

**A LEGAL COMPARISON OF A NOTARIAL BOND IN SOUTH AFRICAN LAW  
AND SELECTED ASPECTS OF A PLEDGE WITHOUT POSSESSION IN  
BELGIAN LAW**

**by**

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## **DECLARATION**

By submitting this thesis, I declare that the entirety of the work therein is my own, original work, that I am the authorship owner thereof unless expressly stated otherwise and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

Lefa Sebolaisi Ntsoane

12 September 2016, Pretoria

## **SUMMARY**

A real security right improves a creditor's chances of recovering a debt owed to him by the debtor. In the case of an ordinary pledge, the pledgor delivers physical control of his movable property to his creditor to serve as security for the repayment of the principal debt. The increasing value and use of movable property as an object of security coupled with technological advancement have resulted in many countries calling for legal reform of real security rights over movable property. In South Africa this led to the introduction of the Security by Means of Movable Property Act 57 of 1993 which makes provision for a pledge without possession. The Act regulates only special notarial bonds and does not apply to general notarial bonds. The real security right vests in the bondholder upon registration of the bond, provided that the movable property encumbered is described in a notarial bond in a way that makes it readily recognisable. The Act has substituted delivery with registration in the Deeds Registry. Registration of the notarial bond in the Deeds Registry is questioned as to whether it complies with the publicity principle. This is because movable property can be shifted from one place to another without any knowledge on the part of the creditor due to the inaccessible and costly registration system. The third party then receives the property subject to the real security right of the creditor. The substitution of delivery with registration is the controversial feature in this study. Linked to the legal problems regarding compliance with the publicity principle, is the description and identification requirement as provided for under the Act, the exclusion of general notarial bonds from the application of the Act, and the question of whether it is appropriate to regard special notarial bonds as pledges without possession. This study questions whether the current land registry system should be used for the registration of notarial bonds and suggests that a new system designed specifically for the registration of real security rights over movables be considered. I compare the position in the Belgian legal system as regards developments in real security rights over movables to identify possible solutions and recommendations for the South African approach.

## **KEY TERMS**

delivery; Deeds Registry Act 47 of 1937; general notarial bonds; insolvency; movable property; perfecting; personal right; publicity; real security right; Security by Means of Movable Property Act 57 of 1993; special notarial bond

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I dedicate this dissertation to my late sister and her son, Lydia Ramaredi and Lucky Ntsoane.

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# CHAPTER 1

## INTRODUCTION

### 1.1 Introduction

In recent years certain legal systems<sup>1</sup> have engaged in legal reform of real security rights over movable property.<sup>2</sup> In the past movable property<sup>3</sup> were generally not as valuable as immovable property. However, in today's world where the cost of a motor car can exceed that of a house, the increasing value of movable things makes it a popular and appropriate security object. Many people do not own immovable property to offer as security but do have movable property which can be offered as security for the repayment of a debt. With the aim of promoting commerce, certain countries have taken the initiative in reforming their laws on pledge to allow the debtor (pledgor) to retain possession<sup>4</sup> of the movable property that serves as security.<sup>5</sup> Furthermore, technology has advanced to a level where national registration systems which can be accessed easily at a minimal cost can be established. Another changing factor is the increase of the use of incorporeal things (eg a claim) as a form of security in the current economic climate. Although there is still room for the common-law pledge construction – giving your antique watch as security for the repayment of a debt there is clearly a need for reform of real security by means of movable property, including security rights where the debtor remains in control of his<sup>6</sup> thing and security rights over incorporeal movables. This study focuses on real security rights over movable property by means of notarial bonds in South Africa. It examines the efficacy of the current legal position of notarial bonds in South African law and identifies areas for development.

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1 The Netherlands, Germany, Scotland and Belgium.

2 The research for this dissertation has been done until August 2016.

3 For purposes of this dissertation the terms 'movable property' and 'movable things' are used interchangeably.

4 Possession refers to the broad interpretation. In other words, it refers to physical control. Any reference to possession includes control and any reference to control includes possession.

5 See Scott 2010 *CILSA* 95.

6 In this dissertation, the terms he/him and his are used in preference to the more 'politically correct' he/she, etc. This is neither a political statement nor an act of rebellion, but a simple reflection of the fact that it would be incorrect to speak of 'him or her' in Roman, early Roman-Dutch, or Germanic law, where – although they certainly existed – women had few if any rights.

## 1.2 Background

In order to create a limited real right, a real agreement followed by delivery (in the case of movable property) and registration (in the case of immovable property) are required. The delivery of movable property is aimed at ensuring compliance with the principle of publicity<sup>7</sup> through (direct) control.<sup>8</sup> The principle of publicity entails that third parties should be able to infer from externally perceivable indications whether a real right in a thing exists and when transfer of a real right from one person to another person occurs.<sup>9</sup> In South Africa a common-law pledge requires delivery of the pledged object to the pledgee. As stated above, there is a need for establishing a form of security over movable property without relinquishing control over the security object.

South African law has known general notarial bonds (*algemene notariële verbande*) since 1880, and subsequently special notarial bonds (*spesiale notariële verbande*) too.<sup>10</sup> The aim of notarial bonds is to provide security to the creditor without the debtor losing control of his thing. A general notarial bond, governed by the common law, applies to all of the debtor's movable property – corporeal and incorporeal. This may include movables acquired after the execution of the bond.<sup>11</sup> A general notarial bond does not confer a limited real right on the holder despite its registration in the Deeds Office.<sup>12</sup> A creditor (general notarial bondholder) will only acquire a limited real right once the bond has been perfected in terms of a valid and an enforceable perfecting clause.<sup>13</sup> In *Development Bank of Southern Africa Ltd v Van Rensburg*<sup>14</sup> (the *Development Bank* case), the court held that a perfecting clause amounts to an agreement to create a pledge. In order to exercise a right under a perfecting clause, the creditor must obtain control over the property either with the consent of the debtor, or if the debtor refuses such consent, by means of a court order for attachment in terms of the specific performance of a contract. Once the bond has been perfected the creditor is in the same position as a pledgee and acquires a

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7 See 3.3.2 below.

8 Van Erp & Akkermans *International Property Law* 439.

9 Mostert & Pope *Property Law* 56. See also *Ikea Trading Und Design v BOE Bank* 2005 (2) SA 7 (SCA).

10 See 5.2 below.

11 Mostert & Pope *Property Law* 322.

12 *LAWSA* Vol 17(2) 511.

13 *Chesterfin (Pty) Ltd v Contract Forwarding (Pty) Ltd* 2003 (2) SA (SCA) para 3.

14 2002 (5) SA 425 (SCA) para 20.

limited real right. Should the bond not be perfected, the creditor will only enjoy a preference over the debtor's concurrent creditors<sup>15</sup> in respect of the free residue if he (debtor) is declared insolvent or when his estate is wound up.<sup>16</sup>

Before the enactment of the Security by Means of Movable Property Act (the SMPA)<sup>17</sup> a special notarial bond had to be perfected before the bondholder acquired a limited real right. Since 1938 the Notarial Bond (Natal) Act<sup>18</sup> incorporated legal principles distinct from those applicable in the rest of the country. This Act deemed the movable property specified and described in a duly registered notarial bond to have been delivered to the notarial bondholder (creditor) as if it had in fact been delivered. The creditor acquired a limited real right on registration of the notarial bond. The notarial bondholder enjoyed a secured claim which took preference over other of the debtor's creditors. In the other provinces of South Africa *Cooper v Die Meester*<sup>19</sup> (the *Cooper* case) laid down the principles applicable to the rest of the country: a special notarial bondholder who had not perfected his bond ranked equally with all other unsecured creditors in the case of insolvency. Consequently, he was in a weaker position than a general notarial bondholder who had not perfect his bond or a special notarial bondholder in Natal.

The SMPA was introduced to rectify the unsatisfactory legal consequences of the *Cooper* case. The position of special notarial bonds changed significantly throughout the country in that the legal principles applicable in Natal were extended to the rest of the country. The legislature's main objective in enacting the SMPA was to justify the position of a pledge economically without the debtor having to pass control of the movable property to the creditor.<sup>20</sup>

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15 S 102 of the Insolvency Act 24 of 1936.

16 Jansen 2003 *Juta Business Law* 154.

17 53 of 1993.

18 18 of 1932.

19 1992 (3) SA 60 (A).

20 The purpose is to allow the debtor to retain control of the movable property that serves as security as the same property may be utilised by the debtor in order to repay the debt. This may be the case where, for example, the debtor, being a farmer, borrows money from the creditor and gives his tractor (movable property) as security for the repayment of the loan. The debtor may need his tractor to continue with his farming operations in order to generate an income enabling him to repay the loan. His practical business needs require this to be the case.

In terms of the SMPA the specified movable property<sup>21</sup> over which a notarial bond is registered is deemed to have been delivered to the notarial bondholder as if delivery had in fact taken place. This means that the bondholder<sup>22</sup> acquires a limited real right over the property that serves as security upon registration of the bond in terms of the Deeds Registries Act,<sup>23</sup> despite the absence of delivery.<sup>24</sup> However, section 1(1) of the SMPA places a condition that must be met before the movables can be deemed pledged and delivered: the movable property must be specified and described in a way that renders it readily recognisable. The test of specifying and describing the movable property in the notarial bond has been set out in *Ikea Trading Und Design AG v Boe Bank Ltd*<sup>25</sup> (the *Ikea Trading* case). The test is whether a third party is able to identify the property from the terms of the bond itself without recourse to extrinsic evidence.

A general notarial bond is not governed by the SMPA and the legal position of a general notarial bondholder is unchanged. The SMPA is also not applicable to incorporeal property. Incorporeal property can, therefore, only be used as security under a general notarial bond.

This study includes a comparative legal analysis of the position of real security rights under Belgian law. Belgian law is relevant to the development of South African law because of its Roman-law origin and the recent reform of real security rights over movable property. On 30 May 2013, the Belgian House of Representatives adopted a new Act on security interests – the Belgian Pledge Act<sup>26</sup> – which allows for a non-possessory pledge over movable property. The new Act abolished the compulsory requirement of dispossession of the movable property that serves as security as a constitutive element of a pledge and allows the parties to either opt for a pledge without dispossession.<sup>27</sup> In terms of the Belgian Pledge Act, the pledge is perfected and becomes effective towards third parties after registration of the pledge in a newly created public register called the ‘Electronic Pledge Register (EPR)’. The reform of

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21 The terms ‘movable property’ and ‘movable thing’ are used interchangeably.

22 Special notarial bondholder.

23 47 of 1937.

24 Publicity for movables.

25 2005 (2) SA 7 (SCA).

26 Act of 11 July 2013.

27 De Backer & Van Oekel A “Pledge over moveable assets-time for a radical change” available at <http://www.lexology.com/library/detail.aspx?q=ae845af5-f915-4638-bcc7-6d5b0724224a> (date of use: 19 August 2014).

the law of security over movable property in Belgium was (as in South African law) also based on a desire to promote the economic needs of the debtor (pledgor).

With reference to terminology, it is important to note that the term 'pledge without possession' refers to the situation where the debtor (pledgor/mortgagor) retains control over the movable property that serves as security. Although this term will be used throughout the dissertation (also when Belgian law is dealt with), a clear distinction should be drawn between a 'pledge' and a 'notarial bond' in South African law. In terms of section 1(1) of the SMPA, movable property specified and described in the notarial bond shall be deemed to have been pledged, thus creating a fictitious pledge. However, we refer to this form of security as a 'special notarial bond' and not a 'pledge'. In South African law the term 'pledge' refers to the common-law pledge.

### 1.3 Problem statement

Before the SMPA came into operation, Sacks<sup>28</sup> questioned the efficacy of registering security rights over movable property and whether this complies with the principle of publicity, in the following terms:

The difficulties that arise from the fact that movable property can be moved, that movables are now so frequently mass-produced as to render the identification of an article extremely difficult and that no system of registering any interest in movable goods may exist at all call for very careful solutions to be rationally applied when movables are to be used as security.

Although the introduction of the SMPA brought about significant changes, there are still many questions surrounding notarial bonds in South Africa.<sup>29</sup>

The fact that the debtor is not divested of the control of the property that serves as security allows him to transfer the title to someone else without any knowledge on the part of the creditor or third party. Issues of preference in the case of insolvency may therefore arise. The acid test of whether a real right of security is functional is whether it is effective if the debtor becomes insolvent and grants the holder of the real right a preference over other creditors.<sup>30</sup> A real right of security is effective when

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28 Sacks 1982 *SALJ* 605.

29 Sonnekus & Neels *Sakereg Vonnisbundel* 745-60. See also Scott 1995 *THRHR* 672.

30 See Wood *Security and Guarantees* 3. See also Eidenmuller & Kieninger *Secured Credit* 248.

the creditor can prevent the debtor from disposing of the movable property that serves as security.

In the case of notarial bonds, the debtor can easily alienate the movable property that serves as security without the creditor's knowledge. The third party will then receive the thing subject to the creditor's real security right. The question is whether registration of the real security right in movable property serves as sufficient publicity to third parties and the debtor's other creditors. Two problems result from the above: the effectiveness of the creditor's real security right over the movable property; and the legal position of the third party who has bought the property. The position of third parties and creditors will, therefore, be investigated.

It is questionable whether the current Land Registry (Deeds Registry) should be used for registration of notarial bonds. A new system specially designed for the registration of real security rights over movable property should be considered. Currently it is not possible for third parties to access the registry easily and inexpensively in order to establish the existence of a real security right over a specific movable thing. It is a challenge to identify the exact content of the real security right. There are no guidelines describing a movable asset apart from the vague wording: 'readily recognisable without use of extrinsic evidence' as contained in section 1(1) of the SMPA. The current registration system does not allow registration of a special notarial bond over a debtor's revolving assets and excludes incorporeal movable property as security object. In the current economic climate there is a dire need for the inclusion of these things as security objects. The system must be easy and inexpensive to access. All of these shortcomings in the current registration system contribute to legal uncertainty and possible prejudice to either the creditor or third parties and the underutilisation of special notarial bonds as security.

#### **1.4 Purpose of study**

Academic writers<sup>31</sup> have shown the need for reform of real security rights over movable property. Other countries, for example Belgium, Scotland, the Netherlands and Germany, have or are in the process of reforming their laws governing real security rights. In 1988 The South African Law Commission conducted a study on

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31 See Scott 1995 *THRHR* 675; Sonnekus 1983 *TSAR* 252-3; and Brits 2015 *SA Merc LJ* 246-74.

possible reform of real security rights over movable property. As a result the SMPA was enacted in 1993. Although the SMPA was welcomed, it did not entirely satisfy all concerned parties. The purpose of this study is to investigate the merits of earlier criticism of the SMPA and the efficacy of the legal position of notarial bonds in South African law 23 years after the enactment of the SMPA. The aim is to establish whether the SMPA – still or at all – effectively addresses the need for security based on movable property in the current economic climate.

I further undertake a comprehensive analysis of the purpose of the publicity principle. I consider whether the way in which the principle is applied truly reflects its purpose. Throughout the dissertation the publicity required to vest a real right is carefully considered. The success of a legal system acknowledging a pledge without possession depends to a great extent on a registration system that complies with the publicity requirement. The problems with the current registration system, as set out above, are analysed and possible solutions or recommendations made. I consider whether our legal system should perhaps endeavour to accept a more contemporary reading of the publicity principle.

Furthermore, the purpose of and the need for a general notarial bond are reconsidered in the light of its current exclusion from the SMPA. The South African legal position with regard to the non-possessory pledge is compared with the legal position in Belgian law, not only to identify problems relating to the non-possessory pledge, but also to focus on effective legal practices, plausible solutions, and useful recommendations for South African law.

Lastly, I provide an overview of important criticism of and discussions on the topic of notarial bonds in South African law published in Afrikaans. This English overview will, to a certain extent, open these commentaries to a broader audience.

## **1.5 Methodology and outline of chapters**

This study is not empirical. Legislation, case law and international instruments<sup>32</sup> serve as primary sources, while journal articles, academic writing and electronic

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32 Legislative guide on secured transactions (UNCITRAL); Cape Town Convention on International Interests in Mobile Equipment (UNIDROIT); Organisation for the Harmonisation of Business Law in Africa (OHADA); Model Law on Secured Transactions (EBRD); Draft of a

resources are my secondary sources. Qualitative research is the focus of this dissertation.

An overview of the historical background to and development of real security rights in Roman and Roman-Dutch law is provided in Chapter 2. This overview illustrates the need to secure due performance of an obligation by a debtor from as early as Roman times. It explains the origin and legal development of the first phenomenon of a notarial bond as we know it today.

In Chapter 3 the nature and operation of real security rights in South African law are discussed. The publicity function, as a key element in the vesting of a real right, is fully discussed and analysed in this chapter. A clear distinction is made between the legal position of the holder of a real security right before and after the insolvency of the debtor.

Chapter 4 focusses on the common-law pledge. The chapter sets out the legal nature, vesting, and operation of a common-law pledge in South African law. This discussion is necessary to establish the difference between a common-law pledge and a fictitious pledge as granted by the SMPA. (A fictitious pledge is a special notarial bond under the SMPA, or a perfected general notarial bond.) The influence of the National Credit Act<sup>33</sup> on the validity of certain clauses in a pledge agreement (secured loan) is discussed.

The background and historical development of notarial bonds in South African law is fully discussed in Chapter 5. I concentrate, in particular, on legislation and case law which have proved pivotal in the development of notarial bonds in South African law. Thereafter the nature, vesting and legal operation of a general notarial bond is discussed. I draw particular attention to the fact that the SMPA excludes general notarial bonds from its operation.

In Chapter 6 I discuss special notarial bonds in detail. The discussion is divided into two main periods: the legal position before the enactment of the SMPA; and the legal

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33 Common Frame of Reference (DCFR); and Model Inter-American Law on Secured Transactions (OAS).  
34 of 2005.

position after the enactment of the SMPA. Thereafter the problems encountered with notarial bonds in South African law are set out.

Chapter 7 provides an overview of the Belgian legal system. Emphasis falls on real security rights and pledge under the Civil Code followed by a study of the non-possessory pledge under the New Belgian Pledge Act.

To close, Chapter 8 offers a comparative summary, recommendations and concluding remarks.

## CHAPTER 2

### HISTORICAL BACKGROUND OF REAL SECURITY RIGHTS

#### 2.1 Introduction

This dissertation deals with notarial bonds in South African law and with pledge without possession in Belgian law. Both notarial bonds and pledge without possession are real security rights. A brief overview of the historical development of real security rights in Roman and Roman-Dutch law is necessary if one is fully to comprehend their nature and operation in the respective legal systems.

#### 2.2 Terminology

Real security rights (*saaklike sekerheidsregte / zakelijke zekerheidsrechten*) are a sub-category of limited real rights and are classified as *iura in re aliena*.<sup>34</sup> Real rights (*saaklike regte / zakelijke rechten*) as a category of rights (consisting of ownership, servitudes, usufruct, pledge and mortgage) do not appear in the *Corpus Iuris*.<sup>35</sup> The *Corpus Iuris* did, however, provide certain legal actions for the creditor – for example, the *Actio Serviana*.<sup>36</sup> The terms *ius in re* and *ius in personam* were unknown in early Roman law. Later, during the Middle Ages, Romanists used the term *ius reale* (meaning *ius in re*) and developed the concept of real rights. They failed, however, to draw a clear distinction between real rights and limited real rights (*beperkte saaklike regte / beperkte zakelijk rechten*). In the 16<sup>th</sup> century Hugo De Groot formulated the distinction between ownership (*ius in re propria*) and limited real rights (*ius in re aliena*).<sup>37</sup>

I first reflect on the term ‘real security right’ and ‘mortgage’ and distinguish between conventional and legal or tacit hypothecs, and special mortgages and general mortgages. Thereafter I briefly discuss the different types of mortgage in Roman and Roman-Dutch law.

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34 Sonnekus & Neels *Sakereg Vonnisbundel* 403.

35 “De gedachte dat eigendom enerzijds, vruchtgebruik, servituten, pan den hypotheek anderzijds samen tot één categorie behoren, nl. Die der zakelijke rechten, is in het Corpus iuris nerens te vinden”. Feenstra *Romeinsrechtelijke Grondslagen* 81.

36 This real action was available to a landlord in the case of the tacit hypothec of a landlord. The landlord could claim the *invecta et illata* from the tenant and/or third parties. Once the landlord was in control thereof he was in the same position as a pledgee and could also rely on the *ius distrahendi*. See Thomas Ph J *Essentialia* 83-4.

37 Feenstra *Romeinsrechtelijke Grondslagen* 81.

A real security right can be defined as:

The right of a creditor over the debtor's property that serves as security is a limited real right which is usually designated by the generic term of mortgage.<sup>38</sup>

The term 'mortgage' is a generic term that, in the broader sense, refers to mortgage, hypothec or pledge. A special notarial bond is included in the reference to 'mortgage'.<sup>39</sup> 'Mortgage' and 'pledge' are also used to refer to the contract of mortgage and the contract of pledge. This then refers only to the conventional mortgage as it is based on contract. At times, mortgage is used to refer to the property that is the subject of the real security right. In the narrowest sense, 'mortgage' and 'pledge' are used to refer to the specific real rights and the privileges that attach to them.<sup>40</sup>

The term 'mortgage' (meaning a right) used in a comprehensive sense is "a right over the property of another which serves to secure an obligation".<sup>41</sup> This definition does not qualify the nature of the property that is the subject of the mortgage, how the mortgage is constituted, or the nature of the obligation it secures. In the restricted sense 'mortgage' refers to security over immovable property.<sup>42</sup> 'Pledge' is a form of 'mortgage' in the comprehensive sense. A pledge is "a right over the movable or incorporeal property of another which serves to secure an obligation".<sup>43</sup>

In its restricted sense a mortgage is a real right in favour of a person (the mortgagee) over the property of another person (the mortgagor) for the repayment or fulfilment of a debt due by the mortgagor or a third party to the mortgagee. The mortgagee has a preferential claim that must be satisfied from the proceeds of the sale of the property. This preferential claim is enforceable against all creditors of the mortgagee save for creditors who have a prior or stronger claim to the property. The real right attaches to the property and limits the entitlements of the owner of the property. When the property that forms the object of the security is movable, the real right is referred to

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38 Hosten et al *Introduction* 544.

39 S 11(a)(i) of the Prescription Act 68 of 1969. See *Land and Agricultural Development Bank of South Africa t/a The Land Bank v Factaprops 1052 CC and Another* 2016 (2) SA 477.

40 Hall *Maasdorp's Institutes* 180-81 and Wille *Mortgage and Pledge* 1.

41 *Ibid.*

42 *Ibid.*

43 *Ibid.*

as a pledge and the parties are the pledgor (owner of movable property) and the pledgee (the creditor in whose favour the real right vests).

A mortgage may arise from a contract in which case it is referred to as a conventional (or express) mortgage. A tacit or legal mortgage arises through operation of law. Furthermore, mortgages may be classified as either general or special. In principle a general mortgage bond binds all present and future property of the debtor, whereas a special mortgage bond binds specifically defined property of the debtor.<sup>44</sup>

In Roman law and Roman-Dutch law the term *hypothecation*, in its widest sense, includes mortgage and pledge. The term 'mortgage' was unknown in Roman law. In early Dutch law, the term '*vadium*' was used for the object that was given as security for repayment of a debt. The transaction of securing due performance of an obligation was called a '*vadium contract*'. A '*mortuum vadium*' was, in early English law, a transaction referring to a pledge of land that was effected by conveying the land to the creditor to hold until the debtor paid his debt. The parties could agree that the creditor would use the rent and profits from the land to reduce the debtor's debt, or he (creditor) received the land without any liability or duty to maintain the land. In French the term '*mortuum vadium*' is referred to as a mortgage – dead pledge. The term is appropriate seeing that the debtor will receive dead or unprofitable land once he has paid off the principal debt.<sup>45</sup>

In Roman law the term *pignus* denoted security in cases where possession of the property was given to the creditor. This usually applied to movable property although it even at times applied to immovable property. *Hypotheca* denotes a security where possession was not given to the creditor. Roman-Dutch law jurists distinguish between *pignus* and *hypothec* on two grounds: possession; and the nature of the property. *Pignus* is a right which secures due performance of an obligation over the movable property of the debtor and that property is delivered to the creditor. *Hypotheca* is a right which secures due performance of an obligation, over the immovable property of the debtor and the property remains in control of the debtor.<sup>46</sup>

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44 *Id* at 40, 61 and 66.

