the security interests of the chargor or the cedent compromised and then made complete again, as corporeal property or receivables are disposed of or acquired? In English charge law, the fluid nature of the secured assets does not adversely affect the chargee's security rights because the charge rights are registered against the secured assets in their varying condition as assets move in and out of the pool of assets. Wright's view is that the floating charge *'automatically catches new assets which the chargor acquires from time to time'*.[1467]

The cedent's position in a cession *in securitatem debiti* regarding the mobility of secured assets and its effect on creditors depends on the terms of the cession.[1468] If, for example, the cession does not permit such mobility or does not include a cession of future rights, then mobility is not allowed, and the cession does not incorporate new assets that the cedent may acquire from time to time.[1469] It is, however, rarely the case that a cession agreement restricts or, worse still, prohibits mobility because that would restrict the cedent's ability to trade. However, if the cedent disposes of secured assets without replacing them, then the cessionary is left without security.[1470]

The system of registering security interests

English law has a mandatory security rights registration system in respect of certain types of security, including charges. A distinction exists between registering security rights against certain types of assets (namely, aircraft, land, ships and intellectual property), which must be registered in the relevant asset register, and against companies, which must be registered at the Companies Registry.[1471]

South African law does not have such a mandatory security registration system, except in respect of security rights in listed securities, movable and immovable property, aircraft, ships, registered trademarks and prospecting rights or mining rights. The security rights are registered against these assets, not against the companies that own them. In respect of security rights in all other types of rights and property, no registration

[1467] Wright *International Loan Documentation* (2014) 330.
[1468] This goes to the parties' intention about the subject matter of the cession *in securitatem debiti*; see Lubbe *Contract: General Principles* (2020) 405–496 para 13.4, 497–498 para 13.6, 501 para 13.10, 502 para 13.12 and 503 para 13.13 as to the parties' intention.
[1469] Ibid.
[1470] A cedent's obligation to maintain a stipulated level or value of security cover for as long as the loan remains unpaid is contractually achieved by including a security cover ratio in the facility agreement. In section 6.8 *Commercial considerations*, I discuss the meaning, nature and operation of a security cover ratio.
[1471] Wright *International Loan Documentation* (2014) 334.

or notice requirements exist. Our legal system does not have a uniform security rights system under which all types of security rights must be registered in a central registry.[1472] I submit that the absence of a standard, mandatory regulatory registration requirement for security rights is a systemic deficiency in South African law because requirements for registrable security rights differ as between each other,[1473] and certain security rights have no registration requirements.[1474] Ideally, all security rights should be subject to the same standard, mandatory registration requirements, which will create legal certainty in the market.

Termination of the security rights

Charges are terminated when the secured debt for which the charge was provided as security has been discharged, and the chargor has a right in equity to redeem the charge.[1475]

Similarly, cession *in securitatem debiti* terminates when the secured debt has been discharged. According to *Grobler*,[1476] the ceded right automatically reverts at that time, without the need for further action such as a re-cession.[1477]

In both cases, on settlement of the secured debt, the rights acquired by a chargee in English law in terms of a charge, and the rights acquired by a cessionary in South African law in terms of a cession *in securitatem debiti*, are restored to the chargor and the cedent respectively. The charge or cession *in securitatem debiti* is cancelled or released, thereby freeing the assets or property from the erstwhile encumbrances.

Conclusion and lessons in respect of the comparison between English law and South African law

English law and South African law use different terminology to describe the different aspects of security rights. However, both legal systems treat security rights that comply with its substantive law as enforceable against the security provider and third parties. Requirements to notify third parties of the existence of security rights and their priority as against competing claims exist in both legal systems, but differ. Furthermore, whereas South Africa has a security rights system based on asset type, the UK system of charges (excluding other forms of UK security rights) can be applied across asset types. For example, in South Africa bonds are registered against property (movable and immovable) to create security interests, pledges are effected against movable property to create security interests, and cessions *in securitatem debiti* create security interests in personal rights. However, in the UK, charges can be registered over both assets and

[1472] This matter is discussed in chapter 8 *The Reform of South African Law on Secured Lending, specifically including Cession in Securitatem Debiti*.
[1473] Compare, for example, the requirements for bond registrations with the requirements for the pledge and cession *in securitatem debiti* of listed securities.
[1474] Such as the pledge and cession *in securitatem debiti* of the rights to credit balances in bank accounts or unlisted shares.
[1475] McCormack *Secured Credit under English and American Law* (2004) 41.
[1476] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.
[1477] See the views of Nienaber and Scott on whether there is a need for a re-cession when the debt is settled in section 6.5 *The pactum fiduciae theory*.

rights. Another interesting difference is that whereas the UK system distinguishes between registering security rights against a security provider's assets and against the security provider itself, South African law draws no such distinction. The lessons for South African secured lending law are those aspects of English law that can be incorporated into South African law: functionality (using one security instrument to create security over assets and personal rights), mandatory registration of security rights, and the distinction between registering security rights against the assets and the security provider.

7.3 Article 9 of the American Uniform Commercial Code

The Uniform Commercial Code was first published in the USA in 1952, with the objective of governing and harmonising the laws of commercial transactions and sales in all 50 US states, the District of Columbia, and the territories of the USA.[1478] The Uniform Commercial Code is not considered a federal law but rather a *'uniformly adopted state law'*.[1479] The Uniform Commercial Code was sponsored by the American Law Institute and the National Conference of Commissioners on Uniform State Laws,[1480] and has been amended numerous times since its adoption. The responsibility for maintaining the Uniform Commercial Code vests in the Permanent Editorial Board for the Uniform Commercial Code, which consists of members of the Uniform Law Commission and the American Law Institute.[1481]

Article 9 of the Uniform Commercial Code governs secured transactions in personal property and is titled *'UCC Article 9, Secured Transactions'*.[1482] According to McCormack:

> *The fundamental features of Article 9 and other systems modelled upon it such as those in the common-law provinces of Canada and now in New Zealand are firstly, a bias in favour of functionalism rather than formalism and secondly, a registration obligation that is very extensive in its ambit. In other words, there is a general principle enshrined in the law that public notice of the security interest must be given. In Article 9 in a sense substance emerges triumphant over form with the UCC abandoning the old distinctions, still prevalent in English law, between different ways of securing a claim and also the use of absolute title as security. All the old terminology of the law and the favourites beloved of lawyers such as pledge, mortgage, conditional sale, trust receipt etc. have been consigned to the corridors of legal history and replaced by the unitary concept of security interest. Article 9 does not make any distinction between legal and equitable security interests or between fixed and floating security interests.*[1483]

[1478] See https://en.wikipedia.org/wiki/Uniform Commercial Code.
[1479] Uniform Law Commission at https://www.uniformlaws.org/acts/uss.
[1480] McCormack *Secured Credit under English and American Law* (2004) 70 and n 2.
[1481] Uniform Law Commission at https://www.uniformlaws.org/acts/uss.
[1482] Ibid. Each state has an office where financial statements are filed wherein security interests in property are publicly disclosed. In 1998, Art 9 was substantially revised, and was adopted in all states. Further revisions to Art 9 were made in 1999, 2000, 2001 and 2010. The version of the Uniform Commercial Code relied on and quoted in this section is the one made available by Cornell Law School's Legal Information Institute, which provides the version of sections of the Uniform Commercial Code that is most widely adopted by US legislatures. Therefore, according to Cornell Law School, it may not be the most current version of the Uniform Commercial Code if that version was not widely adopted by US legislatures.
[1483] McCormack *Secured Credit under English and American Law* (2004) 71.

According to him, the most important characteristics and features of Article 9 are functionality, registration and public notice, the use of which have resulted in the abandonment of old security instruments like conditional sale, mortgage, pledge and the like. An analysis of Article 9 reveals, as indicated by McCormack, that US law has adopted a standard, unitary concept of security interests that cuts across the different traditional common-law forms of creating security interests.

A detailed analysis of Article 9 is outside the scope of this thesis and the comparison with South African law will only consider the nature of security interests, attachment, enforceability and perfection, because the substance of these concepts is also utilised in South African secured lending laws.

Scope

Article 9-109 of the Uniform Commercial Code applies to *inter alia*: (i) any transaction, regardless of its form, that creates a security interest in personal property or fixtures (defined as goods that have become so related to particular real property that an interest in them arises under real property law)[1484] by contract;[1485] (ii) a security interest arising under Articles 2-401,[1486] 2-505,[1487] 2-711(3),[1488] or 2A-508(5),[1489] as provided for in Article 9-110;[1490] and (iii) a security interest arising under Articles 4-210[1491] or 5-118.[1492] Article 1-102 states that Article 1[1493] applies to a transaction to the extent that it is governed by another Article of the Uniform Commercial Code. Since Article 9 applies to the transactions in (i), (ii) and (iii), Article 1 also finds application. Thus, Article 1-103 must be applied to any Article 9 transaction. Article 1-103(a) states that:

> *The Uniform Commercial Code must be liberally construed and applied to promote its underlying purposes and policies, which are: (1) to simplify, clarify, and modernize the law governing commercial transactions; (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and (3) to make uniform the law among the various jurisdictions.*

While Article 9 also applies to other types of transactions, such as an agricultural *lien*;[1494] a sale of accounts, chattel paper, payment intangibles, or promissory notes;[1495] and a consignment, the comparison is limited to categories in (i), (ii) and (iii) because these three categories deal with security interests.[1496]

[1484] Article 9-102(41), the definition of 'fixtures'.
[1485] Article 9-109(a)(1).
[1486] This Article deals with the passing of title and reservation for security purposes.
[1487] This Article deals with a seller's shipment under reservation.
[1488] This Article deals with a buyer's remedies in general and a buyer's security interest in rejected goods.
[1489] This Article deals with a lessee's remedies.
[1490] Article 9-109(a)(5). This Article deals with security interests arising under Art 2 or Art 2A.
[1491] This Article deals with the security interests of a collecting bank in items and accompanying documents and proceeds.
[1492] Article 9-109(a)(6). Article 5-118 deals with the security interests of an issuer or nominated person.
[1493] Titled 'General Provisions (2001)'.
[1494] Article 9-109(a)(2).
[1495] Article 9-109(a)(3).
[1496] Article 9-109(a)(4).

