THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case no: 98/10

DESERT STAR TRADING 145 (PTY) LTD	First Appellant
BRIDGING ADVANCES (PTY) LTD	Second Appellant
and	
NO 11 FLAMBOYANT EDLEEN CC	First Respondent
CHRISTIAAN SCHOEMAN	Second Respondent

Neutral citation: ***Desert Star Trading v No 11 Flamboyant Edleen*** **(98/10) [2010] ZASCA 148 (29 November 2010)**

BENCH: **NAVSA, CLOETE AND PONNAN JJA, EBRAHIM AND K PILLAY AJJA**

HEARD: **10 NOVEMBER 2010**

DELIVERED: **29 NOVEMBER 2010**

SUMMARY: Winding-up – locus standi of applicant as creditor – indebtedness disputed on bona fide and reasonable grounds – winding-up order correctly refused.

ORDER

On appeal from: North Gauteng High Court (Pretoria)(B van den Heever AJ sitting as court of first instance)

1 The appeal against paragraphs 3 and 4 of the order of the court below is allowed and the order is amended by the deletion of those paragraphs. Subject thereto and paragraphs 5 and 6 being renumbered 3 and 4 respectively, the order of the court below is confirmed.

2 Save as is set out in paragraph 1 hereof the appeal is dismissed.

3 The appellants are ordered to pay the respondents' costs jointly and severally, the one paying the other to be absolved.

JUDGMENT

PONNAN JA (NAVSA and CLOETE JJA and EBRAHIM and K PILLAY AJJA concurring):

[1] 'Neither a borrower nor a lender be' is Polonius' counsel to his son Laertes in Shakespeare's Hamlet (Act 1 Scene 3). 'For loan' as Polonius explains 'oft loses both itself and friend, [a]nd borrowing dulls the edge of husbandry'. Increased consumption, a desire-based need for credit, attractive borrowing options and alluring methods of repayment have all contributed to many of us not living our lives by that aphorism. Our modern consumer driven society does however come at a cost. As recently as 2005 it was reported that South Africa's consumer debt crisis was costing the country around R12 billion annually and that 40 per cent of households nationally were experiencing financial difficulty as they were unable to meet loan repayments to micro lenders and other service providers.[1] The protection of the consumer has become a common feature

[1]S Renke & M Roestoff 'The Consumer Credit Bill – A Solution to Over-Indebtedness?' 2005 (68) *THRHR* 115.

in many legal systems. Many countries have adopted consumer protection legislation to regulate credit grantor–credit consumer relationships because they can and do give rise to abuse and exploitation.[2] Given the borrower's weaker economic position[3] (that is usually why a loan is being sought), he or she is often helpless in the face of contracts - particularly standard form contracts presented by the lender. To borrow from Voet:[4]

'A needy debtor, pressed by tightness of ready cash, will readily allow any hard and inhuman terms to be written down against him. He promises himself smoother times and better fortune before the day put into the commissary term, and thus hopes to avert the harshness of the agreement by payment; though such a hope, quite slippery and deceptive as it is, not seldom finds nothing at all to encourage it in the aftermath.'

[2] Consumer credit legislation is usually the means by which credit grantor–credit consumer relationships are regulated. The main purpose of consumer legislation is said to be the protection of the consumer from exploitation.[5] But as Monica L Vessio points out:

'What is equally, if not more important, is an actual balancing of the interests of both credit consumers and credit grantors. The reason for the emphasis on this balance is that over-protecting the consumer may result in the investor (credit grantor) withdrawing his funding from the consumer credit market, due to the fact that the general administrative expenses of making credit available, no longer proves a lucrative venture due to stringent consumer laws. Another feature of the over-protection of the consumer may be the passing-on of administrative costs to the consumer. A subtle balance needs to be obtained. The risk of over-protecting the consumer could prove detrimental.'[6]

That balance has been sought to be achieved in this country by the enactment of the relatively recent National Credit Act 34 of 2005 (the NCA), which seeks, according to its Preamble, inter alia to: 'provide for the general regulation of consumer credit and improved standards of consumer information; . . . prohibit certain unfair credit and credit-marketing practices; and to promote responsible credit granting and use and for that purpose to prohibit reckless credit granting'.