45 Hall *Maasdorp's Institutes* 180-1; Nathan *Common Law* 1043; and Wille *Mortgage and Pledge* 2.

46 Wille *Mortgage and Pledge* 3.

A real security right is a right over the property of another securing due performance of an obligation. In modern law, the term mortgage may be interpreted either comprehensively or restrictively. When interpreted comprehensively mortgage refers to all forms of security right, including mortgage over immovable property, pledge, and hypothecs. In the restrictive sense, mortgage refers to the real security right over immovable property for which a mortgage bond is registered in the Deeds Office. In Roman law real security rights were not specifically formulated in the *Corpus Iuris*. However, three forms of security in favour of a creditor were acknowledged: *fiducia*; *pignus*; and *hypotheca*. Roman-Dutch law distinguished between two forms of hypothecation: *pignus* and *hypotheca*. I turn now to the legal position governing real security rights in Roman and Roman-Dutch law.

### 2.3 Roman law real security rights (hypothecation)

In Roman law lawyers treated real security rights (hypothecation<sup>47</sup>) as a contract

that ... exists between the parties that a certain thing shall be granted, or a grant understood of a right on the object pledged, as a security for the outstanding debt, and it is said to be *re*, because all those contracts are such which are perfected by the delivery of a thing ... But it is not termed a real contract, because it gives a *jus in re*, for no contract gives other than *actio personalis*.<sup>48</sup>

The real security right was therefore not seen as a real contract, but as a contract which was perfected through delivery. Only after delivery did the real security right holder acquire a *jus in re*. Nathan<sup>49</sup> explains that a real security right in Roman law could be described as a quasi-contract: the parties did not necessarily intend to create a real security right, but the right arose by operation of law as a consequence of some other contract between the parties.

Thomas<sup>50</sup> emphasises two aspects of real security rights in Roman law: (i) the real security right is dependent on the debt that it secures and a debtor-creditor relationship is therefore a pre-requisite for the existence of a real security right; (ii) the creditor has no intention to use and enjoy the thing – he holds it for security

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47 [U]sing the term in the widest sense, as embracing both mortgage and pledge'. Nathan *Common Law* 1043.

48 *Ibid.*

49 *Ibid.*

50 Thomas *Essentialia* 83.

purposes only. Various tacit hypothecs, created in statutes, were available in Roman law.<sup>51</sup> A mortgage in Roman law was created by agreement with or without delivery of the thing.<sup>52</sup> As stated previously, Roman law acknowledged three forms of real security right – *fiducia*, *pignus* and *hypotheca*.<sup>53</sup>

*Fiducia* is the oldest form of real security and has its origins in the *Ius Civile*. This form of security applied only to *res mancipi*,<sup>54</sup> although over time it was extended to cover all corporeal property. The *fiducia* operated as follows: the debtor transferred ownership of the security object to the creditor by means of *mancipatio*<sup>55</sup> or *iure cessio*.<sup>56</sup> This means that the debtor lost ownership and the creditor acquired ownership subject to the condition that the creditor transfer ownership back to the debtor once the debt had been paid (*pactum fiducia*).<sup>57</sup> In practice the creditor often gave use and control of the thing to the debtor in terms of a hire-purchase agreement. This was done to enable the debtor to exploit the thing in order to acquire money to repay the debt.<sup>58</sup> Initially the debtor had to rely on the good faith of the creditor and had no right with which he could reclaim his thing if the creditor did not return it once the debt had been paid. Later, the debtor acquired a right – the *actio fiducia* – with which he could enforce the *pactum fiducia* against the creditor. The creditor, who acquired a *ius in re propria*,<sup>59</sup> was in a very strong position.<sup>60</sup>

The right of *pignus*, on the other hand, is not found in the *Ius Civile*. *Pignus* only applied to movable corporeal things and vested through *traditio* (delivery). *Pignus* is a pledge: the pledgor (debtor) gave control of his thing to the pledgee (creditor) as

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51 The hypothec in favour of the state for outstanding taxes is an example of a tacit hypothec created in classic Roman law, while most others were created in post-classical Roman law. See Van der Merwe *Sakereg* 609.

52 Lee *Introduction* 185.

53 Thomas *Romeinse Reg* 83.

54 Land, buildings, certain rural servitudes, slaves and 'certain beasts of draught and burden (oxen, horses, mules and donkeys)'. Thomas, Van der Merwe, & Stoop *Historical Foundations* 140.

55 The act of transferring ownership of a thing. Thomas, Van der Merwe & Stoop *Historical Foundations* 159.

56 The act of transferring ownership of a thing during a mock trial in front of the *Praetor*. Both parties and the thing appeared before the *Praetor*. The transferee (creditor) took the thing and declared that it was his. The transferor (debtor) did not contest the declaration, and the *Praetor* then declared that the thing belonged to the transferee (creditor). Thomas, Van der Merwe & Stoop *Historical Foundations* 160.

57 Thomas *Romeinse Reg* 83-4.

58 Van der Merwe *Sakereg* 607.

59 A right in your own property.

60 Thomas *Romeinse Reg* 83-4.

security for the repayment of the debt. Even though this right was not found in the *Ius Civile*, it was used in practice. Only later did it become a real security right granted by the *Praetor*. Before or during the physical transfer of the thing, the parties agreed that the pledgee would return the thing once the debt had been paid. This agreement (*pactum*), together with delivery of the thing, created an agreement of pledge. The pledgor had a right – the *actio pignoratitia* – to reclaim his thing from the pledgee once the debt had been settled. Should the thing be in control of a third party (other than the pledgee) the pledgor could claim his thing using the *rei vindicatio*. Roman law acknowledged certain clauses in the *pactum*.

The *pactum antichresis* is an agreement that the pledgee may use the thing and the use serves as ‘payment’ of interest on the amount due. In terms of the *pactum distrahendi* the parties could agree that the pledgee could sell the pledged thing if the debtor could not pay his debt. The pledgee could redeem only his claim, and the remainder of the proceeds of the sale went to the pledgor. Emperor Constantine prohibited a clause (*pactum commissorium*) in terms of which a pledgee could keep the thing if the pledgor was not able to pay his debt.<sup>61</sup>

The third form of security in Roman law is *hypotheca*. *Hypotheca* was seen as a ‘suspensive pledge’ or ‘pledge without possession’. The creditor had the right to take possession, but was not in control from the outset. It originated from the rent and lease of land. The landlord required some form of security from the tenant for the rental amount and the parties agreed that the *invecta et illata* serve as security for payment of the rent. This was a *pactum* (agreement) between the parties and could not be enforced against third parties. Later, the *Praetor* granted an interdict (*interdictum Salvianum*) in favour of the landlord by which he could claim the *invecta et illata*. The interdict was only enforceable against the tenant. In order to accord the landlord greater protection, the *Praetor* granted him a real action, the *actio Serviana*. With this real action the landlord could claim the *invecta et illata* from the tenant and/or third parties. Once the landlord was in control of the goods he was in the same position as a pledgee and could also rely on the *ius distrahendi*.<sup>62</sup>

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61 See 4.3.2 below for the discussion on *pactum commissorium* in South African law and 7.4.1.3 below for the discussion in Belgian law.

62 *Ibid.*

In later classical Roman law the distinction between *pignus* and *hypotheca* fell away and the terms were used interchangeably. In practice the term *pignus* was generally used to refer to a pledge over movable property, while *hypotheca* was used for pledge without possession of an immovable thing. The creditor was, however, not required to be placed in control of the thing. The terms were basically synonyms and Roman law of pledge was generally referred to as *pignus hypotheca*.<sup>63</sup>

The Roman law of pledge may be criticised for failing to address the rights of the debtor's other creditors. No publicity was required and third parties and other creditors of the debtor were in most instances unaware of the existence of a right of *pignus hypotheca*. A general hypothec could vest in the creditor over all the things of the debtor without it being described at all. This was contrary to the principle that the object of the security must be determined or determinable.<sup>64</sup>

Owing to the fact that Roman-Dutch law can be described as a compilation of Roman law and Germanic law, it is important to note certain differences between Roman law and Germanic law as regards hypothecation. In Germanic law the debtor's estate as a whole was not liable for his debt. Only a specific movable or immovable thing was assigned to the creditor as security object, and the creditor's security was limited to that specific thing. Pledge in Germanic law was not, as in Roman law, accessory in nature. Essentially, the debtor provided the thing as an alternative form of payment should he fail to pay his debt. The debtor could reclaim the specific thing assigned to the creditor once he had paid the debt. If the debtor was unable to pay the debt the pledge lapsed or expired and the creditor became owner of the thing specified. This was referred to as '*vervalpand*' (lapse or expiry of pledge). Later, the '*vervalpand*' was replaced with the '*verkoop pand*' (sale pledge) and the pledge object was sold at a judicial sale. The creditor's claim was satisfied and the remainder of the purchase price was given to the debtor. Germanic law drew a clear distinction between movable and immovable property. A pledge of a movable thing required transfer of physical control to the creditor. The rule *mobilia non habent sequelem ex causa hypothecate* applied in Germanic law, and a creditor (pledgee) could only claim the pledged thing from a third party if there had been involuntary loss of possession. From the 14<sup>th</sup> century, a *hypotheca* over immovable property could only vest if there

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63 Van der Merwe *Sakereg* 608.

64 *Id* at 609.

was some form of publicity. Later, the right only vested if there was a process in a court where the property was situated, by which the right was noted.<sup>65</sup>

## 2.4 Roman-Dutch real security rights

Roman-Dutch law drew a significant distinction between legal or tacit hypothecs and conventional mortgages. Legal or tacit hypothecs<sup>66</sup> were created by operation of law, while conventional mortgages arose from agreement.<sup>67</sup> Various hypothecs created by operation of law were acknowledged in Roman-Dutch law. It is interesting to note that the landlord's tacit hypothec is classified as a hypothec created by law, and not, as in Roman law, a hypothec created by contract. Other examples of Roman-Dutch law hypothecs created by operation of law included, but were not limited to, legal hypothecs in general, the hypothec of the state or the Treasury, the hypothec of churches and public bodies, and the hypothec for dowry.<sup>68</sup>

For purposes of this discussion I consider only the legal position of conventional mortgages. Four different conventional (express) mortgages were known in Roman-Dutch law: a special mortgage over immovable property; a special mortgage over movable property delivered to the creditor; general and special mortgages over movable property not delivered to the creditor; and a mortgage over a right (*res incorporales*).<sup>69</sup>

Conventional mortgages in Roman-Dutch law were *pignus* (pledge) and *hypotheca* (mortgage). The Roman law *fiducia* fell away.<sup>70</sup> In Roman-Dutch law a hypothecary right was used as an umbrella term for a *pignus* (pledge) and *hypotheca* (mortgage). The hypothecary right is defined as “a real right attaching on a thing belonging to another, granted to a creditor as security for his claim”.<sup>71</sup> Voet defined *pignus* as “a contract attached to the thing which is the subject of pledge, whereby possession of the thing passes to the creditor”.<sup>72</sup> A *hypotheca* can be defined as “a *jus in re* (real right) constituted in favour of the creditor in security of what is due to the creditor,

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65 *Id* at 610.

66 It is interesting to note that tacit hypothecs are unknown to English law.

67 Morice *English and Dutch law* 54.

68 See Nathan *Common Law* 1059-95 for a comprehensive discussion of Roman-Dutch hypothecs.

69 Lee *Roman-Dutch Law* 185.

70 For a comprehensive discussion see Feenstra *Romeinsrechtelijke Grondslagen* 104-5.

71 Nathan *Common Law* 1045.

72 *Ibid.*

while the possession is not transferred to the creditor".<sup>73</sup> In the case of a *pignus*, the creditor was in control of the thing and held the remedy in his hands. His remedy was available to him without judicial intervention, whereas the creditor with a *hypotheca* could only enforce his remedy through legal action.<sup>74</sup>

Hypothecation was divided into general or special mortgage. This distinction applied to both conventional mortgages and mortgages arising through operation of law. A general mortgage extended over all the present and future property of the debtor. Property included movable things, immovable things, and incorporeal things. A general mortgage over immovable property had to be registered, duty<sup>75</sup> had to be paid, and it must have been accepted by a court.

A special mortgage could vest over movable and immovable property. The object of the mortgage was the specified property. Special mortgages usually contained a 'general clause':

This had all the effects of a general mortgage, or of a duly registered notarial general bond in insolvency. It applies to all present and future property to which the mortgagor or pledgor may become entitled, from whatever source, whether inheritance or gifts, whether movable or immovable [...]. The right of general mortgage in a bond is not lost by discharge of the special hypothecation contained therein [...]. But the right of general mortgage must be conferred by the bond; and if it is not mentioned it will not apply.<sup>76</sup>

The general clause provided a general mortgage conjoined with the special mortgage. However, the clause had to be set out in the bond and could not be implied.

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73 *Ibid.*

74 *Id* at 1044.

75 '[A]ccording to Roman-Dutch Law, after the promulgation of the Placaat of 1665 – (1) no public instrument, containing a clause of general hypothecation of movables, was entitled to any preference whatever, unless payment of the fortieth penny -2½ per cent. – on the amount of the debt had been made when the instrument was passed[.]' See also Nathan *Common Law* 1046.

76 Nathan *Common Law* 1045-6.

The fruit of the specified property (before *litis contestatio*) was also subject to the special mortgage. Fruit that accrued after *litis contestatio* was not subject to the special mortgage, unless the principal thing was insufficient to repay the debt.<sup>77</sup>

Nathan<sup>78</sup> discusses the vesting of a mortgage in Roman-Dutch law. He refers to Voet and indicates that a real security right would only enjoy preference over other creditors if the mortgage were registered. Voet further stated that the Registrar of Deeds could be held liable for damages to a creditor who lost his right of mortgage due to the Registrar's omission (negligently or fraudulently) to comply with registration formalities. It is interesting to note that these characteristics of a positive registration system do not apply in South African law. South African law follows the negative registration system in terms of which the Registrar of Deeds is not responsible for any damages resulting from omissions or mistakes in the Deeds Registry.<sup>79</sup> The system of registration of real rights in land was unknown in Roman law and originated in Roman-Dutch law.<sup>80</sup>

Roman-Dutch law acknowledged two ways in which a real security right could be granted over movable property. Firstly, this could be done by means of a pledge agreement together with delivery; and secondly, by means of a notarial bond without delivery. In *Hare v Heath's Trustee*<sup>81</sup> Judge De Villiers discussed the legal position of a notarial bond in the law of Holland:

The mortgagee in whose favour a notarial bond has been passed but without delivery, had no greater security than was afforded by the personal honesty of the debtor. He took his mortgage subject to all prior special or general hypothecations affecting the property, and if the debtor chose afterwards to alienate the property, or even if the property was judicially attached at the suit of another creditor, the mortgagee lost his right of preference *pro tanto*. But as far as the concurrent creditors were concerned he might in a *concursum creditorum* claim a preference to the extent of the value of the mortgaged articles in the possession of the debtor or his trustee in insolvency.

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77 *Id* at 1044-5.

78 *Id* at 1047.

79 Sonnekus & Neels *Sakereg Vonnisbundel* 403.

80 *Ibid.*

81 3 SC 32.

In terms of earlier Dutch law an unregistered notarial bond could be valid against the insolvent debtor and concurrent creditors. Later Dutch law (as relied on in South African law) required registration of the notarial bond with the Registrar of Deeds for it to be valid against the insolvent debtor and concurrent creditors.<sup>82</sup>

In Roman-Dutch law a general conventional hypothec over movable property gave the person in whose favour the hypothec was made a preferential right. The movables had to remain the *dominium* of the debtor and must not have been delivered to a third party in terms of a special hypothec. The rule *qui prior est tempore potior est in jure* applied to general hypothecs over movable property. If however, the debtor, alienated the movables to a third party the creditor lost his right of pledge.<sup>83</sup> In the case where the debtor granted a special hypothec over the movables to another person, the creditor's general hypothec ranked below the special hypothec. A creditor's right in terms of a general hypothec also ranked below a *ius retentionis*. In the case of a special conventional mortgage containing a general clause,<sup>84</sup> the creditor had to realise the specially mortgaged property before he could execute the property generally bound to him (unless all the debtor's creditors agreed that he could execute the goods generally bound to him).<sup>85</sup>

Hypothecation in Roman-Dutch law was accessory: the right of mortgage depended on a principal obligation. The principal obligation could be a principal debt or an accessory obligation (eg suretyship). A person could constitute a mortgage over his property for his own debt or for that of someone else.<sup>86</sup>

Roman-Dutch law acknowledged a *pactum anthichresis* – an agreement that the pledgee could use the pledged thing instead of receiving interest on the debt. Roman-Dutch law (as did Roman law) prohibited a clause (*pactum commissorium*) in terms of which a pledgee could keep the thing if the pledgor was unable to repay the debt. The parties could, however, agree that the pledgee take over the pledged object at a fair valuation if the pledgor could not fulfil the obligation.

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82 Nathan *Common Law* 1048-9.

83 The debtor will be guilty of a crime. Nathan *Common Law* 1052.

84 See discussion above on 2.4. See also Nathan *Common Law* 1045-6.

85 Nathan *Common Law* 1051-2.

86 *Id* at 1052.

## 2.5 Summary

The need to secure due performance of an obligation by a debtor arose in early Roman law. Real security rights in the form of mortgage and pledge have been acknowledged for centuries. In Roman law the legal institution of *fiducia* was found in the *Ius Civil*. The debtor transferred ownership of his thing to the creditor and relied on the creditor to re-transfer ownership once the debt had been paid. This form of security placed the creditor, who acquired ownership, in a very strong position. Initially the debtor had no right to compel the creditor to transfer ownership back to him, but as the law developed the debtor acquired an action (*actio fiducia*) with which he could force the creditor to re-transfer the security object to him.

*Pignus* was not found in the *Ius Civil* but was practiced amongst citizenry: a debtor gave possession of his thing (generally movable but also immovable on occasion) to the creditor as security for repayment of the debt. The creditor had to return the thing to the debtor once he had paid his debt. Later, the *Praetor* acknowledged this right and granted the debtor an *actio pigneraticia* with which he could reclaim his thing from the pledgee once the debt had been satisfied. *Pignus* was a very effective form of security and *fiducia* became less attractive to parties in secured transaction. Lastly, Roman law acknowledged *hypotheca* – pledge without possession. The landlord's hypothec over the *invecta et illata* of the tenant granted him the right to claim the goods if the tenant failed to pay his rent.

*Fiducia*, *pignus* and *hypotheca* are regarded as contracts in terms of which the debtor's obligation towards the creditor is secured. Roman-Dutch law distinguished between legal or tacit hypothecs and conventional hypothecs. The latter arose from contract and the former by operation of law. Roman-Dutch law drew a clear distinction between security over movable property and security over immovable property. Movable property could be used as security in terms of *pignus* or a notarial bond. In the case of *pignus* the property had to be delivered to the creditor, while in the case of a notarial bond the property remained in possession of the debtor. Immovable property could serve as security for repayment of a debt in the case of *hypotheca*. The debtor remained in control of the immovable property.

In the following chapter I analyse South African law with regard to real security rights in detail. I focus specifically on the legal nature and operation of pledge and notarial bonds. I also highlight problem areas surrounding notarial bonds.

## CHAPTER 3

### BASIC PRINCIPLES OF REAL SECURITY RIGHTS IN SOUTH AFRICAN LAW

#### 3.1 Introduction

This chapter provides an overview of the legal nature and operation of real security rights in South African law. Real security rights aim to strengthen a creditor's legal position in the case of a concurrence of creditors (*concursum creditorum*) on the debtor's insolvency. Where several creditors have claims against the debtor's insolvent estate, the principle of equality of creditors (*paritas creditorum*) applies: all creditors must be treated equally. A creditor may, however, secure his claim for payment by means of a real security right. His real security right gives the creditor preference over the claims of other creditors.<sup>87</sup> South African law distinguishes between express or conventional real security rights, tacit real security rights, and judicial real security rights. These rights vest and operate in different ways. When considering the operation of a real security right it is important to distinguish between the secured creditor's position in the case of default by a solvent debtor, and his position in the case of default by an insolvent debtor. I first consider the definition and legal nature of a real security right and then discuss the vesting requirements and legal operation of the real security right.<sup>88</sup>

#### 3.2 Definition and legal nature

A real security right is generally defined as a limited real right over the debtor's property.<sup>89</sup> It is a *ius in re aliena*. Du Bois et al<sup>90</sup> provide the following all-inclusive definition of a real security right:

Real security in the form of a mortgage, pledge, tacit hypothec or lien is a limited real right in the property of another that secures an obligation by entitling the creditor to exercise certain rights in respect of encumbered property in preference to unsecured creditors.

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87 LAWSA Vol 17(2) 323.

88 I consider real security rights in general but provide a more focussed discussion of certain aspects of express real security rights.

89 Scott & Scott *Wille's Law of Mortgage and Pledge* 632. See also Thomas *Introduction to Roman Law* 67 where he defines a real security right as a situation where the debtor or third party offers an object over which a real right in favour of the creditor is vested.

90 Van der Merwe CG 'Real Security' in Du Bois *Wille's Principles* 630.

This right limits the owner's right of ownership. Since the aim is to secure the repayment of a principal debt, a limited real right is classified as a real security right.<sup>91</sup> It secures performance of an obligation by the debtor towards the creditor.<sup>92</sup> The creditor is the real security right holder while the debtor is the person who must repay the debt to the creditor. A real security right can be created expressly or tacitly.<sup>93</sup> An express real security right (or 'conventional mortgage' under Roman-Dutch law) is created by means of an agreement between the parties (a debtor and a creditor – or sometimes even a third party),<sup>94</sup> while a tacit real security right (or 'legal mortgage' under Roman-Dutch law) is created by operation of law. Express real security rights can be divided into pledge (which includes security by means of claims), notarial bonds (both general and special), special mortgage bonds over immovable property, the *kustingbrief*, covering bonds, and participation bonds. Tacit real security rights are divided into the tacit hypothec of a credit grantor, the tacit hypothec of a landlord, and right of retention (lien).<sup>95</sup> Judicial mortgage or pledge is regarded as a third category of real security right which is regulated by statute and arises from judicial attachment.<sup>96</sup>

Real security rights are accessory in nature.<sup>97</sup> This means that the creation and existence of a real security right depends on the existence of a valid principal debt.<sup>98</sup> A real security right can therefore not be created in the absence of a valid principal debt.<sup>99</sup> Should the principal debt be invalid, the real security right will not come into existence. When the principal debt is discharged, the real security right is extinguished *ex lege*.<sup>100</sup>

A real security right gives its holder (the creditor) no entitlement to use and enjoy the thing. The creditor holds it for security purposes only. Unlike other limited real rights –

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91 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 630-65.

92 Lee *Elements* 175.

93 Mostert & Pope *Property Law* 357.

94 This may be the case where a third party provides security on behalf of the debtor. It is, however, important to note that the security grantor must be the owner of the property that serves as security or be a legally recognised representative of the owner.

95 According to some authors a right of retention is not a 'right' but a 'defence' and therefore not a real security right. See Wiese 2014 *PELJ* 2526-53.

96 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 631.

97 Mostert & Pope *Property Law* 300.

98 Badenhorst, Pienaars & Mostert *Law of Property* 51. See also *Thienhaus NO v Metje and Ziegler Ltd and Another* 1965 (3) SA 25 (A).

99 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 631.

100 Mostert & Pope *Property Law* 325. See also *SA Timber and Joinery Works (Pty) Ltd v The Sherriff* 1955 (4) SA 56 (O).

servitudes, for example – a real security right accords its holder the right to execute the property in the case of default by the debtor.<sup>101</sup>

I turn now to a consideration of how a real security right vests, its legal nature, and how it operates. This discussion focuses principally on express real security rights over movable property as the main thrust of the study is the pledge and the notarial bond – both express real security rights.

### **3.3 Vesting**

#### **3.3.1 General**

Tacit real security rights vest by operation of law (*ex lege*). In all instances the vesting of the real right depends on a debt due by the debtor. The landlord's tacit hypothec is regarded as a real security right only once the landlord is in control of the movable property (*invecta et illata*). A lien depends on continuous control by the lien holder.<sup>102</sup> The tacit hypothec of a creditor changes the ownership of the owner who has reserved ownership in terms of a credit agreement, to a real security right on the insolvency of the debtor.<sup>103</sup> The vesting of a judicial mortgage or pledge is constituted by judicial attachment in terms of a writ of execution to satisfy a judgment debt.<sup>104</sup>

In order to create an express real security right, three legal acts are required: (i) the conclusion of a credit (loan) agreement; (ii) the conclusion of a security agreement; and (iii) publication.<sup>105</sup> The credit agreement describes the arrangement between the creditor and the debtor in terms of which the former lends a sum of money or makes credit available to the latter. In addition to the loan agreement, a security agreement must be concluded. In terms of the security agreement a debtor agrees to provide security to the creditor for the repayment of the principal debt. Both the credit agreement and the security agreement give rise to personal rights and are governed

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101 Badenhorst, Pienaar & Mostert *Law of Property* 358.

