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**THE SUPREME COURT OF APPEAL
OF SOUTH AFRICA**

Case No: 230/96

In the matter between:

SHIRLEY ANN PFEIFFER

Appellant

and

**FIRST NATIONAL BANK OF
SOUTHERN AFRICA LTD**

Respondent

CORAM: SMALBERGER, NIENABER, HARMS, MARAIS and
ZULMAN JJA

HEARD: 7 MAY 1998

DELIVERED: 28 MAY 1998

JUDGMENT

HARMS JA/

HARMS JA:

Perseverance may not pay interest, but it sometimes produces dividends. The spider, under the contemplating eyes of Robert the Bruce, persevered and succeeded. Counsel's persistence is to some extent the reason for this judgment.

The facts and the terms of the deed of suretyship appear from the judgment of Nienaber JA and I shall assume that the reader is conversant with his judgment.

The deed of suretyship was intended to limit the liability of the surety and did so in two relevant respects. First there is the limitation in relation to the R175 000 to which I shall refer as "cap A". This liability may arise in relation to any *causa*, including interest. Generally speaking, the significance of cap A is that as soon as the limit is reached, the surety is not liable for any further capital advances made to the debtor. If the debtor's liability drops below the level of cap A, the surety remains liable

for any indebtedness of the debtor until it returns to that level.

The second limit, cap B, relates to interest. Once the level of cap A is reached, the surety's liability for interest is limited to "such further sum or sums for interest on that amount [that is cap A, the R175 000] ... as may from time to time ... become due and payable by the said Debtor". (I have not lost sight of the surety's liability for certain charges above cap A. The Bank did not claim these amounts from the appellant and this liability has no effect on the principle involved.) The agreement does not impose any limitation on the amount of interest payable by the surety, but only in relation to the base on which it is to be calculated.

The practical consequences of the restrictions upon the surety's liability are these. Until the limit of cap A is exceeded, the liability of the debtor and surety remains fully coextensive. Once it is exceeded the liability is no longer coextensive in all respects. Only the debtor is liable for further capital advances in excess of the cap and for any interest in

relation to these amounts. In all other regards the liability remains coextensive - for the R175 000 and the interest on that amount. If the surety is called upon to pay, the Bank cannot simply claim the amount due by the debtor. A separate accounting exercise has to be done. Although this exercise may involve a theoretical division of an otherwise indivisible liability of the debtor, it is not a cause for concern because the calculation is contemplated by the suretyship agreement. A determination of the notional interest "due and payable by the debtor" on the amount of R175 000 is necessarily required because it would otherwise be impossible to calculate the cap B interest for which the surety is liable in terms of the agreement.

Because the debtor's liability springs in this case from a fluctuating overdraft account, it is difficult to illustrate the problem. A simple example might be useful. A debtor borrows R200 from the Bank on an open account. The surety binds himself for payment of no more than

half the amount borrowed (namely R100) plus interest thereon. Each month interest on the amount borrowed is duly calculated, compounded and debited against the debtor's account. The interest amounts to R2 per month. The debtor studiously pays R2 per month in reduction of the account. If these payments are appropriated to interest, it will mean that after any period, say one year, the liability of the principal debtor will still amount to only R200 and that of the surety to R100. If they are not appropriated to interest but to the capitalised amount, the liability of the debtor will at the end of year one be unchanged at R200, but the liability of the surety will be R100 plus interest calculated on that amount. This means that the surety is liable for notional interest for which the principal debtor is not. Was that what the parties intended? The answer has to be found in the deed of suretyship.

To return to the facts of this case. Once cap A was exceeded, the surety became liable for cap B interest, but only to the extent of the

debtor's liability in relation to it. From 25 October 1990, when cap A was exceeded the account remained active with a substantial number of debits and credits. Compound interest was calculated and debited at the end of each month. The credits exceeded the amounts of interest debited in respect of the total account until 22 October 1991, the last date on which any amount was deposited in the account. Reduced to its essentials, the question is whether the appellant is liable for compound interest on R175 000 for the period 25 October 1990 to 22 October 1991. I am satisfied for the other reasons given by Nienaber JA that she is liable for interest from 22 October 1991 until 1 September 1993 (the date she paid the R175 000).

Interest is capitalised whenever an agreement provides for compound interest. Capitalisation is an accounting exercise designed to simplify the calculation of compound interest. One can conceive of a situation where capitalisation amounts to a novation (thereby converting the interest element into capital), but it is hardly likely that the accounting

procedure of the Bank was intended by either party to amount to a novation.

