BUSINESS RESCUE: ARE YOUR SURETYSHIPS ENFORCEABLE? A R5.5M LESSON FOR DIRECTORS AND CREDITORS

“Some people use one-half their ingenuity to get into debt, and the other half to avoid paying it” (George Prentice, newspaper editor and author)

You are owed a lot of money by a company that goes into business rescue. The business rescue plan provides for creditors like you to accept a dividend of only a few cents in the Rand in settlement of your debt. You stand to lose heavily.

But perhaps there’s hope yet - a director with assets has signed personal suretyship. Can the director now say “sorry, you adopted the business rescue plan so your claim no longer exists”, and refuse to pay you?

The directors’ defence

A creditor was owed R6.5m for the lease of mining equipment to a company which was placed under business rescue. In terms of a business rescue plan approved by the creditor it was paid only a portion of its claim, losing its right to claim anything further from the debtor company.

The two directors of the debtor had signed a deed of suretyship in terms of which they stood as co-sureties and co-principal debtors with their company for all amounts owing.

The creditor duly sued the directors for its shortfall of some R5.5m. The directors’ defence was that they were not liable because –

* The suretyship entitled the creditor to go after them only for “any sum which after the receipt of such dividend/s or payment/s may remain owing by the Debtor.” (Own underlining).

* Nothing remained owing by the debtor which had been released from its debt by the business rescue plan.

In other words, argued the directors, nothing was owed by the debtor company, so they were liable for nothing.

Not so, said the Court. That “would render the terms of the deed of suretyship nonsensical and militates against the very reason for a creditor obtaining security against the indebtedness of a debtor i.e. to mitigate the risk of the debtor being unable to fulfil its obligations due to inter alia business rescue.” The business rescue plan made no provision for the position of sureties and therefore “the liability of the sureties is in my view preserved. And while the debt may not be enforceable against [the company], it does not detract from the obligation of the sureties to pay in the circumstances of this case.” In other words, a surety’s liability is unaffected by the business rescue unless the plan itself makes specific provision for the situation of sureties.

Bottom line - the directors must personally cough up the R5.5m (plus interest and costs).

Lessons for directors and creditors

The outcome here could have been very different had the wording of either this particular suretyship or the business rescue plan supported the directors’ defence.

Creditors - when securing your claim with a director’s suretyship check that you are fully covered in any form of business failure situation. And ensure that a business rescue plan specifically provides that its adoption does not release sureties.

Directors – when you sign personal surety understand exactly what you are letting yourself in for. And if you are unlucky enough to find yourself in the middle of a business rescue, actively manage your personal liability danger - particularly when it comes to the wording of the rescue plan.