Definitions

I will now consider some of the relevant definitions of Article 9. I quote general definitions, and then specific definitions. A debtor is defined in Article 1-201(28) of the Uniform Commercial Code as follows:

> *'**Debtor'** means:*
>
> *(A) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;*
>
> *(B) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or*
>
> *(C) a consignee.*[1497]

By comparison, chapter 11 of the USA's Bankruptcy Act defines a debtor as follows:

> *The term 'debtor' means a person or municipality concerning which a case under this title has commenced.*[1498]

Chapter 11 thus defines a debtor in broad terms without limiting the type of debtor to a category or class, as Article 9 does, and defines a debtor as one against whom or which bankruptcy proceedings have commenced, but have by implication, not been completed.

The South African Insolvency Act defines a debtor as follows:

> *'**debtor**', in connection with the sequestration of the debtor's estate, means a person or a partnership or the estate of a person or partnership which is a debtor in the usual sense of the word, except a body corporate or a company or other association of persons which may be placed in liquidation under the law relating to Companies.*

This definition of *'debtor'* is somewhat circular as it refers to *'a debtor in the usual sense'*, without actually defining a debtor substantively. This may be because the term *'debtor'* in the Insolvency Act is used in respect of insolvency laws as opposed to secured debt, although the two concepts are inextricably linked. Unlike the Uniform Commercial Code's definition, which defines a debtor in relation to a security interest in the collateral, the South African definition makes no reference to security interest in collateral, nor to the other aspects in (B) and (C) of the definition of *'debtor'* in the Uniform Commercial Code.

A security interest is defined in Article 1-201(35) of the Uniform Commercial Code as follows:

> *'**Security interest**' means an interest in personal property or fixtures which secures payment or performance of an obligation. 'Security interest' includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9. 'Security interest' does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not*

[1497] Emphasis added.
[1498] Section 101(13).

a 'security interest', but a seller or lessor may also acquire a 'security interest' by complying with Article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under Section 2-401 is limited in effect to a reservation of a 'security interest'. Whether a transaction in the form of a lease creates a 'security interest' is determined pursuant to Section 1-203.

The definition of a security interest is wide ranging, including within its scope all forms of movable property, except for the excluded property. By comparison, the definition of security in the Insolvency Act is limited.

The Uniform Commercial Code defines a secured party and a security agreement in Articles 1-201(73) and (74) as follows:

*'**Secured party**' means:*

(A) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding;

(B) a person that holds an agricultural lien;

(C) a consignor;

(D) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;

(E) a trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or

(F) a person that holds a security interest arising under Section 2-401, 2-505, 2-711(3), 2A-508(5), 4-210, or 5-118.

***'Security agreement'** means an agreement that creates or provides for a security interest.*[1499]

The Insolvency Act does not define *'secured party'* or *'security agreement'*, and uses the term *'secured creditor'* without defining it. If one considers the Insolvency Act's meaning of *'security'* and the ordinary grammatical meaning of the undefined term *'creditor'* in the context of the Insolvency Act, then clearly a *'secured creditor'* must mean a person who holds *'security'* as defined in the Insolvency Act, which is a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention.

Security interest in a deposit account

A security interest in a deposit account as contemplated in the Uniform Commercial Code is similar to the pledge and cession *in securitatem debiti* of rights to moneys in bank accounts under South African law. In both instances, security interests can be created in bank accounts. The pledge and cession *in securitatem debiti* by cedents of their rights to

[1499] Emphasis added.

moneys in bank accounts is a common feature of both bilateral and syndicated loans.[1500]

A deposit account is defined in Article 1-201(29) of the Uniform Commercial Code as follows:

> *'**Deposit account**' means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.*

A secured party has control of a deposit account if three criteria are met. First, a secured party has control if the bank is the secured party at which the deposit account is held.[1501] In this case, the bank is the lender. Second, a secured party has control if the debtor, the bank and the secured party have agreed in an authenticated record that the bank will comply with instructions given by the secured party directing how to dispose of the funds in the deposit account without further consent from the debtor.[1502] In this case, the bank is not the lender but a third party is. Third, the secured party has control if it becomes the bank's customer with respect to the deposit account.[1503] If a secured party (whether that is the bank or another party) has satisfied all three criteria, it has control of a deposit account even if the debtor retains the right to direct how to dispose of the funds in the deposit account.[1504]

Priority of competing or conflicting interests

Article 9-327 governs the priority of competing or conflicting security interests in the same deposit accounts, and the principles are as follows. A security interest held by a secured party having control of the deposit account under Article 9-104[1505] has priority over a conflicting security interest held by a secured party that does not have control.[1506] Except as otherwise provided, security interests perfected by control under Article 9-314 rank according to priority in time of obtaining control.[1507] Except as otherwise provided, a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.[1508] A security interest perfected by control under Article 9-104(a)(3)[1509] has priority over a security interest held by the bank with which the deposit account is maintained.[1510]

In South Africa, although *'account'* is defined in the Insolvency Act,[1511] the definition refers to *inter alia* a *liquidation account* and not to accounts over which security can be created. South African law does not limit the types of accounts in which security interests

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[1500] LexisPSL at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/docfromresult under the heading *Taking security over cash deposits in bank accounts.*
[1501] Article 9-104(a)(1).
[1502] Article 9-104(a)(2).
[1503] Article 9-104(a)(3).
[1504] Article 9-104(b).
[1505] This Article is explained above.
[1506] Article 9-327(1).
[1507] Article 9-327(2).
[1508] Article 9-327(3).
[1509] The secured party becomes the bank's customer with respect to the deposit account.
[1510] Article 9-327(4).
[1511] Section 2 of the Insolvency Act defines an account as follows:
'account', in relation to a trustee, means a liquidation account or a plan of distribution or of contribution, or any supplementary liquidation account or plan of distribution or contribution, as the case may require.

can be created, as is the case under Article 9, where investment property accounts or accounts evidenced by instruments are excluded. In South African law, this approach is premised on the principle that all rights are freely cedable unless common law, statutory or contractual restrictions apply.[1512] Technically, though, a security interest under South African law is not created in the bank account but in the cedent's right to credit balances in the bank account.

Sufficiency of description

The Uniform Commercial Code considers the description of personal property or real property in which a security interest is held as sufficient if it reasonably identifies what is described.[1513] Collateral is reasonably identified if, for example, *'it identifies the collateral by specific listing; category; … ; quantity; computational or allocational formula or procedure; or except as otherwise provided in subsection (c), any other method, if the identity of the collateral is objectively determinable'*.[1514] Interestingly, it is insufficient to describe the collateral as *'all the debtor's assets'* or *'all the debtor's personal property'* or similar generic wording, as such descriptions do not reasonably identify the collateral.[1515] It seems that a security interest held in personal property or real property, the description of which fails to meet the sufficiency of description requirement as set out in Article 9-108, would thus be open to being contested.

In South African law,[1516] it is similarly necessary to reasonably identify the subject matter in which the security interests are held; without certainty as to the subject matter of the contract, it is void for vagueness. However, it has become standard practice to include, after so describing specific pledged assets and property, generic descriptions of the debtor's assets and property that are also pledged and ceded *in securitatem debiti*, by using descriptions such as *'all the debtor's/cedent's right, title and interest in and to its assets and property'*. These generic descriptions have been accepted by our courts as grounds for valid security interests. However, they have also been a source of litigation. For example, as discussed, in *Coopers & Lybrand and Others v Bryant*[1517] the cedent, Mr Bryant, ceded *in securitatem debiti* all his rights, title and interest to all his book debts, other debts and claims of whatsoever nature, present and future, to a bank. This resulted in a dispute as to whether the cession included his claims against his auditors for breach of contract. It is apparent that the Uniform Commercial Code outlaws such descriptions, or considers such generic descriptions as not reasonably identifying the collateral, because they may result in the parties disputing the scope of the security right, as happened in *Coopers & Lybrand*. The approach of Article 9-108(c) also protects debtors by requiring the creditor and debtor to specifically identify and agree on the collateral that will serve as

[1512] See section 6.1 *Rights as security for a debt;* De Wet & Van Wyk *Kontraktereg* (1992) 415–416; Lubbe 'Cession' *LAWSA* (2013) para 179; Lubbe *Contract: General Principles* (2020) 513 para 13.23, 518 para 13.30, 520 para 13.34 and 539 para 13.62.
[1513] Article 9-108(a).
[1514] Article 9-108(b)(1), (2), (4), (5) and (6).
[1515] Article 9-108(c).
[1516] At common law, which governs the pledge and cession *in securitatem debiti* of personal rights not governed by statute, and in terms of statutory law, which governs the creation of security interests in aircraft, property, listed securities and ships.
[1517] *Coopers & Lybrand and Others v Bryant* 1995 (3) SA 761 (A).

security.