The agreed facts do not suggest an automatic monthly novation. If the capitalisation of interest does not amount to a novation of the debt, the interest element cannot lose its character as interest, not only for the purposes of the *in duplum* rule and related subjects, but for all purposes.

The payments credited during the first mentioned period were not allocated by the debtor or the Bank and the law then takes its ordinary course (cf *Northern Cape Co-operative Livestock Agency Ltd v John Roderick & Co Ltd* 1965 (2) SA 64 (O) 73F-H). All credits or payments must be appropriated first to payment of the interest element and then to capital (*Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd (in liquidation)* 1998 (1) SA 811 (SCA) 832F-G). On the wording of the agreement the effect of this is that no sum for interest is due and payable on R175 000 by the debtor in respect of the period 25 October 1990 to 22 October 1991.

The rule taken from *Standard Bank* invariably is formulated on the assumption that the liability for interest arises from the same and not a different debt. Christie *The Law of Contract in South Africa* 3rd ed p 478 is clear on the point:

“If capital and interest are owing on the same debt, the payment must be credited first to interest and, if not exhausted, to capital.”

The other appropriation rule that, conceivably, can be invoked is that a secured debt should be paid before an unsecured debt. This rule as found in textbooks is formulated on the assumption that there is more than one debt, one secured and the others not. The obvious reason for the rule is that good faith requires that the creditor and the debtor should as far as possible ease the burden of the surety. Whether there is reason in principle, logic or fairness why this rule should not also apply, depending upon the terms of the deed of suretyship, if a debt is partially secured does not arise on the

facts of this case.

In short, the difference between my approach and that of Nienaber JA can be summarised as follows. I believe that I attach more weight to the wording of the deed of suretyship quoted in the fourth paragraph of this judgment. I am in respectful disagreement with the view that once cap A is reached, the surety's liability rests squarely on the terms of her contract with the Bank and is no longer coextensive in any remaining respect. The next point concerns the legal effect of capitalisation, especially whether it can differ depending on the context, and the last relates to the surety's entitlement to the benefit of the first appropriation rule referred to above.

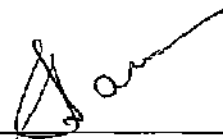
In the result I am of the view that the learned Magistrate erred in ordering the appellant to pay interest from 25 October 1990 instead of from 22 October 1991 until 2 September 1993. I may in conclusion mention that the Magistrate ordered payment of interest - simple, not

compound - at the legal rate on the interest as from the last mentioned date, presumably to the date of payment. This part of the order, for reasons that are not apparent, was never the subject of a cross-appeal to the court below, and must stand. So must his order for costs. It is therefore ordered that

- (a) the appeal is upheld with costs;
- (b) the order of the court *a quo* is replaced with an order upholding the appeal against the order of the magistrate (excluding the costs order) with costs and substituting for the magistrate's order the following:

“Judgment for the plaintiff for payment of interest at the plaintiff's prime overdraft rate from time to time on R175 000, calculated daily and compounded monthly, for the period 22 October 1991 to 2 September 1993, together with interest thereon at the legal rate as from 2 September 1993 to date of

payment."



L T C HARMS
JUDGE OF APPEAL

SMALBERGER JA) Concur
ZULMAN JA)

5A/98

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Respondent

CORAM: SMALBERGER, NIENABER, HARMS, MARAIS *et*
ZULMAN JJA

DATE HEARD: 07 MAY 1998

DELIVERED: 28 MAY 1998

JUDGMENT

MARAIS JA

MARAIS JA:

I have had the benefit of reading the judgments of Nienaber JA and Harms JA. I agree with the former.

I think that the answer to appellant's argument based upon the principles of appropriation becomes less elusive if one goes back to basics. Consider a simpler case which is not complicated by an interest component but which illustrates the principles involved. A debtor has a running account with a department store. A surety has undertaken continuing liability for the debtor's existing and future debts but has limited his liability. The maximum amount recoverable from him is R1000. Now take this example: at a particular date the liability of the debtor stands at R500. The surety is therefore liable for R500. On the same day the debtor pays the store R500. The debtor's existing liability drops to zero and so does the surety's. However, the surety's potential liability of R1000 continues to exist. It has not been reduced to R500. Take a second

example: if, say two months later, the liability of the debtor stands at R2000 the surety owes the store R1000. If the debtor on that date pays the store R1000 he continues to owe the store R1000 and so does the surety.

