PARATE EXECUTIE AND PUBLIC POLICY. THE SUPREME COURT OF APPEAL PROVIDES FURTHER GUIDELINES*

1 Introduction

The right of a creditor to realise the property of its debtor without first obtaining the permission of the court is clouded in controversy. This type of extra-judicial execution is known in Roman-Dutch law as *parate executie* (literally: "immediate execution"). The essence of *parate executie* is that it allows the creditor to self-help in the event of default by the debtor. The tenability of *parate executie* has come under judicial scrutiny in the recent past, not least because of its potential infringement of the provisions contained in section 34 of the Constitution of the Republic of South Africa, 1996. Section 34 provides that "[e]veryone 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" (see in this regard, *First National Bank of South Africa Ltd v Land and Agricultural Bank of South Africa; Sheard v Land and Agricultural Bank of South Africa* 2000 3 SA 626 (CC); (2000 8 BCLR 876); *Chief Lesapo v North West Agricultural Bank* 2001 1 SA 409 (CC); *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 1 SA 251 (E); *De Beer v Keyser* 2002 1 SA 827 (SCA); *Senwes Ltd v Muller* 2002 4 SA 134 (T); *Shoprite Checkers (Pty) Ltd t/a OK Franchise Division v Juglal NO* (unreported case no 6049/01, 13 Sep 2002 (D)) (which was endorsed on appeal in *Juglal NO and another v Shoprite Checkers (Pty) Ltd t/a OK Franchise Division* 2004 5 SA 248 (SCA)); *Graf v Buechel* 2003 4 SA 378 (SCA) (which dealt with a forfeiture clause (*ie*, *pactum commissorium*) and therefore falls outside the direct scope of the present note); and *Bock v Dubororo Investments (Pty) Ltd* 2004 2 SA 242 (SCA)).

These cases have further been discussed in a number of case notes (see Scott "Summary Execution Clauses in Pledge and Perfecting Clauses in Notarial Bonds" 2002 65 *THRHR* 656 *et seq*; Steyn "Perfection Clauses, Summary Execution (*Parate Executie*) Clauses, Forfeiture Clauses (*Pacta Commissoria*) and Conditional Sales in Pledge Agreements and Notarial Bonds – The Position Clarified" 2004 *Obiter* 443 *et seq*; and Schulze "*Parate Executie, Pacta Commissoria*, Banks and Mortgage Bonds" 2004 37 *De Jure* 256 *et seq*).

Although *parate executie* is employed by many creditors to realise the security that they hold, commercial banks, being the prime example of money lenders in modern times, have a particular vested interest in retaining

* I am indebted to my colleague, Prof Susan Scott, for her valuable comments on an earlier draft of this case note. Any mistakes that remain are, of course, my own.

parate executie as a valid instrument to realise movables that were given to the bank as security.

In the recently reported decision in *SA Bank of Athens Ltd v Van Zyl* (2005 5 SA 93 (SCA)) the court was asked to pronounce on the validity of a clause that provides for *parate executie* on the movable property (in the present case: four investment policies) of a defaulting debtor which were held by a bank. The court was further asked to determine whether a *parate executie* clause is in conflict with public policy.

2 SA Bank of Athens v Van Zyl

2 1 Facts

The facts in *SA Bank of Athens v Van Zyl* were as follows. The plaintiff ("Van Zyl") instituted action against the defendant ("the bank"). The court *a quo* gave judgment in favour of the bank. Van Zyl averred that while in a vulnerable psychological condition after the death of her husband, she was persuaded by one Joubert, an insurance representative and "financial advisor" in the employ of an insurance company ("Sanlam"), to invest money in a trust in which members of his family had an interest. Without her knowledge, she was made a trustee of the trust. Early in 1998 Joubert requested Van Zyl to sign certain documentation in connection with the business of the trust. She accompanied him to the bank where she found documents spread on a table. She signed these without reading their contents. She further alleged that she had no idea what she was signing. The nature of the documents was never explained to her. In particular she was unaware that she was signing a deed of suretyship. She denied ever having the intention of binding herself as a surety (par 2).