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[2] Monica L Vessio 'The Preponderance of the Reckless Consumer – The National Credit Bill 2005' 2006 (69) *THRHR* 649.
[3] R Zimmerman *The Law of Obligations: Roman Foundations of Civilian Tradition* (1990) 166.
[4] Cited in *Graf v Buechel* 2003 (4) SA 378 (SCA) at 384A.
[5] NJ Grové & JM Otto *The Basic Principles of Consumer Credit Law* 2ed (2002) 4.
[6] Monica L Vessio op cit p 650.

[3] Against that backdrop I turn to the facts in this case. Unable to raise a loan from any of the established banking institutions, but being desperately in need of financial assistance, Mr George Ehlers (Ehlers) turned to small private lenders although as he put it, he knew he 'was going to pay a heavy price for the loan'. One such private lender to whom Ehlers turned during 2007 was Desert Star Trading 145 (Pty) Ltd (Desert Star), the first appellant. Not being creditworthy he did not qualify for the loan that he sought. The loan application was then revised and re-submitted in the name of his son, Mr Eugene Ehlers (Eugene). The amount lent and advanced together with interest and costs by Desert Star to Eugene was the sum of R859 600. On 8 June 2007 Eugene acknowledged his indebtedness in writing to Desert Star and undertook to effect repayment of that sum within twelve months of that date. The agreement provided that in the event of the loan remaining unpaid after 8 June 2008 then the interest would be recalculated with effect from the date of the agreement at the rate of 1.5% per week compounded. As security for the loan, Ehlers in his capacity as the sole member of the first respondent, No 11 Flamboyant Edleen BK (the CC), bound it as a surety and co-principal debtor in favour of Desert Star in respect of the indebtedness of Eugene. And as further security a security bond was registered in favour of Desert Star over an immovable property, the sole asset of the CC. Eugene failed to repay the loan and as at 30 May 2008 his indebtedness to Desert Star stood at R1 253 000.

[4] In the meanwhile on 29 January 2008 Ehlers approached another small private lender, the second appellant, Bridging Advances (Pty) Ltd (Bridging) for a loan. This time the application was made in the name of his wife, Lèone Ehlers. A written agreement was concluded in terms of which Bridging loaned and advanced the sum of R160 053 (being R150 000 plus interest and costs) to Ms Ehlers. Here as well Ehlers bound the CC as a surety and co-principal debtor in favour of Bridging for the indebtedness of Ms Ehlers. And as further security a mortgage bond was registered in favour of Bridging over the Ehlers family home which was registered in the name of Ms Ehlers. Sporadic payments in the total sum of R41 000 were effected by the Ehlers to

Bridging, but given the annual interest rate of 42.2% applicable to the loan, the outstanding balance had grown by 6 February 2009 to R205 363.55.

[5] On 30 May 2008 Desert Star caused a notice in terms of s 69[7] of the Close Corporations Act[8] to be served on the CC claiming payment of the outstanding amount within 21 days. Bridging took a similar step on 3 February 2009. In each instance the s 69 notice pointed out that a failure to timeously comply with the statutory demand would have the result that the CC would be deemed to be unable to pay its debts. In that event each of the notices threatened as a consequence an application for the winding-up of the CC. The notices went unanswered.

[6] On 17 July 2008 Desert Star launched the winding-up application threatened in its s 69 notice. The CC took no steps to oppose the application and on 21 November 2008 the North Gauteng High Court (Pretoria) granted a provisional order of winding-up and a rule nisi calling upon all persons concerned to show why a final order should not issue. Thereafter Christiaan Schoeman (Schoeman), the second respondent, sought leave to intervene in the application with a view to setting aside the provisional order. In his affidavit he stated that Ehlers was a long-standing business associate, who had advanced R 2.5 million to the CC for the purchase of its sole asset, the immovable property and that the loan to the CC constituted Ehlers' loan account in the CC which had been ceded to him (Schoeman). He said:

'To assist G Ehlers I have taken cession of his loan account for value received and consequently I am a creditor of the respondent in an amount of R 2.5 million. The Deed of Cession [is] annexed hereto marked CS1.'