It is not open to the surety, in the first example, to say that the debtor's payment of R500 extinguished his entire liability, both existing and potential, under the suretyship or, in the second example, to say that the payment by the debtor of R1000 had the same effect because it had to be appropriated to the oldest debts and those were the debts which went to make up the **first** amount of R1000 for which the debtor became liable and which therefore also went to make up the limited amount of R1000 for which he was liable under the suretyship.

If he could say that it would mean that the suretyship would not achieve its stated aim, namely, of providing continuing security to the store for the debtor's debts subject only to the maximum amount recoverable from the

surety being R1000. It would mean that as soon as a point was reached when the debtor's debit balance exceeded R1000 and subsequent payments by the debtor matched or exceeded R1000, the store would no longer be able to look to the surety for even the limited sum of R1000 for which he had agreed to be liable. That would flatly contradict the terms of the suretyship. In principle, as I see it, it is substantially this kind of approach that appellant is asserting to be the result of a proper construction of the agreement. In my view it is an untenable construction.

~~R M MARAIS~~



50B/98

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HEARD : 7 MAY 1998

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JUDGMENT

/NIENABER JA

NIENABER JA:

This is a matter of some interest. The appellant stood surety for the debts of one Wilson to the respondent bank. As such she was the defendant in the magistrates' court, Wynberg, the appellant in the Cape Provincial Division and is now, with the leave of that court, finally the appellant in this court. Wilson, trading as *Galerie Interieur*, operated a current account at the respondent's Rondebosch branch. He was granted overdraft facilities. It was in respect of that account that the appellant, on 25 July 1986, bound herself as surety and co-principal debtor in favour of the bank. In the deed of suretyship the appellant is the surety, the bank is the creditor and Wilson is described as "the said Debtor". A photostatic copy of the first page thereof is annexed hereto. Those terms of the deed of suretyship which are of special significance to this appeal have been highlighted in the margin.

The surety's liability, interest apart, is expressly limited to R175 000. On

25 October 1990 Wilson's overdraft (taking into account cheques drawn against it, interest calculated at the bank's prime rate from time to time calculated daily but capitalised monthly and bank charges, as well as credits passed) exceeded R175 000. Thereafter it consistently remained above that level until 1 September 1993. It was on that date that the appellant, payment having been demanded from her as surety on 19 April 1993, paid in R175 000 to the bank.

The issue is to what extent the appellant remains liable for interest in addition to this R175 000. The appellant conceded that she is liable for compound interest on R175 000 at the agreed rate from 20 April 1993 (the day after demand was made on her) to 1 September 1993 (the date of payment). The bank insists on payment of compound interest on R175 000 calculated at the agreed rate from 25 October 1990 (when the overdraft first exceeded R175 000) to 1 September 1993 (the date of payment).

The action commenced in the magistrates' court, the appellant having

consented to that court's jurisdiction in terms of the deed of suretyship. The claim, as finally amended, was for R124 503,77. This amount was calculated at the bank's prime rate of interest from time to time on R175 000, calculated daily but compounded monthly. No evidence was led. This was because the parties, at a pre-trial conference, reached agreement on the validity and the terms of the deed of suretyship, on the correctness of Wilson's bank statements (annexure B to the summons) and on the accuracy of "a schedule of the calculation of interest on the capital sum at prime rate compounded monthly" (exhibit B at the trial). It was also agreed that it is standard banking practice to debit interest on overdraft daily and to compound it monthly.

The parties formulated the issues to be decided as follows:

- "3.1 The Defendant contends that payments on the account of the principal debtor should have been credited first to interest and then to the oldest capital debt and that this principle should have been applied in determining Defendant's liability under the Suretyship;
- 3.2 The Plaintiff contends that the sequence in which payments

were credited to capital and interest on the principal debtor's account did not affect the Defendant's liability under the suretyship for payment of the capital sum of R175 000 or interest thereon calculated from 25 October 1990;

- 3.3 The Defendant avers that her liability under the Deed of Suretyship only becomes enforceable when the principal debt is due for payment and until such time she is not liable for interest."

