RECTIFICATION AND *CONCURSUS CREDITORUM*

Nedbank Limited v Chance
2008 4 SA 209 (D); 2008 2 All SA 367 (D)

1 Introduction

In *Nedbank Limited v Chance* (2008 4 SA 209 (D); 2008 2 All SA 367 (D)), the court refused a claim for rectification of a contract, although it was common cause that it did not reflect the actual agreement between the parties, because the debtor had been declared insolvent and a *concursus creditorum* had been established. The result was that the insolvent debtor's sureties, its erstwhile directors, managed to evade liability to the creditor for an amount in excess of R2.8 million. Given that the principles concerning a *concursus creditorum*, as well as those regarding rectification, have equity as their purpose, this highly prejudicial outcome for the creditor is most unsatisfactory and the decision merits closer scrutiny.

2 The facts

The material facts were common cause (see par 1-8). The plaintiff, Nedbank Ltd (hereinafter "Nedbank"), had, in 1998, obtained an order placing the sixth defendant, Chance Brothers (Pty) Ltd (hereinafter "Chance Brothers"), in provisional liquidation. They subsequently concluded a "reorganisation agreement" with the purpose of restructuring Chance Brothers' indebtedness to Nedbank and to ensure its removal from provisional liquidation. The reorganisation agreement recorded the fact that Chance Brothers owed Nedbank an amount in excess of R10 million and that its sureties, who were directors of Chance Brothers (this fact does not appear in the judgment, but it was ascertained from Nedbank's legal representative in the matter), had personally guaranteed its obligations to Nedbank in terms of suretyship agreements executed during 1993. In terms of their agreement, a portion of the debt, an amount of R3.5 million, was to be repaid to Nedbank by the issue to it of 3.5 million cumulative redeemable preference shares, and the balance was to be dealt with in terms of a loan agreement concluded by the parties during 1996. However, by mistake, the reorganisation agreement was not accurately reduced to writing and the signed document reflected the redemption value of the preference shares as R35,000, instead of the intended R3.5 million.

In 2002 Chance Brothers was wound-up on account of its insolvency. Nedbank's claim against it, in liquidation, for R10,752,119.85 (which included an amount of R3.5 million as the redemption value of the

preference shares) was accepted by the joint liquidators and was reflected in the second and final liquidation and distribution accounts. These were confirmed by the Master of the High Court in 2004 and 2007, respectively. Nedbank received dividends of R7,936,835.81. Thereafter, Nedbank sued the sureties for the balance which it contended was owed to it by Chance Brothers at the time when it was wound-up, less the dividends received from the joint liquidators. In the same action, Nedbank sought rectification of the contract document to reflect correctly the redemption value of the preference shares as R3.5 million.

The sureties' defence was that, as a matter of law, the reorganisation agreement could not be rectified after the winding-up of Chance Brothers. It was common cause that, if, in the circumstances, Nedbank failed in its claim for rectification, there would be no outstanding balance for which the sureties would be liable to Nedbank.

3 The decision

The court, *per* Theron J, decided the issue by stating (par 9):

> "On liquidation and by operation of the common law a *concursus creditorum* (concourse of creditors) comes into existence. The effect of a liquidation order is that it:
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> > 'crystallises the insolvent's position; 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.*'[1] [Footnote 1: *Per* Innes JA in *Walker v Syfret NO* 1911 AD 141 at 166. Although these comments were made in respect of a sequestration order, they are equally applicable to a liquidation order.] [emphasis added].
>
> The insolvent estate is 'frozen' and nothing can thereafter be done by any one creditor that would have the effect of altering or prejudicing the rights of other creditors.[2] [Footnote 2: *Vather v Dhavraj* 1973 (2) SA 232 (N) at 236B-C.] As between the estate and the creditors and as between the creditors *inter se*, their relationship becomes fixed and their rights and obligations become vested and complete.[3] [Footnote 3: *Incledon (Welkom) (Pty) Ltd v QwaQwa Development Corporation Ltd* 1990 (4) SA 798 (AD) at 803G-J.] One consequence of this is that a creditor who at the date of winding-up was only a concurrent creditor cannot by rectification of an agreement alter its position to become a preferent or secured creditor as this would disturb the *concursus*.[4] [Footnote 4: *Durmalingam v Bruce NO* 1964 (1) SA 807 (D) at 811G-H; *Thienhaus NO v Metje & Ziegler Ltd and another* 1965 (3) SA 25 (AD) at 30A-C; *Klerck NO v Van Zyl & Maritz NNO and another and related cases* 1989 (4) SA 263 (SE) at 279F-G.] The same must hold for a creditor who seeks rectification to improve its position from that of a preferent creditor in a certain amount, to a preferent creditor in a greater amount. This approach is in line with the general principle that the claim of each creditor must be dealt with as it existed at the date of liquidation. Rectification post *concursus* would almost inevitably prejudice the rights of other creditors."

