Short notes on:

CAN SURETIES ESCAPE LIABILITY

Introduction

In a difficult economy, it is seemingly more and more common that commercial agreements require a personal surety from one or more of the directors of a company and often that friends or family seek the assistance of someone to act as surety for credit agreements.

Often person's don't understand the implications of agreeing to act as surety for a credit agreement, particularly in instances where they have done so for family or friends. The promise is that nothing would go wrong with the credit agreement and therefore the surety should rest assured that they won't be liable for the debt.

However, this is not consistent with the reality that many actions before our courts are taken against the principal debtor and surety.

What does it mean to be a surety?

A suretyship agreement generally is concluded in addition to the principal credit agreement where one person takes responsibility for the debt in the event that the debtor can no longer meet the obligations of the credit agreement. As in the example above, it is common to find banks requesting a director to sign as surety for finance advanced to the company by a bank.

Surety agreements usually involve three parties namely the creditor, the principal debtor and the surety. In these agreements, the surety undertakes to the creditor that should the principal debtor fail in its obligations that he will indemnify the creditor. This practically means that the surety will assume the financial obligations of the principal debtor.

What does it mean to be surety and co-principal debtor?

When a surety signs an agreement that binds him as not only surety but as co-principal debtor, it has the effect that the surety's obligations are equal to that of the principal debtor. In other words, the creditor is now in the position to take action against the surety as co-principal debtor without having to first claim from the principal debtor.

Can a surety escape liability after signing the agreement?

The basic principal in law is that when you sign an agreement, it is your responsibility to make sure that you understand all the terms of that agreement. It follows that courts will not easily move away from the principal and not hold the surety liable for a debt he agreed to in writing.

A surety can generally only defend against an action by a creditor is the agreement was entered into under duress, mistake, induced by fraud or misrepresentation.

While circumstances of fraud or duress can generally be ascertained from an unpleasant factual event the surety may have been in when signing the agreement, the ordinary person may find themselves in a situation where the content of the surety agreement was either actively misrepresented to them or that a material term or fact pertinent to the surety was not disclosed.

While the contracting parties are generally required to satisfy themselves of the terms of the contract and the other party is not required to "tell all", in the case of some facts being pertinently concealed a surety may be able to successfully defend against a creditors claim.

This was illustrated in *Absa Bank Limited v Van Eeden and Others*[1]:

In this case, a property developer borrowed R 10 000 000 to an associate's company for the development of a shopping mall. The associate then went ahead and borrowed a further R 5 000 000 from a bank, which in turn registered a R 5 000 000 mortgage bond over the property as security. The developer then signed suretyship for the R 5 000 000 in his personal capacity and on behalf of the family trust.

The developer believed that the property had sufficient equity to cover the bond and another bond which he was told was to the value of R 2 700 000. Unknown to the developer was a third bond registered over the property for R 15 000 000. This information was not disclosed to the developer by his associate or the bank when he signed the surety.

When the associate's company failed the bank then sought recourse from the developer as surety for repayment of R 5 000 000 plus interest.

The court held that while generally, the surety would have been liable for the bond, because in principal he understood his obligations, the non-disclosure of the R 15 000 000 bond was a material fact which the bank had a duty to disclose. It follows that had the information been disclosed to the developer he would have known that there was not sufficient equity in the property to cover the debts and consequently was not likely to sign surety.

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[1] (4078/2012) (2018) ZAECPEH 14

While the developer successfully defended the banks claim, this is a very narrow and limited instance and not a common scenario.

Conclusion

One should be cautious when signing surety and taking responsibility for the debts of another as it would be very difficult to escape liability once you have agreed to be bound by this agreement.

Before signing a surety agreement seek advice from an expert at SchoemanLaw.

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