

## **PLEDGE**

### **Introduction**

In this lecture we will consider the following questions –

1. What is the nature of a pledge? What sort of relationship does it create between the parties to it?; and
2. What lawful steps may a pledgee take in relation to the pledged property in order to recover the debt secured against it?

### **Pledge: Definition**

In order to secure a principal obligation (usually payment of a debt), a debtor may deliver to a creditor **corporeal or incorporeal moveable property**. Once the creditor takes possession of the property, he acquires a limited real right in it until the principal obligation is discharged.

Once a pledge is constituted, the debtor becomes the **pledgor** and the creditor becomes the **pledgee**.

The fruits of an object form part of the pledge. The parties may agree that these fruits may be taken by the pledgee in lieu of interest on the principal debt. This is called a **pactum antichreseos**.

### **Delivery is essential to constitute the real right**

In order to obtain a limited real right, the pledgee must take possession of the object of the pledge. It must be delivered to him in a manner that allows him to exercise control over it. The law recognises real delivery and *traditio brevi manu* (short hand delivery) as valid to constitute a pledge. Real delivery takes place where factual possession actually passes from the pledgor to the pledgee. Short hand delivery is a form of constructive delivery which is deemed to take place when the thing “delivered” is already in the possession of the pledgee. In that case, all that happens is that the pledgee’s intention to possess the object of the pledge changes from one of ordinary possession to possession in terms of a contract of pledge.

The law obviously does **not** recognise delivery in the form of a *constitutum possessorium* as a valid means to delivery for the purposes of constituting a pledge. *Constitutum possessorium* is another form of constructive delivery where the ownership of a thing passes while it remains in the possession of the seller. Because a contract of pledge requires that factual possession of the pledged object actually passes before a real right comes into existence, this form of delivery cannot validly constitute a pledge.

### **Vasco Dry Cleaners v Twycross 1979 (1) SA 603 (A)**

This principle is illustrated by the **Vasco Dry Cleaners** case.

In this matter a man called Duff controlled a company called Air Capricorn (Pty) Ltd. Air Capricorn purchased Vasco Dry Cleaners from a man called Peter Carides. It was a term of the sale agreement that ownership of the dry cleaning machines,

which formed part of the business, would not pass until the purchase price was paid in full. Duff ran into financial difficulties. He fell short of the full purchase price of the business by R4650.

In order to raise this capital, Duff entered into an agreement with his brother-in-law, Twycross. The agreement was that Twycross would pay Carides the R4650 outstanding, in return for which Twycross would receive “ownership” of the machinery. Twycross would then agree to sell the machinery on to Air Capricorn for R4650. This “purchase price” was never paid. Air Capricorn retained possession of the machinery. It was later suggested that “delivery” of the machinery in terms of this agreement took place by means of a *constitutum possessorium* - i.e. Air Capricorn retained possession of the machinery, but Twycross “owned” it.

Later on, Air Capricorn sold Vasco Dry Cleaners, including the machinery, to a man called Butcher. In that agreement of sale, Air Capricorn warranted that it was the owner of the machinery.

Twycross, on hearing of the sale, sued Vasco Dry Cleaners for the return of the machinery of which he claimed ownership. The High Court ruled in favour of Twycross on the basis that he was owner of the machinery, the sale of Vasco Dry Cleaners could not have included the sale of the machinery, the warranty of ownership in the sale agreement was a misrepresentation, and Twycross was entitled to “his” machinery back.

On appeal, the Appellate Division disagreed. It held that the arrangement between Twycross and Air Capricorn was not really one of sale and resale, but one of pledge.

This decision was reached having regard to the facts that:

1. Duff did not wish to dispose of the machinery;
2. Twycross did not really require the machinery;
3. What Duff really wanted was a financial accommodation which allowed him to pay Carides;
4. What Twycross really wanted was security for the reimbursement of the payment he made to Carides;
5. The purchase price was not a serious one and Duff probably considered the machinery “sold” to be worth far more than R4650;
6. Duff warranted that Air Capricorn was the owner of the machinery when he sold the business.