That was confirmed by Ehlers in his affidavit. I should perhaps add that neither the existence nor the validity of the cession was disputed by either appellant.

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[7] Section 69 provides:
'(1) For the purposes of section 68(c) a corporation shall be deemed to be unable to pay its debts, if □
(a) a creditor, by cession or otherwise, to whom the corporation is indebted in a sum of not less than two hundred rand then due has served on the corporation, by delivering it at its registered office, a demand requiring the corporation to pay the sum so due, and the corporation has for 21 days thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; . . .'

[8] Act 69 of 1984.

[7] On 9 April 2009 Bridging also launched an application for the winding-up of the CC, but given the fact that a provisional winding-up order had already issued at the instance of Desert Star, took no further steps to advance its application. Instead on 3 August 2009 Bridging sought leave to intervene in Desert Star's application.

[8] On 25 November 2009 after certain further affidavits had been filed by the parties and after hearing argument, Van den Heever AJ:

1 granted Schoeman leave to intervene in the winding-up application;
2 dismissed Bridging's application to intervene in the winding-up application;
3 declared the deed of suretyship concluded between Desert Star and the CC on 26 September 2007 unlawful and *ab initio* void;
4 cancelled Desert Star's rights arising from the deed of suretyship;
5 set aside the provisional winding up order; and
6 ordered Desert Star and Bridging to pay the CC's and Schoeman's costs jointly and severally such costs to include those occasioned by the employment of two counsel.

[9] With the leave of the court below the appellants appeal to this Court against the whole of the judgment and order of Van den Heever AJ.

[10] It can hardly be in dispute that, if the appellants are to qualify as persons having *locus standi* to apply for the winding-up of the CC, it can only be on the ground that each was a creditor (including a contingent or prospective creditor) of the CC within the meaning of s 346(1)(b) of the Companies Act.[9] Each of the appellants alleges that it is indeed such a creditor. That is disputed. It thus becomes necessary to consider the nature of the debt secured by the CC.

[11] The appellants in each instance relied upon a deed of suretyship. It is so that a contract of suretyship is a separate contract from that of the principal debtor and his or her creditor. It is however accessory to that main contract.[10] Thus for there to be a valid

[9] Act 61 of 1973 read with s 66(1) of the Close Corporations Act.
[10] *Kilroe-Daley v Barclays National Bank Ltd* 1984 (4) 609 (A) at 622I.

suretyship there has to be a valid principal obligation. Put differently, every suretyship is conditional upon the existence of a principal obligation.[11] For, as Nienaber JA put it '[g]uaranteeing a non-existent debt is as pointless as multiplying by nought'.[12] It follows that a surety is not liable to a person to whom the principal debtor is not liable.[13] It is well settled that the general rule is that a surety may avail himself or herself of any defences that the principal debtor has save for those defences that are purely personal to the principal debtor.[14]

[12] It is common cause that each of the underlying principal agreements is a credit agreement as defined in s 8(4)(f) of the NCA and that the Act applies to them. The thrust of the respondents' case is that the deed of suretyship is ineffectual inasmuch as the debtor identified therein is not indebted to the creditor by virtue of the fact that the principal debt that it sought to secure is, in terms of the NCA, either ab initio void (solely in the case of Desert Star) and in addition one that is liable to be set aside or suspended.

[13] It is undisputed that when Desert Star contracted with Eugene it was not a registered credit provider. The NCA required it to be. The effect of it not being so registered according to Schoeman is that the agreement concluded between it and Eugene is void ab initio. In that regard he states:

'It is clear from the provisions of Section 40(1)(a) and (b) read with Section 42(1) of the Act and Government Gazette 28893 dated the 1st of June 2006 that [Desert Star] was required to register as credit provider before or within 30 days from the date of the transaction between [it] and [Eugene].