102 *Id* at 416-7.

103 *Id* at 403-04 and s 84 of the Insolvency Act 24 of 1936.

104 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 631 and Badenhorst, Pienaar, & Mostert *Law of Property* 407-08.

105 Mostert & Pope *Property Law* 303.

by the law of contract and the provisions of the National Credit Act.<sup>106</sup> The third requirement, publication, necessitates a comprehensive analysis.

### **3.3.2 Publication**

Valid loan and security agreements alone do not create a real security right. Some form of publication is required for this right to vest. It is a principle of the law of property that the existence of a real right must be public knowledge. The publicity principle serves two purposes. Firstly, this principle ensures that a real right (which is effective against third parties) cannot be kept secret. Secondly, it provides information for those who might need it, such as actual or prospective creditors or third party purchasers.<sup>107</sup> In its 'Model Law on Secured Transactions',<sup>108</sup> (Model Law) the European Bank for Reconstruction and Development considered the importance of secured credit in a growing economy. The Model Law was designed to provide a fair balance between the competing interests of debtors, secured creditors, and other parties who might have some dealings with the property that serves as security. This goal can only be achieved if the publicity principle has been sufficiently complied with. Creditors of the debtor and other third parties who may wish to have some dealings with the movable property that serves as security, must be aware of the existence of the right. Hamwijk<sup>109</sup> explains the position as follows:

[I]n both civil and common-law traditions the principle of publicity is regarded as a fundamental principle of property law and accordingly secured transactions law. In a nutshell, it is based on the idea that property rights (should) only have effect vis-à-vis third parties if they are actually public, *i.e* can be known by such third parties.

It is necessary at this point to examine the publicity principle more closely. The notion of non-possessory security has elicited considerable criticism in Europe in that it is seen as a violation of the publicity principle.<sup>110</sup> Hamwijk<sup>111</sup> discusses two different lines of reasoning with regard to publicity: the problem solving approach; and the

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106 Act 34 of 2005.

107 Van der Merwe D and Wortley S 'Rights in Security' in Zimmerman, Visser & Reid *Mixed Legal Systems* 725.

108 Model Law on Secured Transactions available at [www.ebrd.com...and /pdf-model-law-on-secured-transactions.pdf](http://www.ebrd.com...and /pdf-model-law-on-secured-transactions.pdf) (date of use: 8 December 2014).

109 Hamwijk *Publicity in Secured Transactions* 35.

110 *Id* at 36.

111 *Id* at 37.

dogmatic approach. The problem solving approach refers to the problem of the false appearance of creditworthiness. She formulates this approach as follow:

Hence, in the first line of reasoning (let us refer to it as the 'problem solving' approach), possession in the hands of someone who does not have any rights in the asset as suggested by its possession is said to cause the problem, whereas publicity would have prevented this problem.

The dogmatic approach refers to third parties' duty to respect property rights which they can only do if they are aware of the existence of the rights.

Both approaches involve publicity. In most legal systems publicity is achieved through either registration – in the case of immovable property – or delivery (possession) – in the case of movable property. Hamwijk question whether possession as a means of publicity is really effective. Publicity means that the existence of a security right and who hold that right (the creditor) is made public to the world at large. The point at which a real security right arises is determined by when the creditor gained possession of the thing. Thereafter the effectiveness of possession as publicity may be questioned:

[E]ven if we *could have noticed* the transfer of possession, this in itself does not *tell* us much. It is impossible to conclude from the dynamic movement (nor from the newly arrived static situation) that a special legal transaction must have taken place, let alone which one. ... Since physical possession can mean a wide variety of things including leasing or borrowing, it hardly tells the observer anything.<sup>112</sup>

The purpose of possession as publicity should therefore be further investigated. According to Hamwijk<sup>113</sup> one argument is that the debtor is stripped of his possession so preventing him from misleading third parties. The debtor, who is no longer in control of the thing, is unable to alienate the thing or to use it as security for another debt. Depriving the debtor of possession prevent the problem of 'false appearance of creditworthiness'.<sup>114</sup> It does, however, allow the creditor who is in control of the thing, the opportunity to create a false appearance of ownership:

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112 *Id* at 40.

113 *Id* at 36.

114 Sonnekus 1989 *TSAR* 535, also emphasises this advantage of the debtor not being in control of the thing.

A full-blown Babylonian confusion presents itself: when held by one party, an asset is said to create a false impression, but when held by another party it is said to provide information. Or conversely: when held by one party, an asset is said to not give (correct) information and thus to create false impression. It is sometimes difficult to keep track.<sup>115</sup>

The author states that the publicity principle may be read in two ways: “publicize security rights as much as possible” or “property rights should not be enforceable against third parties, unless these rights were public to them”.<sup>116</sup> Hamwijk argues that the publicity principle originates from the latter interpretation as it is based on “typical bona fide protection rules”.<sup>117</sup> A third party will easily place confidence in the debtor who is in control of the thing and should therefore be protected should the debtor sell the thing to him or offer it as security when there is another existing right over the thing. However, possession by the debtor (or even the creditor) offers no information as to who has a right in the thing, what that right is, and in what capacity the person holds the thing. Hamwijk proposes that a public filing would ensure compliance with the principle of publicity:

I believe that the original publicity principle has given way for a more modern reading of the publicity principle as to entail a call for public filing. In theory, this modern version of the publicity principle is better than the old one because it serves the interest of third parties across the full spectrum: both first-in-time owners and lenders and not second-in-time (‘third’) parties ‘win’ as the conflicted is avoided in the first place.<sup>118</sup>

This argument of Hamwijk is contrary to the statement made by Sacks<sup>119</sup> on the effectiveness of registration of real security rights over movable property.

In my concluding chapter I comment on the feasibility of a public filing system (an online registration system of real security right over movable property) in South Africa. For the present, however, I consider the legal position in South African law as regards publicity and real security rights.

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115 Hamwijk *Publicity in Secured Transactions* 45.

116 *Id* at 50.

117 *Ibid.*

118 *Id* at 52.

119 Sacks 1982 *SALJ* 605. See 1.3 above.

In general, the nature of the security object determines the required form of publicity: either registration or delivery. If the security object is an immovable thing, the real security right (mortgage bond) in favour of the creditor must be registered against the title deed of the immovable property. If the object of the real security right is a movable thing, delivery is generally a prerequisite for the vesting of a real security right.<sup>120</sup> The registration of a notarial bond over movable property is an exception to the rule – no delivery is required, but the notarial bond must be registered in the Deeds Office.<sup>121</sup> For both registration and delivery there must be a real agreement to create a security right. The content of the real agreement determines whether ownership is transferred or whether the movable property is merely given as security for the repayment of the principal debt. In the case of delivery the debtor must have the intention to deliver the movable property as security for the repayment of the debt, and the creditor must have the intention to receive the thing as security for the repayment of the debt. The debtor must have the intention to provide security for the repayment of the debt in the form of registration of a mortgage over his property in favour of the creditor, and the latter must have the intention to receive the mortgage as security for the repayment of the debt. The security agreement must clearly indicate an intention to grant real security for the due performance of the principal obligation by the creation of the real security right in a specified immovable thing.<sup>122</sup>

A claim (personal right), as an incorporeal thing, can also be the object of a real security right. It can be: (i) ceded; (ii) pledged; or (iii) used as security in terms of a general notarial bond. The cession of a claim requires no publicity – the debtor need neither receive notice of nor consent to the cession of the claim.<sup>123</sup> In order to comply with the publicity principle in the case of a pledge of claims, the facts must be made known to the debtor so that he can respect the right of the pledgee. It is not certain whether compliance with the publicity principle in this case can be achieved through registration or by any other means. Notice to the debtor of the existence of the pledge of a claim seems to be method most favoured in ensuring compliance with the principle of publicity. Registration of the pledge of a claim is not a method favoured to

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120 Mostert & Pope *Property Law* 302.

121 A special notarial bondholder acquires a real security right on registration. A general notarial bondholder must, however, still perfect the bond in order to acquire a real security right.

122 *Legator Mckennar v Shea and Others* 2010 (1) SA 35 SCA. See also Schutte 2008 *PELJ* 3.

123 Van der Merwe & Du Plessis *Introduction* 272. The debtor is protected by the rule that 'a payment made in good faith to the cedent immunises [him] against liability towards the cessionary'.

ensure compliance with the publicity principle as it places an unnecessary burden on the debtor to ascertain whether his creditor has not ceded or pledged his right against the debtor.<sup>124</sup> A general notarial bond over a claim will not grant the bondholder a real security right – only once the bondholder acquires physical control of the thing through perfecting the bond will he have a real security right in the form of a pledge.

### 3.4 Operation

A distinction should be drawn between the situation where a debtor does not repay his debt but is solvent, and the situation where a debtor is declared insolvent. In the first instance the holder of the real security right (creditor) institutes his claim against the debtor, while in the latter he institutes his claim against the debtor's insolvent estate. In the first instance the creditor may apply for a court order instructing the debtor to pay his debt. Should the debtor fail to comply with the court order, a writ of execution can be issued in terms of which the Sheriff may attach the security object and have it sold in execution at public auction. The proceeds of the sale are used to repay the debt and any net proceeds are paid to the debtor.<sup>125</sup>

The realisation of a real security right when the debtor is declared insolvent is more complicated. Any one of the debtor's creditors may apply for a court order declaring the debtor insolvent. The debtor himself may also apply to court to be declared insolvent. The aim of this analysis is not to provide a detailed discussion of insolvency law and procedure: it suffices to say that all the requirements of insolvency as prescribed in section 8 and other relevant sections of the Insolvency Act<sup>126</sup> must be complied with.<sup>127</sup> I now briefly discuss the legal position of a secured creditor with a real security right against the insolvent estate of the debtor.<sup>128</sup>

Neither a secured creditor nor a preferential creditor is defined in the Insolvency Act. However, the meaning attributed to secured creditors and preferential creditors is derived from the definitions of 'security' and 'preference'. A secured creditor has a preferential right over some of the property in the insolvent estate by virtue of a

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124 Scott 1989 *THRHR* 460.

125 *LAWSA* Vol 17(2) 367. However, in the case of two or more competing real security rights over the same property that serves as security, the one registered first enjoys preference. See also Mostert & Pope *Property Law* 296.

126 24 of 1936.

127 S 8(b) of the Insolvency Act 24 of 1936.

128 S 2 Act 24 of 1936: 'insolvent estate' means an estate under sequestration'.

special mortgage, a landlord's legal hypothec, a pledge, or a right of retention.<sup>129</sup> A special mortgage is defined as

'special mortgage' means a mortgage bond hypothecating any immovable property or a notarial mortgage bond hypothecating specially described movable property in terms of section 1 of the Security by Means of Movable Property Act, 1993 (Act No. 57 of 1993), or such a notarial mortgage bond registered before 7 May 1993 in terms of section 1 of the Notarial Bonds (Natal) Act, 1932 (Act No. 18 of 1932), but excludes any other mortgage bond hypothecating movable property.

The Insolvency Act<sup>130</sup> defines preference as follows

'preference', in relation to any claim against an insolvent estate, means the right to payment of that claim out of the assets of the estate in preference to other claims; and 'preferent' has a corresponding meaning.

A secured creditor has a real security right over property for his claim. He is entitled to be paid out of the proceeds of the property that serves as security for his claim. His preference arises from his 'security interest in the specific property'.<sup>131</sup> A preferential creditor differs from a secured creditor with a preferential right. The former does not have security for his debt but is entitled to payment of his claim before concurrent creditors in terms of the Insolvency Act. His (preferential creditor's) preferential right arises from the provisions of the Act whereas a secured creditor's preferential right arises from his security interest in the property.<sup>132</sup>

The secured creditor's preferential right operates as follows: Once the debtor has been declared insolvent and a trustee has been appointed, the creditor must prove his claim against the insolvent estate. If the creditor is in control of the movable property, the trustee of the insolvent estate may take over the movable property which is held by the creditor as security for his claim. The trustee will take over the property against a value determined by the parties (trustee and creditor) or the full amount of the creditor's claim.<sup>133</sup> Should the trustee decide not to take over the

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129 *Ibid.*

130 *Ibid.*

131 *LAWSA* Vol 17(2) 323.

132 *Ibid.*

133 S 83(3) of Act 24 of 1936.

property, the creditor may realise his security by selling the property at public auction.<sup>134</sup> Before such a sale the creditor must notify the trustee of the public auction and the trustee must, in turn, give written notice to all other creditors of the insolvent estate.<sup>135</sup> Any net proceedings from the sale at the public auction must be paid to the insolvent estate.<sup>136</sup> If the secured creditor's claim exceeds the proceeds of the sale, he becomes an unsecured concurrent creditor in the free residue<sup>137</sup> of the insolvent estate.<sup>138</sup>

When a debtor has more than one secured creditor and the first ranked secured creditor realises his secured claim by court order and a sale in execution, his claim will be satisfied from the proceeds of the sale. Thereafter other secured creditors are entitled, in the order of their ranking, to the surplus of the proceeds of the sale. It is possible for a later creditor (not the first-ranked creditor) to foreclose on his mortgage and execute his property. However, the first-ranked mortgage creditor may then set a reserve price for the sale in execution and will be paid first. Even unsecured creditors may apply for a court order to have the mortgaged property sold in execution. The proceeds of the sale will, however, be paid first to secured creditor/s, and only then will the unsecured concurrent creditors be entitled to their share of surplus of the proceeds of sale.<sup>139</sup>

### 3.5 Summary

Real security rights are divided into three categories: express (also known as conventional) real security rights; tacit real security rights; and judicial real security rights. Express real security rights include pledges and mortgages. These types of right are based on agreement between the debtor and the creditor, or even a third party. Tacit real security rights – such as a tacit hypothec of credit grantors, tacit hypothecs of landlords and liens – are created by operation of law. Judicial real security rights are created by statute or by court order. This dissertation is concerned with an express real security right. Movable corporeal, movable incorporeal, and

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134 S 83(8)(d) of Act 24 of 1936.

135 S 83(9) of Act 24 of 1936.

136 S 83(10) of Act 24 of 1936.

137 S 2 of Act 24 of 1936: "free residue", in relation to an insolvent estate, means that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention'.

138 S 83(13) of Act 24 of 1936.

139 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 638-9.

immovable property can form the object of an express real security right. Real security rights require some form of publicity save in the case of cession (incorporeal property). The form of publicity required is determined by the nature of the security object. Registration or delivery is required in the case of corporeal movable property. In the case of immovable property the real security right must be registered in favour of the creditor against the title deed of the immovable property.

Criticism has been levelled against the debtor retaining possession (physical control) of the property that serves as security subject to registration in the Deeds Registry. The criticism is based on the fact that possession of the property can mislead third parties as to the wealth of the debtor, and does not in itself show the existence of a real security over the property. The debtor can sell or give the property as security to another creditor without any knowledge on the part of the security holder.

In a situation where the debtor is solvent, the creditor may apply for a court order instructing the debtor to pay his debt. A writ of execution can be issued for the attachment of the property and to have it sold in execution at public auction should the debtor fail to comply with the court order. In the case of the debtor's insolvency a secured creditor is entitled to be paid from the proceeds of the property that serve as security in order of his ranking as secured creditor. Lower-ranked secured creditors are entitled to the surplus of the proceeds of the sale in accordance with their rankings. A preferential unsecured creditor is entitled to payment of his claim before concurrent creditors.

This chapter provided an overview of the legal position of a real security right holder in general. In the following chapter I discuss the nature and legal operation of a common-law pledge in South African law.

## CHAPTER 4

### PLEDGE

#### 4.1 Introduction

Debtors often do not have any or sufficient immovable property to offer as security for the repayment of a debt and so can offer only movable property. It is also not uncommon for debtors who do not have sufficient movable corporeal property to offer their incorporeal property as security.<sup>140</sup> The value of movable property has increased over the decades to the point where it may now constitute a suitable security object.<sup>141</sup> The most common form of security over movable property, both corporeal and incorporeal, is a pledge. I therefore now consider the definition, legal nature, vesting, and operation of a pledge. Notarial bonds grant the bondholder a right described as 'deemed to be pledged' and it is therefore important to establish the extent of a pledge in South African law. Having established these aspects, I turn to a brief overview of why the Law Commission's proposed pledge without possession has not been included in the SMPA.

#### 4.2 Definition and legal nature

A pledge can be defined as a limited real right over the movable property of the pledgor in favour of the pledgee, securing repayment of the principal debt, and is constituted through delivery of the pledged thing to the pledgee.<sup>142</sup> Delivery of the movable property that serves as security is, therefore, essential to ensure compliance with the publicity principle and so create a real security right.<sup>143</sup> This requirement gives effect to the principle of publicity through direct control.<sup>144</sup>

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140 Scott 1989 *De Jure* 119.

141 Sonnekus 1989 *TSAR* 524.

142 Badenhorst, Pienaar & Mostert *Property Law* 390; Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 630; Havenga et al *Commercial Law* 349. There has been an on-going academic debate on whether future movable property can be the object of a pledge. This position is still uncertain.

143 As mentioned earlier, a personal right, unlike a real right, can only be enforced against the parties to the pledge agreement. It is relative in nature.

144 Sonnekus 1993 *TSAR* 111.

A pledge can only be established over movable property and immovable property can consequently not be pledged.<sup>145</sup> Incorporeal movable property may be pledged: a debtor (pledgor) cedes (pledges) a claim in the form of a personal right to his creditor (pledgee) as security for a debt.<sup>146</sup> This is termed cession *in securitatem debiti*.<sup>147</sup> No transfer of ownership takes place in this form of cession.<sup>148</sup>

The pledgor is the person whose movable property forms the object of security. A pledgor can, however, provide security to the pledgee on behalf of a third party for the repayment of the third party's principal debt. The pledgor must be the owner of the movable property which serves as security, or must have a legally recognisable right in the property. The pledgee is the person (creditor) in whose favour the pledge vests.<sup>149</sup>

### 4.3 Vesting

In order for the pledgee to acquire a limited real right over the movable property that serves as security, three legal acts are required: (i) a credit agreement; (ii) a pledge agreement; and (iii) delivery of the thing pledged. I discuss each of these legal acts separately in what follows.

#### 4.3.1 Credit agreement

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145 S 63(1) of the Deeds Registries Act 47 of 1937 provides for registration of the immovable property in order for the mortgage bond to be effective.

146 Sharrock *Business Law* 577-8.

147 *Bank of Lisbon and South Africa Ltd v The Master* 1987 (1) SA 276 (A). See also *Grobler v Oosthuizen* 2009 (5) SA 500. For a full discussion of the law of cession, see *Scott Cession*.

148 Innes J in *National Bank of South Africa v Cohen's Trustee* 1911 AD 235 at 251 explained the enforcement of a cession *in securitatem debiti* by the secured creditor as follows: 'The secured creditor, so far as the enforcement of the right is concerned would seem to occupy a position practically equivalent to that of an owner. He alone can sue upon the ceded obligation, and he may do so for the full amount, however much in excess of the secured debt. Nor need he excuse the pledgor before taking steps to realise the security.' Cession of claims can also take place by means of an out-and-out cession. (A distinction between a cession *in securitatem debiti* and an out-and-out cession was made clear in *Picardi Hotels (Pty) Ltd v Thekwini Properties (Pty) Ltd* 2009 (1) SA 493 (SCA).) In the case of an out-and-out cession, ownership in the incorporeal property passes to the cessionary. (*Grobler v Oosthuizen* (2009) ZA SCA 51; *Picardi Hotels (Pty) Ltd v Thekwini Properties (Pty) Ltd* 2009 (1) SA 493 (SCA).) The cessionary becomes the legal holder of the personal right and the cedent is entitled to a reverse cession by the cessionary only when the secured debt has been paid. (*Leyds NO v Noord-Westelike Koöperatiewe Landboumaatskappy Bpk* 1985 (2) SA 769 (A) 780.) Alternatively, a reverse cession to the cedent can also take place where the proceeds of the personal right have exceeded the amount necessary for the discharge of the debt secured.

149 Mostert & Pope *Property Law* 314.

The credit and pledge agreements are often contained in a single document. A credit agreement refers to the principal obligation which the pledge intends to secure.<sup>150</sup> This may be the case where, for example, the pledgor and the pledgee enter into an agreement in terms of which the pledgee will loan the pledgor a sum of money or make credit available to him subject to repayment at a later stage.<sup>151</sup> This agreement gives rise to personal rights only and is governed by the law of contract and the provisions of the National Credit Act.<sup>152</sup> A pledge can be used to secure an existing or a future debt.<sup>153</sup> A future debt refers to a debt that has not yet been incurred when the credit agreement is concluded.

#### **4.3.2 Pledge agreement**

In terms of a pledge agreement<sup>154</sup> (*pactum*), the pledgor agrees to secure a valid underlying principal debt by pledging his movable property to the pledgee.<sup>155</sup> A pledge agreement is governed by the law of contract and gives rise to personal rights only.<sup>156</sup> The pledgor need not be the person who owes the debt as he may also give a valid pledge for a debt owed by a third party.<sup>157</sup> This agreement must clearly indicate an intention to create a pledge.<sup>158</sup>

There are certain clauses that may be included in a pledge agreement.<sup>159</sup> Parties to the pledge agreement may agree that the pledgee may use and enjoy the property that serves as security and take its fruits in return for not charging interests on the debt (*pactum antichresis*).

Parties may also include a summary execution (*parate executie*) clause in their pledge agreement. In terms of this clause, parties may validly agree that the pledgee may sell the movable property without obtaining a court order<sup>160</sup> in the event of default by the pledgor. The sale must be by public auction and the pledged property

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150 Kleyn & Boraine *Law of Property* 390.

151 See 2.2.2 above.

152 Act 34 of 2005.

153 Van der Walt & Pienaar *Introduction to Property* 292-3.

154 A pledge agreement classifies as a 'secured loan' in terms of the NCA.

155 Mostert & Pope *Property Law* 315.

156 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 642.

157 Badenhorst, Pienaar & Mostert *Law of Property* 391.

158 LAWSA Vol 17(2) 418.

159 Mostert & Pope *Property Law* 316.

160 A pledgor may, however, seek the protection of the court if the pledgee acts in a manner that prejudices his interests. In contrast, a mortgage bond over immovable property may not include a *parate executie* clause.

must be sold to the highest bidder. Any net surplus of the proceeds must be paid to the pledgor. Should the proceeds of the sale be insufficient to satisfy the creditor's claim in full, the creditor acquires an unsecured claim for the balance against the debtor's solvent estate or against the free residue of the debtor's insolvent estate.<sup>161</sup>

In *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd*<sup>162</sup> Judge Froneman declared summary execution clauses unconstitutional. He based his decision on the fact that a summary execution clause infringes the debtor's right of access to the courts as provided for in section 34 of the Constitution.<sup>163</sup> Scott<sup>164</sup> criticises the *Findevco* decision on the basis that the debtor hands over his movable property to the creditor voluntarily and authorises the creditor to sell his property should he default. According to Scott, a summary execution does not amount to spoliation or self-help by the creditor. Furthermore, the debtor may seek the protection of the court if the creditor or his representative breaches any of his duties in terms of the mandate or if the debtor has suffered prejudice as a result of the creditor's actions and there is a dispute in this regard.<sup>165</sup> In 2004 the Supreme Court of Appeal, in *Bock v Duburoro Investments (Pty) Ltd*,<sup>166</sup> reinstated the validity of summary execution clauses as set out in, amongst others, *Osry v Hirsch Loubser and Co Ltd*.<sup>167</sup> Consequently, a *parate executie* clause may still be included in a pledge agreement.

The National Credit Act<sup>168</sup> (the NCA) impacts on summary execution clauses in a pledge agreement. The Act defines a 'secured loan'<sup>169</sup> as an agreement in terms of which a creditor lends money or grants credit to a debtor and retains any movable property as security for the loan or credit amount. A loan agreement secured by a pledge therefore qualifies as a 'secured loan'.<sup>170</sup> A 'pawn transaction'<sup>171</sup> is defined in

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161 Van der Merwe CG 'Real Security' in Du Bois *Wille's Principles* 650.