Because of the way in which the argument developed those issues may be restated more broadly and be discussed more conveniently in the following, albeit perhaps less logical, order:

- A. The correctness of the basis on which the bank's claim against the appellant was computed.
- B. Whether the appellant's liability for interest due as surety arose only on the date when a demand for payment was made on the principal debtor (which was admittedly never proved as a fact) or, at worst for the appellant, on the date when such demand was made on the surety herself (i.e. 19 April 1993).

Ad A:

The suretyship was a continuing but limited one. The limitation is contained in the provision in the deed of suretyship commencing with the words “Provided that ...”. That proviso is concerned with different aspects of the relationship between the bank and the surety:

- (i) It limits the accessory liability of the surety in respect of the balance owing by the principal debtor.
- (ii) In addition (“plus”) it renders the surety liable for interest on the balance owing by the principal debtor if such balance is or falls below R175 000 or on R175 000 if the balance owing by the principal debtor exceeds that limit (“... on that amount ...”). That interest, it is common cause in this case, would include interest on interest i.e. compound interest. That follows *inter alia* from the phrase “... interest on that amount, charges and costs as may from

time to time, and howsoever arising, become due and payable by the said Debtor ...". The debtor is liable for interest at the bank's prime rate from time to time; so too is the surety. The underlined words fulfil more than one function. They render the surety liable for "charges and costs" (as opposed to the "monies" referred to in the opening paragraph); they emphasize that the surety cannot be liable for even the limited sum (referred to in (i)) unless the principal debtor is liable in an equivalent amount; and lastly, they indicate the rate at which interest is to be levied against the surety i.e. the rate of interest due by the principal debtor. In his heads of argument counsel for the appellant contended that such interest was *mora* interest which had to be calculated at the legal rate. There is ample authority, commencing with *The National Bank of South Africa v Graaff and Others* (1904) 21 SC 457, for the contrary proposition

that such interest is conventional interest to be calculated at the agreed rate. (For the most recent in that line of cases see *Snaid v Volksskas Bank Ltd* 1997 (1) SA 239 (W).) In argument before this court counsel conceded the point. (The correctness of these cases was, however, challenged in a different context to which I shall return later in this judgment.)

- (iii) It renders the surety liable for certain expenses incurred by the bank and other entitlements such as interest, discount, commission, stamps and legal costs incurred in the institution of action against either the principal debtor or the surety as well as certain other necessary and usual bank charges and expenses. The interest referred to in this context may well refer to *mora* interest owed by either the principal debtor or indeed the surety herself. Nothing in this case turns on the point. It is accordingly not necessary to express a firm view on it.

The deed of suretyship provides for a two tier system. As long as the balance owing by the principal debtor remained below R175 000 or, having exceeded it, returned to below R175 000, the liabilities of the principal debtor and the surety were completely and exactly co-extensive both in respect of the *quantum* of the balance owing and the interest owing thereon. Hence the statement in the deed of suretyship:

“... without derogating from the generality of the foregoing it is agreed and declared that *my/our liability is co-extensive with that of the principal debtor* and if his liability be novated or extended or changed howsoever that may be and from whatever cause then so too shall mine/ours.” (My emphasis.)

As stated earlier such interest included (in accordance with banking practice throughout South Africa, implicitly incorporated into the agreement between the bank and Wilson) interest on interest, calculated daily and capitalised monthly. The balance owing by the principal debtor to the bank from time to time therefore consisted not only of the capital initially advanced by the bank, if any, and of the

aggregate of cheques drawn and costs charged against the account but also of compound interest. The balance owing from time to time accordingly included past interest. And by its very nature that balance would never remain static.

Once the balance owing reached or exceeded R175 000 the situation changed. For as long as that situation pertained the liabilities of the principal debtor and the surety were no longer co-extensive. To that extent the statement in the deed of suretyship quoted earlier is true only in part. The liability of the principal debtor is unlimited while that of the surety is limited in two respects: as far as the balance owing is concerned it is limited to R175 000 and as far as interest on the balance owing is concerned it is limited to interest on only R175 000.