During October 1998 the bank instituted action in the magistrate's court against Van Zyl for payment of R75 525.08 in respect of amounts allegedly owing by the trust on its cheque account. She was cited in her representative capacity as a trustee, and in her personal capacity as a surety. Van Zyl entered appearance to defend and, when the bank thereupon applied for summary judgment, she filed an affidavit resisting the application. At the time that the present appeal was heard, the summary judgment application had not yet been finalised (par 2).

The basis of Van Zyl's claim against the bank (which formed the crux of the present appeal) was that, while the opposed summary judgment application was pending in the magistrate's court, the bank, acting without court sanction, called up and retained the proceeds of four investment policies held by her with Sanlam, the total of which amounted to R206 907.00 (par 3).

Van Zyl argued that the bank had purported to act in terms of *parate executie* clauses contained in deeds of cession. Van Zyl denied knowledge of the existence of these deeds of cession. Alternatively, so she argued, these *parate executie* clauses were in conflict with section 34 of the Constitution and therefore invalid. As a result, so she averred, by effecting *parate* execution of the policies, the bank had unlawfully taken the law into

its own hands. She concluded that the bank was therefore obliged by law to pay her the amount realised by it on the policies (par 4).

In the court *a quo*, Spilg AJ pointed out that the position in regard to the realisation of the first two policies was unclear insofar as it could not be established whether the bank was aware of Van Zyl's objections at the stage when these policies were realised. However, the bank was well aware of Van Zyl's defence at the time when the last two policies were realised. The learned judge made no bones in expressing his disapproval of the bank's conduct. In this regard he remarked:

> "I find it difficult to use restrained language in describing the bank's conduct, particularly as it is conduct of a financial institution. Suffice that its conduct on the papers before me is disgraceful and for this reason I consider it appropriate that investigations be conducted into the matter by appropriate authorities" (par 6).

The relevant portion of the deeds of cession provided that:

> "[Van Zyl] hereby appoint … irrevocably and *in rem suam* as [her] *attorney and agent* to apply for the surrender, to realise or otherwise deal with the policy in [the bank's] absolute discretion in the event of [Van Zyl's] failure to pay any amount which [Van Zyl] may owe or in which [she] may be or become indebted to [the bank] and to apply the proceeds of such surrender, realisation or other dealing to [the] aforesaid debt …" (own insertions) (emphasis added) (par 8).

In the court *a quo* it was held this portion of the deed of cession was indeed *contra bonos mores* and therefore invalid in that it constituted a "classic *parate executie* provision" (par 9).

In passing I should perhaps mention that it is not necessarily cut and dried that this clause constituted a "classic *parate executie* provision". The clause provided that the bank was appointed as Van Zyl's "attorney and agent … to … deal with the policy". The bank acted therefore on behalf of Van Zyl, and with her consent, and there was thus no question of "self help" in the present case.

It was further held that an agreement that allows a person to be the arbiter of whether a debt is owed by another without due process of law and which denies access to the courts, offends the provisions of section 34 of the Constitution (par 9).

It was accordingly held in that court that the bank's action in realising Van Zyl's investment policies was invalid, which meant that there was no *bona fide* defence to Van Zyl's claim recognised by law and that she was therefore entitled to summary judgment (par 9).

2 2 Common law

It is trite that *parate* execution has long been acceptable under the common law, provided that the terms of the agreement authorising the procedure are not unconscionable or incompatible with public policy (see in this regard *Sasfin (Pty) Ltd v Beukes* 1989 1 SA 1 (A) 13J-14A; Scott and Scott *Wille's Law of Mortgage and Pledge in South Africa* 3ed (1987) 122; Kritzinger *Principles of the Law of Mortgage, Pledge & Lien* (Series: Ellison Kahn

(general editor) *Principles of Commercial Law*) (1999) 22-23; and Steyn 2004 *Obiter* 443-445). Examples of a procedure that would be in conflict with public policy will be where the agreement entitled the creditor to determine the fact of the debtor's default, or where it authorises the creditor to seize the debtor's property without the court's sanction (*SA Bank of Athens v Van Zyl supra* par 10).