Accordingly, the arrangement was really an agreement to constitute a pledge. On that construction of the facts, Twycross had failed to prove that he was the owner of the machines, as opposed to a pledgee.

It is also clear that, since possession was never passed from Air Capricorn to Twycross, the pledge was never perfected. Accordingly, Twycross never acquired a limited real right in the machinery. It was not enough to allege that the machinery was “delivered” to Twycross by means of a “*constitutum possessorium*”, because the law relating to pledge does not recognise that form of delivery.

Twycross had no remedy as against, Butcher, the new owner of Vasco Dry Cleaners. This is because when pledged property is alienated to a *bona fide* third party after the conclusion of the contract but before delivery, no limited real right is established.

The position would have been different, if Butcher knew about the contract of pledge. In that case, he would be required to deliver the pledged object to the pledgee, so that the limited real right can be established.

## **Rights and Remedies of the Pledgee**

### Execution without the Leave of the Court

If the principal debt is not paid, the pledgee may sell the property in execution of the principal debt. A clause in the contract of pledge which allows for this to be done without the leave of the court (*paratie executie*), is not necessarily unlawful, unless the clause deprives the pledgor of any right to approach a court at all. Normally, clauses in contracts which allow for *paratie executie* are considered unlawful. This is because it is a fundamental principle of the common law that a person may not help himself to (i.e. take possession of) the property of another without lawful authority. Pledge, however, is different, because the pledged object is already in the possession of the pledgee – and he acquired it lawfully through the pledge agreement. When he sells it in execution without the leave of the court, he is not “helping himself” to property in possession of another; he is realising a limited real right he has in property which he already possesses. If there is some reason why the pledgor would be prejudiced by the sale, the pledgor will always be able to go to court in order to prevent the sale. However, in the case of a validly constituted pledge, the onus is on the pledgor to approach a court to prevent a sale in execution – **not** on the pledgee to seek the court’s permission to sell something in execution.

See further **Bock v Duburoro Investments (Pty) Ltd 2004 (2) SA 242 (SCA) at paras 7, 9, 10, 11 and 13 to 17.**

### Pacta Commissoria

A pledgee may **not** keep the pledged object for himself if the principal debt goes unpaid. This is known as a “pactum commissorium”. It is unlawful. The reason for this, as Voet states, is that –

*“anyone with whom the arrangement is made that, on the debt not being paid within a definite time, the pledge shall remain with the creditor for the debt, would often find that things of the greatest import and value would go to pay off a paltry liability. A needy debtor, pressed by the tightness of ready cash, will readily allow any hard and inhuman terms to be written down against him. He promises himself smoother times and better fortune before the day put in to the commissory term, and thus hopes to avert the harshness of the agreement by payment; though such a hope, quite slippery and deceptive as it is, not seldom finds nothing at all to encourage it in the aftermath”.*

See **Graaf v Buechel 2003 (4) SA 378 (SCA) at paras 9 to 26.**

### Conditional Sale

However, it is possible for a contract of pledge to contain an agreement that the pledgee can retain the pledged object on payment of a fair price for it **on the day that the debt falls due**. If the value of the pledged article is greater than the principal debt, the excess must be paid to the pledgor.

For example, imagine that I pledged an early drawing of William Kentridge for a debt of R2000 twenty years ago and the agreement was that I would pay the R2000 back today, failing which my creditor could pay the fair value for drawing on the day (today) that the debt falls due. Twenty years ago, the drawing was worth, say, R3000. Today, though, my creditor would probably have to purchase the drawing for

several hundred thousand (if not millions) of rand. He would then be required to pay the difference between the principal debt (R2000) plus any interest agreed and the fair market value of the drawing (say R1 million) to me.

You can see the injustice that would result if the purchase price was calculated by reference to the value of the painting on the date on which I entered into the agreement. My creditor would earn far more from the transaction than the money he loaned me.

See further **Graaf v Buechel 2003 (4) SA 378 (SCA) at paras 27 to 31.**