The liability of the surety, although no longer co-extensive, remained accessory in nature. All the principles and rules of suretyship applied to her. One such principle is that the surety, while she may be liable for less, can never be

liable for more than the principal debt. Another such principle is that her liability as a surety would be fully extinguished if the principal debtor's liability were fully extinguished and finally terminated. This suretyship being a continuing one in respect of the principal debtor's continuing and fluctuating indebtedness, the surety's liability endures, notwithstanding payments made in reduction of the debt, "until the credits and transactions contemplated by the parties, and covered by the guarantee, have been exhausted or until the guarantee itself has been revoked"

(*S A General Electric Company (Pty) Ltd v Sharfman & Others* NNO 1981 (1) SA 592 (W) 595F-H). The appellant can only escape future liability if she gives written notice of termination, as she is free to do at any time. But the bank is then entitled to demand that the surety first discharge "... the full indebtedness of the said Debtor to you [the bank] at the date of such termination subject to the limitation in amount aforementioned." While a payment by the surety of the full balance outstanding by the principal debtor at that time would extinguish the

surety's liability *pro tem*, it does not follow that the surety's debt would be reduced commensurately if the principal debt were to be extinguished only partially by the principal debtor. That is because the principal debtor's debt is not limited but the surety's is. If Wilson should make a payment of R20 000 on a balance owing of R200 000 his liability would be reduced to R180 000 (apart from interest on R180 000) while that of the appellant would remain at R175 000 (apart from interest on R175 000). Her liability rested squarely on the terms of her own contract with the bank. Her contract, for all that it was predicated on the existence of the principal debtor's liability, differed in its terms from the principal debtor's contract with the bank. Consequently the bank was perfectly justified in measuring her liability on a different footing from that of the principal debtor. In terms of her own contract she was liable to the bank for interest at the agreed rate on R175 000 if the balance owing by the principal debtor exceeded R175 000. And that, from 24 October 1990, it consistently did.

It was on that basis, that the liability of the surety, although accessory, no longer coincided precisely with that of the principal debtor, that the bank's claim against the appellant was separately calculated in exhibit B. That calculation took as its base figure the sum of R175 000 as at 24 October 1990, as if this had been the balance owing by the principal debtor on that date. The first item of interest was calculated at the bank's then prime rate of interest for the period 24 October 1990 until 31 October 1990. The sum so produced, R704,79, was capitalised on that date and the interest for the next month was thereafter calculated on R175 704,79, producing, for the next month, a figure of R3 032,71. And so the process continued. The amounts separately calculated for each month (R704,79, for the first month, R3 032,71 for the second month and so forth) were added to produce an aggregate of R124 503,71 on 1 September 1993, the date on which the amount of R175 000 was paid to the bank. The sum of R124 503,71 was the sum claimed by the bank from the surety.

This method of computation was attacked on behalf of the appellant on the ground that it made no allowance for the credits reflected in the principal debtor's statement of account, annexure B. Over the first five days which the calculation covered, from 24 to 31 October 1991, that account, for example, was credited with three sums, R3 615,68 on 26 October 1990, R2 074,12 on 29 October 1990 and R6 000 on 31 October 1990. As I understood the appellant's argument these credits served to cancel the amount of R704,79. If all the credits passed are thus set-off against the debits in the bank's calculation, the final figure in the calculation would obviously not be correct. Counsel for the appellant did not attempt a recalculation of the amount, if any, that would be due to the bank on that approach. That was because the onus, so it was contended, was on the bank to prove its case; hence it was not incumbent on the appellant to recalculate the bank's claim on what was suggested to be the proper basis.

Assuming in favour of the appellant that this is a permissible approach, the

real issue then is whether the credits reflected in Wilson's account served to discharge the items of interest calculated by the bank as being owed by the appellant during the same period. That calculation was made on the basis that the balance owed by Wilson to the bank consistently exceeded R175 000. This issue is essentially the first of the two issues in dispute which was formulated earlier in this judgment as issue A.

The credits reflected in Wilson's account were not paid by Wilson to discharge the appellant's interest indebtedness. (I shall henceforth refer to such credits as "payments" made by him.) Those payments were obviously intended to reduce *his* liability to the bank. His liability in terms of *his* contract with the bank does not correspond and run parallel to *her* liability in terms of *her* contract with the bank. These were separate debts owed by separate debtors. The appellant, though a co-principal debtor, was not a co-contractor with Wilson. Between them there was no privity of contract. While a payment can undoubtedly be made by a

stranger to a debt (cf Van der Merwe *et al*, *Contract General Principles* 367), it is plain from the bank statements, annexure B, that the payments made by Wilson were never intended to be payments by him on the appellant's account, either in whole or in part, but were made in reduction of his own liability. If the payments made by Wilson are therefore to be credited to the appellant, even though her liability was no longer co-extensive with that of the principal debtor (whose liability was much greater), some other basis for doing so will have to be found.