2 3 Constitutional and judicial developments

Since 1996 the relevant common law principle has been tempered to a certain extent by the provisions of the Constitution, most notably those contained in section 34. In *Chief Lesapo v North West Agricultural Bank* (*supra*) the court held that a statutory provision that permitted a creditor to seize a defaulting debtor's property, and to sell it in defrayal of the debt, without recourse to a court of law, was unconstitutional and invalid – notwithstanding the fact that there was no dispute as to the debtor's default. It is important at this stage to point out that the *Lesapo* case involved immovable property.

In the *Findevco* case, which was decided in a local division of the High Court, the court relied on the *Lesapo* case in declaring invalid a clause in a general notarial bond that authorised the creditor to take possession of the debtor's *movable property* and to dispose thereof in payment of the debt. The court in *Findevco* reasoned that because legislation authorising *parate executie* is unconstitutional (based on the finding in the *Lesapo* case), therefore the common law cannot countenance such a stipulation in a contract. As a result, so the court in *Findevco* held, the stipulation in the particular provision authorising *parate* execution was unconstitutional (*Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd supra* 256E-F).

In the *SA Bank of Athens* case, counsel for the bank informed the court that at the time when Van Zyl instituted action against the bank (on 29 November 2001), they (*ie*, counsel) took it that the particulars of claim were drafted on the basis of the law as stated in *Findevco* and that they accepted that the law was settled on that basis. But after Van Zyl had instituted action against the bank and after the court *a quo* had held in favour of Van Zyl, the judicial tide had turned against the decision in *Findevco*. The correctness of the decision in the *Findevco* case was questioned in academic circles (see Scott 2002 65 *THRHR* 656-664) and subsequently also rejected by the Supreme Court of Appeal (in *Bock v Duburoro Investments supra*: for a discussion of which, see Steyn 2004 *Obiter* 451-452; and Schulze 2004 37 *De Jure* 264-266). In this regard Harms JA in the *Bock* case held that since the debtor may seek the protection of the court at any stage of the proceedings where the creditor takes *parate* execution of a movable, and if the debtor can show that the creditor acted in a manner which prejudiced him in his rights, the creditor cannot be said to have taken the law into his own hands (par 13 of the *Bock* case). Harms JA concluded that the decision in the *Findevco* case, finding that the law relating to *parate executie* of movables is unconstitutional, was wrong (par 15 of the *Bock* case).

It is important to point out that the court in *Bock's* rejection of the *Findevco* case was nothing more than an *obiter dictum* because the judgment in *Bock* did not turn on the validity of *parate* execution clauses in general, but on the

constitutionality of the procedure followed by the creditor in that case (par 13 of the *SA Bank of Athens* case).

Of more direct relevance was the refusal by Hurt J in the court *a quo* in *Shoprite Checkers v Juglal* (*supra*) to follow the decision in *Findevco*. Hurt J held that:

> "[T]he common law, insofar as stipulations for *parate* execution are concerned … which are not so far-reaching as to be contrary to public policy, are valid and enforceable; that, as a matter of practice, creditors seeking to enforce such stipulations take the precaution of applying for judicial sanction before doing so; and that the debtor can avail himself of the court's assistance in order to protect himself against prejudice at the hands of the creditor" (par 14 of the *SA Bank of Athens* case).