Attachment and enforceability

Article 9 recognises the importance of the secured party being able to enforce its security rights. Accordingly, a security interest attaches to the collateral when it becomes enforceable against the debtor with respect to the collateral, unless the parties have agreed to postpone the time of attachment.[1518] McCormack states that a security interest that attaches becomes enforceable between the creditor and the debtor, that is, it creates an obligation, and gives the secured party the rights to the proceeds.[1519] Then, the Uniform Commercial Code regulates when and how a security interest becomes enforceable. A security interest is enforceable against the debtor and third parties if the following self-explanatory conditions in Article 9-203(b) are fulfilled:

> *Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if:*
>
> *(1) value has been given;*
>
> *(2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and*
>
> *(3) one of the following conditions is met:*
>
> *(A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;*
>
> *(B) the collateral is not a certificated security and is in the possession of the secured party under Section 9-313 pursuant to the debtor's security agreement;*
>
> *(C) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under Section 8-301 pursuant to the debtor's security agreement; or*
>
> *(D) the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under Section 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement.*

Perfection

Perfection is the process whereby the security interest becomes effective against third parties. It must be distinguished from attachment, which is when the security interests become enforceable against the debtor with respect to the collateral. In terms of Article 9, perfection occurs through filing or, in certain instances, by taking possession: for purposes of Article 9-203(b), a secured party may perfect a security interest in negotiable documents, goods, instruments, money or tangible chattel paper by taking possession of the collateral. A secured party may also perfect a security interest in certificated securities by taking

[1518] Article 9-203(a).
[1519] McCormack *Secured Credit under English and American Law* (2004) 73.

delivery of the certificated securities under Article 8-301.[1520]

McCormack describes the US perfection system as a notice filing one, where a simple record, known as a financing statement, must be filed, either before or after the security interest attaches.[1521] The notice that is filed indicates that a person may have a security interest in the collateral, and the party seeking the information would have to make further inquiries to ascertain the details. To be sufficient, a financing statement must provide the debtor's name, the name of the secured party or its representative, and the collateral.[1522]

McCormack indicates that the notice filing system, where only a financing statement is filed, has the following advantages. In finance transactions that involve repeat transactions in respect of stock-in-trade or receivables, one filing suffices and there is no need for repeat filings. The same applies where the collateral continually changes. It also covers after-acquired property as indicated in a financing statement and perfects future advances mentioned in the financing statement.[1523]

If one applies McCormack's distinction between transactional filing systems and notice filing systems to classify our filing systems in relation to security rights held by creditors in aircraft, property, listed uncertificated securities and ships, then ours is a transactional filing system.

In terms of Article 9-609, after default, a secured party may take possession of the collateral[1524] and, without removal, may render equipment unusable and dispose of collateral on a debtor's premises under Article 9-610.[1525] A secured party may proceed either pursuant to a judicial process,[1526] or without judicial process if it proceeds without a breach of the peace.[1527] Article 9-610 sets out the principles that govern the disposition of collateral after default. It states that, for example, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or follow any commercially reasonable preparation or processing.

The South African law on cession in securitatem debiti and Article 9 of the American Uniform Commercial Code

The workhorse of security rights

The workhorse of the American secured credit system is Article 9 of the Uniform Commercial Code, whilst in South Africa it is the pledge of movable property, the pledge and cession *in securitatem debiti* of personal rights, or a bond.[1528]

[1520] Article 9-313(a). Article 8-301 deals with the delivery of certificated securities to a purchaser.
[1521] Ibid.
[1522] Article 9-502(a).
[1523] McCormack *Secured Credit under English and American Law* (2004) 77; Art 9-204(a), (b) and (c).
[1524] Article 9-609(a)(1).
[1525] Article 9-609(a)(2).
[1526] Article 9-609(b)(1).
[1527] Article 9-609(b)(2).
[1528] A bond could be registered as a continuing covering, notarial, mortgage or a surety bond.

The doctrinal bases

Like the English law on charges, US law in this field does not suffer from the doctrinal controversy that complicates the South African law on cession *in securitatem debiti.*[1529] In fact, Article 9 contains a generic, standard definition of security interest that is devoid of common-law concepts such as pledge and cession, and all the complexities that accompany them.

The substance of security rights

Article 9 does not distinguish between rights *in rem* and rights *in personam.* Any type of right to which Article 9 applies can be used as security provided the registration and other requirements of Article 9 are complied with.

In contrast, although the Insolvency Act has a standard meaning of *'security',* South African case law and statutes have a disparate and mixed approach to security, which consists of rights *in rem* and rights *in personam*, with some types of rights being statutorily registrable and others not. As mentioned above, even as between different South African statutes, there are disparities in the treatment of security interests. In a cession *in securitatem debiti*, the cedent's rights, the cessionary's rights and the principal debtor's rights have been clearly elucidated by the courts.

The rights of the debtor in terms of Article 9 and the cedent in terms of a cession in securitatem debiti in South African law in respect of their businesses

Generally, a debtor who has agreed to create a security interest in its assets or property retains its rights to continue trading that business for the duration of the security interests. Specifically, a debtor retains the right to direct the disposition of funds from a deposit account.[1530]

I mentioned above that South African law is silent on whether a cedent of rights in *securitatem debiti* has the right to control, manage, operate and freely dispose of the assets that comprise the ceded rights in the ordinary course of its business. Transfer (cession) agreements, as a matter of practice, typically entitle a cedent to exercise the ceded rights up until the cedent defaults on its obligations, despite the cession and the transfer of *locus standi* to the cessionary. In a cession *in securitatem debiti* the rights retained by the cedent and the rights transferred to the cessionary are both subject to common-law limitations.[1531]

The similarities

The two legal systems have a number of similarities. An asset is appropriated or ring-fenced to satisfy the secured debt, and is consequently used to satisfy the secured debt, if the debtor in Article 9, or the cedent in South African law, is unable to pay the secured debt. The claims of all creditors in the same class rank *pari passu* but such claims are usually

[1529] The doctrinal controversy is discussed and analysed in detail in chapter 6 *The Law of Cession in Securitatem Debiti*.
[1530] Article 9-104(b).
[1531] These issues are discussed and analysed in chapter 5 *The Law of Cession*.

ranked one after the other, based on the first-in-time or first-in-registration principle. Security interests afford priority to secured creditors over preferent creditors and ordinary creditors on insolvency of the debtor in Article 9 or the cedent in South African law. Article 9 and cession *in securitatem debiti* both confer present security over the assets of the debtor in US law or the assets of the cedent in South African law, respectively. Article 9 and cession *in securitatem debiti* both employ the concepts of perfecting security interests.[1532]

The differences

Article 9 and cession *in securitatem debiti* are fundamentally different in law. The object of Article 9 security could be any asset (movable property), a right (for example, a receivable), or immovable property. The object of a cession *in securitatem debiti* is always a right, never an asset (movable property) or immovable property. Whereas Article 9 security rights are devoid of common-law concepts such as pledge and cession, and all the complexities that accompany them, South African security rights are based on pledge (in respect of movable property) and on pledge and cession *in securitatem debiti* (in respect of rights). Article 9 uses the concept of attachment of a security interest, which is when the security interest becomes enforceable between the creditor and the debtor, while there is no similar concept in South African security rights law. Instead, a security interest becomes enforceable between the creditor and the debtor when the common-law requirements for an enforceable contract have been fulfilled. If the security interest takes the form of a cession *in securitatem debiti,* then it is also enforceable against third parties by an order of court.

Perfection

Article 9 contains a combination of jurisdictional perfection rules where perfection is governed by local law applicable to the security interest, and substantive perfection rules where Article 9 actually stipulates the perfection rules.

An example of jurisdictional perfection rules is that the local law of a jurisdiction in which a debtor is located, or the collateral is located, governs perfection, the effect of perfection or non-perfection, and the priority of a security interest (in the case of a debtor) in collateral or the priority of a possessory security interest (in the case of collateral) in collateral.[1533]

Examples of substantive perfection rules are certain types of security interests which are perfected when they attach, such as an assignment of accounts or payment intangibles,[1534] which do not on their own or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles. Another example is the security interest of a collecting bank arising under Article 4-210.[1535] South African common law and statutes, where applicable, govern

[1532] See, for example, Arts 9-301, 9-305, 9-308, 9-312 and 9-313, to mention a few.
[1533] Article 9-301(1) and (2).
[1534] Article 9-102(a)(61) defines a payment intangible as *'a general intangible under which the account debtor's principal obligation is a monetary obligation'.*
[1535] Article 4-210 states, *inter alia*:
(a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

perfection.[1536]

The mobility of secured assets and its effect on creditors' security interests

Whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than Article 9-401(a), save in certain mentioned Articles.[1537] An agreement between the debtor and the secured party that prohibits a transfer of the debtor's rights in collateral, or makes the transfer a default, does not prevent the transfer from taking effect.[1538]

The position of the cessionary in a cession *in securitatem debiti* in South African law regarding the mobility of secured assets and its effect on creditors depends on the terms of cession. If, for example, the cession does not permit such mobility or does not include a cession of future rights, then mobility is not allowed, and the cession does not incorporate new assets that may be acquired from time to time. It is, however, rarely the case that a cession agreement restricts or, worse still, prohibits mobility, because that would restrict the cedent's ability to trade.