The argument advanced on behalf of the appellant is founded on the common law principle that, in the absence of a contrary agreement between debtor and creditor, a payment on account of a debt is to be allocated to interest before capital. That is so. Appropriation of payments occurs when a debtor, who is indebted to a creditor in respect of more than one obligation, makes a payment of less than the total amount due by him to the creditor in respect of all such obligations. Payment being a bilateral juristic act between debtor and creditor

(*Saambou-Nasionale Bouvereniging v Friedman* 1979 (3) SA 978 (A) 993A-C)

it is, in the first instance, a matter for those parties themselves how the allocation is to be made when different obligations are owed by the debtor to the creditor.

Failing agreement the law has devised a set of residual rules which apply to determine the ranking of the different obligations to be discharged. The different obligations must be between the same parties. A payment is then allocated in accordance with these rules to one or more of the obligations. One of the rules is that if capital and interest are owing in respect of the same indebtedness, a payment must be credited first to the interest then owing by the debtor and then, if not exhausted, to the capital owing by him (cf Christie, *The Law of Contract in South Africa* 3rd edition 478; *Trust Bank of Africa Ltd v Senekal* 1977 (2) SA 587 (W) 602E-H). The obligations to pay capital and conventional interest are different obligations mostly, but not invariably, arising from separate provisions in the same agreement (cf *LTA Construction Bpk v Administrateur, Transvaal*

1992 (1) SA 473 (A)). That rule (relating to capital and interest) also applies where the indebtedness was in the form of an overdraft owing by a customer to a commercial bank (cf *Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd (in liquidation)* 1998 (1) SA 811 (A) 832A-G). Other rules are, inter alia, that an enforceable debt is extinguished before an unenforceable one and, as between enforceable debts, that the more onerous debt is extinguished first. A debt secured by a deed of suretyship is classified as an onerous debt. Older debts are settled before more recent ones. Where none of the specific rules applies, the various debts are settled proportionally. These propositions are trite.

For the purpose of the rule under discussion capital in this case is represented by cheques met and charges and costs debited against the customer. Interest is represented by the interest debited on the balance owing on the account from time to time. As soon as interest is capitalised at the end of the agreed period for capitalisation, it *de facto* merges as part of the balance owing and as such

forms the new data base for the next calculation of the interest (cf *Standard Bank of South Africa Ltd v Okeanate Investments (Pty) Ltd (in liquidation) supra*, 831F). Interest so capitalised retains its character as interest for the purpose of the *in duplum* rule. According to that rule arrear interest stops running when it equals the amount of unpaid capital. In order to make the comparison, past payments are deemed to have been apportioned to interest before capital (cf *Standard Bank of South Africa Ltd v Okeanate Investments (Pty) Ltd (in liquidation) supra* 827H; 828J-829F; 832F-G). There may be other instances, such as the calculation of finance charges in moneylending transactions, perhaps even within the field of prescription, where it may be a matter of importance whether a payment is *ex post facto* deemed to have been appropriated to interest before capital. But when it comes to the actual allocation of payments to different debts, it seems to me that there is much to be said for the view that the moment of consolidation of interest and capital through capitalisation is a cut-off point beyond which the rules of

appropriation will no longer be operative. On that approach the ranking of debts according to antecedence, when their discharge is in issue, will not extend beyond the last date of capitalisation. But because the point has not been fully debated in this court, I express no final view on it.

Appropriation of payments operates *inter partes*, when the debtor intends to discharge his liability to the creditor, when more than one debt is owed by him to the creditor, and when his payment is insufficient to discharge his total indebtedness to the creditor. In short, the rules of appropriation of payments operate between different debts, not between different debtors.

The surety is a different debtor. If he is to get the benefit of a payment made by the debtor to his creditor, he acquires it because of the derivative nature of his liability - not because the debtor intends a discharge of the surety's debt and not because of an appropriation of the payment by the debtor to the debt of the surety.

As stated earlier there is no contractual privity between debtor and surety: they

are different parties to different obligations albeit with a common creditor. When a debtor makes a payment in discharge of his own indebtedness which is first appropriated to his own interest indebtedness, it would as a rule and by the same token reduce the surety's liability for interest as well. But that would only be so if the liabilities of the debtor and the creditor were truly co-extensive. Once co-extensivity is subverted, as in this case it is (because of the limitation of the surety's liability), that payment cannot then by a process of appropriation be redirected as if it were a payment made by the surety to the creditor, whether in respect of capital or in respect of interest. Otherwise any payment by the debtor made in excess of his interest liability would have to be appropriated, in order to be consistent, to a pro rata reduction of the surety's contractual limit of R175 000.