162 2001 (1) SA 251 (E).

163 Constitution of the Republic of South Africa, 1996.

164 Scott 2002 *THRHR* 658 and 660.

165 See *Osry v Hirsch Loubser and Co Ltd* 1922 CPD 53 and *Sakala v Wamambo* 1991 (4) SA 144 (ZH).

166 2004 (2) SA 242 (SCA) para 15.

167 1922 CPD 531.

168 35 of 2005.

169 NCA 35 of 2005 s 1: "secured loan" means an agreement, irrespective of its form but not including an instalment agreement, in terms of which a person-

a) advances money or grants credit to another, and

b) retains, or receives a pledge or cession of the title to any movable property or other thing of value as security for all amounts due under that agreement;'

170 See *Brits* 2013 *SA Merc LJ* 561.

the NCA as an agreement in terms of which a creditor: (i) lends money or advances credit to the debtor; (ii) takes property belonging to the debtor as security for the repayment of the debt; and (iii) may sell the property if the debtor does not repay him after a specified period and retain the proceeds of the sale to satisfy the debt owing to him. A pledge agreement with a summary execution clause, therefore, qualifies as a pawn transaction.<sup>172</sup> A pawn transaction is a 'small agreement'<sup>173</sup> which generally involves smaller debts.<sup>174</sup> The NCA<sup>175</sup> allows a credit provider to sell the debtor's property should he fail to pay the debt within a prescribed period. Any credit agreement which is not a pawn agreement but which qualifies as a 'secured loan', may not authorise the creditor to act as agent in the private sale of the property.<sup>176</sup> The legal effect of the provisions in the NCA is that summary execution clauses are only valid and enforceable in pawn transactions as opposed to any other credit agreement or a secured loan.<sup>177</sup>

A *pactum commissorium* is a forfeiture clause in terms of which the parties to a pledge agreement agree that the pledgee may retain the property that serves as security as his own should the pledgor default with payment. This clause is invalid.<sup>178</sup> Parties may, however, agree that the pledgee may acquire ownership of the movable property at a fair price should the pledgor default (*pactum deprehenta* as known in Roman and Roman-Dutch law).<sup>179</sup> This agreement (clause) must be entered into

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171 NCA 35 of 2005 s 1: ' "pawn transaction" means an agreement, irrespective of its form, in terms of which-

- a) one party advances money or grants credit to another, and at the time of doing so, takes possession of goods as security for the money advanced or credit granted; and
- b) either-
  - i) the estimated resale value of the goods exceeds the value of the money provided or the credit granted, or
  - ii) a charge, fee or interest is imposed in respect of the agreement, or in respect of the amount loaned or the credit granted; and
- c) the party that advanced the money or granted the credit is entitled on expiry of a defined period to sell the goods and retain all the proceeds of the sale in settlement of the consumer's obligations under the agreement.'

172 See Brits 2013 SA Merc LJ 561.

173 S 9(2)(a) Act 35 of 2005.

174 S 92(3)(a) Act 35 of 2005.

175 S 99.

176 This amounts to an unlawful act in terms of s 90 Act 35 of 2005.

177 See Brits 2013 SA Merc LJ 555-77 for a comprehensive discussion of summary execution clauses and the NCA.

178 *Graf v Buechel* 2003 (4) SA 378 (SCA); *Mapenduka v Ashington* 1919 AD 343; *Bock v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 SCA.

179 LAWSA Vol 17(2) 427. See also *Bock v Duburoro Investments (Pty) Ltd (Pty) Ltd* (228/2002), [2003] ZASCA 94, [2003] 4 All SA 103 SCA.

after the debt has become due and the debtor must be willing to part with his thing at that point.<sup>180</sup> The parties must agree on a purchase price and if they cannot, a third party must determine a fair price.<sup>181</sup>

A clause stipulating that the debtor may not repay the debt and is not entitled to have the thing restored to him, is invalid.<sup>182</sup>

### **4.3.3 Delivery**

Delivery of the movable property is the third act that must take place in order for the pledgee to acquire a real right in property that serves as security. In *Zandberg v Van Zijl*<sup>183</sup> the (then) Appellate Division confirmed that a pledge comes into being as a real right only once the pledged object has been delivered to the pledgee. The pledgor retains ownership of the movable property that serves as security. The requirement of delivery from the pledgor to the pledgee serves to protect the pledgee's real right of security by preventing the pledgor from alienating the property to other person or giving it as security for another debt.<sup>184</sup> It also serves as notice to third parties of the existence of a real security right.<sup>185</sup>

Delivery of the movable property may be actual or constructive.<sup>186</sup> Actual delivery refers to the transfer of physical control over the movable property that serves as security from the pledgor to the pledgee – for example, when the pledgor hands over a gold watch to the pledgee. Constructive delivery takes different forms some of which are accepted by our courts, while others are not.<sup>187</sup> The forms of constructive delivery accepted by our courts are *traditio brevi manu* (delivery with the short hand),<sup>188</sup> *clavium traditio* (symbolic delivery),<sup>189</sup> and attornment.<sup>190</sup> *Constitutum*

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180 *Mapenduka v Ashington* 1919 AD 343.

181 *Bock v Duburoro Investments (Pty) Ltd* [2003] 4 All SA 103 SCA.

182 *Michell v De Villiers* (1900) 12 SC 85.

183 1910 AD 302 318.

184 LAWSA Vol 17(2) 421.

185 See the discussion on the publicity principle and the effectiveness of delivery as publication in 3.3.2 above.

186 There are different forms of constructive delivery and some are accepted by the South African courts while others are not. The forms of constructive delivery accepted by our courts are: *traditio brevi manu*; *traditio longa manu*; *clavium traditio*; and attornment. *Constitutum possessorium* is a form of constructive delivery which is not accepted by our courts.

187 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 525.

188 Kleyn & Boraine *Law of Property* 184. No transfer of physical control takes place in this form of delivery as the transferee is already in physical control of the thing. This can arise in the case of an instalment sale transaction in terms of which the transfer transfers physical control of the thing to the transferee but retains ownership of the thing upon payment of the full purchase

*possessorium* as a form of constructive delivery for purposes of pledge is not accepted by our courts.<sup>191</sup> In terms of *constitutum possessorium* the pledgor retains physical control of the movable property that serves as security.<sup>192</sup> South African courts did not accept this form of delivery because of the possibility that third parties may be misled as to the true state of affairs with regard to the pledged thing. Delivery of incorporeal things is also somewhat problematic.<sup>193</sup>

The leading case on delivery through *constitutum possessorium* and simulated transactions is *Vasco Dry Cleaners v Twycross*.<sup>194</sup> In this case Carides sold his business and other dry-cleaning machines to a company (Air Capricorn (Pty) Ltd) controlled by Duff. In terms of their contract of sale, the purchase price would be paid in instalments and ownership would be reserved to Carides until the last instalment had been paid. Air Capricorn then ran into financial difficulties before the last instalment had been paid. Fearing that Carides would reclaim the dry-cleaning machines, Duff approached his brother-in-law, Twycross, for financial assistance. Twycross then bought the machines from Air Capricorn. The purchase price was

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price. On payment of the last instalment, the transferee acquires ownership by means of *traditio brevi manu*. Kleyn & Boraine *Law of Property* 184.

189 *Id* at 181-2. This form of delivery refers to a situation where a symbol or a token of a thing which cannot be physically delivered, due to its size or nature, is delivered from one person to the other. The symbol or token of the thing indicates that delivery of the object has taken place, eg, the handing over of the keys to a house.

190 This form of delivery takes place by means of an agreement between the transferor, the transferee and a third party in terms of which the parties agree that the third party will exercise physical control of the property on behalf of the transferee. The owner of the property (transferor) will therefore transfer ownership of the property in circumstances where he is not in physical control. A discounting agreement is an example of attornment. In a discounting agreement a car dealer sells a motor vehicle to a purchaser in terms of a credit transaction. The car dealer then cedes his personal rights in terms of the sale agreement with a purchaser and his reserved ownership in the motor vehicle to the bank which pays the full purchase price to the car dealer. The effect of this is that the motor vehicle is sold and delivered to the bank. Therefore, the transfer of the motor vehicle from the dealer to the bank takes place by means of attornment. See Van der Merwe CG 'Real Security' in Du Bois *Wille's Principles* 530-3. The court in *Air-Kel (Edms) Bpk h/a Merkel Motors v Bodenstein* 1980 (3) SA 917 (A) considered the question of whether delivery by means of attornment remains effective where the third party loses physical control of the property to another person, eg where the third party's cousin borrows the property (movable) to go to the nearby store. In this case the court held that delivery by means of attornment still remains effective as long as the third party can regain physical control of the property without any legal assistance (eg, by means of a court order). A difficult situation arose in *Hearn & Co (Pty) Ltd v Bleiman* 1950 (3) SA 617 (C). In this case the third party was not in physical control of the property at the time of the tripartite agreement though the third party agreed to hold on behalf of the new owner. The court found that delivery by attornment had not taken place. See also *Southern Tankers (Pty) Ltd t/a Unilog v Pescana D Oro Ltd (Velmar Ltd Intervening)* 2003 (4) SA 566 (C).

191 Kleyn & Boraine *Law of Property* 189.

192 Mostert & Pope *Property Law* 203.

193 See discussion of an incorporeal thing as right of security in 3.3 above.

194 1979 (1) SA 603 (A).

equivalent to the sum owed to Carides. The agreement provided that Twycross would pay the purchase price directly to Carides and not to Air Capricon. Air Capricon and Twycross entered into a further agreement in terms of which Twycross 'resold' the machines to Air Capricon for exactly the same purchase price. Their contract required the purchase price to be paid in instalments and provided that Twycross remained the owner of the machines until the final instalment had been paid. In all these transactions, no physical transfer of the machines took place and Air Capricon retained physical control of the machines at all times. Approximately four months later, Air Capricon sold and delivered the dry-cleaning machines to Vasco Dry Cleaners. Air Capricon warranted that it owned the dry-cleaning machines although it had paid no instalments to Twycross as required by their 'resale' agreement. This means that Air Capricon had not acquired ownership in the machines. Twycross then claimed ownership arguing that when he bought the machines from Air Capricon and paid the purchase price to Carides, ownership in the machines was transferred from Carides to Air Capricon by means of *traditio brevi manu*, and then from Air Capricon to him by means of *constitutum possessorium*. This argument was, however, rejected by the Appellate Division. In its judgment the court looked at the actual intentions of the parties (Twycross and Air Capricon) and came to a finding that the parties had not intended to enter into a sale and resale, but rather to create a pledge. Consequently, the court held that the agreement between the parties amounted to a simulated transaction. Since actual physical control of the machines was never exercised by Twycross, a pledge had not been created and no real security right had vested in the pledgee as required by the common law.

There is a different line of thinking with regard to what constitutes a simulated transaction. Scott<sup>195</sup> is of the view that there are two approaches: an 'old fashioned' approach and a 'modern' approach, which can be used to determine whether the parties intended to enter into a pledge agreement or a sale and resale transaction. The old fashioned approach originates from the Roman law test which regards every juristic act as simulated when its economic and practical consequences are not in accordance with the normal legal consequences of the juristic act intended by the

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195 Scott 1992 *THRHR* 615.

parties. This approach was adopted in *Skjelbreds Rederi A/S v Hartless (Pty) Ltd*<sup>196</sup> though the case does not specifically deal with a pledge without possession. This case involved the cession of a foreign claim by a *peregrinus* cedent to an *incola* cessionary in order to allow an action to be brought to found jurisdiction in a South African court by the cessionary against another *peregrinus*. The cedent was a *peregrinus* who had no standing in the South African courts. In examining the deed of cession, the court concluded that the agreement did not reflect the true intention of the parties. It was found that in form the agreement appeared to be a cession, but in substance it amounted to a mandate to the cessionary to enforce the cedent's claim. In terms of the modern approach, a juristic act is regarded as a simulated transaction only when it appears clear from the transaction as a whole that the parties falsified their intention to conclude the juristic act which they supposedly entered into.<sup>197</sup>

Scott supports the modern approach as adopted in *Hippo Quarries (Tvl) (Pty) Ltd v Eardley*.<sup>198</sup> This case involved the supply of goods by a cessionary to a company and the transaction was secured by a deed of suretyship signed by the director of the company. The company was subsequently liquidated and the cessionary instituted action against the director as surety. The cessionary withdrew the action when it realised that the suretyship was in favour of the cedent, a company associated with the cessionary. This resulted with the cedent executing a deed of cession in which it purported to cede its rights against the director to the cessionary. In deciding the case, the court looked at the true intention of the parties to the disputed cession rather than their falsified intention and disregarded the simulated transaction.

Van der Merwe<sup>199</sup> points out that the South African courts have on several occasions accepted sale and lease-back transactions as transactions reflecting the true intention of the parties. Van der Merwe's view is that the parties did not intend a form of pledge which requires delivery of the movable property to the pledgee, but rather a

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196 1982 (2) SA 710 (A). This case involved a cession of a foreign claim by a *peregrinus* cedent to an *incola* cessionary to allow an action to be brought to found jurisdiction in a South African court by the cessionary against another *peregrinus*. The cedent was a *peregrinus* who did not have standing in the South African court. In examining the deed of cession, the court came to a finding that the agreement did not reflect the true intention of the parties. It was found that the agreement appeared to be a cession in form, but in substance it amounted to be a mandate to the cessionary to enforce the cedent's claim.

197 Scott 1992 *THRHR* 615 and 620. See also *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* 1992 (1) SA 855 (A).

198 1992 (1) SA 855 (A).

199 Van der Merwe *Sakereg* 689.

form of security created by the passing of ownership of the movable property. Instead of pledging the thing and losing control over it, the debtor (owner) sells the thing to the creditor and enters into a hire-purchase or credit agreement. If the debtor does not repay his debt, the tacit hypothec of a credit grantor will secure the creditor's claim against the debtor. This view has, however, been rejected by the South African courts.<sup>200</sup> Sonnekus<sup>201</sup> argues that simulated transactions undermine the principle of publicity in that third parties can easily be misled as to the true state of affairs with regard to the property.

In *Zandberg v Van Zijl*,<sup>202</sup> the court found that simulated transactions did not prove to be a practical alternative to the common-law pledge. The court therefore reduced a simulated transaction to that of a pledge without possession. Whether the parties intended to create a pledge depends on whether the requirements for the creation of a valid pledge were complied with.<sup>203</sup> A simulated transaction was also considered by the Appellate Division in *Goldinger's Trustees v Whitelaw and Son*.<sup>204</sup> In arriving to its judgment, the court looked at the true intention of the parties and came to the finding that there had been no transfer of ownership. A pledge rather than a sale and resale agreement had therefore been created. This judgment is in line with *Vasco Dry Cleaners v Twycross*.<sup>205</sup>

To summarise: Actual physical control is required to vest a pledge. Fictitious delivery in the form of *constitutum possessorium* is not delivery for purposes of vesting a pledge. With reference to simulated transactions, South African law does not acknowledge a simulated transaction, for example a sale and lease back agreements, as a substitute for delivery.

The following discussion focuses on the operation of a pledge and explains how effective this right is once all the legal acts have been complied with.

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200 *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A). See also *Parton and Colam NNO v GM Pfaff (SA) (Pty) LTD* 1980 (4) SA 485 (NPD) where the same principles were adopted in dealing with simulated transactions.

201 Sonnekus 1993 TSAR 110.

202 1910 AD 302.

203 A credit agreement, a pledge agreement, and delivery.

204 1917 AD 66. See also *Quenty's Motors (Pty) Ltd v Standard Credit Corporation Ltd* [1994] 2 All SA 340 (A).

205 (1884) 3 EDC 439.

#### 4.4 Operation

A real security right of pledge serves to ensure performance of a principal obligation by the pledgor or a third party to the pledgee. It is enforceable against the pledgor personally, and against all third parties.<sup>206</sup> Any real security right to the movable property established after that of the pledgee is subject to the pledge on the basis of the maxim *prior in tempore, potior in iure* (first in time, first in law).

The pledged thing provides two forms of security. Firstly, if the debtor fails to pay his debt the pledgee may have the pledged thing sold in execution. Secondly, if another of the pledgor's creditors attempts to attach the pledged thing, or if the debtor is declared insolvent, the pledge gives the pledgee a preferential right over the proceeds of the sale of the pledged thing.<sup>207</sup>

In an ideal situation the debtor will repay his debt and the creditor will restore possession of the pledged property to the pledgor together with all its fruits.<sup>208</sup> When the debtor does not repay the debt the creditor may realise his security in the movable property of the debtor. Although the pledgee is already in control of the pledged thing, he must still obtain a court order to sell it in execution (unless there is a summary execution clause in the pledge agreement<sup>209</sup>). The pledgee is, however, in a better position than unsecured creditors: he has already identified the security object (pledged thing) and is in control of it. Unsecured creditors, on the other hand, must identify a security object and obtain an attachment order instructing the Sheriff to attach the security object. Furthermore, the pledgee's secured right enjoys preference over all the rights of other concurrent creditors. The pledgee is also in a better position than other secured creditors. The order of preference of all secured creditors is determined by the *qui prior in tempore* rule. As a pledgee is in control of the thing, it is impossible for multiple pledges to vest over it. Should the pledged thing be the object of a general notarial bond, a landlord's tacit hypothec, or a credit grantors hypothec, the creditor must still attach the thing in order to establish a real right. If the pledged thing is the object of a special notarial bond, the pledge ranks first. In terms of the maxim *mobilia non habent sequelam ex causa hypothecae* a

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206 Van der Walt & Pienaar *Introduction to Property* 287.

207 Van der Merwe *Sakereg* 651.

208 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 650.

209 See the discussion of the validity of summary execution clauses in 4.3.2 above.

pledgee's right of pursuit is restricted. If the pledgee loses control of the pledged object voluntarily he cannot claim it from whomever is in control of it. If he loses control of the thing involuntarily, he may claim it from whoever is in control of it.<sup>210</sup>

The common-law pledge as discussed above certainly places the pledgee in a very strong position. The fact that the pledgor loses control over his thing is, however, a considerable negative and not economically desirable. I now discuss the termination of a pledge.

#### 4.5 Termination of pledge

A pledge remains effective so long as the pledgor retains physical control over the movable property that serves as security.<sup>211</sup> In *Heydenrych v Fourie*<sup>212</sup> the court held that the pledgee must retain control of the movable property that serves as security for the existence of the pledge.<sup>213</sup> A pledge terminates should the pledgor voluntarily lose control of the pledged object.<sup>214</sup> *Stratford's Trustees v London and South African Bank*<sup>215</sup> dealt with voluntary loss of control of the movable property that serves as security. In this case the court held that a pledgee who returned the pledged wool to the pledgor to wash, had not lost his right of pledge. The court explained further that if the wool had been returned for the personal use of the pledgor, then the pledge would have terminated. The rationale for the court's decision was that the wool was returned solely on the basis of *locatio operis faciendi*.<sup>216</sup>

In terms of the maxim *mobilia non habent sequelam ex causa hypothecae*, a pledgee's right of pursuit is restricted. If the pledgee loses control of the pledged object voluntarily he cannot claim it from whomever is in control of it. If he loses

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210 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 648 and 650.

211 Stander 2000 *TSAR* 549.

212 (1896) 13 SC 371

213 *Ibid.*

214 *Zandberg v Van Zyl* 1910 AD 302 313; *Heydenrech v Fourie* (1896) 13 SC 371.

215 (1884) 3 EDC 439.

216 This view was approved by the Scottish court in the case of *North Western Bank v Poynter, Son and Macdonalds* (1894) 22 R (HL) 1. In this case the pledgee returned the property to the pledgor to act as his agent with regard to the sale. As a result, the creditor of the pledgor sought to attach the property and the House of Lords refused holding that the pledge remained in existence. See 7.4.1.2 below. In Belgian law a third party may also be in control as discussed in 7.4.1.2 below.

control of the thing involuntarily he may claim the thing from whomever is in control of it.<sup>217</sup>

Other ways in which a pledge may be extinguished include: the discharge of the debt; sale in execution; destruction of the pledged thing; repudiation of the pledge by the pledgee; where the pledgee becomes owner of the pledged thing; a court order; and novation.<sup>218</sup>

I now discuss the South African Law Commission's 1988 proposal to introduce pledge without possession in South African law together with criticism levelled at and arguments for pledge without possession.

#### **4.6 Pledge without possession**

In 1988 the South African Law Commission published a paper (Project 46 (1987)) on Security by Means of Movable Property. The SMPA is a result of this project. Two aspects were addressed in this publication – security over corporeal movable property, and security over incorporeal movable property. Security over corporeal movable property consisted of two proposals: pledge without possession (clause 1); and notarial bonds (clause 2). For purposes of the present discussion I focus only on pledge without possession (*'besitlose pand'*) as proposed in clause 1. Notarial bonds are dealt with later.<sup>219</sup>

The only requirements for the vesting of a pledge without possession were: the agreement must be in writing (clause 1(1)(a)); it must prescribe the content of the written agreement (clause 1(1)(b)); and a clause that the pledgee may not enforce his right against future *bona fide* acquirers must be included in the written agreement (clause 1(3)). It appears that clauses 1(1) and 1(3) were intended to ensure compliance with the publicity principle. According to Scott<sup>220</sup> the lack of compulsory notarial execution as a formality leaves the door wide open for fraud. A debtor will easily be able to deceive his creditors. Once the debtor realises he is in financial

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217 Van der Merwe CG 'Real Security' in Du Bois Wille's *Principles* 648 and 650.

218 Van der Walt & Pienaar *Introduction to Property* 271.

219 See the discussion in 5.1 below.

220 Scott 1989 *De Jure* 122. 'Die gewetenlose insolvente skuldenaar sal nie eens besonder vindingryk hoef te wees om te sorg dat daar uit een van sy lessenaarlaaie 'n besitlose pandoreenkoms soos 'n *deus ex machina* te voorskyn kom nie, waarin 'n goedgesinde samespanner, die gewaande pandhouer, bevoordeel word ten koste van derdes.'

trouble and that he will be declared insolvent, he draws up an agreement (pledge without possession) in favour of a conspirator who poses as a creditor of the debtor. All or much of the debtor's movable property will then be 'subject' to the conspirator's pledge without possession. A written agreement as proposed in clause 1(1) will not provide sufficient protection for third parties.

Sonnekus<sup>221</sup> indicates that the agreement as described in clause 1(1) has no face value for third parties, and that it does not replace possession for purposes of publication. The written contract/document is proof of an agreement between the pledgor/debtor and the pledgee/creditor but does not give notice to third parties of its existence or content.

Another concern raised by Scott<sup>222</sup> is the provision in clause 1(4) which stipulates that pledgee has the right to claim physical control of the pledged object on the debtor/pledgor's insolvency. The creditor has the right to acquire control without court intervention. Clause 1(4) makes no provision for the creditor of a solvent debtor to take control of the pledged object in the case of the latter's default.

Sonnekus<sup>223</sup> warns that the acknowledgement of pledge without possession as formulated in clause 1 would exclude the operation of the legal maxim *traditionibus et usucapionibus dominia rerum, non nudis pactis transferuntur*<sup>224</sup> which is deeply rooted in South African law. In his view the Project 46 (1987) dealt with the publicity principle haphazardly without paying the necessary attention to the role and function of the publicity principle in property and insolvency law. The lack of publication in the proposed pledge without possession impacts on insolvency law. This negative influence is explained<sup>225</sup> as follows: The effectiveness of any real security right depends on the preference/priority enjoyed by the holder of the real security right over other creditors. In terms of the Insolvency Act<sup>226</sup> a preferential creditor does not have to contribute to the cost of the winding up of the insolvent estate – these costs are covered primarily by unsecured creditors. This privileged position enjoyed by the

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221 Sonnekus 1989 *TSAR* 524.

222 Scott 1989 *De Jure* 123.

223 Sonnekus 1989 *TSAR* 527.

224 Ownership of things is transferred by delivery, not by naked promise or on mere agreement between parties. Van der Merwe CG 'Real Security' in Du Bois *Wille's Principles* 520 fn 476.