The system of registering security interests

Whilst Article 9 has a central notice filing system that uses one registry for the registration of security interests, South African law has a disparate and mixed transactional filing system in the limited instances that South African law requires filing.

South African law does not require filing for the security rights to be effective in some cases, such as the pledge of goods under an agreement or contract of pledge and the cession *in securitatem debiti* of personal rights to moneys in bank accounts, book debts, insurance policies and unlisted securities. In these instances, the security rights are effective against the cedent, and can be enforced against the world at large by instituting court proceedings.

Termination of the security rights

Article 9 security rights are terminated when the secured debt for which the security was provided has been discharged. Article 9 styles the termination of security rights as the right to redeem the collateral.[1539] It states that a debtor, secondary obligor[1540] or any secured party or lienholder can redeem the collateral by tendering fulfilment of all obligations secured by the collateral, and by tendering the reasonable expenses and attorneys' fees

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(1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;
(2) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or
(3) if it makes an advance on or against the item.

[1536] Perfection in South African law is dealt with in section 4.9.2 *Perfection* and section 7.2 *English law on charges*.
[1537] Article 9-401(a).
[1538] Article 9-401(b).
[1539] Article 9-623.
[1540] Article 9-102(a)(73) defines a secondary obligor as an obligor to the extent that (i) the obligor's obligation is secondary; or (ii) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or the property of either.

described in Article 9-615(a)(1).[1541] Article 9 then proceeds to stipulate the time when redemption may occur. A redemption may occur at any time before a secured party (i) has collected collateral under Article 9-607;[1542] (ii) has disposed of collateral or entered into a contract for its disposition under Article 9-610;[1543] or (iii) has accepted collateral in full or partial satisfaction of the obligation it secures under Article 9-622.[1544]

Similarly, cession *in securitatem debiti* terminates when the secured debt for which the cession was given as security has been discharged. According to *Grobler*,[1545] it automatically reverts at that time without the need for further action, such as a re-cession.[1546]

In both cases, on settlement of the secured debt, the rights acquired by the secured party in US law in terms of Article 9 and the cessionary in South African law in terms of the cession *in securitatem debiti* are restored to the debtor and the cedent respectively, and the Article 9 security right or cession *in securitatem debiti* is cancelled or released.

Conclusion and lessons in respect of the comparison between Article 9 and South African law

As is the case in the comparison between English law and South African law, Article 9 and South African law use different terminology to describe the different aspects of security rights. However, both legal systems treat security rights that comply with its substantive law as enforceable against the security provider and third parties.

As a security instrument, Article 9 can be applied widely to create security rights in different asset types and property. Cession *in securitatem debiti* on the other hand, applies narrowly to create security rights in only personal rights. For this reason, South African law relies on other security instruments such as bonds and pledges to create security interests in other asset types and property.

Article 9 applies functionality as a premise for security rights and does not use the common-law concepts of conditional sale, mortgage, pledge and so forth. South African secured lending law is not premised on functionality although functionality is a consequence thereof and it still uses all the common-law concepts of cession, conditional sale, pledge, mortgage, and so forth. A fundamental feature of Article 9 is the registration of security rights whereas in South African law some types of security rights are registrable, and others are not. The result is that third parties receive notice of some security rights but

[1541] Article 9-623(a) read with (b). Article 9-615(a)(1) referenced in this sentence deals with the application of proceeds of a disposition and liability for deficiency and the right to surplus. It states that a secured party shall apply or pay over for application the cash proceeds of disposition under Art 9-610 in the order set out therein to *inter alia* settle the reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorneys' fees and legal expenses incurred by the secured party.
[1542] Article 9-607 deals with collection and enforcement by a secured party.
[1543] Article 9-610 deals with the disposition of collateral after default.
[1544] Article 9-623(c). Article 9-622 deals with the effect of acceptance of collateral.
[1545] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) para 20.
[1546] See the views of Nienaber and Scott on whether there is a need for a re-cession when the debt is settled. This is discussed in section 6.5 *The pactum fiduciae theory*.

not others.

Aspects of American law such as functionality (using one conceptual approach to create security over assets and personal rights), mandatory registration of security rights, notice of the security rights to third parties, and the use of one central, public registry to register security interests can usefully be incorporated into South African law.

7.4 Summary

Comparing the UN Model Law, the UN Assignment of Receivables, the English law on charges, and Article 9 of the US Uniform Commercial Code to South African security rights law, and specifically cession *in securitatem debiti*, reveals fundamental conceptual differences in the definition of security, the meaning and use of attachment, perfection, priority, registration, notice and enforcement of security rights.

The common denominator in these legal systems is that an asset or a right owned by the borrower or debtor or an obligor is appropriated to a debt, which is held in security by the lender or creditor pending satisfaction of that debt, which renders that debt secured.

These differences and the common denominator, and the analyses in the previous chapters, inform section 7.5 (*The reform of South African law*) and chapter 8, where I contend *inter alia* that the reform of aspects of South African security rights law and, specifically, cession *in securitatem debiti* is necessary to address the substantive and systemic deficiencies identified in this thesis, and to ensure its alignment with international trends. Remedial action, based on the reform objectives and principles discussed below, will create a system of security rights that investors can be confident about; they will have peace of mind that their loans will be repaid or, if not, recouped in full by the realisation of their security rights.

7.5 The reform of South African law

The proposals to codify and reform South Africa's secured lending laws arise from the controversies, deficiencies and inconsistencies[1547] that are identified in the thesis and are based on certain objectives and principles.

Objectives

A fundamental objective when reforming, clarifying and developing South Africa's secured lending law should be to improve the relationship between the legal system of which the rule of law is an integral part[1548] and economic growth, by addressing the deficiencies

[1547] The controversies, deficiencies and inconsistencies are analysed in chapter 8 *The Reform of South African Law on Secured Lending, specifically including Cession in Securitatem Debiti* and are referred to collectively as the deficiencies.
[1548] As to the meaning of the rule of law, see *Rikhotso v Premier, Limpopo Province and Others* 2021 (4) BCLR 436 (CC) and Tamanaha *On the Rule of Law History, Politics, Theory* (2004).

identified.[1549] It is contended by the World Bank[1550] and various studies that an effective legal system will encourage foreign direct investment in a host country,[1551] which could take the form of loans. The legal system is described as constituting officials and institutions involved in the creation and implementation of law, such as bureaucrats, courts, judges and politicians.[1552] The UNCITRAL Legislative Guide on Secured Transactions, New York, 2010, is based on a similar premise that sound secured lending laws foster economic growth, and that lenders (foreign and local) will avail credit.[1553] At a national level, laws should therefore be accessible, accurate, available, clear and transparent.[1554] They should be administered in a transparent manner and not arbitrarily,[1555] and with predictable legal results.

Another fundamental objective should be that laws must help businesses to maximise the value that is inherent in their assets and property by using it to raise finance.[1556] The UN Guide states, correctly, I submit, that ensuring the effectiveness of security rights against third parties and the priority of claims are important aspects of achieving this objective.[1557] Additionally, it is important to achieve a functional security rights system that treats *'all transactions with the same practical purpose … the same way, despite diverging formulations or doctrinal considerations'.*[1558]

Yet another fundamental objective should be to give effect to the Protection of Investment Act[1559] so that the legal position of foreign lenders[1560] is embedded in the reformed South African secured lending laws. Within the context of these objectives I consider the specific principles that apply to reforming, clarifying and developing the law in this area.

Principles

The Constitutional Court has held that the threshold to clarify the law is triggered when a matter is of general public importance in that it transcends the litigants' narrow interests and implicates the interests of a significant part of the general public.[1561] The deficiencies in South African secured lending laws are clearly a matter of general public importance that meets this threshold as it affects the interests of a significant part of the general public who are lenders and borrowers, and it is in the national interest to remedy the deficiencies. The

[1549] Cross and Donelson discuss the important relationship between the rule of law, which is an important aspect of a legal system, and economic growth by citing Barro's study where data of more than 100 countries between 1965 and 1990 were analysed; this data showed that maintaining the rule of law could yield average annual growth rates of up to 0.5%. See Cross & Donelson 'Creating Quality Courts' (2010) 7(3) *Journal of Empirical Legal Studies* 490 at 491.
[1550] Perry-Kessaris 'Recycle, Reduce, and Reflect: Information Overload and Knowledge Deficit in the Field of Foreign Investment and the Law' (2008) 35 *Journal of Law and Society* 67.
[1551] Perry 'Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence' (2000) 49(4) *International and Comparative Law Quarterly* 779. However, Perry contends (at 779 and 784ff) that there is some doubt as to the validity of the theory that an effective legal system will encourage foreign direct investment and little empirical evidence to support it.
[1552] Ibid 781.
[1553] UN Guide, Introduction, A. Purpose of the Guide at 1 para 2.
[1554] Ramaiah 'Towards a multilateral framework on investment?' (1997) 6(1) *UNCTAD/ITE/IIT* 14.
[1555] Ibid.
[1556] Brits *Real Security Law* (2016) 273–274; UN Guide, Introduction, A. Purpose of the Guide at 2 para 8.
[1557] UN Guide, Introduction, A. Purpose of the Guide at 2 para 8.
[1558] Brits *Real Security Law* (2016) 299.
[1559] Protection of Investment Act 22 of 2015.
[1560] The legal position of foreign lenders is analysed in section 2.4 *Foreign lenders.*
[1561] *Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd* 2015 (3) SA 479 (CC).

needs of commerce would be better served by law that clearly and unequivocally sets out the parties' rights and obligations in relation to the key aspects of secured lending laws, including the meaning and application of security, and the registration, attachment, perfection, priority, subordination and enforcement of security rights, all of which are analysed in this thesis.