On the facts of this case, for instance, if the credits passed in Wilson's account during the period 24 to 31 October 1990 (totalling R11 689,80) were to extinguish the surety's interest liability as calculated for that period (R704,79), as the

appellant contended, the surplus of R10 985,01 would have to be applied to reduce the "cap" from R175 000 to R164 014,99. On that approach the "cap" might fluctuate as debits and credits are entered. This is patently not correct. The rules relating to the appropriation of payments by the debtor cannot be deployed to distort the express terms of the agreement between the creditor and the surety. A payment made by the debtor which is intended to reduce his own liability and as such is allocated to his own interest indebtedness first, cannot simply be siphoned off to reduce the interest liability of a different party, the surety, which is owed on a different debt and computed on a different capital sum. The rule that a payment is allocated to interest before capital cannot therefore assist the surety.

Nor can the rule that a payment is appropriated to a secured rather than to an unsecured debt assist the surety, whether the rule is enlisted on its own or in tandem with the rule that a payment goes to interest before capital. The secured debt is Wilson's debt to the bank. There is no unsecured debt. The situation

would have been different if Wilson had a separate but unsecured personal account with the bank and he had made a payment without stipulating the account concerned. The cases I have consulted in which the rule is mentioned all deal with the latter type of situation. (Of the more recent ones, see *Northern Cape Co-operative Livestock Agency Ltd v John Roderick & Co Ltd* 1965 (2) SA 64 (O) 73D-G; *Zietsman v Allied Building Society* 1989 (3) SA 166 (O) 178A-D.)

The fact that Wilson's trading account with the bank is secured by the suretyship to a limit of R175 000 does not divide his indebtedness to the bank, as if it were a binary obligation, into two compartments, one secured and one unsecured, to which a payment can be separately appropriated. A debt which is partially secured is not by that fact alone converted into two debts of which one is secured i.e. a first debt of R175 000 (plus interest thereon) which is secured and a second debt for the residue (plus interest thereon) which is unsecured. The corollary, if the contrary is asserted, is presumably that a payment made by Wilson

to the bank would first be applied to payment of the interest owing by him on that part of the debt which is below the mark of R175 000; that would be the "interest ... due and payable by the said Debtor" in the proviso to the deed of suretyship; the surety is only liable for interest "due and payable by the said Debtor"; since that interest has now been paid the surety, on that approach, is no longer liable for it. Or to rephrase the argument: because this 'first debt' is not only the oldest debt but is also a secured debt, any payment must be allocated to the interest owing on it; because it matches the limit of the appellant's indebtedness (R175 000) there is complete co-extensivity between the two debts; that being so, any payment by Wilson is first re-routed to the interest portion which is due by him thereon, and by a further bifurcation would finally be applied to the appellant's obligation to pay interest on R175 000.

The fallacy of this argument, in both its forms, is its premise. Wilson is indebted to the bank for the balance owing, not for one debt for R175 000 and for

another for the balance above R175 000. The sum of R175 000 is a limit which is to endure throughout the tripartite relationship and “travels”, so to speak, with the surety. It is not an existing debt although there may be times when there is in existence a debt equivalent to or exceeding that limit. When the limitation clause speaks of “such further sum or sums for interest on that amount [i.e. R175 000] as may ... become due and payable by the Debtor” it cannot mean anything else but the following: No new and independently existing liability on the principal debtor to pay interest on the limited sum of R175 000 for which the surety has become liable springs into existence when the limit is reached. He is not liable because the surety is liable. The reverse is the case. The principal debtor's liability for interest is a *sine qua non* for the surety's liability for interest. That is why the limiting clause speaks of “interest on that amount ... as may from time to time become due and payable by the said Debtor”. The principal debtor is not liable *because* the surety is liable and certainly does not *become* liable for the

surety's debt merely because the extent of it has been quantified by the application of the limiting clause. The premise on which that part of the limitation clause which deals with interest is founded is that the principal debtor became antecedently liable for interest in his own right in *at least* an equivalent sum. All the words quoted are intended to do is to emphasize the obvious: the surety cannot be liable for even the limited sum unless the principal debtor is liable in an equivalent or greater amount. The terms of one agreement (between the surety and the bank) cannot in effect be projected onto the terms of another earlier agreement (between the principal debtor and the bank), so as to artificially create, *ex post facto*, a debt of R175 000 which corresponds to the contractual limit of the surety's liability; and which is then used as the justification for re-introducing co-extensivity - but only up to a point.