In the circumstances, Nedbank's claim for rectification was dismissed with costs (par 11).

4 Comments

It is submitted that this decision is open to criticism in the following respects:

- It is based on a misconception of rectification and its effect, as well as the prejudice to third parties which would exclude rectification.
- It reflects a misunderstanding of the purpose and effect of the *concursus creditorum*.
- Use of authority is inappropriate in that precedents cited are not all in point and do not support the conclusion reached.
- The outcome is manifestly unfair.

4 1 Rectification

Where parties have failed to record their agreement accurately in a document, it may be rectified to bring it into line with their common intention (see Van der Merwe *et al Contract: General Principles* 3ed (2007) 178ff). Rectification has equity as its purpose: because it would be unfair to prevent parties from establishing terms upon which they intended to contract, our law provides for rectification in the context of the parol evidence rule (see Van der Merwe *et al* 179). A party who seeks an order of rectification must prove that the document does not accurately reflect the terms upon which they intended to, or did, contract and must also show what the terms of the written agreement should be for it to reflect their intention accurately. It should be noted that rectification is a

> "correction of a contractual document by a judicial decree … What is rectified is not the contract itself as the juristic act, but the document, inasmuch as it does not express what the contractants intended to be the content of their juristic act: 'All that the Court ever touches is the document'.[189] [Footnote 189: *Lawrence v Spiller* 1976 (1) SA 307 (N) 310]" (Van der Merwe *et al supra* 178-9).

Thus,

> "[r]ectification does not alter the contract, but 'perfects the written memorial so as to accord with what the parties actually had in mind'.[239] [Footnote 239: *Milner Street Properties (Pty) Ltd v Eckstein Properties (Pty) Ltd* 2001 (4) SA 1315 (SCA)]. Although rectification takes effect *e tunc*, as if the document had from its inception expressed the true intention of the parties, … it does not operate to the detriment of third parties who have relied on a written instrument in good faith.[241] [Footnote 241: *Weinerlein v Goch Buildings Ltd* 1925 AD 282 291; *Industrial Finance and Trust Co (Pty) Ltd v Heitner and Another* (1961 (1) SA 516 (W); *Akasia Finance v Da Sousa* 1993 (2) SA 337 (W) and see *Klerck v Van Zyl & Maritz* 1989 (4) SA 263 (SE)]" (Van der Merwe *et al* 185).

4 2 The effect of the formation of a concursus creditorum

It is trite that the rules regarding the formation of a *concursus creditorum*, on sequestration or liquidation, have as their purpose the equitable distribution among the creditors of the insolvent's assets in accordance with a pre-

determined ranking of claims (see Sharrock *et al Hockly's Insolvency Law* 8ed (2006) 4.) The position is "crystallized" at the time of the sequestration order so that nothing may be done, after the insolvency order has been granted, to alter it. Thus the *status quo* is preserved and creditors' claims must be dealt with in accordance with the position as it was at the moment of the declaration of insolvency. The reason is to prevent a creditor from taking any step to secure an advantage or benefit that he did not have, or to which he was not entitled, at the date of the sequestration.

4 3 Authorities cited, viewed in context

4 3 1 *Walker v Syfret*

The reported judgment in *Nedbank v Chance*, does not mention the context in which the well-known *dictum* of Innes JA, in *Walker v Syfret* (*supra* 166), was expressed. The issue was that the holder of debentures in a company had transferred them to his brother, after liquidation, in an attempt to avoid the operation of set-off. When the brother lodged a claim against the liquidated company, the court held that set-off also operated in relation to the brother's claim because he had no greater rights in respect of the debentures than the transferor himself would have had if he had proved his claim on them instead of selling them to his brother.

It should be noted that, according to the *dictum*, a creditor cannot enter into any "*transaction*" (my emphasis) after the liquidation order has been granted, which would prejudice the general body of creditors. In *Nedbank v Chance* there was no question of Nedbank entering into any *transaction* after liquidation, but it was simply seeking what Innes JA stated ought to be done in the circumstances: that the court must deal with its claim as it existed at the issue of the liquidation order. This would not, in principle, exclude rectification of a document to allow it to reflect correctly rights which had arisen from a contract concluded before, and which existed at the time of liquidation. This, I submit, is borne out by the majority decision in *Thienhaus v Metje & Ziegler* (*supra*), cited by Theron J (fn 4) and which is discussed below.