In reforming the law, the competing interests of the lender(s) and the borrower must be balanced. A guiding principle was adopted by the Constitutional Court in *Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd*,[1562] where the court, faced with the constitutionality of suspending the *in duplum* rule *pendente lite*,[1563] discussed the approach to be taken to the competing interests of debtors and creditors. It weighed their interests equally but resisted the temptation to create law based on the court's personal preference as to whose interests ought to prevail. The court criticised the *Oneanate* judgment on a number of grounds, including its failure to consider the effect of suspending the application of the *in duplum* rule on debtors, noting that financially ruinous interest would run when court processes were served that would force debtors to settle claims rather than challenge them, even though debtors may have valid defences against the claims.[1564] The result is that *'the Oneanate principle does implicate a debtor's section 34 right. Indeed, it inhibits rather than promotes it.'*[1565] For these and other reasons, the court overruled *Oneanate* insofar as *Oneanate* held that the *in duplum* rule was suspended *pendente lite*.[1566] In these last two statements the court considered debtors' interests. It is submitted that the best way to balance the interests of debtors, creditors and regulators, without giving undue preference to any one category, is to take into account each of their interests in a balanced manner that creates legal certainty about the parties' rights and related obligations.

When developing the law, it is equally necessary to consider any concerns that regulators such as the Companies and Intellectual Property Commission, the Johannesburg Securities Exchange Limited and the market, generally, may have. After all, the regulators will in the end administer and register security interests as proposed, and the systems that will be used by the regulators must be accurate, easily accessible, functional, practical and cost-efficient.

Lubbe's view is that there is nothing as practical as good legal theory:

> *Dogmatic exercises are not to be underestimated; conceptual jurisprudence plays a valuable role in generating creative solutions to the challenges posed by the doctrine of notice or cession in securitatem debiti. However, Lubbe cautions that such academic exercises run the risk of becoming academic in the worst sense when they fail to take into account the demands of justice*

[1562] Ibid para 82.
[1563] The effect was that interest runs (again) uncapped when litigation commences, according to the judgment in *Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd (in liquidation)* [1998] 1 All SA 413; 1998 (1) SA 811 (SCA). The *Oneanate* judgment was, for this reason, heavily criticised by the Constitutional Court in *Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd* 2015 (3) SA 479 (CC).
[1564] *Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd* 2015 (3) SA 479 (CC) para 53.
[1565] Ibid para 63.
[1566] Ibid para 90.

on the one hand, and the needs of practice on the other.[1567]

Furthermore:

> *Gerhard Lubbe has consistently demonstrated that complex problems, like cession in securitatem debiti or the role of public policy in the law of contract, can often be resolved by the careful development of doctrinal instruments which are responsive to values, but which nevertheless take into account practical considerations.*[1568]

According to Lubbe, one should use conceptual jurisprudence to develop the law. This means revisiting fundamental conceptual matters legally, balancing the demands of justice and the needs of practice, and developing value-based doctrinal instruments.

The views of Renaudin regarding the harmonisation[1569] and modernisation of secured credit law regimes should be taken into account in reforming the law.[1570] Although her analysis relates to the harmonisation of the laws of national legal regimes in the European Union, the principles regarding the harmonisation of laws can also be applied to disparate laws within a country. She contends that harmonisation can be defined as accommodating and reducing legal differences between different regimes. She distinguishes between harmonisation and legal unification as distinct methods of legal reform and contends that the aim of harmonisation is *'to reach a modern, efficient and predictable secured credit law regime'*.[1571] The wider academic approach to harmonisation seeks to achieve *absolute uniformity* in legislation between different countries, whereas the narrower academic approach to harmonisation seeks to achieve a *similarity* in government policies or regulatory requirements. In the latter scenario, there would be no unification of legal instruments.[1572]

In reforming secured lending laws, the property law principles set out in section 25(1) of the Constitution of the Republic of South Africa, 1996, must be incorporated into the reforms. Section 25(1) states that *'[n]o one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property.'* Possible deprivation of the borrower's property arising from lenders exercising their security rights must be carried out in a constitutionally compliant manner. Section 25(4)*(b)* of the Constitution states that, for purposes of section 25, property is not limited to land. Nevertheless, many of the judgments relating to section 25 deal with corporeal property or immovable property. However, some judgments indicate that a wider meaning can be ascribed to constitutional property so as to include personal rights.[1573] Thus personal security rights[1574] would be worthy of constitutional protection in terms of section 25(1) of

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[1567] Du Plessis & Myburgh 'Gerhard Lubbe and the Development of Private Law' 2016 *Stellenbosch Law Review* 210 at 214.
[1568] Ibid 214–215.
[1569] Harmonisation is a method used to reform the law.
[1570] Renaudin *Secured Transactions Law Reform and the Modernisation of Personal Property Law* (PhD thesis, Swansea University, 2010) http://cronfa.swan.ac.uk/Record/cronfa43139.
[1571] Ibid 173, 177 and 181.
[1572] Ibid 178–180 and the footnotes cited there.
[1573] *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* 2002 (4) SA 768 (CC); *National Credit Regulator v Opperman and Others* 2013 (2) SA 1 (CC).
[1574] Personal security rights are analysed in section 4.5.1 *Personal and real security.*

the Constitution.[1575]

[1575] Marais 'The Constitutionality of Section 89(5)(c) of the National Credit Act under the Property Clause: *National Credit Regulator v Opperman & Others*' (2014) 131 *South African Law Journal* 215; Cheadle, Davis and Haysom 'South African Constitutional Law: The Bill of Rights', Chapter 20.3 *Is the interest at stake constitutionally protected property?* 2021.

8 Chapter Eight: The Reform of South African Law on Secured Lending, specifically including Cession *in Securitatem Debiti*

8.1 Introductory remarks

It is necessary from time to time to reform the law to reflect the changing conditions in society. In order to do so, old regimes come under scrutiny and must be changed. As Innes CJ aptly said in *Blower v Van Noorden*:[1576]

> *There come times in the growth of every living system of law when old practice and ancient formulae must be modified in order to keep in touch with the expansion of legal ideas, and to keep pace with the requirements of changing conditions. And it is for the Courts to decide when the modifications, which time has proved to be desirable, are of a nature to be affected by judicial decision, and when they are so important or so radical that they should be left to the Legislature.*[1577]

The reforms proposed in this chapter are, it is submitted, so fundamental that the legislature should take the responsibility for reforming the law.

In this chapter, I will provide a summary of the principal conclusions of my analysis and critique of the South African law of secured lending. The summary is followed by a discussion of the deficiencies and inconsistencies in South African security rights laws, a summary of the objectives and principles that ought to be observed when the security rights laws are reformed, and the reforms that are needed to remedy the deficiencies and inconsistencies.

8.2 The law on loans for consumption

South African common law has developed substantive principles and rules that govern and regulate loans for consumption. The South African law on loans for consumption has its genesis in classic Roman law and Roman-Dutch law.[1578] Whilst some characteristics of classic Roman law were adopted by and remain the same in South African law, other characteristics changed and were not adopted. The change occurred mainly as a result of the change in contract law from classic Roman law, which required delivery of a consumable or fungible thing to create or constitute a binding loan, to later Roman-Dutch law, which did not have such a contractual requirement, because mere consensus to lend and borrow was sufficient to create a binding contract. The South African law on loans for consumption adopted the Roman-Dutch legal position, retaining some principles of Roman law.[1579]

Bilateral and syndicated loans in South Africa are forms of loans for consumption. Syndicated loans have numerous advantages, including sharing the risk of non-payment of the loan between the syndicate members, and extending the credit cycle. As syndicated

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[1576] *Blower v Van Noorden* 1909 TS 890.
[1577] Ibid 905.
[1578] See section 2.2 *The nature and genesis of loans in South African law*.
[1579] Ibid.

loans typically have multiple lenders, they cannot each hold security rights directly in the borrower's assets or property. Accordingly, a Security SPV holds all the security rights, and, through a series of agreements, contracts to repay the syndicate lenders' loans.

8.3 The law on security rights

South African common law and legislation have developed substantive principles and rules that govern and regulate security rights, including specific types of security rights, such as bonds over corporeal movable property and immovable property, the pledge of corporeal movable property, and the pledge and cession *in securitatem debiti* of personal rights. By and large, these principles and rules protect lenders who hold security rights, and do not treat borrowers unfairly. However, I submit that, based on my analysis and critique of secured lending in this thesis, there are at least seven fundamental deficiencies and inconsistencies in South African security rights law. Some deficiencies are substantive whilst other deficiencies are systemic in nature.