225 Sonnekus 1989 *TSAR* 533.

226 24 of 1936.

secured creditor with a real security right should rely on the degree of publicity with which his real security right or preferential position is made public or known to the outside world. A registered mortgage bond over immovable property, possession of the pledged object, or a thing held in terms of a lien, are all forms of publicity of the existence of a preferential right. They serve as a warning to third parties carefully to consider the creditworthiness of the proposed borrower (debtor). This enables future creditors to determine the risk involved in lending money to the debtor. When the risk is high, the interest payable on the loan will probably also be high, which makes the loan more 'expensive'. Sonnekus regards this as a healthy market mechanism which ensures that credit is provided to non-creditworthy persons only at a high premium. It partly captures the increased risk of default by the debtor and prevents the non-creditworthy debtor from sinking into a bottomless pit of debt. Furthermore, it aids in detecting acts of insolvency timeously which limits the risk of a negative impact on economically sound enterprises or individuals. Any material amendment to real security rights will influence insolvency law. The meaning and benefit of real security rights emerge in the case of a *concursum creditorium*. No statutory amendments to security rights should be undertaken unless their impact on the insolvency law principles has been examined. There is no sense in creating unconsidered new real security rights if they will contribute to the negation of the basic principles of insolvency law.

Sonnekus<sup>227</sup> offers four reasons why possession of the pledged object by the creditor should be required for the creation of a valid pledge. Firstly, there is a rebuttable presumption that the person in possession of the thing is its owner. When the debtor (pledgor) is still in control of the thing it creates the impression that he is the owner of the thing.<sup>228</sup> Secondly, subsequent potential credit providers should not be misled as to the possible creditworthiness of the debtor who is in control of the pledged thing. The fact that he is in control of the thing might create the impression that he is creditworthy. Thirdly, the debtor should have no authority to sell the thing or offer it as security to more than one creditor. It is, therefore, of cardinal importance that the pledged thing is in possession of the creditor and not the debtor. Lastly, the debtor

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227 Sonnekus 1989 *TSAR* 525.

228 Although an objective third party who sees that the person is in possession of the thing will not know what the relationship between the person and the thing is. See the discussion on the effectiveness of possession as means on publicity in 3.3.2 above.

loses his entitlement to use and enjoyment of the thing. This negative consequence of a pledge might serve as a deterrent for debtors to incur reckless debts.

It is clear that pledge without possession as proposed in clause 1 amounts to pledge without publication. A registered pledge in terms of Belgian law (a special notarial bond in terms of the SMPA) is a pledge without possession but with publication in the form of registration.

Both Scott<sup>229</sup> and Sonnekus<sup>230</sup> are of the opinion that the legislature itself did not appear convinced of the efficacy of a pledge without possession as formulated in clause 1 in that clause 2 stipulates that nothing prevents the parties to the pledge agreement from rather registering a notarial bond. The argument is that if the legislature considered the pledge without possession construction effective it would not have provided an alternative in the form of a notarial bond.

Based on the above, it is clear that the legislature made the right decision in not including a pledge without possession in the SMPA. The need to broaden forms of security over movable property was, to some extent, addressed in the SMPA. In Chapter 6 I discuss the provisions of the SMPA with reference to special notarial bonds over movable property.

#### **4.7 Summary**

Three legal acts are required for the pledgee to acquire a limited real right in the movable property that serves as security: a credit agreement; a security agreement; and delivery. The pledgee, as the holder of a real security right, has a preferential claim to the proceeds of the sale in execution of the pledged property, or upon the insolvency of the pledgor. He has a concurrent claim against the proceeds from the realisation of the other assets of the debtor should the proceeds of the sale in execution prove insufficient to cover the principal debt. The legal position of a pledgee as set out in this chapter, applies to a notarial bondholder (general or special, before the enactment of the SMPA) once he has perfected his bond.

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229 Scott 1989 *De Jure* 123.

230 Sonnekus 1989 *TSAR* 525.

After consideration, a pledge without possession as proposed by Project 46 (1987) was not included in the SMPA. This is generally perceived as the correct decision. The SMPA was enacted and granted a 'fictitious pledge' in the form of a special notarial bond. I now discuss the background and development of notarial bonds in South African law, after which I consider the nature, vesting and operation of general notarial bonds.

## CHAPTER 5

### GENERAL NOTARIAL BONDS

#### 5.1 Introduction

This chapter provides a general introduction to notarial bonds, an overview of the historical development of notarial bonds, and relevant legislation and case law dealing with notarial bonds in South African law. Thereafter the legal nature, vesting, and operation of general notarial bonds are discussed. Chapter 6 provides a comprehensive discussion of special notarial bonds in South African law.

#### 5.2 Notarial bonds in South African law

##### 5.2.1 Introduction

A notarial bond in present-day South African law is a bond, attested by a notary public, which hypothecates movable property, either generally or specifically, and which has been registered in the Deeds Registry.<sup>231</sup> It provides a means by which a debtor may hypothecate the movable property that serves as security without having to deliver the property to the creditor.<sup>232</sup> The debtor may continue to use the property.

South African law divides notarial bonds into general and special notarial bonds.<sup>233</sup> General notarial bonds, governed by the common law, are registered over all the movable property, corporeal or incorporeal, owned by the debtor. Special notarial bonds burden specifically described movable property of the debtor and are limited to corporeal movable property.<sup>234</sup> I now discuss the historical evolution of general notarial bonds in 1880s into notarial bonds in current South African law.

##### 5.2.2 Historical development

A notarial bond in South African law can be traced back to the Roman law *hypotheca*.<sup>235</sup> In terms of the *hypotheca* a lessee of rural land could give the lessor security in the form of a security right over his movable property. Later, this form of

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231 S 102 of the Deeds Registries Act 47 of 1937.

232 Kleyn & Boraine *Law of Property* 384.

233 *Id* at 452.

234 Scott 1995 *THRHR* 675.

235 See the discussion in 2.3 above.

security was extended to any debtor and creditor who agreed to it. The creditor was granted a *ius re in aliena* over the property of the debtor, while the debtor retained his ownership of the property. It became a popular form of security, especially when immovable property was used as security. The modern-day mortgage developed directly from this form of securing a credit. This form of security was also applied in Roman-Dutch law. With regard to movable property Roman-Dutch law developed certain rules determining that the security over movables was valid only “so long and so far as the *res* remained in the ownership and the possession of the debtor”.<sup>236</sup> These rules were later encapsulated in the maxim *mobilia non habent sequelam*. In essence the maxim means that movables cannot be followed up from third parties. Should the debtor transfer ownership or give away possession of the thing to a third party, the creditor will not be able to claim the thing from the third party. Therefore, the security was only effective “so long and so far as the *res* remained in the ownership and the possession of the debtor”.<sup>237</sup> This maxim did not apply in Friesland and the creditor with a security right in movable property could claim it from any person in possession thereof.<sup>238</sup>

Through the reception of Roman-Dutch law as applied in the provinces of Holland, the *hypotheca* was applied in the European agricultural community at the Cape. This form of security was referred to as a ‘general bond’ and it burdened all the movable and immovable property of the debtor. It took the form of a single document which vested *hypotheca* over movable and immovable property. In 1886 and 1896 the Cape legislature attempted, without success, to abolish general bonds (‘general mortgages’).<sup>239</sup>

Between 1916 and 1993 a series of legislative measures and an Appellate Division judgment resulted in fundamental changes to common-law notarial bonds in South African law. I now discuss these in the following order: Insolvency Acts 1916 and 1936; Natal Bond (Natal) Act, 1932; Deeds Registry Act, 1937; *Cooper v Die Meester*<sup>240</sup> 1992; and the Security by Means of Movable Property Act, 1993.

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236 Sacks 1982 SALJ 606.

237 *Ibid.*

238 *Id* at 606-07.

239 *Id* at 607.

240 1992 3 SA 60 (A).

### 5.2.3 Relevant legislation and case law

#### 5.2.3.1 Insolvency Act 32 of 1916<sup>241</sup>

Developments in the South African insolvency law eventually changed the legal position of the general notarial bond.<sup>242</sup> Before the enactment of the 1916 Insolvency Act,<sup>243</sup> a general clause in a general notarial bond created a general bond over all the debtor's property. In the event of two or more creditors with a general bond, the principle *qui prior est tempore potior est jure* applied: the earlier bond (right) enjoyed preference (was stronger in law) over later bond/s. The bondholder was not required to perfect his bond – he enjoyed a preferential right over other creditors for the value of the mortgaged property in possession of the debtor (or the trustee of his insolvent estate).<sup>244</sup>

In terms of the section 87 of the 1916 Insolvency Act general bonds registered after the enactment of the Act had no operation as regards the proceeds of immovable property.<sup>245</sup> A bond specifically describing certain movable property (special bond) without delivery to the creditor (bondholder) conferred a preference in respect of the movables specially described in the special bond upon their realisation by the trustee in insolvency.<sup>246</sup>

Section 86 of the 1936 Insolvency Act<sup>247</sup> preserved the abolition of any preference in respect of immovable property conferred by a general mortgage bond:

No general mortgage bond registered after the thirty-first day of December, 1916, shall confer any preference in respect of immovable property, and no general clause in a mortgage bond hypothecating immovable property registered after the said date shall confer any preference in respect of any property ...

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241 In 1916 the Parliament of the Union of South Africa repealed all the statutes which applied in the four provinces and enacted the Insolvency Act 32 of 1916. This was replaced by the current Insolvency Act 24 of 1936 which has been amended on a number of occasions.

242 See Steyn *Statutory Regulation* 52-9 for a comprehensive analysis of the development of insolvency law in South Africa.

243 32 of 1916.

244 See *Cooper v Die Meester* 1992 3 SA 60 AD 71G-H.

245 Bertelsmann et al *Law of Insolvency* 343.

246 *Id* at 344.

247 24 of 1916.

A distinction was drawn between secured creditors and preferential creditors.<sup>248</sup> Section 102 granted preference to a general notarial bondholder:

Thereafter any balance of the free residue shall be applied in the payment of any claims proved against the estate in question which were secured by a general mortgage bond, in their order of preference [...]

This preference was granted to the bondholder irrespective of whether or not the bond had been perfected. It should be noted that the preference granted to the notarial bondholder was limited to the value of the mortgaged property over which the notarial bond extended. If the claim exceeded the value of the mortgaged property, the notarial bondholder had an unsecured claim (with no preference) in the free residue<sup>249</sup> of the insolvent estate for the outstanding amount.

#### 5.2.3.2 Natal Bond (Natal) Act 18 of 1932

In 1932 the Natal Bond (Natal) Act<sup>250</sup> came into operation in the South African province of Natal. The Natal Act provided as follows:

This Act shall apply only to movables situate within the Province of Natal and shall apply to a notarial bond only in so far as such bond hypothecates movables specially described and enumerated therein: Provided that such bond is passed by a person (hereinafter referred to as "mortgagor") and registered in the deeds registry in Pietermaritzburg at a time when no other notarial bond generally hypothecating such mortgagor's movables is registered in such deeds registry: Provided further that notwithstanding anything to the contrary in any law, usage or custom, no notarial bond shall have the force or effect of a pledge on movables without delivery thereof by the debtor and taking and keeping in possession by the creditor unless it has been passed and registered as aforesaid.<sup>251</sup>

This section speaks to the security object, the vesting of the rights, and their operation:

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248 See the discussion in 3.4 above.

249 See s 103(1) of Act 24 of 1936.

250 Act 18 of 1932. See also *Milne No and Du Preez No v Diana Shoe and Glove Factory (Pty) Ltd* 1957 (3) SA 16 (W).

251 S 1(1) of the Natal Act as quoted in Sacks 1992 SALJ 608-09.

(a) The security object is: (i) movables within Natal Province; which are (ii) specially described and enumerated in the bond.

(b) The right vests when: (i) the bond is passed by the mortgagor; (ii) registered in the Pietermaritzburg Deeds Registry; and (iii) the security object is not subject to any other general notarial bond registered in the deeds registry.

(c) The right *operates* as a pledge over movables provided (a) and (b) have been complied with.

From the above it is clear that the Natal Act did not apply to general notarial bonds. The Act did not provide for the registration of general notarial bonds and any registered general notarial bond was governed solely by common law and the Deeds Registry Act.<sup>252</sup>

It is necessary to examine the operation of a notarial bond in terms of the Natal Act more closely. Sacks<sup>253</sup> notes that the most significant effects are not found in the provisions of the Natal Act, but in the operation of the Insolvency Act. Section 4 of the Natal Act provides:

The movables specially hypothecated by a notarial bond shall not form part of the free residue (as expressed and defined in any law relating to the sequestration or assignment of estates) of the mortgagor's insolvent or assigned estate but shall nevertheless be realized by the mortgagor's trustee or assignee and the proceeds derived from such realization shall be dealt with in the same manner as if they were the proceeds of a special bond hypothecating immovable property, save that the landlord's hypothec shall to the extent set forth in section 86 of the Insolvency Act, 1916, or any amendment thereof, rank in priority to the hypothec of the holder of the notarial bond.

The Insolvency Act 1936 defined security as

movable property of that estate over which the creditor has a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention.

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252 47 of 1937.

253 Sacks 1992 SALJ 609.

A special mortgage is defined as

a mortgage bond hypothecating any immovable property or a notarial mortgage bond hypothecating specially described movable property in terms of section 1 of the Notarial Bonds (Natal) Act, 1932 (Act No 18 of 1932), but excludes any other mortgage bond hypothecating movable property.

Sacks<sup>254</sup> points out that a special notarial bondholder in Natal had a 'security' based on two foundations. Firstly, as the holder of a 'security' as described in the Insolvency Act ('Natal bondholder per se'). Secondly, as 'a pledgee in law' as provided for in section 1(1) of the Natal Act.

General notarial bonds in Natal, and all notarial bonds in the other South African provinces, were governed by the common law and the Deeds Registry Act,<sup>255</sup> and granted limited preference to the creditor's claim on the insolvency of the debtor.<sup>256</sup>

#### 5.2.3.3 Deeds Registry Act 47 of 1937

The Deeds Registry Act was enacted in 1937, six years after the enactment of the Natal Act and one year after the enactment of the 1936 Insolvency Act. Section 102 defines a notarial bond as 'a bond attested by a notary public hypothecating movable property generally or specifically'.

Section 3(j) makes provision for the registration of notarial bonds:

- (1) The registrar shall, subject to the provisions of this Act -
  - (j) register notarial bonds, and cancellations and cessions thereof (including cessions made as security) and cancellations of such cessions if made as security;

Section 53(1) excludes the registration of a general clause in a mortgage bond and therefore proscribes the registration of a general notarial bond over all the property, movable and immovable, of the debtor. It explicitly prohibits the registration of a notarial bond over immovable property:

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254 *Id* at 610.

255 47 of 1937.

256 Brits 2015 SA *Merc LJ* 246-74.

Save as provided in any other law the registrar shall not attest any mortgage bond which purports to bind movable property or which contains the clause, commonly known as the general clause, purporting to bind generally all the immovable or movable property of the debtor or both and shall not register any notarial bond which purports to bind immovable property.

The requirements for the registration of a notarial bond are dealt with in sections 61 and 62. In short, a notarial bond must be registered within three months of the date of its execution. This period may be extended by a court. The notarial bond must disclose the place and date of execution and the place where the notary practices. Furthermore it must disclose the place where the debtor resides and the place where he carries on business (if any). Section 62 prescribes where the notarial bond is to be registered

(1) ... every notarial bond shall be registered in the deeds registry for the area in which the debtor resides and carries on business, or if he resides and carries on business in areas served by different deeds registries, in the deeds registry for the area in which he resides and in every deeds registry serving any area in which he carries on business: Provided that notarial bonds passed in Natal in pursuance of the Notarial Bonds (Natal) Act, 1932 (Act No. 18 of 1932), irrespective of whether the debtor resides or carries on business in Natal, shall be sufficiently registered for the purposes of this Act if registered in the deeds registry at Pietermaritzburg.

(2) Registration of a notarial bond in accordance with the provisions of subsection (1) shall be effective as registration for the whole Republic.

It is clear from the above that there is no distinction between the registration requirements for general and special notarial bonds. The Deeds Registry Act does not speak to the legal operation of notarial bonds. The provisions of sections 61 and 62 determine when a notarial bond is registered, and in terms of the Natal Act and the SMPA, a registered special notarial bond vests a real security right. The fulfilment of the requirements in sections 61 and 62, together with the provisions of the Natal

Act or the SMPA, vest a real security right in favour of the holder of a special notarial bond.

Before the enactment of the SMPA the Appellate Division delivered judgment in a case that dealt with all of the above: the Insolvency Act, the Natal Act, and the Deeds Registry Act. I now discuss this case and the criticism levelled at the judgment.

#### 5.2.3.4 *Cooper v Die Meester*<sup>257</sup>

In 1985 a debtor, Aldrich, registered a notarial bond over specified movable property in favour of one of his creditors, Sentraalwes. The notarial bond secured a debt of R150 000 owed by him to Sentraalwes and was registered in the Bloemfontein Deeds Office. At no point did Sentraalwes acquire control of the specified movables. In 1987 Aldrich was sequestrated and the proceeds of the specified movable property totalled R138 895. Sentraalwes proved an outstanding claim of R148 128 against the insolvent estate. Cooper, the trustee of the insolvent estate, acknowledged Sentraalwes's claim but regarded it as an unsecured non-preferential claim. As concurrent creditor, Sentraalwes was awarded R6 540 from the free residue of the insolvent estate. Trustbank, another creditor of Aldrich's insolvent estate, had a claim against the insolvent estate secured by a general notarial bond. Trustbank was favoured by Cooper's decision: as the holder of a general notarial bond it had a preferential claim over concurrent creditors. Sentraalwes appealed Cooper's decision. The Master of the High Court relied on *Vrede Koöp Landboumaatskappy Bpk v Uys*<sup>258</sup> and held that Sentraalwes had a preferential claim against the insolvent estate. Cooper approached the Orange Free State Provincial Division for a declaratory order affirming that Sentraalwes's claim was not preferential.

In the Free State Provincial Division Olivier J held that the general bond ('*algemene verband*') referred to in section 102 of the Insolvency Act includes a special bond ('*spesiale verband*'). Special bonds, consequently, enjoy the same preference as provided for in section 102. Furthermore, Olivier J held that a claim secured by a special notarial bond over specified movable property enjoys preference over claims of other concurrent creditors in terms of the common law. He referred to *Vrede Koöp*

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257 1992 3 SA 60 (A).

258 1964 2 SA 283 (O).

*Landboumaatskappy Bpk v Uys*<sup>259</sup> as authority for the statement that the common law granted a preferential claim to the holder of a special bond. According to Olivier J, section 86 of the 1936 Insolvency Act abolished the preference that a general notarial bond over immovable property enjoyed over other creditors. However, the 1936 Insolvency Act did, according to the judge, not abolish the common-law preference of a special notarial bond over concurrent creditors. He therefore held that Sentraalwes's claim (secured by the special notarial bond) was preferential.

Cooper took this decision on appeal to the Appellate Division. Joubert JA formulated the legal question:

The legal question ... is whether Sentraalwes as mortgagee of a registered notarial bond on certain movable things that remained in the possession of the mortgagor, Aldrich, until his sequestration, had any preference or priority over other concurrent creditors in respect of the free residue that is made up of proceeds of the mortgaged movable properties. [My translation.]<sup>260</sup>

Referring to Roman and Roman-Dutch law, Joubert JA stated that creditors may be divided into four groups. The first group consists of creditors with death-related claims, including a funeral undertaker's claim and claims for medical expenses. The second group consists of creditors with preferential mortgages, including claims secured by special mortgage bonds over immovable property. The third group consists of creditors with non-preferential mortgages, including the tacit hypothec of a landlord. The fourth group consists of creditors with unsecured non-preferential personal claims. The order of preference of claims to the proceeds of the realised security objects<sup>261</sup> is as follows: The first group of creditors enjoys preference over the second, third and fourth groups. The second group of creditors enjoys preference over the third and fourth group. The third group enjoys preference over the fourth group. The preference referred to in this regard refers to the preferential claims on

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259 1964 2 SA 283 (O).

260 69E-F: 'Die regspraak ... is of Sentraalwes as verbandhouer van 'n geregistreerde notariële verband oor bepaalde roerende sake wat in die besit van die verbandgewer Aldrich gebly het totdat sy boedel gesekwestreer is, enige preferensie of voorrang het bo ander konkurrente skuldeisers ten opsigte van die opbrengs van die te gelde gemaakte beswaarde roerende sake wat die vrye oorskot uitmaak.'

261 At para 73 the court refers to the 'opbrengs van die tegeldgemaakte beswaarde saak'.

the proceeds of the realised security object. If there is more than one creditor in a group, preference is awarded in accordance with the *prior in tempore* rule.<sup>262</sup>

The judge studied the relevant provisions of the 1936 Insolvency Act and drew a clear distinction between: (i) proceeds of *securities*; and (ii) proceeds of *non-securities* which make up the free residue of the estate.

#### (i) Securities

This is property subject to the following secured claims: landlord's tacit hypothec; a special mortgage bond; a pledge; and a lien. The creditor's claim must be satisfied from the proceeds of the specific property, for example the landlord's claim must be satisfied from the proceeds of the lessor's *invecta et illata*. Any surplus proceeds from the realisation of the securities will fall in the free residue of the estate.

#### (ii) Non-securities

The Insolvency Act, sections 96-102, accords unsecured creditors preference over the free residue of the insolvent estate in the following order: funeral and death costs (section 96(1)); sequestration costs (section 97(1)); execution costs (section 98(1)); statutory liabilities (section 99(1)); salaries and wages of employees (section 100(1)(a)); personal income and profit taxes (section 101); claims secured by a general bond (section 102); and concurrent unsecured creditors with non-preferent claims (section 103) rank after unsecured creditors listed in sections 96-102.

A special notarial bond is not listed under securities or non-securities as provided for in sections 96-102 of the Insolvency Act. The court held that sections 96-102 contain an exhaustive list of statutory preferences. Special notarial bonds are excluded from this list and consequently a claim secured by a special notarial bond is not a preferential claim.

The ensuing question was whether Olivier J's conclusion that a 'general bond' in section 102 includes a 'special bond' was correct. According to the Joubert JA, the legislature did not make provision for 'special bonds' as it did for 'general bonds' and the other preferential claims specifically described in sections 96-101. It therefore did

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262 73F-I.

not have the intention to grant preference to special bonds and it would be wrong to assume that section 102 'general bonds' include 'special bonds'. Joubert JA also rejected the view of Olivier J that the common law grants preference to the holder of a special bond.<sup>263</sup> Consequently Joubert JA held that Sentraalwes had no preferential claim against the insolvent estate and ranked equally with concurrent creditors. Sentraalwes was only entitled to R6 540 of the free residue.

The case changed the whole spectrum on the issue of insolvency by rejecting the assumed legal principle that a special notarial bond afforded the creditor a preferential claim to the free residue of the debtor's insolvent estate in the same way a general notarial bond did.<sup>264</sup>

The *Cooper*-case evoked considerable academic criticism<sup>265</sup> which I highlight briefly in what follows.

Scott<sup>266</sup> raises serious concerns about the impact of the *Cooper* case on the business and credit world. Credit grantors who have gone to the trouble of specifically describing certain movable property in notarial bonds, have no secured right and all costs incurred in the registration of these special notarial bonds have been wasted. In her view the common law granted preference over concurrent creditors to the holder of a bond registered over specified movable property which is not in his control. The 1936 Insolvency Act did not explicitly abolish this preference. Her criticism focuses on the purpose of the law, the functioning of the courts, and aspects of Joubert JA's interpretation of the common law.

Sonnekus<sup>267</sup> concerns are similar to those of Scott. He also criticises the judgment on its analysis of the common law. Sonnekus<sup>268</sup> provides a thorough discussion of the development of general and special mortgages and other preferential rights in Roman law, Roman-Dutch law, and Germanic law. He refers to section 13 of the *Politieke Ordinansie* which clearly stated that the *prior in tempore* rule is the only

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263 Olivier J relied on *Vrede Koöp Landboumaatskappy Bpk v Uys* 1964 (2) SA 283 (O). Consequently, *Cooper v Die Meester* rejected the decision in *Vrede Koöp Landboumaatskappy Bpk*.

264 Scott 1992 *De Jure* 496-9; *Sentraalwes (Koöp) Bpk v Die Meester* 1992 (3) SA 86 (A). See *Vrede Koöp Landboumaatskappy Bpk v Uys* 1964 (2) SA 283 (O).