4 3 2 *Vather v Dhavraj*

In *Vather v Dhavraj* (*supra*), the court (*per* Leon J, Shearer J concurring) also applied the *dictum* of Innes JA, but in a very different context from that in *Nedbank v Chance*. *Vather v Dhavraj* concerned an action against the insolvent personally, based on his post-sequestration undertaking to pay a specific amount to the appellant once his creditors had been paid under a composition reached in terms of section 119 of the Insolvency Act (24 of 1936). The issue was whether the appellant's claim was excluded by section 123(1) of the Insolvency Act (24 of 1936), which provides that it is only creditors who have not proved a claim against the insolvent estate who may claim from the insolvent personally. Leon J quoted the *dictum* of Innes JA to support a conclusion that section 123(1) referred only to the claims of

creditors who formed part of the *concursus creditorum*, that is, claims against the estate at the time of sequestration. Thus it was held that section 123(1) did not preclude the appellant from suing the insolvent personally on his post-sequestration undertaking. I submit that *Vather v Dhavraj* is not relevant to, and provides no support for, the conclusion reached by Theron J in *Nedbank v Chance*.

4 3 3 *Incledon v QwaQwa Development Corporation*

Although not indicated in the reported judgment, in *Nedbank v Chance*, the statement by Theron J that "[a]s between the estate and the creditors and as between the creditors *inter se*, their relationship becomes fixed and their rights and obligations become vested and complete" (par 9) is a *verbatim* quotation from *Incledon v QwaQwa Development Corporation* (*supra* 803J). Again, I submit, it is significant to consider the context in which that statement was made. The court had to determine the effect, if any, of a proclamation published in the Government Gazette which effectively dissolved one of the creditors of a company in liquidation and passed its assets, liabilities, rights and obligations to various regional development corporations, including the QwaQwa Development Corporation (hereinafter "the QDC"). The court (*per* Goldstone AJA; Hoexter, Van Heerden and Milne JJA and Nicholas AJA concurring) held that the proclamation published *after* the liquidation of the company did not affect the rights of creditors as at the date of liquidation (803G). If one reads beyond the passage quoted by Theron J, the purpose of Goldstone AJA's statement becomes apparent within the context of that case. The reasoning was that, considering the intention of the Legislature, the proclamation did not interfere with, or affect, completed transactions or vested rights and, therefore, the claims of creditors had to be dealt with by the liquidator as they existed at the time of the company's liquidation, unaffected by the proclamation (804A-E).

Thus my submission is that *Incledon v QwaQwa Development Corporation* does not support the conclusion reached in *Nedbank v Chance*. On the contrary, if it has any bearing on the issue in *Nedbank v Chance*, it serves only to suggest that, in principle, rectification is permissible. Later in the judgment (805E-J), Goldstone AJA considered a submission on behalf of the QDC that a cession *in securitatem debiti* to Incledon fell to be rectified because the parties had not intended it to apply to the concessions in question. He did not reject this contention as inherently unsound but did so purely on the basis that the QDC had failed to discharge the onus of proving that the written cession, by reason of common error, did not reflect the true intention of the parties.

4 3 4 *Durmalingam v Bruce*; *Thienhaus v Metje & Ziegler and Klerck v Van Zyl & Maritz*

Theron J cited three cases, *Durmalingam v Bruce* (*supra*), *Thienhaus v Metje & Ziegler* (*supra*) and *Klerck v Van Zyl & Maritz* (*supra*), as authority for the statement that "a creditor who at the date of winding-up was only a

concurrent creditor cannot by rectification of an agreement alter its position to become a preferent or secured creditor as this would disturb the *concursus*" (par 9).

In *Klerck v Van Zyl & Maritz*, where the signature of the mortgagor had been forged, the court held that estoppel could not operate to create, out of an invalid mortgage bond, a real right over an insolvent debtor's immovable property. This case has no bearing on the issue in *Nedbank v Chance*.