The first deficiency is that South African security rights are, in relation to each other, incongruent or inconsistent. In other words, South African law takes different and varied approaches to creating security in different asset types, and when one compares security interests across the board, the differences emerge. First, at common law, personal rights can be pledged and ceded *in securitatem debiti* as security to repay a loan for consumption. The legal position is that a pledge over a personal right encumbers the right in the cessionary's favour, while the cession gives effect to the pledge by transferring either part of the right, namely, the right of action (under the pledge theory), or the entire right (under the *pactum fiduciae* theory), out of the cedent's estate into the cessionary's estate. This is the essence of a cession *in securitatem debiti*. However, for insolvency law purposes, cession *in securitatem debiti* is not mentioned in the definition of *'security'* in the Insolvency Act. Did the legislature intend to exclude creditors who are cessionaries as secured creditors from the definition of *'security'* in the Insolvency Act? The question affects an entire category of creditors who advance loans on the assumption that a cession *in securitatem debiti* of personal rights entitles them, on the borrower's insolvency, to first repayment as secured creditors before all other creditors. In answering this question, one has to rely on legal principles of interpretation, and especially case law, to conclude that *'pledge'* in that definition includes cession *in securitatem debiti.*[1580] Second, the definition of *'security'* is not used consistently in legislation. For example, the definitions of *'security'* in the Insolvency Act and the Municipal Finance Management Act[1581] differ.[1582] Third, legislation that does use the term *'security'* does not state that it means *'security'* as defined in the Insolvency Act. The Municipal Finance Management Act[1583] defines *'security'* but does so differently from the Insolvency Act. Fourth, security rights in different types of

[1580] *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).
[1581] Local Government Municipal Finance Management Act 56 of 2003.
[1582] The Insolvency Act defines *'security'* as *'in relation to the claim of a creditor of an insolvent estate, … property of that estate over which the creditor has a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention'* whereas the Municipal Finance Management Act defines *'security'* as *'any mechanism intended to secure the interest of a lender or investor and includes any of the mechanisms mentioned in section 48(2)'.*
[1583] Local Government Municipal Finance Management Act 56 of 2003.

assets and property are regulated by different legal instruments. On the one hand, asset-specific security, such as security rights in aircraft, movable property, immovable property, ships and uncertificated listed securities, are all regulated differently by national legislation that applies to only those assets. On the other hand, the common law governs the pledge of corporeal movables and the pledge and cession *in securitatem debiti* of personal rights, and the legal principles that apply are different from, and work differently to, the legal principles that govern asset-specific security. This incongruent approach, regarding both the different legal instruments (legislation and the common law) and the content of the security rights, to creating security interests in different assets and property types stands in stark contrast to the standard, uniform and functional approach taken to creating security interests in Article 2(kk) and related Articles of the UN Model Law,[1584] or Article 1-201(35) of the Uniform Commercial Code,[1585] both of which enable a person to create security interests in any type of asset or property.

The second deficiency is that regardless whether security rights are governed and regulated by the common law or by legislation, the lender's security rights are always in the asset or personal right, other than suretyships and guarantees, where the lender's security rights are held against the surety or the guarantor personally and not in its assets, and not against the borrower. The security rights in cessions are exercisable against the borrower as pledgor or cedent only because it contractually bound itself, as the owner of the asset or holder of the personal right, to grant the lender a security interest in its asset or right. Ideally, the law should provide that the security right must be registered not only against the asset or personal right, but also against the borrower who owns or holds it,[1586] so that if the borrower disposes of it to a third party in contravention of the pledge or cession, the lender still has recourse against the borrower, despite the borrower having parted with its ownership of the asset or personal right. In other words, the borrower must make good the lender's loss even if a third party acquired the asset in good faith and the borrower therefore cannot transfer the asset or personal right to the lender. The register in which security rights are recorded must be set up so that both the asset and the borrower's details are recorded.

The third deficiency is a conceptual one. As is evident from my analysis in this thesis, the South African legal system requires statutory registration of some types of security rights with governmental authorities, while others need not be registered. Such a disparate and mixed approach to security rights has legal consequences on two levels, namely, enforceability and third-party notice. First, regarding enforceability, security rights that are statutorily registrable are legally effective against third parties once registered,[1587] while non-registrable security rights are in theory legally effective against third parties upon conclusion of a binding contract, although a court order is needed to enforce such rights. Second, regarding third-party notice, registrable security rights constitute, on their

[1584] See section 7.1 under the heading *The UN Model Law*.
[1585] See section 7.3 under the heading *Definitions.*
[1586] This is the case in English law. See section 7.2 *English law on charges* and Wright *International Loan Documentation* (2014) 334.
[1587] For example, in terms of s 39*(d)* of the Financial Markets Act, a pledge or cession *in securitatem debiti* effected in accordance with s 39*(a)* is stated as being effective against third parties.

registration, notice to third parties of the existence of such security, while there is no notice to third parties of non-registrable security rights, despite its third-party effectiveness. The inconsistent conceptual approach on both levels is not ideal for lenders. All security rights ought to be statutorily registrable, which would ensure both enforceability and third-party notice of the security rights.

The fourth deficiency is that South African security structures for secured bilateral and syndicated loans are not ideally designed to facilitate the transfer of, and sharing in, security rights to new lenders. Deficiencies arise if a secured bilateral loan is syndicated with more than one new lender[1588] as extant security rights will have to be terminated, or an out-and-out cession undertaken to allow the borrower to create new security rights in favour of a Security SPV.[1589] Furthermore, the methods by which new lenders may share in extant and new security rights are untested in South African law.

The fifth deficiency is the absence of a coherent and uniform security rights system that applies to all types of security rights, from a statutory bond over movable property or immovable property, to a common-law pledge of movable property, to a common-law pledge and cession in *securitatem debiti* of personal rights. The absence of a coherent and uniform security rights system is detrimental to investment in, and potential loans that could be made to, South African businesses. Before advancing loans, lenders who are unfamiliar with South Africa's laws have to familiarise themselves with a complex, mixed security rights system that consists of common-law principles and legislation, and they must then have the security rights created and, where applicable, registered with the relevant South African governmental authorities. A potential lender needs advice or knowledge to be able to take the business decision whether or not to advance a loan. Lenders would need to retain the services of legal counsel to advise them, given the complexity of the security rights system and the absence of a single document that sets it out.[1590]

The sixth deficiency is in respect of the theories that govern the pledge and cession in *securitatem debiti* of personal rights. First, parties can elect to apply either the pledge theory[1591] or the *pactum fiduciae* theory,[1592] and should they fail to make an election, the default legal position is that the pledge theory will apply to their cession. However, if the parties elect to apply the *pactum fiduciae* theory, the cessionary's potential insolvency in circumstances where the cedent is servicing or repaying the loan (for which the security cession was given) will expose the cedent to the undesirable consequence that the ceded asset or personal right falls into the cessionary's insolvent estate and is accounted for by

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[1588] See the analysis under section 4.11 *Security structure and security rights of syndicate lenders.*
[1589] In section 4.11 *Security structure and security rights of syndicate lenders* the complexities accompanying the out-and-out cession of existing security rights are analysed and it is concluded that, because of those complexities, the cancellation of existing security rights is preferred.
[1590] Hewko 'Foreign Direct Investment in Transitional Economies: Does the Rule of Law Matter' (2002) 11(4) *East European Constitutional Review* 71 at 72. Compare the South African security rights system with the US security rights system, where in one (admittedly voluminous) document, the Uniform Commercial Code, the parties to a loan can easily establish what their rights and obligations are, and how the security rights system works. The parties to a loan in a country that has adopted the UN Model Law can do the same.
[1591] Analysed in section 6.6 *The pledge theory.*
[1592] Analysed in section 6.5 *The pactum fiduciae theory.*

the liquidator of the cessionary's estate.[1593] The cedent would suffer the misfortune of losing the ceded asset or personal right to the cessionary's insolvent estate even though it was not in default of the loan, and the cedent will rank as a concurrent creditor in the cessionary's insolvent estate unless the cedent holds security for the cessionary's obligation to re-cede the ceded asset or personal right when the secured debt is repaid. In the unlikely event that the cedent does hold security, it will rank as a secured creditor. The unfairness of these legal effects is obvious. The cedent, having abided by its contractual obligations to timeously repay the loan, provided security for its repayment obligations in the form of a fiduciary security cession of its asset or personal right, but then loses the ceded asset or personal right to the insolvent estate of the cessionary, and must stand in line behind the secured and preferent creditors waiting for payment. After the secured and preferent creditors have been paid, and the cedent's secured debt has been paid, and depending on the circumstances, it is likely that concurrent creditors such as the cedent will receive less in the rand than the value of the cedent's asset or personal right. This is the main reason why the *pactum fiduciae* theory as a theory to create security rights is considered flawed.[1594] I submit that the solution is to legislate to protect the cedent's rights to the asset or personal right in these circumstances by vesting title thereto in the cedent if the cessionary is placed under business rescue or becomes insolvent.[1595] Second, if the parties elect to apply the *pactum fiduciae* theory, how does one explain the contradiction that the cedent accounts for the asset or personal right in its estate when in law it has completely divested itself of ownership of the asset or personal right pursuant to an effective out-and-out cession? Third, neither the pledge theory nor the *pactum fiduciae* theory indicate whether the cedent may continue to trade the ceded right in the ordinary course of its business for the duration of the cession. The trading issue must be distinguished from the cessionary's *locus standi* to enforce the ceded right on the terms of the agreement between the cedent and the principal debtor. Fourth, the pledge theory raises a number of fundamental, and as yet judicially unresolved, conceptual issues, such as whether personal rights are divisible in law, whether one can have real rights over personal rights, the ownership of personal rights, and *locus standi* to enforce the ceded right.[1596] Possible solutions to these conceptual issues are offered in section 8.5 (*The reform of the South African law on secured lending*). Fifth, the theoretical complexities of the pledge theory[1597] make its application to syndicated lending difficult.