I respectfully submit that considering the provisions of Section 4(1) read with Section 8(1)(a) of the Act the credit transaction between [Desert Star] and [Eugene] concluded on the 8th of June 2007 is a credit agreement within the Act and subject thereto.

The implication of not being registered is simple; the principal agreement of debt concluded between [Desert Star] and [Eugene] is void. In this regard I draw the Honourable Court's attention to Section 40(4)[15] and Section 89(1)(d) read with 89(5)(a) of the Act.

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[11] CF Forsyth & JT Pretorius *Caney's Law of Suretyship in South Africa* 6ed (2010) 30.
[12] *African Life Property Holdings (Pty) Ltd v Score Food Holdings Ltd* 1995 (2) SA 230 (A) at 238F.
[13] Digest 46.1.16; Voet 46.1.3; Pothier *Law of Obligations (Translated by WD Evans)* 4.1.393-394.
[14] *Worthington v Wilson* 1918 TPD 104 at 105; *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 (2) SA 693 (C) at 695F-H.
[15] Section 40(4) reads: 'A credit agreement entered into by a credit provider who is required to be

In terms of the Provisions of Section 89(5)(a)[16] of the Act I submit that the Honourable Court is obliged to declare that the credit agreement concluded between [Eugene] and [Desert Star] on the 8th June 2007 is void *ab initio*.

The enforceability of the instrument of suretyship, which forms the basis of this application, is conditional upon the existence of an enforceable debt in favour of [Desert Star] by [Eugene].

On this basis alone I submit that the application must fail and the Provisional Order be discharged.'

[14] In support of the additional contention that the agreements are liable to be set aside or suspended, the respondents assert that both Desert Star and Bridging are in common parlance 'loan sharks' and that each of the principal agreements constitutes 'reckless credit agreements in terms of the [NCA]'. The prevention of the granting of reckless credit is an important lodestar of the NCA. Section 81(3) of the NCA precludes a credit provider from entering into a reckless credit agreement with a prospective consumer. To determine when exactly a credit agreement is a reckless one it is to s 80 that one must turn, which provides that:

'(1) A credit agreement is reckless if, at the time that the agreement was made . . .

(a) the credit provider failed to conduct an assessment as required by section 81(2), irrespective of what the outcome of such an assessment might have concluded at the time; or

(b) the credit provider, having conducted an assessment as required by section 81(2), entered into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that—

(i) the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed credit agreement; or

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registered in terms of subsection (1) but who is not so registered is an unlawful agreement and void to the extent provided for in section 89.'

[16]Section 89(5) reads:'If a credit agreement is unlawful in terms of this section, despite any provision of common law, any other legislation or any provision of an agreement to the contrary, a court must order that -

(a) the credit agreement is void as from the date the agreement was entered into;

(b) the credit provider must refund to the consumer any money paid by the consumer under that agreement to the credit provider, with interest calculated -

(i) at the rate set out in that agreement; and

(ii) for the period from the date on which the consumer paid the money to the credit provider, until the date the money is refunded to the consumer; and

(c) all the purported rights of the credit provider under that credit agreement to recover any money paid or goods delivered to, or on behalf of, the consumer in terms of that agreement are either -

(i) cancelled, unless the court concludes that doing so in the circumstances would unjustly enrich the consumer; or

(ii) forfeit to the State, if the court concludes that cancelling those rights in the circumstances would unjustly enrich the consumer.'

(ii) entering into that credit agreement would make the consumer over-indebted.'

Sections 81(2) and (3) in turn provide that:

'(2) A credit provider must not enter into a credit agreement without first taking reasonable steps to assess -

(a) the proposed consumer's -

(i) general understanding and appreciation of the risks and costs of the proposed credit, and of the rights and obligations of a consumer under a credit agreement;

(ii) debt re-payment history as a consumer under credit agreements;

(iii) existing financial means, prospects and obligations; and

(b) whether there is a reasonable basis to conclude that any commercial purpose may prove to be successful, if the consumer has such a purpose for applying for that credit agreement.