265 See Fevrier-Breed 1993 *THRHR* 144-9; Sonnekus 1993 *TSAR* 110-38.

266 Scott 1992 *De Jure* 498.

267 Sonnekus 1993 *TSAR* 114.

268 *Id* at 121-7.

ground for preference in the case of competing general and special notarial bonds. He further emphasises the fact that the holder of both a general and special notarial bond has only a preferential claim over other concurrent creditors – it is not a secured claim. In order to acquire a secured claim there must be some form of publication, and, before the enactment of the SMPA, registration of both a general and a special notarial bond (with the exception of the legal position in Natal) was not regarded as publication. Only after perfecting the bond did the holder acquire a secured preferential claim.

Van der Spuy<sup>269</sup> criticises Joubert JA's judgment on the basis of his examination of the legislature's intention that 'general bonds' do not include 'special bonds'. According to Van der Spuy, the judge's reference to the Natal judgment *In re Insolvent Estate Carter*<sup>270</sup> is inappropriate in that Natal had a unique legal framework and legislation governing the operation of notarial bonds. He points out that it is inequitable that preferential rights can be given to a special notarial bondholder within the jurisdiction of Natal, but not to special notarial bondholders outside the jurisdiction of Natal. For purposes of this discussion it suffices to say that the judgment placed holders of special notarial bonds in an unfavourable position.

The SMPA changed this unsatisfactory legal position. Section 1(3) of the Act provides that a special notarial bondholder of specified and described movable property, whose bond was registered before the commencement of the Act, enjoys the same preference in respect of the entire free residue of the debtor's estate as that enjoyed by the general notarial bondholder. The decision in *Cooper* case continues to apply to unregistered special notarial bonds created after the commencement of the Act.

#### 5.2.3.5 Security by Means of Movable Property Act (SMPA)

In 1993 the Security by Means of Movable Property Act 57 of 1993 came into operation. This Act applies only to special notarial bonds and not to general notarial bonds, and only to corporeal movables and not to incorporeal movables. The most significant consequence of the Act is the distinction between special and general notarial bonds as regards the protection enjoyed by holders on the insolvency of the

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269 Van der Spuy 1992 *De Jure* 371.  
270 1923 NPD 248.

debtor. In terms of the SMPA, the holder of a special notarial bond is a secured creditor whether or not the special bond has been perfected. But the holder of a general notarial bond is not a secured creditor unless he has perfected the bonds.

As the SMPA applies only to special notarial bonds, it is dealt with comprehensively in the following chapter.

#### **5.2.4 Summary**

General notarial bonds have been acknowledged in South African law since 1880. South African legislation first provided for notarial bonds in 1916. The Insolvency Acts (1916 and 1938), the Notarial Bond (Natal) Act (1932), the Deeds Registry Act (1937), and the SMPA (1993) provided/provide rules for the operation of notarial bonds. A turning point in the law governing notarial bonds came in 1993 after the *Cooper* case. This case placed special unperfected notarial bonds in a weaker position than general unperfected notarial bonds and special notarial bonds registered in Natal. The SMPA is a result of this case and of the Law Commission's Project 46 (1987).

I turn now to the nature and operation of general notarial bonds.

### **5.3 General notarial bonds**

#### **5.3.1 Introduction**

It is important to note that neither the SMPA nor the Natal Bond (Natal) Act applies to general notarial bonds. The legal nature of general notarial bonds, therefore, subsists even after the commencement of the SMPA.<sup>271</sup> Despite registration in the Deeds Registry, a general notarial bondholder acquires only a personal right over the property that serves as security. Third parties and potential creditors or purchasers are not bound by this bond. The real security right vests when the bondholder obtains physical control of the property through a valid and enforceable perfecting clause. Once he has perfected the bond, the creditor is in the same position as a pledgee who is in control of the pledged object.<sup>272</sup>

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271 Scott 1995 *THRHR* 673.

272 Mostert & Pope *Property Law* 322. See chapter 4 above for a discussion on pledge.

### **5.3.2 Legal nature**

A general notarial bondholder acquires a personal right over all the debtor's movable property – including movable property acquired by the debtor after registration of the notarial bond. If the bond has not been perfected, the bondholder acquires no real right to the movable property.<sup>273</sup>

### **5.3.3 Security object**

A general notarial bond, governed by the common law and the Deeds Registry Act, is registered over all the movable property, corporeal or incorporeal, owned by the debtor.<sup>274</sup> This includes movables acquired after the execution of the bond.<sup>275</sup> Movables that may be used as security for purposes of notarial bonds include: normal corporeal movable property (eg vehicle or machinery); a registered contract of lease (incorporeal); and a liquor licence. In terms of legislation<sup>276</sup> aircraft and ships may not be mortgaged as security for the discharge of an obligation under a notarial bond. Crops, both existing and future, that have not been harvested cannot be mortgaged by notarial bond as they are classified as immovable property.<sup>277</sup>

### **5.3.4 Legal operation**

A general notarial bond is created by means of a principal debt followed by the conclusion of a security agreement between the debtor and the creditor, or even the debtor and a third party, in terms of which a debtor agrees to provide security for the repayment of the principal debt. However, no real right to the movable property is created without a further legal act: the perfecting of the bond.

A distinction should be drawn between the position before insolvency and the position after insolvency of the debtor.

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273 *Chesterfin (Pty) Ltd v Contract Forwarding (Pty) Ltd* 2003 (2) SA 253 (SCA) par 3.

274 Kleyn & Boraine *Law of Property* 385.

275 Mostert & Pope *Property Law* 322.

276 Art 3(1) of the Convention on the International Recognition of Rights in Aircraft 59 of 1993 and items 9 to 11 of Schedule 1 to the Ships Registration Act 58 of 1998.

277 West A "What may Serve" *Ghost Digest* 30 September 2010 available at <http://www.ghostdigest.com/articles/what-may-serve/53777> (date of use: 14 April 2016).

(i) Before insolvency

In order for a general notarial bondholder to acquire a real security right in the movable property that serves as security, the bond must include a valid and enforceable perfecting clause.<sup>278</sup> The perfecting of a bond refers to the moment at which a real security right arises.<sup>279</sup> The perfecting clause allows the creditor to claim control of the defaulting debtor's movable property. The creditor acquires control over the property with the consent of the debtor who delivered the thing to the creditor. If the debtor refuses to deliver the thing to the creditor the latter can apply for a court order ordering specific performance of the perfecting clause in the bond.<sup>280</sup> The court has a discretion whether or not to grant specific performance. A notarial bondholder who waits to perfect his bond until just before the sequestration of the debtor, might be limited by section 30<sup>281</sup> of the 1936 Insolvency Act – undue preference to creditors.<sup>282</sup>

According to Sonnekus,<sup>283</sup> the creditor acquires a right of pledge once the bond is perfected and he secures physical control of the thing. The creditor's status as pledgee does not arise from the perfecting clause in the bond, but from his compliance with all the requirements for the vesting of a real security right (pledge). The perfecting clause is a mechanism by which to acquire the physical control over the secured object required for vesting a right of pledge.

Academic opinion differs as to the correctness of the assumption that a notarial bondholder is in the same position as a pledgee upon the perfecting of his security right. Van der Walt<sup>284</sup> is of the view that a notarial bondholder is in a stronger position

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278 Jansen 2003 *Juta's Business Law* 155. See also *Barclays National Bank Ltd and Another v Natal Fire Extinguishers Manufacturing Co (Pty) Ltd and Others* 1982 (4) SA 650 (D).

279 Scott 1995 *THRHR* 675.

280 *LAWSA* 17(2) 512.

281 'If a debtor made a disposition of his property at a time when his liabilities exceeded his assets, with the intention of preferring one of his creditors above another, and his estate is thereafter sequestered, the court may set aside the disposition.' Section 2 of the Act defines 'disposition' as: "means any transfer or abandonment of rights to property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract therefor, but does not include a disposition in compliance with an order of the court; and "dispose" has a corresponding meaning...". Clearly a notarial bondholder who perfects his bond and thus acquires a pledge over the movables, falls within the definition of 'disposition'. See Sonnekus 2002 *SALJ* 567, 569.

282 *Id* at 568.

283 *Ibid*.

284 Van der Walt 1983 *THRHR* 334.

than a pledgee because of the protection he enjoys without having control over the movable property, whereas a pledgee's real security right terminates should he lose control of the property. In terms of Van der Walt's argument, a notarial bondholder, unlike a pledgee, does not lose his real security right when he loses control over the movable property. When a notarial bondholder loses control of the movable property, he loses his right of pledge but can still rely on his position as a notarial bondholder. The ordinary pledgee also loses his right of pledge when he loses control over the movable property, but has no other form of security (for example, registration in the case of a special notarial bondholder) on which to rely. Van der Walt's argument is based on the way in which an ordinary pledge and the notarial bondholder's pledge are constituted.

(ii) Insolvency of the debtor

In the case of the insolvency of debtor, the bondholder enjoys a right of preference in the free residue of the insolvent estate, over the debtor's other concurrent creditors<sup>285</sup> This preference extends to all the movables owned by the debtor at the time of sequestration. The general notarial bondholder can only become a secured creditor once the bond has been perfected.<sup>286</sup> It is generally accepted that before the perfecting of the bond, the general notarial bondholder enjoys preference only against unsecured creditors.<sup>287</sup> The perfecting of the bond after insolvency is not possible in the light of section 20 of the Insolvency Act.<sup>288</sup> The effect of the sequestration of the insolvent estate is to divest the insolvent of his estate and to vest it in the Master until a trustee has been appointed, at which point the insolvent estate will vest in the trustee.<sup>289</sup>

There may also be several registered notarial bonds none of which has been perfected. In this case the *prior tempore potior iure* rule (first in time, first in law) applies.<sup>290</sup> In terms of this rule the bond that was registered earlier is preferred to the

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285 S 102 of the Insolvency Act 24 of 1936.

286 Jansen 2003 *Juta's Business Law* 155. See also *Cooper v Die Meester* (1992) 3 SA 60 AD 71G-H.

287 Scott 1981 *De Jure* 144.

288 24 of 1936.

289 Evans 2014 *PELJ* 2746.

290 *Contract Forwarding v Chesterfin* [2003] 1 All SA 267 (SCA) 259.

one registered later.<sup>291</sup> If one of the general notarial bondholders has perfected his bond before the debtor's insolvency, he has a real right to the movables that are in his physical control. He is therefore in the same position as a pledgee and his real right therefore enjoys preference over those of other general notarial bondholders. An unperfected registered general notarial bond gives rise to a personal right which is only enforceable amongst the parties to the agreement. Therefore, the registration of a general notarial bond short of perfecting, has no meaningful effect on the bond. However, failure to register a general notarial bond affects its validity as a notarial bond and can nullify the security right. Section 102 of the Insolvency Act gives the creditor preference in respect of the free residue of the debtor's estate.

### **5.3.5 Summary**

A general notarial bond, which applies to all movable property, both corporeal and incorporeal, in the debtor's possession, is regulated by the common law and the Deeds Registries Act. Neither the SMPA nor the Natal Bond (Natal) Act applies to this bond. In order for the general notarial bondholder to acquire a real security right in the property, a valid and an enforceable perfecting clause must be included in the bond. Perfecting of the bond allows the debtor to take physical control of the property of the defaulting debtor and he therefore becomes a secured creditor. Upon the debtor's insolvency and before the perfecting of the bond, section 102 of the Insolvency Act provides that the bondholder enjoys a right of preference only over the debtor's other concurrent creditors as regards the free residue of the insolvent estate. In the case of several registered general notarial bonds the *prior tempore potior iure* rule applies. The bondholder becomes a secured creditor once the bond has been perfected and is, therefore, in the same position as a pledgee.

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291 Van der Walt & Pienaar *Introduction to Property* 296. See also Jansen 2003 *Business Law* 406-97.

## CHAPTER 6

### SPECIAL NOTARIAL BONDS

#### 6.1 Introduction

A special notarial bond burdens specifically described movable property belonging to the debtor.<sup>292</sup> In 1993 the Security by Means of Movable Property Act 57 of 1993 came into operation. The SMPA changed the legal position of special notarial bondholders. The ensuing discussion of the legal position of notarial bonds in South African law distinguishes between the legal position before the enactment of the SMPA (ie pre-1993), and the position after its enactment (ie post-1993).

#### 6.2 Legal position pre-1993

##### 6.2.1 Introduction

A principal debt and a security agreement were required for the creation of a special notarial bond. However, the holder of a special notarial bond acquired no real right over the movable property that served as security. In order for a special notarial bondholder to acquire a limited real right (other than a special notarial bond in Natal which was regulated by the provisions of the Notarial Bond (Natal) Act),<sup>293</sup> a valid and an enforceable perfecting clause<sup>294</sup> had to be included in the bond. The bondholder could only acquire a limited real right upon delivery of the movable property that served as security.<sup>295</sup> A distinction should be drawn between the legal position before insolvency and the legal position after insolvency.

##### 6.2.2 Before insolvency

The holder of a special notarial bond had no security right. He had to obtain physical control of the movable property in order to acquire a real security right in the property. This was done by perfecting the bond in terms of a valid and enforceable perfecting

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292 Scott 1995 *THRHR* 675.

293 18 of 1932. See the discussion in 2.4.1.1 above regarding the application of the Act.

294 For the creditor to acquire physical control of the movable property in terms of the perfecting clause, either the debtor can give control of the thing to the creditor, or the creditor can obtain a court order compelling the debtor to give him control of the thing. See Fevrier-Breed 1993 *THRHR* 146. See 5.3.4(i) above for a comprehensive discussion of a perfecting clause.

295 Sonnekus 1983 *TSAR* 252-3.

clause in the bond. Once he had acquired physical control of the movable property, the special notarial bondholder was treated as a pledgee.<sup>296</sup>

In Natal (s 2 of the Natal Act) corporeal and incorporeal movables that had been specifically described in a notarial bond, were regarded as having been delivered to the bondholder who acquired a pledge over the movables. The bondholder acquired a right of pledge without ever obtaining physical control. All movables subject to the special notarial bond were immune from attachment in execution. This special notarial bond ranked below the tacit hypothec of a landlord (s 4 of the Natal Act). A special notarial bondholder in Natal did not have to perfect his bond in order to obtain a right of pledge.<sup>297</sup>

### **6.2.3 After insolvency**

Before the commencement of the SMPA, the issue of notarial bonds in the case of insolvency was, to a large extent, uncertain. There was a fragmentation of laws governing special notarial bonds: the Natal Act<sup>298</sup> (granting real security right to the creditor/bondholder) applicable only in Natal; and the Deeds Registry Act (granting no real security right to the creditor/bondholder but merely a preference on the entire free residue of the insolvent estate over concurrent creditors).<sup>299</sup>

In 1982 the South African Law Commission embarked upon an investigation into real security rights over movable property. The final report<sup>300</sup> was published in 1991 and acknowledged the need for a form of security that allows the debtor to remain in control of his thing, while granting a real security right over the thing to the creditor. The Law Commission's proposed Bill introduced two possible forms of security over movable property: (i) unregistered pledge without possession; and (ii) registered pledge without possession. Each of these is briefly considered in what follows.

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296 Sonnekus & Neels *Sakereg Vonnisbundel* 755. See 4.4 above for the legal operation of a pledge.

297 Scott 1995 *THRHR* 673.

298 See 5.2.3.2 above for a comprehensive discussion of the provisions of the Natal Act.

299 Lubbe & Van der Walt 1988 *TSAR* 554.

300 South African Law Commission Report (Project 46) 'The Giving of Security by Means of Movable Property' (1991).

(i) Unregistered pledge without possession<sup>301</sup>

The proposed pledge without possession (clause 1 of the Bill) was discussed in Chapter 4. I repeat the essence here in order to provide a comprehensive overview of the Law Commission's Proposals. This proposed form of security did not require the debtor to give the creditor control over the property. All that was required was a written agreement signed by the parties in which the security object was specified and described. The proposal was that this agreement would have the same legal effect as a pledge – ie it would create a real security right. The unregistered pledge would therefore create a real security right without compliance with the publicity requirement. Should the debtor be declared insolvent, section 83 of the Insolvency Act would apply to the creditor. If the debtor is solvent but in default, the creditor has no preferred right over the debtor's other creditors. Furthermore, if the debtor offers the thing as security to another creditor(s), the first creditor has no right to claim the thing from these creditor(s) and in essence has no security. Sonnekus refers to this as '*mooiweers-sekerheidsregte*' ('fair weather security rights') which means that the rights are effective only if the debtor is still in control of the thing and is declared insolvent. However, if the debtor is no longer in control of the thing and in default, the creditor has no security.<sup>302</sup> The unregistered pledge proposed in clause 1 of the Bill was not included in the SMPA.

(ii) Registered pledge without possession

The second proposed form of security (clause 2 of the Bill) was the nationwide introduction of special notarial bonds over specified movables which would grant the creditor preference over the debtor's other creditors. The creditor has a right of preference as if he is in control of the movable property but is in fact not in control of the property. This form of security is based on the Natal regime. The two requirements for the vesting of a registered pledge are registration of the notarial bond, and the satisfactory description of the movable property. Fulfilment of these two requirements justifies the non-delivery of the movable property.<sup>303</sup> This form of security has been included in the SMPA, and was welcomed by most commentators.

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301 See 4.4.6 above for a discussion on pledge without possession.

302 Sonnekus 1989 *TSAR* 525.

303 Brits 2015 *SA Merc LJ* 250-1 and Sonnekus 1989 *TSAR* 525.

Sonnekus<sup>304</sup> distinguishes between security rights without possession (*'besitlose sekerheidsresgte'*) and security rights without publication (*'publisiteitslose sekerheidsregte'*). In my opinion, section 1 of the Bill amounts to security without publicity, whereas section 2 (special notarial bonds in the SMPA) amounts to security without possession. Possession is a means to an end, namely publicity. It is not an end in itself and can therefore be replaced by registration which would then be the means to the end, namely publicity.

As mentioned previously, in *Cooper v Die Meester*<sup>305</sup> the Appellate Division delivered a judgment that led to considerable confusion until the enactment of the SMPA. The judgment emphasised the urgent need for legislation to give legal certainty regarding special notarial bonds and their legal effect. The *Cooper*-case is discussed in 5.2.3.4 above. In short: the court held that a special unperfected notarial bond gave no preference over the claims of other concurrent creditors, and consequently ranked below a general notarial bond (bonds). The court did not acknowledge the common-law preference granted to special mortgages and relied solely on the provisions of sections 96-102 of the 1936 Insolvency Act. The decision resulted in an unequal legal position for special notarial bondholders in Natal as opposed to special notarial bondholders in the other provinces.

The SMPA changed the unsatisfactory legal position established by the *Cooper*-case. However, the decision in the *Cooper*-case continues to govern unregistered special notarial bonds created after the commencement of the Act.

I turn now to an examination of the provisions of the SMPA, relevant case law, and academic opinion, on the nature and operation of special notarial bonds under the SMPA.

## **6.3 Legal position after 1993**

### **6.3.1 Introduction**

The SMPA came into operation on 7 May 1993. The preamble to the Act reads as follows:

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304 Sonnekus 1989 *TSAR* 546 and 549.  
305 1992 3 SA 60 (A).

To regulate the legal consequences of the registration of a notarial bond over specified movable property; to exclude the operation of the landlord's tacit hypothec in respect of certain movable property; to repeal the Notarial Bonds (Natal) Act, 1932; to adjust another law in consequence of such repeal; and to provide for matters connected therewith.

The Act consists of only six sections. I quote the relevant sections below before embarking upon a comprehensive analysis of special notarial bonds created in the SMPA. In analysing the Act, I first consider the vesting requirements as prescribed in the SMPA and then the legal position of a special notarial bondholder with reference to the nature and operation of the right under the SMPA.

The Act reads as follows:

**1. Legal consequences of special notarial bond over movable property**

- (1) If a notarial bond hypothecating corporeal movable property specified and described in the bond in a manner which renders it readily recognizable, is registered after the commencement of this Act in accordance with the Deeds Registries Act, 1937 (Act No. 47 of 1937), such property shall –
  - (a) subject to any encumbrance resting upon it on the date of registration of the bond; and
  - (b) notwithstanding the fact that it has not been delivered to the mortgagee, be deemed to have been pledged to the mortgagee as effectually as if it had expressly been pledged and delivered to the mortgagee.
- (2) Upon the discharge of the debt secured by a bond mentioned in subsection (1) the mortgagee shall, at the request of the mortgagor, furnish to the mortgagor, free of charge, proof of such discharge in the form required for the cancellation of the bond.
- (3) Subject to the provisions of subsection (4) a notarial bond contemplated in subsection (1) other than a notarial bond contemplated in section 1 of the Notarial Bonds (Natal) Act, 1932 (Act No. 18 of 1932), which was registered before the

commencement of this Act shall, upon the insolvency of the mortgagor before or after such commencement, confer on the mortgagee the same preference in respect of the entire free residue of the insolvent estate as that conferred on a mortgagee by a general bond in terms of section 102 of the Insolvency Act, 1936 (Act No. 24 of 1936).

- (4) The provisions of subsection (3) shall not apply if any part of such free residue was, before the commencement of this Act, paid out to concurrent creditors in terms of a confirmed account.
- (5) If, at the commencement of this Act, an account has been confirmed but dividends have not yet been paid out as contemplated in subsection (4), such account shall be reopened so as to give effect to the provisions of subsection (3) without obtaining the permission of the court in terms of section 112 of the Insolvency Act, 1936.

## **2. Exclusion of landlord's tacit hypothec**

- (1) Notwithstanding anything to the contrary in the common law or in any other law, movable property –
  - (a) which, while hypothecated by a notarial bond mentioned in section 1(1), is in the possession of a person other than the mortgagee; or
  - (b) to which an instalment agreement as defined in section 1 of the National Credit Act, 2005, relates, (*Section 2(b) substituted by section 172 of Act 34 of 2005*) shall not be subject to a landlord's tacit hypothec.
- (2) The provisions of subsection (1) in respect of movable property hypothecated by a notarial bond mentioned in section 1(1) shall not apply if such bond is registered after the landlord's hypothec has been perfected.

## **3. Repeal of Act 18 of 1932**

The Notarial Bonds (Natal) Act, 1932 (Act No. 18 of 1932), is hereby repealed.<sup>306</sup>

4. **Amendment of section 2 of Act 24 of 1936, as amended by section 2 of Act 16 of 1943, section 1 of Act 6 of 1972 and section 1 of Act 27 of 1987**

Section 2 of the Insolvency Act, 1936, is hereby amended by the substitution for the definition of "special mortgage" of the following definition:

"special mortgage" means a mortgage bond hypothecating any immovable property or a notarial mortgage bond hypothecating specially described movable property in terms of section 1 of the **[Notarial Bonds (Natal) Act, 1932 (Act No. 18 of 1932)]** Security by Means of Movable Property Act, 1993, but excludes any other mortgage bond hypothecating movable property;.

### **6.3.2 Vesting**

The SMPA created what is termed a 'fictitious pledge'. Section 1(1) of the SMPA provides that corporeal movable property, if specified and described in a way that renders it readily recognisable, is deemed to have been pledged and delivered as if it has in fact been pledged and delivered.<sup>307</sup> This right is often referred to as a fictitious pledge. The right vest over the movable property subject to any prior rights resting upon the property (s 1(1)(a)). Section 1(1)(b) of the SMPA provides for the registration of a special notarial bond over defined and specified movables of the debtor without requiring delivery of the movable property from the debtor to the creditor. This 'fictitious pledge' has been criticised by certain academics as a 'very clumsy way of creating a new form of real security'.<sup>308</sup> Others have welcomed the SMPA.<sup>309</sup> In summary, a special notarial bond over movable property vests on its registration, provided that the movable property encumbered is described in the notarial bond in terms that make it readily recognisable.

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306 The Notarial Bond (Natal) Act still applies to special notarial bonds registered in terms of it before the coming into operation of the SMPA.

307 See Locke 2008 *CILSA* 136.

308 Van der Walt, Pienaar & Louw 1994 *THRHR* 619.

309 *Id* at 614.

### 6.3.2.1 Registration

In order to create a real right, *delivery* of the movable property that serves as security is replaced by *registration* in the Deeds Registry. In order for a real security right to enjoy preference in the event of the debtor's insolvency, it must comply with the publicity principle. Negating the publicity principle infringes the basic principles of security and undermines insolvency law.<sup>310</sup> In terms of the SMPA, the special notarial bondholder acquires a real right in the property that serves as security upon registration of the bond in the Deeds Registry. An unregistered notarial bond does not confer any form of security or preference on the special notarial bondholder over that of concurrent creditors of the insolvent estate.<sup>311</sup> Registration of a notarial bond in the Deeds Registry entails that the bond document, setting out the principal debt and describing the movable property that serves as security, must be attested by a notary public and registered in the Deeds Registry within a period of three months after attestation.<sup>312</sup>

Sonnekus and Neels<sup>313</sup> emphasise the fact that the SMPA has not done away with the hassles and limitations attendant upon registration in the Deeds Office. The SMPA does not address this issue and the difficulties and costs of registration consequently still impact negatively on the use of a special notarial bond. Prospective credit grantors will have to search all Deeds Registries in the country to ensure that the movable asset/s offered as security are not already subject to another real security right.