This decision by Hurt J in the court *a quo* in the *Juglal* case was endorsed on appeal (see the decision by Heher JA in *Juglal v Shoprite Checkers* (*supra*)). On appeal Heher JA held that the common law does not limit the right of access to the courts, nor does it fall short of the "spirit, purport or the objects of the Bill of Rights [contained in the Constitution]" (own insertion) (par 12 of the *Juglal* case). In the *Juglal* case the court held that in order to establish whether a contractual provision (also one which purports to allow *parate* execution), is in conflict with public policy, one has to take into account the cumulative effect of the implementation of the provisions that allow the creditor to take *parate* execution. It held that the mere fact that a contractual provision is capable of implementation by the creditor in a manner that is against public policy, but the tenor of the provision is neutral, then the offending tendency is absent (par 12 of the *Juglal* case).

With this background to the existing law, the court in the *SA Bank of Athens* case turned to the facts of that case.

2 4 The decision in SA Bank of Athens

Erasmus AJA held (Mpati AP, Farlam, Mthiyane and Van Heerden JJA concurring) that the court *a quo* erred in finding that the deeds of cession signed by Van Zyl allowed the bank to be the arbiter of whether the debt was owing. The cession agreements did not expressly authorise such action on the part of the bank, nor was this objectionable feature of *parate executie* implicit in the cession deeds (par 15).

Next, the court drew an important distinction between the provisions of a *parate executie* clause, on the one hand, and the actual purported reliance on it by the creditor, on the other hand. In this regard it held that the mere fact that the provisions in the cession agreements allowing for *parate* execution were valid, did not necessary entail that the bank's actions in purported reliance on it were lawful (par 16).

It further held that the proceedings in the court *a quo* were from their commencement to their conclusion misdirected by the mistaken acceptance by the parties and the court of the correctness of the decision in *Findevco*. On appeal it was pointed out that the bank's affidavit resisting summary judgment was not as comprehensive as it should have been. This might have been ascribed to the fact that the affidavit was not directed at justifying the bank's *parate* execution of Van Zyl's investment policies, but was

designed to accommodate the legal argument which was presented on behalf of the bank in the court *a quo*, but which was not persisted with at the hearing of the appeal (par 16). This could perhaps be ascribed to the fact that the determination of the lawfulness of the bank's conduct (*ie*, in taking *parate* execution of Van Zyl's policies) required a value judgment which could have been properly made upon consideration of all the "relevant facts and attendant circumstances". But these were not placed before the court *a quo*. As a result, so the court on appeal reasoned, it would be unfair and improper towards the bank to leave standing a summary judgment which was given without consideration of all the relevant facts and circumstances. This would especially be the case where such failure was the result of a misunderstanding of the law by both the plaintiff (Van Zyl) and the court, and where such misunderstanding was caused by the acceptance of the correctness of the decision in *Findevco*, notwithstanding the subsequent rejection of the reasoning in *Findevco* by the Supreme Court of Appeal in the *Juglal* case (par 16).

In conclusion the court held that the real focus in the present appeal was not the constitutional validity of a *parate executie* clause because that has been settled in both the *Bock* and *Juglal* cases. The crux of the present matter turned on the lawfulness of the bank's actions in the purported execution of those provisions of the deeds of cession (par 18).

The court allowed the appeal, not *because* of the bank's explanation of its actions (there was no explanation at all), but rather *despite* its failure to set out the relevant facts and circumstances in its affidavit opposing summary judgment. This failure was caused by the misunderstanding by both parties as to the law applicable to the present case (par 18).

Because both parties were to blame for the misdirection of proceedings, the court held that no order be made as to the costs of the appeal.

3 Comment

The decision in *SA Bank of Athens* merits a number of comments. These mostly concern not what was said in that case, but rather what was remained unsaid. I will merely mention five of these aspects here.