The seventh deficiency is that when our security rights system generally, and particularly the pledge and cession in *securitatem debiti* of personal rights, is measured against the UN Model Law, the UN Guide, the English law on charges and Article 9 of the Uniform Commercial Code, it is found wanting in a number of respects, including attachment, perfection, priority, registration, publicity or notice, and the enforcement of

[1593] In *MV Snow Delta Serva Ship Ltd v Discount Tonnage Ltd* 2000 (4) SA 746 (SCA) 753 para 9 the Supreme Court of Appeal, in a case dealing with whether the rights of a charterer of a ship was property located where the ship was, held that generally a right forms an asset in the creditor's estate.
[1594] Lubbe 'Cession' *LAWSA* (2013) 140 para 180.
[1595] Scott, for example, recommends that contractual limitations on the cessionary's rights be included in the relevant agreement to protect the cedent's interests. See *Scott on Cession* (2018) 497.
[1596] These aspects are analysed at length in section 6.7 *Theoretical issues arising from the pledge theory*.
[1597] Section 6.7 *Theoretical issues arising from the pledge theory*.

security rights. Attachment in English law and Article 9 of the Uniform Commercial Code occurs when security interests become enforceable against the borrower or debtor, while perfection is notice of the security interest to third parties, the effect of which is to make the security rights enforceable against third parties. In South African law, a security interest is enforceable against the borrower or debtor when contract and security law principles are fulfilled, and perfection of security rights addresses the enforcement and realisation thereof. There is therefore no South African law equivalent to the concepts of *'attachment'* or *'perfection'* as these concepts are understood in English law and Article 9 of the Uniform Commercial Code, because South African law treats these concepts differently. Furthermore, South African law has no mandatory requirement in respect of perfection as being notice of the security interest to third parties. In fact, South African law ascribes a different meaning to the concept of perfection, which is the lender taking possession of the pledged assets or personal rights to enforce the contract.[1598] Our mixed common-law and legislative security rights system takes a fairly dogmatic and traditional approach to Roman-Dutch law concepts that are the foundation of our security rights system. Dogmatism and tradition are not problematic in themselves, as long as they serve the needs of commerce and all its stakeholders. On the other hand, the UN Model Law and Article 9 of the Uniform Commercial Code take a functionalist approach to security rights and have abandoned all the old concepts of pledge, cession and the like. Although South African law is found wanting in respect of attachment, perfection and priority, these shortcomings are not fatal to the enforceability of South African security rights law. While I do not propose the abandonment of our common-law concepts of pledge and cession *in securitatem debiti* I believe that the functionalist approach of the UN Model Law and Article 9 of the Uniform Commercial Code is a useful benchmark for measuring the development of South African law, and for improving it.

The South African security rights system is deficient, but not legally defective, since it by and large protects lenders who hold security rights, and does not treat borrowers unfairly. The body of law that governs the pledge and cession *in securitatem debiti* of personal rights is substantive, well-crafted and works in practice. The identified deficiencies can be remedied which will improve South African security rights law. Before I make submissions for the reform of South African law, I will reiterate the principles that should inform the reform of South Africa's secured lending law.

8.4 Objectives, principles, international instruments and harmonisation

Objectives

Several objectives and principles ought to be observed when the law is reformed, clarified and developed. The objectives are to improve the relationship between the legal system and economic growth,[1599] to assist businesses to raise the maximum amount of finance

[1598] See section 4.9.2 *Perfection.*
[1599] Cross & Donelson 'Creating Quality Courts' (2010) 7(3) *Journal of Empirical Legal Studies* 490 at 491.

they need by using their assets and property, and to protect foreign lenders.[1600]

Principles

The principles applicable to reforming the law have been developed by South African courts and academic writers over time in relation to areas of substantive law and can be applied generally across different areas of law. The principles are to balance the competing interests of the borrower, the creditors and regulators,[1601] to deal with concerns that regulators such as the Companies and Intellectual Property Commission, the Johannesburg Securities Exchange Limited and the market generally may have, and to take account of academic opinion regarding the development of the law[1602] and property law principles.

International instruments and harmonisation

The extent to which the international instruments (the UN Model Law, the UN Assignment of Receivables and the UN Guide), the English law on charges and Article 9 of the American Uniform Commercial Code should be taken into account in reforming South African law on security rights, including cession *in securitatem debiti,* will depend on the conceptual approach that is adopted to codifying and reforming South African law, on the one hand, and harmonising South African law with the aforementioned laws, on the other hand.

Although the UN Guide treats security rights that are created by agreement thereunder as property rights and not personal rights,[1603] some of its recommendations are useful. It recommends that a country can adopt one of two approaches to reforming its secured lending laws.[1604] First, a country could retain the nomenclature of its security instruments, but its *'creation, third party-effectiveness, priority and enforcement'* would be subject to comprehensive rules that are both functional and integrated.[1605] Second, a country could abolish all its security instruments and replace them with uniform security rights governed by an *'identical regulatory framework'*.[1606] Although the UN Guide recommends that countries adopt the latter option,[1607] it is submitted that South Africa's jurisprudence on secured lending laws (which dates back more than one hundred years) is so well developed that, despite its deficiencies, abolishing it is not in the market's best interests for a number of reasons, including abolishing secured lending laws that work. The UN Guide's first recommendation is therefore the preferred option for the South African lending market.

[1600] The legal position of foreign lenders is analysed in section 2.4 *Foreign lenders.*
[1601] *Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd* 2015 (3) SA 479 (CC).
[1602] Such as the views of Lubbe and Renaudin discussed in section 7.5 *The reform of South African law.*
[1603] UN Guide, Chapter II, Creation of a security right (effectiveness as between the parties), A. General Remarks, 1. Introduction at 65 para 1.
[1604] UN Guide, Chapter I, Scope of application, basic approaches to secured transactions and general themes common to all chapters of the Guide, A. General Remarks, 3. Basic approaches to secured transactions, (v) Approach of the Guide at 57–58 para 110.
[1605] Ibid 58 para 110.
[1606] Ibid.
[1607] Ibid 58 para 111.

I submit that the approach to the harmonisation of laws as expounded by Renaudin should be applied to the disparate and mixed internal South African laws on security rights with the objective of achieving absolute uniformity between such laws *inter se*. I further submit that absolute uniformity between affected laws will achieve a regime of legal certainty that will bring South Africa's security rights laws into line with the conceptual approach to security rights as contained in the UN Model Law, the UN Assignment of Receivables, the English law on charges and Article 9 of the American Uniform Commercial Code.[1608] Cumulatively, this will create an environment that will increase business confidence in South Africa's secured lending market.[1609] Merely creating similarities between different South African laws with respect to security rights laws, as opposed to achieving absolute uniformity, will, I submit, be insufficient to establish an investment environment where lenders' claims can be easily enforced.

8.5 The reform of the South African law on secured lending

The time is opportune, some may say overdue,[1610] to reform and codify the South African law on secured lending to remedy the deficiencies and inconsistencies in our law. The reform and codification should be based on the principles discussed in section 8.4 (*Objectives, principles, international instruments and harmonisation*) and must address the deficiencies discussed in section 8.3 (*The law on security rights*).

My principal submissions are that it has become necessary to reform and codify the South African common law on loans for consumption, security rights, and particularly the law on cession *in securitatem debiti.* Reform will improve these areas of substantive law while codification will document the common-law positions. Investors who wish to fund South African companies will therefore be able to better understand the South African legal requirements for creating enforceable, secured loans.

Specifically, the new legislation should set out the common-law principles that govern the law on loans for consumption, recognising bilateral lending and syndicated lending as forms of loans for consumption, and security rights that foreground the law on cession *in securitatem debiti*.[1611] It should thereafter set out the pledge theory, the *pactum fiduciae* theory, and the attendant legal and practical consequences.[1612] The legislation should state the position adopted by the Supreme Court of Appeal in *Grobler*,[1613] which is that the pledge theory applies to a cession *in securitatem debiti* as the default position, unless the parties elect to apply the *pactum fiduciae* theory. The conceptual issues arising from the pledge theory – whether personal rights are divisible in law into component parts over or in which one can create security interests; whether one can have real rights over personal rights;

[1608] In instances where these laws differ with each other at a conceptual level, South Africa will need to elect which approach to follow.
[1609] Perry 'Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence' (2000) 49(4) *International and Comparative Law Quarterly* 779; Perry-Kessaris 'Recycle, Reduce, and Reflect: Information Overload and Knowledge Deficit in the Field of Foreign Investment and the Law' (2008) 35 *Journal of Law and Society* 67.
[1610] Scott has on a number of occasions called for legislative intervention and the reform of the law of cession.
[1611] As discussed in section 2.3 *Legal title to money and the role of the banker–customer relationship* and chapter 4 *Security for Loans.*
[1612] As discussed in chapter 6 *The Law of Cession in Securitatem Debiti.*
[1613] *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA).

the ownership of personal rights; the residual *locus standi* to protect the *dominium*; and the *locus standi* to enforce the ceded right[1614] – should also be covered. The Security SPV structure for syndicate lenders should be statutorily recognised and permitted, and the identified deficiencies remedied. I submit that the new legislation should furthermore take into account the following proposals.