I reach this conclusion, that a payment by Wilson on his account with the bank, does not coincidentally cancel out an equivalent amount of interest then

owing by the appellant on his account with the bank, without reference to the alternative argument advanced by counsel for the respondent, that the express wording of the surety precludes any reliance on the doctrine of apportionment of payments. The words he has in mind are:

“ ... that notwithstanding ... other payments received by you they shall not, so far as the undersigned is/are concerned go in discharge of the said Debtor's liability to you but that you shall be entitled to recover under this suretyship to the full amount aforementioned and interest or so much thereof as shall together with such dividends or other payments amount to payment in full of the debt due to you by the said debtor; ...”.

I find it unnecessary on the approach I take to express a view on the soundness of that argument.

To summarise: the proposition advanced by counsel for the appellant is that any payment made by Wilson in reduction of his liability to the bank is the equivalent of a payment made by the surety in reduction of her liability to pay interest to the bank. That conclusion does not follow from the accessory nature of the suretyship - because the debts of the principal debtor and the surety were no

longer co-extensive once the level of R175 000 had been reached and for as long as it endured; it does not follow as a matter of direct payment - because Wilson intended to discharge his own liability and not that of the surety; and it does not follow as a matter of appropriation of payments - because that doctrine does not apply where different debtors are involved. The appellant's reliance on the rules of appropriation of payment as the foundation for an attack on the banker's calculation in exhibit B is accordingly misconceived.

For as long as Wilson's indebtedness exceeded the appellant's limit of R175 000, any payments made on his account which did not reduce his indebtedness to or to below R175 000 would have no effect, in my view, on the *quantum* of the bank's claim for interest against the appellant.

Ad B:

The argument, if I understood it correctly, was that the surety's liability for interest only arose when demand was made either on the principal debtor or on the

surety herself. There is no proof of any demand on the principal debtor. On that approach the surety's liability for interest either did not arise at all or, if it did so, it only arose when demand was made on her on 19 April 1993. In my view there is no merit in the argument. The first conclusion, that demand on the principal debtor was a prerequisite for the surety's liability, overlooks the fact that the appellant bound herself not only as surety but also as co-principal debtor (against whom the bank could even proceed without prior excussion of the principal debtor). Cf *Neon and Cold Cathode Illuminations (Pty) Ltd v Ephron* 1978 (1) SA 463 (A) 472B-D; *Millman and Another NNO v Masterbond Participation Bond Trust Managers (Pty) Ltd (under curatorship) and Others* 1997 (1) SA 113 (C) 117I-118J. That conclusion is also impossible to reconcile with the appellant's concession that she was liable to pay interest at the conventional rate from 19 April 1993. The alternative conclusion, that her liability for interest only arose when demand was made on her, overlooks the fact that her overall liability was not

in a finite and fixed amount but was a continuing one, the *quantum* of which remains uncertain until payment was actually made or tendered (cf *SA General Electric Co (Pty) Ltd v Sharfman & Others NNO supra*). As was stated in *The National Bank of South Africa v Graaff* (1904) 21 SC 457 462 - 3:

“The guarantee, therefore, is to be a continuing security until the money has been paid, and if the Canning Company would have been liable, as it is admitted they were, for the compound interest after notice has been given to the defendants, I am afraid that the liability would continue to attach to the sureties.”

I agree with the court *a quo* that the attempt by the appellant to distinguish this case (and those following it) on terminology and fact fails. The surety's liability for the payment of interest arose at the very moment when and to the extent that the principal debtor incurred liability to the bank for interest. Her liability for interest ran parallel to that of the principal debtor until the balance owed by the principal debtor had reached R175 000; thereafter the surety was liable for interest on R175 000 with the general proviso that her overall liability could not by a

manipulation of payments between the principal debtor and the bank be allowed to exceed the liability of the principal debtor. Demand, contrary to what was contended, initiated not the liability as such but the process for its enforcement.

In my view the appeal should be dismissed with costs.



P M NIENABER

JUDGE OF APPEAL