First, given the uncertainty created by the decision in the *Findevco* case (as to which, see Scott 2002 65 *THRHR* 656 *et seq*), one would have preferred to see an explanation in *SA Bank of Athens* of the distinction between the following six legal concepts or situations:

- Perfection clauses. In the case of a perfection clause the debtor retains possession of the movable property, but agrees to relinquish possession to the creditor, should he (the debtor) fall into default. The debtor can either relinquish possession voluntarily, or the creditor may approach the court for an order of specific performance. Perfection clauses are valid (Scott 2002 65 *THRHR* 658-659).
- Statutory measures empowering the state to seize, without the intervention of the courts, movable and immovable property from unwilling debtors. Such measures have been declared unconstitutional in the *Chief Lesapo* and *First National Bank* cases. The reasons for this

unconstitutionality include: the exclusion of recourse to the courts; the seizure of property against his will; and the overriding principle that such measures amount to self-help (Scott 2002 65 *THRHR* 658-659).

- Summary execution clauses in pledge agreements. In *SA Bank of Athens* the court held (par 15-16) that *parate* execution is not per se unconstitutional or offensive to public policy. From this one may conclude that a summary execution clause in a pledge agreement is valid per se, but that subsequent unreasonable conduct by the creditor (*eg*, the procedure that the creditor follows in realising the property) may impact on the validity of the actual execution of the creditor's right. The question whether certain conduct would be unreasonable and thus invalid would depend on the circumstances of each case (see *SA Bank of Athens* case *supra* par 16). This point was emphasised in the *Bock* case (par 7) where it was held that "it is different with movables held in a 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 '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'". In *Graf v Buechel* (*supra* 382) the court held that no reason exists for a cession of incorporeal rights to be dealt with differently from the pledge of a (corporal) immovable (for a discussion of the first three legal concepts or situations, see Scott 2002 65 *THRHR* 657 *et seq*).
- Summary execution clauses in mortgage bond agreements. In this regard a further distinction has to be drawn between a summary execution clause (ie, *parate executie*) that was agreed upon in the *original* loan agreement or mortgage deed, and the right to *parate executie* that was agreed upon by the parties *after* the debtor's (mortgagor's) default. The former agreement is invalid, the latter one not (see Schulze 2004 37 *De Jure* 259-260).

Although not directly relevant to the facts in the *SA Bank of Athens* case, two further types of clauses also merit a brief reference here:

- Forfeiture clauses (also known as *pacta commissoria*). A forfeiture clause in a pledge agreement (movables) or a mortgage deed (immovables) is invalid. However, a conditional sale, or a provision that the creditor may take over the pledged article at a fair price, is valid. If the pledged article realises an amount in excess of the debt secured by it, the excess or "profit" belongs to the pledgor (usually the debtor) (see Steyn 2004 *Obiter* 452; and Schulze 2004 37 *De Jure* 260-261).
- *Quasi* conditional sales whereby the creditor may, upon default, take over a pledge at a fair price. Such sales are valid (see Schulze 2004 37 *De Jure* 262-264).

Secondly, and closely linked to the first comment above, is the fact that the *SA Bank of Athens* case serves as confirmation, albeit in passing only, that our law draws a distinction between *parate* execution on *immovables*, on the one hand, and *parate* execution on *movable property*, on the other hand. Froneman J in the *Findevco* case, held that the constitutional invalidity of a *parate executie* clause did not depend on the nature of the goods in question. His lordship was at pains to emphasise that s 34 of the

Constitution applied to both immovable and movable property. In this regard Froneman J referred to the *Chief Lesapo* case (which dealt with immovable property) and *FNB v The Land and Agricultural Bank* (which dealt with movable property) (*Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd supra* 254E-H). But Harms JA in the *Bock* case rejected the reasoning in *Findevco*. In the *Bock* case it was held that "[i]t is different with movables held in a 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 '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'" (par 7). What the court in the *SA Bank of Athens* case should perhaps have added was that in *Findevco* the court failed to distinguish between *statutory measures* which empower *the state* to seize movable property from unwilling debtors, on the one hand, and *parate executie* clauses in an agreement which are *based on consensus* between the parties, on the other hand. The authority that the court in *Findevco* relied on in finding that *parate executie* clauses in general are unconstitutional and therefore invalid, simply does not support such finding. The finding in the *First National Bank* case should have been restricted to *statutory measures* which empower *the state* to seize movable property, and not also *parate executie* clauses in respect of movables where the state is not involved. Furthermore, in the *Chief Lesapo* and *First National Bank* cases, the creditor dispossessed the debtor of his land, so reverting to a statutory "self-help". It is trite that self-help is illegal (*Nino Bonino v De Lange* 1906 TS 120). Scott (2002 65 *THRHR* 658) further correctly points out that "a fundamental aspect [in dealing with *parate executie* clauses] is the fact that [with statutory powers to seize] one is dealing with the state as opposed to an individual. The individual has no say in the matter" (my insertions).