(i) Personal rights can and should be divided into component or constituent parts for the purpose of creating security interests in part of the personal rights. Ideally, academics and judges should reach consensus as to what these component or constituent parts of personal rights are. A conceptual approach that recognises the divisibility of personal rights fortifies the theoretical foundation for the pledge theory in terms whereof the holder of a personal right can in law temporarily vest an aspect of its personal right, namely, the right of action, in another person (the cessionary) to serve as security for a secured debt, whilst the holder remains the owner of the substantive right. The cedent's reversionary right can be pledged and ceded *in securitatem debiti* to the same cessionary or another cessionary as security for the same or a different debt.

(ii) A real right of security can be created directly in the proceeds (that will arise from the exercise) of a personal right, but not in the personal right itself. It involves separating the right to require performance[1615] from the result of that performance, which are the proceeds, even though the performance and the proceeds are naturally inextricably linked because the one depends on the other, since rendering the performance results in the proceeds.

(iii) Personal rights are not owned in the way that movable property is owned; instead, the holder is entitled to the different incidents of ownership originally conceptualised by Honoré.

(iv) The principles that govern the cedent's reversionary *locus standi* to protect its *dominium* and the cessionary's *locus standi* to enforce the ceded right are sound principles, with both types of *locus standi* having been recognised in case law. Together, the two types of *locus standi* enable the cedent and the cessionary, in relation to their respective rights and obligations under the cession *in securitatem debiti*, to preserve the ceded right. Preservation maintains the value of the ceded right as an asset in the cedent's estate[1616] and consequently acts as an assurance to the cessionary that realising the ceded right will yield sufficient proceeds to settle the loan should the cedent (borrower) fail to repay it.

(v) The Security SPV structure for syndicate lenders should be refined so that it can be optimally used to facilitate the transfer of, and sharing in, security rights to new

[1614] These aspects are analysed at length in section 6.7 *Theoretical issues arising from the pledge theory.*
[1615] The nature of personal rights is discussed in section 4.5 *Personal and real security, and the registration of security rights* under the sub-heading *Personal security rights.*
[1616] Assuming the pledge construction applies to the cession *in securitatem debiti.*

lenders. The deficiencies relating to having to cancel or cede out-and-out, extant security rights given for a bilateral loan and having to recreate security rights in favour of the Security SPV[1617] when bilateral loans are migrated to syndicated loans must be addressed, and the methods by which new lenders may share in extant and new security rights should be statutorily recognised.

(vi) At the same time as the new secured lending laws are drafted and gazetted, current legislation (some of which is discussed in this thesis) must be aligned with the new secured lending laws. If this is not possible, then the current legislation must be repealed and replaced with new legislation.

A coherent and uniform security rights system that is accurate, easily accessible, open to the public and cost-effective will enable investors to establish, in an objective and reliable manner, what security rights or encumbrances have been created by companies over their assets and properties before they lend to these companies. It will minimise the possibility of companies misrepresenting the fact that they have created security rights or encumbrances over their assets and properties. It will further enable investors to establish for themselves how much unencumbered equity exists in companies' assets and properties that can be encumbered as security for loans that they intend making.

A new security rights system should consist of *inter alia* a central register, managed by the Companies and Intellectual Property Commission since it regulates companies, in which all security rights or encumbrances, regardless of form or substance, must be registered.[1618] The mandate of the Companies and Intellectual Property Commission must be expanded to regulate other entities such as individuals, partnerships and trusts to the extent that they act as lenders, borrowers and other obligors.[1619] In terms of the common law, a contract becomes enforceable when the parties reach consensus to be bound by agreed terms,[1620] and when any formalities (if applicable, in relation to the type of contract envisaged) have been complied with. At that point, the contract binds only the parties and not third parties, although the parties' rights could be enforced against the third parties by court order. The registration of security rights under the new system will make the security rights effective against third parties. The nature of the security rights system will have to be decided, that is, whether it will be a transactional filing system that is currently used and that is similar to the English system,[1621] or a notice filing system like the US system.[1622] Related issues are whether the cedent or the cessionary will bear the obligation to register the security interests, and whether statutory fees or taxes will be payable when applying to register the security rights.

[1617] See the analysis under section 4.11 *Security structure and security rights of syndicate lenders*.
[1618] See, for example, Chapter IV *The registry system* of the UN Model Law.
[1619] Relevant legislation, including the Companies Act 2008 and the Trust Property Control Act 57 of 1988, must be amended to give effect to this proposal. The jurisdiction of the Master of the High Court over trusts as set out in the latter Act must be amended to permit the Companies and Intellectual Property Commission to regulate trusts involved in secured loan transactions.
[1620] Lubbe *Contract: General Principles* (2020) 31 para 2.21.
[1621] See the discussion of the English filing system in section 7.2 *English law on charges*.
[1622] See the discussion of the US filing system in section 7.3 under the heading *Perfection.*

Once the central, public register has been designed, the individual registers currently operated by each registrar of deeds in respect of property, the Commissioner for Civil Aviation in respect of aircraft, and the electronic recording of the pledge, cession *in securitatem debiti* or other instruction in respect of listed securities or an interest in listed securities will have to be redesigned to be a mirror image of the relevant information in the central register, reflecting the security rights or encumbrances over the specific types of assets and properties that such individual registers are intended to contain. The data in the central, public register and the individual registers must be accurately captured, and appropriate systems, checks and balances must be put in place to achieve this objective. If listed or unlisted securities are pledged and ceded *in securitatem debiti* for the obligation to repay a *mutuum*, I propose that security rights in respect of both listed or unlisted securities should be registered in both the central, public register and in the cedents' securities register that must be kept under the Companies Act 2008. The Companies Act 2008 defines the *securities register* as the register required to be established in terms of section 50(1) wherein shares, debentures or other instruments issued or authorised to be issued by a profit company, regardless of their title or form,[1623] are recorded. The definition of *securities register* would need to be widened to include security rights. This proposal is based on a similar provision in Article 27(a) of the UN Model Law.[1624] The proposed registration of security rights in respect of listed securities should occur simultaneously with their registration under the Strate[1625] system, in terms of the requirements of the Financial Markets Act.[1626]

An alternative view is that simplifying and achieving uniformity in the law can be achieved not by reconfiguring the law on secured lending and creating the proposed registry system, but by requiring that all security interests in personal rights be registered in an existing registry, and that the registers that currently operate should continue to be used. According to this view, the pledge and cession *in securitatem debiti* of personal rights can be abolished. A range of concomitant issues will need to be addressed to assess the merits of such a view. Although such a proposal may be partially in line with an option in the UN Guide,[1627] it is submitted above that as South Africa's security rights jurisprudence is so well developed, abolishing it (and the pledge and cession *in securitatem debiti* of rights) is not in the market's best interests, despite the deficiencies. Furthermore, the proposed registry system will in any event require the registration of all security rights.

The UN Model Law, the English law on charges and Article 9 of the American Uniform Commercial Code should be considered when drafting new national legislation on secured

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[1623] See the definition of *'securities'* read with the definition of *'securities register'* in s 1 of the Companies Act 2008.
[1624] Article 27 of the UN Model Law reads as follows:
A security right in uncertificated non-intermediated securities may also be made effective against third parties by:
(a) The [notation of the security right] [entry of the name of the secured creditor as the holder of the securities] in the books maintained by or on behalf of the issuer for the purpose of recording the name of the holder of the securities; or
(b) The conclusion of a control agreement.
[1625] Strate is described in n 482.
[1626] The legal requirements of the Financial Markets Act to register pledged or ceded securities are discussed in section 4.5 *Personal and real security, and the registration of security rights.*
[1627] UN Guide, Chapter I, Scope of application, basic approaches to secured transactions and general themes common to all chapters of the Guide, A. General Remarks, 3. Basic approaches to secured transactions, (v) Approach of the Guide at 58 para 111.

lending. This will ensure that our new legislation accords with international trends in secured lending law. Once the new South African law on secured lending has been implemented, South Africa will emerge as an investment destination of choice.

The proposed reforms and codification will mark a new beginning for the law on secured lending and particularly the law on the cession *in securitatem debiti* of personal rights.[1628] The new law will be based on continuity with the present legal regime, but will also adapt international trends in secured lending law to South African market conditions.

[1628] As discussed elsewhere in this thesis, these are typically, but not exclusively, security rights to moneys in bank accounts, book debts, insurance policies, listed and unlisted securities, and shares.

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