ESCAPING LIABILITY UNDER A SURETYSHIP: WHEN THE LENDER MUST BE UPFRONT WITH DETAILS

Absa Bank Limited v Van Eeden and Others (4078/2012) [2018] ZAECPEHC 14 (27 March 2018)

Generally, when one puts pen to paper as a borrower or surety, it is your own responsibility to acquaint yourself with the details of the transaction and responsibility undertaken. However, as this case shows, there are limitations and in very specific circumstances, the lender (in this instance the bank) has a duty to disclose certain details within its knowledge. Failure to do so, allows the surety to escape liability under the suretyship.

The Judgment can be viewed here.

FACTS

Van Eeden is a businessman and property developer and also a trustee of the Frans van Eeden Family Trust (the Trust). During the course of 2010, he developed a business association with the owner of Heneb Properties CC (Heneb). At the time, Heneb was developing a shopping mall at Uitenhage. The shopping mall was owned by Evening Flame (Pty) Ltd (Evening Flame).

At some stage, Van Eeden advanced a loan to Heneb to enable it to complete the Uitenhage development. Subsequently further funds were required and, as a result, Van Eeden and Heneb approached ABSA to secure the additional funds. An amount of R5 million was advanced to Heneb by way of a Term Loan Agreement to enable it to provide the further funds to Evening Flame. The Term Loan was secured by registration of a mortgage bond in favour of ABSA over immovable property of Heneb. Further security was obtained in the form of suretyships executed by Van Eeden as well as the Trust, in the amount of R5 million, in respect of Heneb's indebtedness under the Term Loan Agreement.

Both Heneb and Evening Flame were later liquidated. The Bank proved three claims in the liquidation. These were all secured by the same mortgage bonds. Claim 2 was in respect of the Term Loan account in an amount of approximately R5,4 million.
At the end of the liquidation process, approximately R 9 million was paid to the bank by the liquidators in respect of the proved claims. The bank however, without reference to the liquidators, did not allocate the aforesaid contributions to the Term Loan account but to other debts owed by Heneb to it in terms of the mortgage bond and other suretyship obligations of Heneb.

Since other amounts remained owing to the bank, it instituted proceedings against Van Eeden and the Trust for payment of R5 million together with interest, in terms of the suretyships.

Van Eeden and the Trust denied liability under the suretyships mainly because:

1. At the time of execution of the deeds of suretyship, Heneb had already bound itself as surety for the indebtedness of another entity for an amount of R 15 million (which was secured by the registration of a mortgage bond over Heneb's immovable property). Van Eeden and the Trust were not aware of this or informed thereof by the bank in the several discussions that lead up to the granting of the R 5 million loan to Heneb. They were only aware of a mortgage bond against the property in favour of the bank in an amount of R 2.7 million. The bank was aware of the second surety bond and, so it was argued, was under a duty to disclose it to Van Eeden and the Trust since the bank was aware that they were only prepared to execute suretyships to secure the Term Loan Agreement because of the equity available in the immovable property of Heneb. Its property was valued to be worth approximately R12 million and therefore there was more than sufficient equity in the property to cover the existing bond and the proposed R5 million Term Loan (as well as the existing R 2.7 million loan). It was on this basis that Van Eeden was prepared to provide the suretyship.

   As a result, the bank acted in breach of a duty of care owed to Van Eeden and the Trust and the material non-disclosure constituted a misrepresentation entitling the sureties to resile from the suretyships.

2. The security was limited to the Term Loan Agreement and was not intended to secure all amounts owed by Properties to the bank.

   The bank argued that it was not under a duty to disclose the information to Van Eeden due to client privilege in respect of Heneb. It also argued that Van Eeden and the Trust had failed to establish that the non-disclosure was material and that it had induced them to enter into the suretyship agreements. It argued further that it could appropriate the allocations from the liquidators because Van Eeden and the Trust had bound themselves as sureties for repayment of any and all sums that the principal debtor (Heneb) might owe to the bank and that the bank would be entitled to apply all proceeds of payments received from the debtor or its liquidator in reduction of amounts owed to it without diminishing the liability of the sureties.

HELD:

The non-disclosure / misrepresentation defence

- Suretyship is an accessory liability. Its existence is dependent upon the existence of a valid principal debt between the creditor and debtor. The surety, in executing a deed of suretyship, binds herself to perform the principal debtor's obligations in the event that he fails to do so, alternatively to indemnify the creditor in that event. A contract of suretyship arises in accordance with the general principles applicable to the formation of contracts, save insofar as there are certain formalities prescribed. A surety is equally entitled to resile from an agreement of suretyship if that agreement was induced by fraud, duress, undue influence or mistake, whether induced by misrepresentation or otherwise.

