THE PERILS OF SUBORDINATION - *(Mark McKee, Commercial Partner)*

Botswana Law follows the principles of South African Law with respect to subordination clauses.

In the South African Appeal Court case of **Ex-Parte De Villiers: in re Carbon Developments (Pty) Limited 1993 1 SA 493 (A) 505** it was accepted that a subordination agreement could take many forms including a bilateral agreement only between the debtor and creditor or a multi -party agreement between the debtor, subordinating creditor and other creditors.

Notwithstanding the form of a subordination agreement, all such agreements face the risk of being interpreted as an attempt to rearrange the preference of payments or the order in which those payments will be made to creditors upon insolvency and this in not permissible under Botswana Law.

The aforesaid risk can be avoided by constructing the subordination arrangement or agreement to be one in terms of which the subordinating creditor agrees that it will not have a claim for the debt for so long as the debtor is insolvent or until all other creditors debts are fully repaid. This does not constitute a rearrangement of the order of payments to creditors in a winding up as such an arrangement instead merely creates a condition to enforcement of the debt or loan which in the event of an insolvency, results in that creditor simply having no claim (because the condition upon which the enforceability of the debt depends will not have been fulfilled or may be incapable of being fulfilled). There is thus no re-arrangement of the statutory ranking of creditors as the subordinating creditor simply does not participate as a creditor in the insolvency as until the condition is satisfied it will have no claim.

The South African Courts have held that a liquidator will be obliged to have regard to a subordination agreement in the form described above and we believe that the Botswana Courts will follow this precedent.