(3) A credit provider must not enter into a reckless credit agreement with a prospective consumer.'

In terms of s 83 (1) of the NCA a court, in any court proceedings in which a credit agreement is being considered, may declare it to be a reckless one. If it does do so it may in terms of s 83(2) set aside all or part of the consumer's rights and obligations under that agreement or suspend the force and effect of it.

[15] Eugene is a student, with no employment or fixed earnings, who is not possessed of any assets. Ms Ehlers stands on much the same financial footing. She is a housewife, who also has no fixed employment, earns no salary and aside from the matrimonial home, which is now the subject of a mortgage bond registered in favour of Bridging, is possessed of no assets. It is accordingly submitted by the respondents that both Desert Star and Bridging failed to make any assessment of the financial status of Eugene and Ms Ehlers respectively. Accordingly, so the submission goes, their ability in each instance to service the loan was not investigated. Had such an assessment been made as is required by s 81(2)(a)(i)-(iii) and (b) of the Act, so the submission proceeds, Desert Star and Bridging would ineluctably have concluded that there was no reasonable prospect of either repaying the amount loaned. In those circumstances it is contended that the agreement was a reckless credit agreement which is hit by s 81(3) of the NCA.

[16] On the view that I take of the matter it is not necessary that any firm conclusion be reached at this stage on the respondents' contentions. It suffices that the

indebtedness is disputed on bona fide and reasonable grounds for, as Corbett JA made plain in *Kalil v Decotex (Pty) Ltd:*[17]

'In regard to *locus standi* as a creditor, it has been held, following certain English authority, that an application for liquidation should not be resorted to in order to enforce a claim which is *bona fide* disputed by the company. Consequently, where the respondent shows on a balance of probability that its indebtedness to the applicant is disputed on *bona fide* and reasonable grounds, the Court will refuse a winding-up order. The *onus* on the respondent is not to show that it is not indebted to the applicant: it is merely to show that the indebtedness is disputed on *bona fide* and reasonable grounds.'

[17] Desert Star had caused a provisional sentence summons to be issued against Eugene. In those proceedings Eugene challenged the validity and enforceability of the acknowledgment of debt on which Desert Star sues. Bridging has also instituted proceedings against Ms Ehlers. In her plea to Bridging's summons Ms Ehlers contends that the agreement upon which Bridging relies constitutes a reckless credit agreement. She has also filed a claim in reconvention in which she seeks, inter alia, an order that the agreement be declared a reckless credit agreement and that it be set aside. It goes without saying that the correctness of the respondents' contentions can be determined in those proceedings. It follows that the appellants will not be remediless, for if those proceedings were to be decided in their favour they could thereafter take steps to enforce their rights flowing from the respective suretyship agreements.

[18] One final aspect remains. It has been conceded on behalf of the respondents that the learned Judge erred in declaring the suretyship void *ab* initio and cancelling Desert Star's rights flowing therefrom. It follows that that part of the order of the court below cannot stand and it accordingly falls to be set aside. It was agreed before us that that did not constitute substantial success on appeal and that the costs should follow the result. For the rest the appeal is devoid of any substance and is accordingly dismissed.

[19] In the result:

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[17] 1988 (1) SA 943 (A) at 980B-D.

1 The appeal against paragraphs 3 and 4 of the order of the court below is allowed and the order is amended by the deletion of those paragraphs. Subject thereto and paragraphs 5 and 6 being renumbered 3 and 4 respectively, the order of the court below is confirmed.

2 Save as is set out in paragraph 1 hereof the appeal is dismissed.

3 The appellants are ordered to pay the respondents' costs jointly and severally, the one paying the other to be absolved.

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V M PONNAN
JUDGE OF APPEAL

APPEARANCES:

For First Appellant:	F H Terblanche SC J E Smit
	Instructed by:

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For Second Appellant:	M C Erasmus SC
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