- In order to escape liability under a signed agreement on the basis that there was a justified error as to the nature or contents of the document, a defendant must show that he or she was misled as to the nature of the document or as to the terms which it contains by some act or omission (where there was a duty to inform) of the other contracting party. The misrepresentation need not have been fraudulent or negligent. The duty to inform would or could arise where the document departs from what was represented, said or agreed beforehand or where the other contracting party realises or should realise that the signatory is under a misapprehension or where the existence of the provision or the contract is hidden or not apparent by reason of the way in which it is incorporated in a document or where the provision, not clearly presented, is unusual or would not normally be found in the contract presented for signature.

- Van Eeden's testimony that he was not aware of the existence of the further bond was not disputed. He only found out about that bond at a stage when Heneb was placed in business rescue. He immediately realised that the further bond liability would result in there being no equity in the property and that his position as surety was compromised thereby. Had he known, he would not have agreed to provide surety.

- In addition, it was shown that the non-disclosure was material in the circumstances as Van Eeden and the Trust established that the misrepresentation (or non-disclosure) induced them to enter into the suretyship agreements. (The test here hinges on the legal convictions of the community as the touchstone. Previous cases stated as follows: "The policy considerations appertaining to the unlawfulness of a failure to speak in a contractual context – a non-disclosure – have been synthesized

into a general test for liability. The test takes account of the fact that it is not the norm that one contracting party need tell the other all he knows about anything that may be material …. A party is expected to speak when the information he has to impart falls within his exclusive knowledge (so that in a practical business sense the other party has him as his only source) and the information, moreover, is such that the right to have it communicated to him 'would be mutually recognised by honest men in the circumstances.")

- Van Eeden further testified that he did not obtain this information from Heneb or from a deeds search, because he accepted that there was a relationship of trust operative between himself and the bank's officials and accordingly that he would have expected them to disclose to him the existence of the other bond in the various discussions.

- It was so that the knowledge was not "exclusive" to the bank at the time, but that was not the end of the matter. A 'duty to speak' may arise if a party has knowledge of certain unusual characteristics relating to or surrounding a transaction. On the facts of this matter, it was pertinent that Van Eeden was advised of the R 2.7 million bond, but not the R 15 million bond over the property. The disclosure was therefore incomplete. In these circumstances, having made an incomplete disclosure to Van Eeden, a duty arose requiring the bank to make a full and honest disclosure of the material facts in their knowledge.

- The failure to disclose constitutes a breach of duty owed to Van Eeden and the Trust and the failure to disclose was material: What persuaded him to execute the suretyships was the existence of sufficient equity in the Heneb property.

- Van Eeden's defence based on the material non-disclosure of facts entitles them to resile from the suretyship agreements.

Allocation of funds received from the liquidators

- Van Eeden's argument was basically that the bank had proved three separate claims in the liquidation of Heneb and a further claim against Evening Flame. One of those claims related to the claim in respect of the Term Loan Agreement. It is common cause that the liquidators made identified payments to the bank of dividends then payable in respect of the Term Loan Agreement and as a result, Van Eeden argued that the debt had been extinguished.

- The bank relied on a contractual entitlement to allocate any payments received by it to any debts owed by Heneb.

- However, on the facts of this matter, the allocation followed after a claim was

proved by the bank, reflected in the account of the liquidators and approved by the Master. It was a statutory process, regulated by the Insolvency Act (the Act). This matter dealt specifically with secured claims which were dealt with by the liquidator in terms of section 95 of the Act. In terms thereof, the liquidator presented a liquidation and distribution account which dealt with each of the bank's three claims. The bank did not object to the account which attended to distribution of the proceeds of the liquidation of property in satisfying claims secured by the property in their order of preference. The section is peremptory. The liquidator is obliged to act in accordance with the section. He accordingly has no choice in appropriating payments made in relation to one of several debts owed by the insolvent company.

- Thus, while generally a debtor is free to agree with a creditor that the creditor shall be entitled to allocate payments received, such agreement cannot bind a liquidator or trustee in an insolvent estate. Nor is a creditor entitled to allocate the payment received other than in accordance with a plan of distribution in respect of its separate claims proved against the insolvent estate.

It followed that the bank was not entitled to allocate the dividends received by it in relation to the Term Loan claim in the insolvent estates to the satisfaction of other debts owed by the debtor.

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