Thirdly, and closely linked to the second comment above, is the fact that the court in *SA Bank of Athens* was silent on the criticism that has been expressed in regard to the distinction which is drawn between *parate executie* on immovable property (which is invalid: see *Iscor Housing Utility Company v Chief Registrar of Deeds* 1971 1 SA 614 (T) 616-617), on the one hand, and *parate executie* on movable property (which is valid), on the other hand. In this regard it has been argued, and correctly so, that the distinction should not be based on the value of the property, because nowadays various types of movables (*eg*, aircraft, shares and investment policies to mention but three) have values that far exceed that of many immovable properties (see Scott 2002 65 *THRHR* 664; and Steyn 2004 *Obiter* 454).

Fourthly, the court in the *Bock* case emphasised the fact that *parate executie* of movables does not authorise a creditor to bypass the courts and "seize and sell the debtor's property of which the debtor was *in lawful and undisturbed possession*" (emphasis added) (par 13). The *Bock* case therefore drew a distinction between *parate* execution of movables that are in the possession of the creditor, on the one hand, and *parate* execution of movables that were in the possession of the debtor but then removed from the latter's possession by the creditor against the debtor's will and sold in execution, on the other hand (par 13). That is why the *mandament van spolie* developed to protect the debtor where he has possession of the

security (par 14). Although not directly relevant to the facts in the *SA Bank of Athens* case, I believe that the important distinction between a pledged article which is in the possession of the debtor, on the one hand, and one which is in the possession of the creditor, on the other hand, should have been emphasised by the court in *SA Bank of Athens*.

Finally, *SA Bank of Athens* provides an example of a further type of documentary instrument (movable) (here: investment policies) that creditors, and especially bankers, may rely on as security held by the bank subject to a *parate executie* clause. Other types of securities held by banks and for which there exist judicial precedent, include shares, bills of exchange and bills of lading (see Scott and Scott 123 and the authorities with examples of securities referred to there). It is important here to point out that the security held by the creditor is the right embodied in the document (*eg*, a bill of exchange, share certificate or a policy document), and not the document itself. Destruction or loss of the document would therefore not result in a loss of the security held by the creditor.

4 Conclusion

After the decisions in *Juglal*, *Bock* and *SA Bank of Athens*, read with the principles of our common law, the position under South African law regarding the validity of a summary execution clause (*parate executie*) is as follows: A *parate executie* clause in a mortgage bond permitting the creditor (bondholder) to execute without recourse to the debtor (mortgagor) or the court by taking possession of the immovable property and selling it, is illegal and thus void.

A *parate executie* clause in the case of movable property is in principle valid. But where the movable thing is seized and removed from the lawful possession of the debtor against his will, *parate executie* will not be valid and the debtor will be able to rely on the *mandament van spolie* to restore his possession.

Where the movable thing is in the lawful possession of the creditor, he may validly take *parate executie* where the parties have agreed on that. In the latter case the debtor may still seek the protection of the court if, on any just ground, he can show that, in carrying out the *parate executie* agreement and so effecting a sale, the creditor acted in a manner which prejudiced the debtor in his rights. For this reason, it would therefore be incorrect to say that *parate executie* allows the creditor to be the judge in his own case (see *Bock* par 13).

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