Theron J did not follow the precedent set by the majority judgment in the Appellate Division decision, in *Thienhaus v Metje & Ziegler*, to which she specifically referred (note 4). In *Thienhaus v Metje & Ziegler*, the court allowed rectification, after a liquidation order had established a *concursus creditorum*, of a mortgage bond so that it correctly identified the mortgagee (35B). Having quoted the *dictum* of Innes JA, in *Walker v Syfret*, Williamson JA (Van Blerk JA and Ogilvie Thompson JA concurring), delivering judgment on behalf of the majority, stated that it was "therefore essential to determine exactly what rights the first respondent did have in regard to the bond as at the moment of liquidation" (30C). Having found that, in the circumstances, the formalities requirements for a valid mortgage bond had been met, Williamson JA further stated (32H-33A):

> "In the present case there was at all material times an enforceable claim in existence which the bond was intended to secure …
>
> It would have been a clear case of the parties to the transaction being completely *ad idem* as to all the essentials of their agreement, but the written instrument incorporating that agreement failing, merely by accident, accurately to record that agreement. The position is fully covered by the remarks of DE VILLIERS, J.A., in *Weinerlein v Goch Buildings Ltd*, 1925 AD 282, where, after a reference to authority, he states at p. 289 that 'from the above it is clear that the Romans did not allow the true agreement between the parties to be prejudiced by a slip of the pen or other inaccurate expression'".

I submit that this reasoning ought to have been considered and applied by Theron J, in *Nedbank v Chance*.

Close scrutiny of all the authorities cited reveals that Theron J relied heavily on the decision of Friedman AJ, in *Durmalingam v Bruce*, extending and applying the reasoning behind it, to deal with the issue in *Nedbank v Chance*. However, my submission is that it was wrong to do this as *Durmalingam v Bruce* is not in point. In that case, the insolvent had, prior to his insolvency, passed a notarial bond, duly registered in terms of the Notarial Bonds (Natal) Act (18 of 1832), in favour of Durmalingam over his "Henschell" bus, its licence and the motor carrier certificate pertaining to it (808E). Between the registration of the notarial bond and the declaration of his insolvency, the insolvent replaced this bus with another vehicle, an "International" bus (808F-G). He surrendered the motor carrier certificate which related to the Henschell bus and was issued a fresh motor carrier certificate, on the same terms as the previous one, in respect of the International bus. After the sequestration of the estate of the insolvent, Durmalingam sought rectification of the notarial bond to reflect what he alleged was the parties' common intention, viz, that the bond would hypothecate any certificate obtained in substitution for the certificate in

regard to the Henschell bus (808G-H). The trustee of the insolvent estate excepted to this.

Friedman AJ refused to order rectification of the notarial bond. He referred to *Ward v Barrett* (1963 2 SA 546 (A)), a case in which the court had refused a creditor's claim for the registration of a notarial bond after a *concursus* had been formed in terms of section 48(3)(b) of the Administration of Estates Act (24 of 1913). Friedman AJ reasoned as follows (811G-H):

> "The position in the present case is, in my view, exactly the same. Whatever rights the respondent may have had against the insolvent prior to insolvency, the whole position was altered by the insolvency … The claim of each creditor has to be dealt with by the trustee as it existed at the date of the sequestration of the insolvent's estate. At that date, the respondent was merely a concurrent creditor in so far as the proceeds of the realisation of the certificates relating to the International bus are concerned … [T]he respondent was, at that date, entitled to claim rectification of the notarial bond so as to give him a preference in respect of such proceeds. The respondent's personal right against the insolvent could not be converted into a *jus in rem* under a registered bond."

Nedbank v Chance is clearly distinguishable in that registration was not required for the creation of Nedbank's right to claim from Chance Brothers payment of R3.5 million as the redemption value of the preference shares issued to it. Their oral reorganisation agreement created that right. Nedbank did not enter into any transaction after sequestration, nor did it require any step, such as registration, to take place. It simply sought rectification of the contract document. Ironically, this accorded precisely with Theron J's expressed objective: to adopt an "approach … in line with the general principle that the claim of each creditor must be dealt with as it existed at the date of liquidation" (par 9).

It may also be noted that rectification does not alter a concurrent creditor's position for it to *become* a preferent or a secured creditor, nor, as Theron J viewed it, does it improve, or elevate, a creditor's "position from that of a preferent creditor in a certain amount, to a preferent creditor in a greater amount" (par 9). Rectification would simply have allowed the document to reflect the agreement which existed, and hence provide documentary evidence of the rights which had been created before liquidation. This was what Nedbank sought and what the court refused: a most unsatisfactory decision in light of the fact that the true terms of the agreement were undisputed.