Brits<sup>314</sup> suggest investigating the possibility of a 'more sophisticated and computerised — yet simple, inexpensive and quick — system of publicity for security rights over movables'. He correctly points out that the SMPA was enacted in 1993 and that there have been innumerable technological advances since 1993. Although the registration of land in the Deeds Office is effective and serves as fair publicity, an alternate asset registry for movable property should be considered.

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310 Sonnekus 1993 *TSAR* 111.

311 Locke 2008 *CILSA* 136.

312 S 61 of the Deeds Registries Act 47 of 1937.

313 Sonnekus & Neels *Sakereg Vonnisbundel* 758.

314 Brits 2015 *SA Merc LJ* 272-3.

In principle, the person who registers the notarial bond over the movable property does not have to be the debtor himself. He must, however, have the legal capacity to burden the thing. In *Bokomo v Standard Bank van SA Bpk*<sup>315</sup> Minassian (trading as Rolo Bakery) registered a special notarial bond over movable property (equipment) in favour of Standard Bank for a debt of R115 359. The bond was registered on 26 May 1993 and was subject to the provisions of the SMPA. In terms of the SMPA Standard Bank was in the same legal position as a pledgee who received delivery of the pledged thing. The only qualification was that Standard Bank's right was subject to any real security rights vested over the property before the registration of the special notarial bonds. Minassian bought the equipment from United Bank under an instalment sale agreement. United Bank reserved ownership until payment of the last instalment. On 28 September 1993 Minassian entered into a purchase agreement with Bokomo. On 29 September Minassian paid the final instalment to United Bank and on 30 September ownership was transferred to Bokomo by delivery through *constitutum possessorium*. Minassian hired the equipment from Bokomo and remained in control thereof. Bokomo had never been aware of the special notarial bond registered over the equipment. In September 1994 Standard Bank instituted an action against Minassian for the payment of R198 590 due in terms of a lease agreement. It is not clear whether there was any link between this debt and the debt secured by the special notarial bond. The writ of execution of property to the value of R115 359 did, however, correspond to the movable property (equipment) described in the special notarial bond registered in May 1993. In the magistrate's court Bokomo objected to the attachment of the movable property (equipment) averring that it (Bokomo) was the owner. The objection was denied and Bokomo appealed against the decision. On appeal Standard Bank averred that its right in terms of the special notarial bond was preferential to Bokomo's right as owner. It is clear from the facts that Minassian was not the owner of the equipment when it registered the special notarial bond over the movable property in favour of Standard Bank. However, it did later become the owner and the court held as follows:

On behalf of the respondent the argument was submitted to us that even if Minassian only became owner of the equipment after the notarial bond was registered, such acquisition of ownership by Minassian gave legal effect to the

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315 1996 (4) SA 450 (C) 454.

pledge created by the notarial bond before appellant acquired any rights thereto. In support for the argument reference was made to the following statement in *Wille's Mortgage and Pledge in South Africa* 3rd ed (by Scott and Scott) at 35:

'If a person mortgages the property of another without the latter's consent or authority, and the mortgagor subsequently acquires the *dominium* of the property, the acquisition of the *dominium* has the effect of making the mortgage valid.'

Based on this argument the court held in favour of Standard Bank.

Sonnekus<sup>316</sup> criticises this judgment on the following ground: In order to create a real security right, the person granting the right over the security object must be capable of doing so, either as owner or as a person who has the necessary legal capacity to deal with the thing. As Minaissen had neither, it could not vest a real security right over the equipment and Standard Bank therefore had no real security right (special notarial bond) over the equipment. He refers to Roman law, Roman-Dutch law, and foreign law to substantiate his argument. What is evident from this judgment is that registration of a special notarial bond does not necessarily comply with the publicity principle.

#### 6.3.2.2 *Security object (corporeal movable) described*

The SMPA makes provision only for a special notarial bond over corporeal movable property. In terms of section 1(1) of the Natal Act, a special notarial bond could only be registered over 'movables specially described and enumerated'. Section 1(1) of the SMPA deems corporeal movable property that has been specifically described and is consequently readily recognisable in the bond itself to have been delivered to the notarial bondholder as if delivery had in fact taken place. The test of specifying and describing the movable property as provided for in section 1(1) of the Act, is set out in the *Ikea Trading und Design v BOE Bank*.<sup>317</sup> The test is whether a third party is able to identify the property from the description in the bond itself without recourse to

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316 Sonnekus 1997 TSAR 154.

317 2005 (2) SA 7.

extrinsic evidence.<sup>318</sup> In this case Woodlam Industries CC (Woodlam), a close corporation, registered a special notarial bond in favour of Ikea Trading. This bond was registered in terms of the SMPA. The movable property concerned was listed in a schedule attached to the bond and not specified and described in the bond itself. Woodlam was subsequently declared insolvent. BOE Bank was a creditor of Woodlam and had a general notarial bond registered over Woodlam's movable assets. This general notarial bond was, however, registered in 1991 before the enactment of the SMPA. BOE Bank was therefore not a secured creditor but did have a preferential claim against the free residue of the insolvent estate.<sup>319</sup> The bank challenged the validity of the special notarial bond on the ground that the movable property was not described in a way that rendered it 'readily recognisable'. BOE Bank stated that it was not possible to identify the movable property from the bond itself without having recourse to external evidence such as invoices, other documents, and even the testimony from a former employee familiar with the insolvent's properties. Based on these arguments, the Supreme Court of Appeal held that the special notarial bond was invalid as it did not meet the test set out by the court that:

Third parties must be able to tell, without reference to extrinsic evidence, that the creditor has a right in the property pledged.<sup>320</sup>

Consequently, Ikea Trading was a mere concurrent creditor of the insolvent estate. Woodlam's movable property fell in the free residue of the insolvent estate. In terms of section 102 of the 1936 Insolvency Act, BOE Bank's registered general notarial bond granted it a preferential claim over other concurrent creditors in the free residue of the insolvent estate.

The use of the terms 'specified and described' in the SMPA points to a stricter test than that under the Natal Act which required the property to be 'specially enumerated'.<sup>321</sup> This stricter test, which is applied to determine whether a third party can identify the movable property from the terms of the bond itself without recourse to

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318 See also *Rosenbach and Co (Pty) Ltd v Dalmonte* 1964 2 SA 195 (N) 204G-205A. In this case the court found the description of assets in general terms such as goods, stock-in-trade, merchandise, fittings, furniture and appliances to be insufficient for the specification required by s 1(1) of the Security by Means of Movable Property Act. For a discussion of the test as set out in *Ikea Trading* case see Brits 2015 SA Merc LJ 246.

319 In terms of s 102 of the Insolvency Act 24 of 1936.

320 Para 22.

321 Brits 2015 SA Merc LJ 264.

extrinsic evidence, serves to conform to the principle of publicity. In terms of the Natal Act it was sufficient to 'specially enumerate' the property. The Oxford Dictionary<sup>322</sup> defines enumerate as 'mention one by one' or to 'establish the number of'. It is clear from the *Ikea* judgment that, in terms of the SMPA, the property must be described specifically.

Sonnekus<sup>323</sup> explains that in terms of the Natal Act it was sufficient to say a bond has been registered over a certain number of cans of fish on a shelf. The interpretation of section 1(1) of SMPA in the *Ikea* case is that

[t]he property must be so described that only it, and not other property of a like kind, can be identified as that which is pledged (para 24).

The issue is, therefore, not the number of cans on the shelf, but about the specified description of each can of fish. Instead of physical control by the creditor which indicates to third parties that a right other than ownership exists over the property, the property in the bond must be described in a manner that will indicate with absolute certainty which property is subject to the special notarial bond.

Although Sonnekus welcomes the decision in *Ikea Trading*, he is concerned about the underutilisation of this form of security, and considers the fact that the strict application of the description of the property renders it an expensive form of security.<sup>324</sup> He refers to paragraph 24 of the *Ikea* judgment (quoted above) and comments:

In my view there should be no difficulty in identifying machinery, vehicles, even furniture, that is bonded by reference to labels, numbers or bar codes. [...] each of the assets enumerated could be given an identifying mark referred to in the bond. The third party would then readily be able to recognise the thing from the reference in the bond.

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322 Stevenson & Waite *Concise Oxford English Dictionary* 477.

323 Sonnekus 2005 *De Jure* 135.

324 *Id* at 133-44: "Indien daardie onderbenutting aan die vermybare oorbeklemtoning van duur en omslagtige registrasievereistes te wyte is wat vermy kan word sonder om die aanvanklike oogmerk van voldoende publisiteit te ondergraaf mits dit in samehang met 'n duidelike identifiseringsleutel en behoorlike bateregister gedoen word, behoort die moontlikheid ernstig oorweeg te word."

Referring to the above, he proposes that the thing could be described by using a special mark on the property. The description in the notarial bond must then indicate how the specific couch was marked in order to make it readily recognisable. The mark on the movable property would then have been described in the bond.<sup>325</sup>

The following shows an instance where a special notarial bond would be beneficial, but cannot be registered in terms of the strict application of the description of the thing. A recording label where a company wishes to offer its 'equipment' as security for the repayment of the principal debt. 'Equipment' appears to be a revolving class of assets which does not meet the requirement as provided for in section 1(1) of the SMPA. In principle, a special notarial bond must be registered over each individual piece of equipment. Should some of the equipment be replaced, a new notarial bond would have to be registered over that piece of equipment.<sup>326</sup> This is costly and benefits neither the creditor nor the debtor – only the notary 'scores'. Sonnekus<sup>327</sup> proposes that the property can be determined, and therefore comply with the requirements in section 1(1) of the SMPA, by the use of an assets registry together with a special mark described in the bond.

One could be excused for assuming that the strict application of the description of the thing provides legal certainty and complies with the publicity function. Brits,<sup>328</sup> however, is of the view that the description requirement is relatively unclear and open ended. His view is based on the fact that unlike immovable property, there is no standard uniform manner in which movable property should be described. In some instances it will only be clear whether the description of the movable thing was adequate once the case reaches the court – which is hardly a less desirable state of affairs. It is therefore wise to be conservative in dealing with movables that are used as security under special notarial bonds. Brits agrees with Sonnekus's proposition that there are other ways to describe the movable property. He proposes an amendment to the SMPA to provide a list of methods by which the movable property may be described. I return to this proposition in my final analyses.<sup>329</sup>

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325 *Id* at 137-8.

326 Scott 1995 *THRHR* 672-84, 680-1.

327 Sonnekus 2005 *De Jure* 143.

328 Brits 2015 *SA Merc LJ* 265.

329 See 8.2 below.

### 6.3.2.3 Incorporeal property excluded from the SMPA

A special notarial bond over incorporeal movable property does not enjoy priority over a general notarial bond. The right does not create a real right of security. In order to create a real right of security over a specified incorporeal thing, a perfecting clause must be included in the bond. The bondholder can also acquire a real security right (pledge) if he obtains a court order for the attachment of the incorporeal thing.<sup>330</sup>

According to Scott,<sup>331</sup> the “regrettable decision in the *Cooper* case necessitated the hasty introduction of the SMPA.” The exclusion of incorporeal movable property by the SMPA has a negative impact on the commercial needs of the debtor. She formulates the shortcoming of the SMPA in this regard as follows:

[T]he theoretical and practical unacceptable situation that an act professing to deal with security by means of movables omits to deal with security by means of claims. In the modern credit world, security by means of claims, be it as a pledge, an out-and-out cession or a notarial bond, forms by far the most important form of security.

From this it is clear that the exclusion of incorporeal movable property from the SMPA leaves a void and that legal reform in this regard should be considered as a matter of urgency.

### 6.3.3 Operation

#### 6.3.3.1 Real security right

A special notarial bondholder acquires a limited real right in the movable property that serves as security upon registration of the bond.<sup>332</sup> The Act creates a (fictitious) pledge in favour of a bondholder on registration. The bondholder is deemed a pledgee notwithstanding the fact that delivery has not taken place (s 1(1)(b)). Based on the wording<sup>333</sup> of this subsection, it is assumed that the creditor has exactly the same right of pledge as a normal pledgee. The bondholder does not have to perfect

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330 Scott 1995 *THRHR* 680-2.

331 *Id* at 683.

332 *Senwes Ltd v Muller* 2002 (4) SA 134 (T).

333 “[The property shall] notwithstanding the fact that it has not yet been delivered to the mortgagee, be deemed to have been pledged to the mortgagor as effectually as it if had expressly been pledged and delivered to the mortgagee.”

the bond in order to acquire a real security right (pledge). The common-law principles applicable to a pledge, as set out in 4.4 above, apply to a special notarial bondholder.<sup>334</sup>

The legal position before and after insolvency is the same as that of a pledgee. Upon the insolvency of the debtor, the creditor will be a secured creditor who can realise his claim under section 83 of the Insolvency Act.<sup>335</sup>

### 6.3.3.2 *Special notarial bonds registered before enactment of SMPA*

In terms of section 1(3) of the SMPA, the holders of special notarial bonds registered before the enactment of the SMPA are in the same position as general notarial bondholders in terms of section 102 of the Insolvency Act.<sup>336</sup> This affords the holder of a special notarial bond registered before the enactment of the SMPA, the same preference in respect of the entire free residue as that enjoyed by the general notarial bondholder.<sup>337</sup> In terms of section 1(3) of the SMPA, the holder of a general notarial bond has a preferential claim over the *entire* free residue. This appears to be in contrast with section 102 of the Insolvency Act as interpreted by the Supreme Court of Appeal judgment in *FirstRand Bank Ltd v Land and Agricultural Development Bank of South Africa*.<sup>338</sup> In this case the court had to decide whether the preference afforded to the holder of a general notarial bond extends only to the *portion* of the free residue consisting of the proceeds of movable property, or to the *entire* free residue. The appellant's argument, as the general notarial bondholder, was that section 102 of the Insolvency Act entitled it to claim the entire balance of the free residue over all the movable property of the debtor. The respondent, as a concurrent creditor of the debtor, argued that the appellant had no preferential claim to any part of the balance of the free residue arising from the realisation of the assets not subject to the bond. The argument was that the entire free residue must be distributed amongst all the debtor's concurrent creditors. This argument was rejected by the High Court but leave to appeal to the Supreme Court of Appeal was granted. The Supreme Court of Appeal held that the preference afforded to the holder of a general notarial bond in terms of section 102 of the Insolvency Act was limited to such *portion*

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334 Sharrock *Business Law* 274-6.

335 Act 24 of 1936.

336 Scott 1997 60 *THRHR*.

337 Van der Spuy 1992 *De Jure* 496.

338 2015 (1) SA 38.

of the free residue as may consist of the proceeds of movable assets covered by the bond, and did not extend to the *entire* free residue. The SMPA changed this position. Section 1(3) expressly states that the holder of a special notarial bond registered before the enactment of the SMPA is in the same position as a general notarial bondholder and enjoys preference over other concurrent creditors in the *entire* free residue of the insolvent estate.

#### *6.3.3.3 Movable property under special notarial bond not subject to landlord's tacit hypothec*

Section 2 of the SMPA excludes movables registered in terms of the SMPA under a special notarial bond from the operation of the lessor's tacit hypothec. This means that, upon default of payment of rent by the lessee, a lessor cannot exercise a landlord's tacit hypothec over movables registered in terms of the Act and present on the leased premises. Sonnekus<sup>339</sup> criticises the practical relevance of this section. He argues that the lessor is placed in the position of a pledgee by attachment and as such he will enjoy preference over the notarial bond as provided by section 1(1) of the SMPA. Scott<sup>340</sup> disagrees, saying that attachment by the landlord does not place him in the position of a pledgee. The attachment is an act to perfect the hypothec and to prevent the lessee from removing the movables from the leased property. Should the landlord perfect his hypothec through attachment before the registration of the special notarial bond, the hypothec will not be subject to the notarial bond. If the landlord perfects his hypothec after the registration of a special notarial bond, his hypothec will be subject to the special notarial bond.

#### *6.3.3.4 Amended definition of 'special mortgage' in Insolvency Act*

Section 4 of the SMPA amends the definition of a 'special mortgage' in the Insolvency Act 24 of 1936 to include a special notarial bond registered in terms of section 1(1) of the SMPA. Scott<sup>341</sup> indicates that this provision is superfluous as the special bondholder is a secured creditor (a pledgee) who should rely on section 83 of the Insolvency Act.

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339 Sonnekus & Neels *Sakereg Vonnisbundel* 759.

340 Scott 1997 *THRHR* 630.

341 *Ibid.*

### 6.3.3.5 Perfecting clause in special notarial bond

Brits<sup>342</sup> indicates that special notarial bondholders often still include a perfecting clause in the notarial deed despite the fact that registration grants the notarial bondholder a real security right upon registration. Creditors often feel more secure when they have possession of the movable thing, regardless of the existence of their real security right. The question is whether such a perfecting clause in a special notarial bond is enforceable. According to Brits, under the Natal Act courts would have been opposed to the granting of a perfecting order as “the security was already complete by virtue of the deemed pledge”.<sup>343</sup>

In *Senwes Ltd v Muller*<sup>344</sup> the bondholder sought a court order ordering the debtor to give up possession of the movable property under the special notarial bond in terms of a perfecting clause in the special notarial bond. The debtor argued that the bondholder had a security right in the form of a special notarial bond (fictitious pledge or pledge without possession) and that he was under no obligation to give up his possession. In granting the order, the court held that:

The applicant [bondholder] is contractually entitled to protect its interest by seeking a court order which permits it to take possession of the movables specially and generally placed under the terms of the notarial bonds and, to extent that to the parties have agreed thereto, I consider the respondent [debtor] to be bound thereby ...

According to Brits,<sup>345</sup> a bondholder would want to obtain possession of the movables in order to protect the value of the security and to eliminate the risk of the movable property not being properly described which would leave him without a security right.

### 6.3.4 Summary

The SMPA changed the legal position of the special notarial bondholder. In essence it extended the operation of the Natal Act to all provinces. The position of a special notarial bondholder was strengthened in that he acquired a real security right (fictitious pledge) on registration, as opposed to the previous position where he had

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342 Brits 2015 SA Merc LJ 268-9.

343 *Ibid.*

344 2002 (4) SA 134 (T) 143-4.

345 Brits 2015 SA Merc LJ 268-9.

no secured claim against the insolvent debtor's estate. Although the introduction of the SMPA is regarded as a welcome development in the law of real security rights over movable property, it is not without problems. It is to these problems that I now turn.

#### 6.4 Problems

I have narrowed down the issues relevant to special notarial bonds in South African law to five: the issue of publicity; the existence and operation of the *mobilia non habent sequelam ex causa hypothecate* maxim; revolving assets as security object; the exclusion of incorporeal movables from the SMPA; and finally, the suitability of a special notarial bond as a pledge without possession. I now briefly elaborate on each of these. The purpose of this discussion is to highlight the problem areas in South African law.

There can be no objections to the substitution of delivery with registration as a means of promoting the practical commercial needs of the debtor. In the discussion above reference is made to the purpose and effectiveness of publicity.<sup>346</sup> Arguments are made that delivery of the movable thing to the creditor in an ordinary pledge does not necessarily comply with the publicity principle. Third parties can see that the thing is in the creditor's control but that does not inform them about the nature of the relationship between the creditor and the thing: he might be the owner or he might be holding the thing as a borrower. There is a strong argument that in the case of an ordinary pledge delivery does not necessarily give notice to third parties. Scott<sup>347</sup> explains the interaction between the accessory nature of a real security right and publication. The aim of registration is to notify third parties that a chosen form of real security exists over a specific thing as security for repayment of a principal debt. There must be a link between the real security right and the principal debt. Registration is not only notice to third parties of the existence of a real security right, but should give content to the right by stipulating what the principal debt secured by the real security right is. The real security right and the existing principal debt must be linked.

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346 See 3.3.2 above.

347 Scott 2005 TSAR 847.

The role of the maxim *mobilia non habent sequelam ex causa hypothecate* in protecting *bona fide* third parties in a system where the pledge is publicised through registration, should be considered. The competing interests of the creditor and third parties must be balanced. According to Brits,<sup>348</sup> the legislature (SMPA) placed a special notarial bondholder in the position of a pledgee and in so doing “expressed a policy choice in favour of protecting the creditor’s security regardless of who actually possesses the movable”. He points out that the need for a valid form of pledge without possession “outweighs the prejudice certain third parties might suffer”. This strong position of the creditor is only afforded with due compliance to the provisions of the SMPA.

As I have pointed out, the strict application of section 1(1) of the SMPA (described in a manner that renders it readily recognisable) is a two-sided coin: on the one hand it promotes legal certainty, but on the other hand it prevents owners from using certain movable property as security – for example, revolving assets. The proposed registry<sup>349</sup> must take note of this and provide a way in which revolving assets can be used as security under a special notarial bond.

There is no clear indication of why the SMPA excluded incorporeal movable property. In this regard I agree with Scott<sup>350</sup> who is of the view that the “regrettable decision in the *Cooper* case necessitated the hasty introduction of the SMPA.” This limitation was not found in the Natal Act. Incorporeal movable property can only be used as security under a general notarial bond and the bondholder will have to perfect his bond in order to obtain a real security right. The distinction between corporeal and incorporeal movables, and the weaker position of the owner of incorporeal movable property appears unfounded. The inclusion of incorporeal movable property as security object for a special notarial bond should be seriously considered. The proposals made by Sonnekus<sup>351</sup> with regard to the identification of movable property through a mark or in an inventory must be considered. A balance should be struck between the economic needs of the debtor (inclusion of incorporeal) and the protection of third party creditors in the description of the security object, coupled with the need to comply with the publicity principle.

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348 Brits 2015 SA Merc LJ 260.

349 See 8.3.

350 Scott 1995 THRHR 683.

351 See 6.3.2.2 above.

A final point for consideration is whether a special notarial bond should be classified as a pledge without possession. Would it not be better to legislate a new form of real security right with its own specific rules and regulations suited to the circumstances under which special notarial bonds are created? Brits<sup>352</sup> states as follows:

The practical call for a form of nonpossessory security over movable property is clear, but whether it is altogether necessary or sensible to achieve this by way of a pledge construction with reference to a deemed ('as if') delivery is open to debate. ... Another way could also have been to regard the rights created by the special notarial bond as a sui generis real security right ..... Special notarial bonds simply differ too significantly from both special mortgages and common-law pledges.

In the following chapter I discuss a right of pledge in Belgian law. The current legal position, as well as the position in terms of the Belgian Pledge Act,<sup>353</sup> is discussed below.

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352 Brits 2015 SA *Merc LJ* 260-1.

353 Act of 11 July 2013.

## CHAPTER 7

### BELGIAN LAW

#### 7.1 Introduction

The current legal reform of real security rights over movable property in Belgian law and its Roman-law origin makes this legal system relevant to South African law. Belgian law enacted a new system of security rights as a tool to facilitate the extension of credit to businesses and individuals.<sup>354</sup> This chapter provides an overview of the Belgian legal system. Real security rights and pledge under the Civil Code are discussed so as to contextualise the study of the non-possessory pledge under the new Belgian Pledge Act. In the final chapter I provide a comparative summary and recommendations.

#### 7.2 Belgian legal system

Belgium is a federal state consisting of three communities<sup>355</sup> and three regions.<sup>356</sup> The federal state is a member of the European Union. The Belgian Constitution is the highest domestic law.<sup>357</sup> It deals with the separation of powers, how these powers are exercised, and societal fundamental values and basic rights of citizens. The following acts rank below the Constitution: special acts; acts, decrees and ordinances; royal orders, governmental orders, and ministerial orders.

The law of property in Belgium is based on the Belgian Civil Code.<sup>358</sup> Articles regulating real security rights are spread throughout the Civil Code. The Code is based on the French Civil Code of Napoleon which was introduced in 1831 – the year of the Belgian independence.<sup>359</sup> The provisions of the Belgian Civil Code resemble the corresponding provisions of the French Civil Code as it existed before the 2006 reform. This includes the judicial (courts) system. As a result of the adoption of the Napoleonic Code the Roman legal heritage has been reflected in contemporary

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354 Dirix *EPLJ* 231-51.