4 4 Prejudice

The essential flaw in the reasoning, ie, that rectification may confer a right where none existed before, informed Theron JA's conclusion that "[r]ectification post *concursus* would almost inevitably prejudice the rights of other creditors" (par 9). This statement reflects the rationale expressed by Friedman AJ, in *Durmalingam v Bruce*, "that the interests of other creditors would inevitably be prejudiced by an order of rectification … whether the effect of such an order would be to make the respondent a preferent or a

secured creditor" (812D). Clearly, because rectification does not *create* a right, it does not *make* a preferent or secured creditor out of a concurrent creditor and, consequently, the resultant "inevitable prejudice" to other creditors is ill conceived. It was contended on behalf of Durmalingam, who sought rectification, that the trustee of the insolvent estate ought to have pleaded "facts which would indicate that third persons would be prejudiced" (812B-C). Friedman AJ dismissed this argument although, in my submission, it was a valid one. Friedman AJ cited *Industrial Finance and Trust Co (Pty) Ltd v Heitner* (1961 1 SA 516 (W)) as authority for the effect of rectification having to be limited to the parties concerned. However, the circumstances were significantly different in that case. The plaintiff was the holder for value of a negotiable instrument which had been signed by the two defendants who sought its rectification. Their defence was that they had signed on behalf of a company and not, as their signatures indicated, in their personal capacities, but that the word "for" had been omitted above the company name. The court refused rectification of the negotiable instrument as this would prejudice the plaintiff who had not been party to the defendants' agreement and who had given value for it. In stark contrast to this, in *Durmalingam v Bruce*, there was no factual proof of prejudice to any other creditors (812A-B) and nor was there any in *Nedbank v Chance*.

My submission is that one cannot simply assume that rectification "will almost inevitably prejudice the rights of other creditors" (par 9) in the *concursus creditorum* but that prejudice must be established by the party alleging it before it may exclude rectification. Prejudice would be established, for example, where a creditor, in reliance upon the "unrectified" document, acted to his or her detriment by granting credit to the (now insolvent) debtor. The concept of prejudice should not be equated with deprivation of some unfair advantage which the creditor would otherwise obtain in the absence of rectification. In this regard, I submit that the following remarks made by Williamson JA, in *Thienhaus v Metje & Ziegler* (34E-H), are apposite:

> "If there is anything which might possibly indicate *dolus* as emerging in the present matter, it is the attitude of the creditors in seeking to gain an advantage for themselves out of the admitted mistake of the conveyancer – a mistake which could never have misled them in any material respect. The fact that they are not allowed to gain an advantage from the accidental misdescription, which in itself could not have caused prejudice, is not a prejudice suffered by them."

Theron J made the assumption, in *Nedbank v Chance*, that the sureties would be prejudiced by rectification. On the contrary, they gained a significant advantage for themselves out of an admitted mistake which occurred in the reduction to writing of the reorganisation agreement. As directors of Chance Brothers, presumably, they represented it when that agreement was concluded which would mean that the mistake could never have misled or prejudiced them in any respect. The liquidators, quite correctly, in my submission, saw fit to deal with the liquidation and distribution of the assets of Chance Brothers among the creditors in the *concursus creditorum* in accordance with the true reorganisation agreement, and the Master confirmed the accounts. Thus Nedbank received from the

liquidators a dividend on a preferent claim of R3.5 million, and not only R35 000. This operated to the "advantage" of the sureties in that the outstanding balance for which they were personally liable to Nedbank was significantly less than if the liquidators had regarded the amount of the preferent claim as being that reflected in the incorrect contract document. At that stage, in reality, the unpaid balance for which the sureties were liable exceeded R2.8 million. Yet, because the court refused rectification, it regarded the outstanding balance as nil. This meant that the sureties were allowed to evade any liability on undertakings which they had provided in 1993, well before the *concursus creditorum* was formed or even the reorganisation agreement in question had been concluded. Thus, it may be said, they were allowed to "get off scot-free". The only conceivable "prejudice" to the sureties, in these circumstances, would have been, in the words of Goldstone AJA, "[t]he fact that they … [would] not [be] allowed to gain an advantage from the accidental misdescription, which in itself could not have caused prejudice" (*Thienhaus v Metje & Ziegler* 43H). In the result such misconceived prejudice allowed the sureties to gain a substantially unfair advantage and yielded an incorrect result.

5 Conclusion

The formation of a *concursus creditorum* should not form the basis for a court's refusal of a claim for rectification. Once a *concursus creditorum* has been formed, the claims of creditors must be dealt with as they existed at the time that the insolvency order was issued. Essential also to the understanding of the position is the concept that rectification does not create, or alter, a right but that it merely alters a document so that it correctly reflects a right which already exists. According to the applicable principles, if prejudice to a third party is established, rectification cannot occur. Both the principles concerning the establishment, and effect, of a *concursus creditorum* and those regarding rectification of contractual documents have equity as their purpose. Yet the outcome of the decision, in *Nedbank v Chance*, yielded substantial unfairness. The reasoning in this decision requires reconsideration and thorough analysis, taking into account all relevant authority in its appropriate context. It is hoped that the Supreme Court of Appeal will soon have the opportunity to reassess, clarify and "rectification" the position.

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