355 *Vlaamse Gemeenschap, Franse Gemeenschap and Duitstalige Gemeenschap*. See art 2 of the Belgian Constitution.

356 *Vlaams Gewest, Waalse Gewest and Brussels Gewest*.

357 Art 1 of the Belgian Constitution 1994.

358 Bergkamp 2014 *UCULR* 279-96.

359 "Real Property Law Belgium-Draft Lawfort 29 September 2004" available at <http://www.eui.eu/Documents/DepartmentsCentres/Law/ResearchTeaching/ResearchThemes/EuropeanPrivateLaw/RealPropertyProject/Belgium.PDF> (date of use: 19 November 2015).

European legal systems.<sup>360</sup> Roman law principles of property law and real security rights form the foundation of Belgian law in this regard.<sup>361</sup> Although there have been minor changes to the regulation of the law of property<sup>362</sup> for economic reasons, the Civil Code remains the basic source for the law of property in Belgian law.

I now turn to consider real security rights in Belgian law.

## 7.3 Real security right

### 7.3.1 Definition and legal nature

A real security right can be defined as:

Any right or device created by law or by agreement between the creditor and the debtor, that confers to the creditor the right to recover one or more assets from the estate of the debtor or to obtain a preferential payment out of the proceeds of these assets, in order to satisfy his claim against the debtor.<sup>363</sup>

In essence, the notion of a real security right is that the debtor transfers a possessory interest in his property to the creditor as security for the repayment of the principal debt.<sup>364</sup> As appears from the above definition, a real security right protects the creditor by giving him preferential rights to the assets of his debtor (or a third party). This entitles him to recover his claim from the proceeds of the assets before unsecured and lower-ranking creditors. The secured assets remain in the debtor's estate but are earmarked for the satisfaction of the underlying principal debt. In Belgian law real rights adhere to the *numerous clausus* principle<sup>365</sup> – a principle not followed in South African law.

### 7.3.2 Vesting

Corporeal and incorporeal movable and immovable property may form the security object of a real security right in Belgian law.<sup>366</sup> A real security right may also vest over

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360 Natalie van Leuven -9781849804158 Elgar Encyclopaedia of Comparative law 2 ed (Belgium) Online (date of use: 17 February 2016).

361 Bocken & De Bondt *Introduction* 204-21.

362 For example, privileges given to landowners under the ancient regime.

363 Drobnig *Divergences of Property* 70.

364 Goebel 1961 *Tulane Law Review* 29.

365 Eidenmüller & Kieninger *Secured credit in Europe* 225.

366 Drobnig *Divergences of Property* 71. See art 2093 of the Code Napoléon.

assets which the debtor will acquire in the future. The vesting of a real security right depends on the type of real security right and the nature of the security object. As in South African law, three acts are in principle required for the creation of a real security right: a credit (loan) agreement; a security agreement; and publication. A real security right depends on the existence of an underlying principal debt. The parties conclude a security agreement in terms of which the creditor acquires an interest in the debtor's asset as security for the repayment of the principal debt. The creditor obtains a security interest as from the conclusion of the security agreement.<sup>367</sup> Article 2071 of the Belgian Civil Code refers to the security agreement when it defines a pledge as a *contract* in terms of which a debtor delivers a thing to his creditor as security for a debt. Delivery in this regard serves to fulfil the third requirement (publication). Therefore, a real security right over movable property is perfected through taking physical control of the property.<sup>368</sup> A real security right will only vest in the creditor once all three requirements have been met.

### **7.3.3 Operation**

A real security right, once properly vested, becomes enforceable against third parties.<sup>369</sup> It is generally accepted that a real security right will have no value in secured transactions if the right cannot withstand the entitlement of other unsecured or lower-ranking creditors, or the administrator of an insolvent estate.<sup>370</sup> It is a basic legal principle in all European legal systems that creditors must be treated on an equal footing (*pari passu*) save where the creditor has a legally valid real security right and/or legal privilege.<sup>371</sup> The value of the property that serves as security is therefore distributed proportionally between the creditors, unless there is one or more creditors who has a legitimate basis for preferential treatment.<sup>372</sup> The *pari passu* principle entails that creditors who are on an equal footing (in other words where one creditor does not have a preference over the other) are treated equally. The *pari passu* principle, though highly theoretical in practice, only applies in the case of *concursum creditorum*. A *concursum creditorum* occurs when creditors of the same debtor simultaneously enforce their claims against the debtor's estate or a particular

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367 Art 2075 of the Belgian Civil Code.

368 *Ibid.*

369 Eidenmüller & Kieninger *Secured Credit* 225.

370 Drobnig *Divergences of Property* 69.

371 *Id* at 70.

372 Art 2093 of the Belgian Civil Code.

asset in the estate.<sup>373</sup> This does not raise problems when the debtor is solvent. Issues in *concursum creditorum* arise when the debtor is insolvent. In this case the actions of the debtor before insolvency are carefully scrutinised by the administrator of the insolvent estate. The administrator can choose to avoid real security rights created within a certain time limit before the debtor's insolvency.<sup>374</sup> The *pari passu* principle is not a compulsory principle binding on the parties. Parties are free to enter into agreements to determine their rankings. This principle is rather directed at achieving equality amongst contesting creditors. However, it is important to note that this chapter deals only with one of the exceptions identified above: namely, when a creditor has a real security right over the property of the debtor. The *pari passu* principle, therefore, does not apply if one of the creditors has a real security right and that creditor will rank above other creditors.

As stated earlier as an exception, in the case of competing real security rights the rule of anteriority applies.<sup>375</sup> In terms of this rule, an earlier right enjoys precedence over a later one (*prior tempore, potior jure*).<sup>376</sup> This means that the creditor who acquired a real security right over the debtor's property (either through delivery in the case of movable property, or registration in the case of immovable property) before other secured creditors, has a preferential right based on the nature of his claim in the event of insolvency.<sup>377</sup> The secured creditor's preferential right over the proceeds of the sale of the debtor's assets is limited to the amount of the secured debt, although his right can be enforced over the asset as a whole.

It is clear that in Belgian law a real security right is similar to a real security right in South African law. I now discuss a civil pledge regulated by the Belgian Civil Code and a commercial pledge governed by the '*Wet van 5 Mei 1972*'.

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373 *Ibid.*

374 *Ibid.*

375 Crabb *Constitution of Belgium* 349.

376 Sigman & Kieninger *Cross-border Security* 222.

377 Art 2096 of the Belgian Civil Code.

## 7.4 Civil and commercial pledge

### 7.4.1 Civil possessory pledge

#### 7.4.1.1 General

A pledge governed by the provisions of the Belgian Civil Code has its origin in Roman law. Scott<sup>378</sup> states that the draughtsmen of the Belgian Civil Code did not pay much attention to a right of pledge since little value was attached to movables at the time. The pledge instrument is currently still underutilised, not because of the small value of movables, but because it has certain disadvantages for the pledgor. The transfer of physical control requirement renders a pledge unattractive to debtors.

Article 2071 of the Belgian Civil Code defines a pledge as:

An agreement by which the debtor gives possession of an asset to his creditor as security for his debt. Assets which, by law, cannot be transferred cannot be pledged.

A pledge entails an agreement by which the debtor (pledgor) or other contracting party delivers physical control of the movable property, including corporeal and incorporeal property, to the creditor (pledgee) or an agreed third party as security for the repayment of the principal debt.<sup>379</sup> A pledge is synonymous with a classic form of 'possessory' security. 'Possessory' means that the asset is not held by the debtor (security grantor) but by the secured creditor or a third party. In South African law the pledge object must be delivered to the pledgee himself. Delivery to a third party will not constitute a valid pledge.<sup>380</sup>

The purpose for the transfer of possession of the asset to the secured creditor or a third party is to secure the repayment of the debt should the debtor default with payment. The creditor has the right to sell the movable property should the debtor default and the creditor ranks as a preferential creditor over other creditors in the proceeds of the sale. Article 2078 of the Belgian Civil Code requires the creditor to obtain an authorisation by means of a court order in order to sell the defaulting debtor's movable property. This means that the Belgian Civil Code does not

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378 Scott 2010 *CILSA* 97

379 Art 2072 of the Belgian Civil Code.

380 See 4.3.3 above.

acknowledge summary execution clauses. The New Pledge Act does not abolish a possessory pledge under the Civil Code. Debtors and creditors have the option of choosing between a pledge without possession and a possessory pledge. The New Pledge Act replaces and amends articles 2071-2091 in the Civil Code to provide for a pledge without possession and a possessory pledge.

#### 7.4.1.2 Vesting

Three conditions must be fulfilled in creating a valid pledge.<sup>381</sup> Firstly, there must be an official document or a registered private agreement which contains the amount of the principal debt and a description of the pledge.<sup>382</sup> Secondly, if the pledge is a pledge in respect of a claim or a right, the pledgor's debtor must be notified of the pledge.<sup>383</sup> If, for example, X has a creditor's claim against Y and X wants to use this claim as security for a loan from Z, Y must be notified that the claim is the object of Z's security right. The reason for this is that in the case of a pledge in respect of a claim or right, the publicity principle is fulfilled through notification to the pledgor's debtor.<sup>384</sup> It is generally accepted that the debtor must acknowledge the notification. In the case of a conflict between competing creditors, priority is determined by the time of notification.<sup>385</sup> In the case of corporeal movable property, there must be the transfer of physical control over the movable property, either constructive or fictitious.<sup>386</sup> The property must be under physical control of the creditor or a third party in order for the pledge to remain valid.<sup>387</sup> It is important to note that Belgian law does not require a notarial deed or registration to validate the pledge.<sup>388</sup> Actual physical control must be taken on conclusion of the pledge agreement.<sup>389</sup> The property may, for example, be stored in a warehouse owned and operated by a third

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381 See art 2074 and 2076 of the Belgian Civil Code.

382 *Ibid.*

383 See eg, Case 29 March 1990, RW 1990-1991, 364. In this case the Belgian High Court recognised ways to meet the publicity principle (ie notification) other than the dispossession of the property as required by art 2076 of the Belgian Civil Code. The court held that the nature of the security object (intangible) must be taken into account as well as any other specific provisions adopted by the parties to meet the legal obligation.

384 Art 2075 of the Commercial Code

385 Sigman & Kieninger *Cross-border Security* 222.

386 Art 2076 of the Belgian Civil Code.

387 *Ibid.*

388 Dickson *Security over movables* 8.

389 Art 2075 of the Belgian Civil Code.

party acting as a custodian for the parties to the pledge agreement.<sup>390</sup> This is contrary to South African law where the pledgee must be in physical control of the pledged object and if he loses control he loses his right of pledge.<sup>391</sup>

The pledge will vest a real security right only once all these conditions have been fulfilled. The first two conditions are intended to inform third parties of the existence of a preferential right. As regards the operation of the agreement between the parties, proof of the date that the agreement was concluded, either the date of signature of the agreement if in writing, or oral evidence in the case of a verbal agreement, is sufficient proof of the existence of the pledge. In this regard, the pledge will not bind third parties but only bind parties to the pledge agreement.

#### *7.4.1.3 Operation*

A pledge over corporeal movable property becomes enforceable against third parties once the transfer of physical control of the property has taken place. A pledgee (as the one who has obtained physical control of the property) acquires a preferential claim over unsecured and lower-ranking creditors. Article 2078 of the Belgian Civil Code provides that the pledgee has the right to have the assets of the pledgor sold upon default of payment. This is, however, subject to the authorisation of the court.<sup>392</sup> This means that where the pledgor defaults, the pledgee cannot dispose of the pledged object himself. He must obtain a court order for either a public sale or an order awarding the thing to him (the debtor) as payment of the outstanding debt.<sup>393</sup> Article 2078 further provides that any clause in a pledge agreement which authorises the creditor to appropriate the pledge object or to dispose of it without authorisation by a court, is void.<sup>394</sup> The debtor (pledgor) remains the owner of the pledged property which is in the hands of the creditor or a third party until his ownership of the property is terminated.<sup>395</sup> The pledgee must apply to a court for authorisation to retain the property that serves as security in fulfilment of and to the extent of his obligation, or

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390 De Backer CMS & Van Oekel "A Pledge over movable assets-time for a radical change" available at <http://newsletter.cms-db.info/article.asp?nid=737233cb87dfe0e7b5525a1b7ecc112c&did=2&aid=2995> (date of use: 12 February 2015).

391 See 2.3.2.3 above.

392 Art 2078 of the Belgian Civil Code.

393 Scott 2010 *CILSA* 98.

394 *Ibid.*

395 Art 2079 of the Belgian Civil Code.

to have the property sold by auction. This is similar to South African law which follows the prohibition on *pacta comissorium*.<sup>396</sup>

In addition to the two orders discussed above, a judge may also order that the debtor be granted a moratorium on the repayment of his debt.<sup>397</sup> This will only be possible in specific circumstances<sup>398</sup> and in the case of contractual obligations. The moratorium may entail a deferment of payment or even a remission of partial payments.<sup>399</sup>

#### **7.4.2 Commercial pledge**

In terms of article 2084, the legal principles laid down in articles 2071-2083 of the Belgian Civil Code do not apply to commercial pledges. Commercial pledges are dealt with in the *Wet van 5 Mei 1872*. The nature of the principal obligation is the determining criterion for a commercial pledge: commercial debts. An example of a commercial debt is a merchant's debt(s) incurred in day-to-day business. Despite the provision in article 2084 that the Civil Code provisions are not applicable to commercial pledge, the *Wet van 5 Mei 1872* is not entirely adequate to deal with commercial pledges. Therefore, the general principles applicable to a civil pledge also apply to commercial pledges in so far as they do not conflict with any of the provisions in *Wet van 5 Mei 1872*. Two forms of commercial pledge that do not require physical delivery of the pledge object are a pledge over a business, and a special purpose vehicle pledge.

##### **7.4.2.1 Pledge over a business**

A pledge over a business covers all the movable property of the business enterprise with the exclusion of fifty per cent (50%) of the inventory.<sup>400</sup> It includes all the elements that constitute the goodwill of a business without having to enumerate them.<sup>401</sup> This form of pledge has the advantage that the movable property that serves as security does not have to be delivered to the pledgee and can continue to be used

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396 See the discussion in 4.3.2 above.

397 Art 1244 Belgian Civil Code and Scott 2010 *CILSA* 98.

398 Eg If the debtor is involved in legal proceedings concerning insolvency.

399 Scott 2010 *CILSA* 98.

400 Act of 25 October 1919 published in the *Government Gazette* of 25 November 1919. Act of 15 April 1884 published in the *Government Gazette* of 11 May 1884 also provides an exception to the delivery requirement in the case of agricultural enterprise.

401 A stock is an exception as it needs to be enumerated.

by the pledgor in the normal operation of his business.<sup>402</sup> A pledge over a business is, however, limited in that it is available only to banks and financial institutions. An ordinary pledgor or debtor (as opposed to a pledge over the assets of a business) does not enjoy the benefit of this form of pledge. The position of ordinary debtors could be improved were this flexible form of pledge is extended to them rather than limiting it to banks and financial institutions. This form of pledge is similar to the English 'floating charge' as the pledgee's priority right only extends to the essential assets for running a specific business. It is a security over the present and future assets of a company which changes in the normal operation of a business and which continues to be controlled by the pledgor until payment of the principal debt or when the pledgee executes his security right.<sup>403</sup>

In order to protect third parties, a pledge over business assets must be created by a notarial deed and registered in a Registry Office and competent Mortgage Registry at a place where the pledgor's business operates. Once properly registered, a pledge over a business confers on the creditor a preferential right to the assets constituting the business of the pledgor. Should the debtor default with payment, the creditor can seize the assets of the business. However, the creditor cannot sell these assets without authorisation by a court. The court must validate the sale before it can take place.

It is important to note that registration of this form of security is not accessible nationally but only on the level of the different judicial districts ('*arrondissement*').<sup>404</sup> This raises specific questions as to the legal efficacy of this form of pledge: The accessibility of the register is questionable as to whether or not the publicity principle is sufficiently satisfied as regards accessibility, and whether third party creditors or potential purchasers are adequately protected. I am of the view that the publicity principle would be sufficiently complied with if the register were available on a national level – and preferably in electronic format – as opposed to the current fragmented and complicated searches required on the district level.

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402 Belgian House of Representatives adopt a new act on security interests on movable assets available at <http://loyensloeffnews.be/en/publications/newsflashes/belgian-house-of-representatives-adopts-new-act-on-security-interests-on-movable-assets.html> (date of use: 23 February 2015).

403 Van Erp & Akkerman *International Property Law* 457.

404 Dirix 2014 *Int Insolv Rev* 172.

Subsequent business pledges can be taken by creditors in which case the principle of anteriority (first in time, first in law) will apply.<sup>405</sup> This means that in the case of insolvency, the security right which was registered first enjoys preference over other rights.

In terms of the New Pledge Act a general right of pledge will replace the business pledge. In principle the debtor's entire inventory may be subject to the general pledge and it may be granted to creditors other than banks and financial institutions. The parties can also agree that the pledged object be sold (in specified circumstances) without court intervention.<sup>406</sup>

#### 7.4.2.2 *Special purpose vehicles (SPV)*

A second exception to the delivery requirement is the creation of Special Purpose Vehicles (SPV).<sup>407</sup> An SPV is a commercial company established as a limited liability company (*naamloze vennootschap/société anonyme*) or as a limited liability partnership (*commanditaire vennootschap op aandelen/société en commandite par actions*). In practice, an SPV can be used to buy assets at the request of the enterprise (company or partnership). All rights and obligations attaching to the assets are transferred to the SPV. The SPV can then sell the assets to the enterprise. The purpose is to protect the enterprise against the claims of its creditors.

A consignment can also be used by an SPV. In this case the SPV buys assets and delivers them to the enterprise which then holds and sells them as a consignee. The SPV then buys the assets from the enterprise and sells them back to the enterprise. All rights and obligations attaching to the assets are transferred to an SPV.

An SPV appears to be a form of a simulated transaction which is not recognised by South African courts.<sup>408</sup>

From this overview it appears that the civil pledge is less practical than the commercial pledge, specifically when it comes to the delivery requirement. In conclusion, the current legal position provides for a pledge over movable property

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405 Cour de cassation 19 November 1992 Pas 1992, I 1286.

406 Available at <http://www.dlapiperrealworld.com/law/index.html?c=BE&t=finance> (date of use: 21 July 2016).

407 Kieninger & Harry *Cross-border Security* 221.

408 See 4.3.3 above.

either by way of a possessory pledge (*pand*) or a non-possessory pledge over a commercial business (*pand op de handelszaak*). I turn now to the new Pledge Act.

## 7.5 Belgian Pledge Act

### 7.5.1 Introduction

The new Belgian Pledge Act<sup>409</sup> (the Act), enacted by the Belgian Parliament on 30 May 2013, has changed the law of real security rights over movable property in Belgium. The Act introduces a new title 'XVII' in the Belgian Civil Code which replaces the provisions in articles 2071-2091. The most significant change brought about by the Act is that Belgian law now acknowledges a pledge without possession. Dirix<sup>410</sup> states that the Act "contains a complete modernization of the legal framework regarding security rights over movables including the retention of title and the legal lien". The Act, which follows the functional approach, is not yet in operation although it was expected to come into operation on a date to be determined by Royal Decree, but not later than 1 December 2014. This date has been postponed by the 'Postponement Act' to 1 December 2017 due to the substantial delay in the establishment of the National Electronic Register. On 15 July 2016, the date of operation was again postponed to January 2018.

The Act applies to all security interests over movable property, but does not amend either the Mortgage Act of 16 December 1851, or the Financial Collateral Act of 15 December 2004.<sup>411</sup> As the Act is not yet in operation, this chapter conducts a theoretical evaluation of its significant but projected effect on the law of real security rights over movable property with specific reference to pledge without possession. The framework for the new Electronic Pledge Register (EPR) is also discussed.

The Act brings significant changes to the current legal framework for the creation, perfecting and realisation of security interests on all forms of movable property, corporeal or incorporeal.<sup>412</sup> It does not follow the DCFR and article 9 of the UCC by introducing a general 'security interest' but retains the traditional terms of pledge,

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409 Act of 11 July 2013 (hereafter the Act).

410 Dirix 2014 *Int Insolv Rev* 174.

411 New law on security over movable assets- Significant impact on financing transactions available at <https://www.google.co.za/#q=New+law+on+security+over+movable+assets-+Significant+impact+on+financing+transactions> (date of use: 22 December 2015).

412 Dirix & Sagaert 2014 *EPLJ* 236. Receivables and universalities are also covered by the Act.

retention of title, and legal lien.<sup>413</sup> I now give a brief overview of the '*registerpand*' (pledge without possession).

### **7.5.2 Registerpand**

As discussed above in Belgian law a pledge requires physical control over the pledge object by the pledgee. The Act now provides for a pledge that is registered in the EPR and the debtor (pledgor) remains in control of the pledged object. In so doing the Act makes it easier for a debtor to grant a pledge over his thing. A simplified execution procedure which no longer requires a court order for execution save in the case of a consumer (*consument*), is introduced. The right of pledge remains vested in the movable property regardless of its transfer to someone other than the debtor. Buyers of movable property must therefore consult the EPR before purchasing a thing to ensure that it is not burdened by a right of pledge. The business pledge (*pand op handelzaak*) is replaced by the general pledge as regulated by the Act. There is no longer a distinction between a civil pledge and a commercial pledge.<sup>414</sup> It is important to note that different rules apply to consumers. I now elaborate on noteworthy aspects of the pledge without possession for natural persons, after which I highlight the different rules applicable to consumers.

### **7.5.3 Security object**

The Act applies to all types of movable: specific movable things; a business; a future claim; and intellectual property rights. It applies to pledges on any or all business assets such as inventory, intellectual property rights, deliverables and financial instruments. The Act does, however, not affect security interests on ships and financial assets.<sup>415</sup>

### **7.5.4 Validity of pledge between the parties**

A clear distinction should be drawn between the validity of the pledge between the parties and the effectiveness of the pledge against third parties (third party/real operation). I first consider the validity of the inter-party pledge, followed by an evaluation of the effectiveness of the pledge against third parties.

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413 Dirix 2014 *Int Insolv Rev* 176.

414 Available at <http://www.belexa.be/news.php?id=30> (date of use: 1 August 2016).

415 Dirix 2014 *Int Insolv Rev* 176.

A pledge without the transfer of physical control as introduced by the Act is created by means of a pledge agreement between the pledgor and the beneficiary/ies of the pledge or the representatives of the beneficiaries.<sup>416</sup> Article 2 prescribes that parties may create a valid pledge merely by agreement. In terms of article 4, when one of the parties is a consumer, the pledge agreement must be in 'documentary form signed by both parties'.<sup>417</sup> The requirement of writing depends on the circumstances of each case. It can serve to confirm either the validity of the pledge agreement, or as evidence of the existence of a pledge. However, if a pledgor is not a consumer or if delivery of the pledged object has taken place, the need for written pledge agreement falls away. It is, however, advisable for parties to enter into a written pledge agreement. Certain information must be included in a pledge agreement and this information must refer precisely to the pledged object, the secured obligations, and the maximum amount secured. The written agreement must also state the value of the property subject to the pledge if the pledgor is a consumer. The parties remain free to include all other information they deem necessary. The pledgor, as a party to the pledge agreement, must be the owner of the movable property subject to the pledge or be legally authorised to pledge the movable property. The pledge agreement will, nevertheless, be valid and enforceable if the pledgee could, at the time the pledge agreement was entered into, reasonably assume that the pledgor was authorised to enter into the pledge agreement. The pledgor does not necessarily need to be an actual debtor secured under the pledge agreement. A pledgor might be acting as surety for an actual debtor.<sup>418</sup>

The pledgee is the person entitled to benefit under the pledge agreement (the so-called beneficiary/ies). The Act empowers the representative of the beneficiary/ies of the pledge to conclude a pledge agreement on his/her/their behalf. It is, however, important that the beneficiary/ies are identifiable.<sup>419</sup>

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416 Art 2 of the Belgian Pledge Act.

417 Dirix 2014 *Int Insolv Rev* 176.

418 *Ibid.*

419 New law on security over movable assets- Significant impact on financing transactions available at <https://www.google.co.za/#q=New+law+on+security+over+movable+assets-+Significant+impact+on+financing+transactions> (date of use: 22 December 2015).

### **7.5.5 Effectiveness of pledge against third parties**

Publicity was formerly a fundamental aspect of Belgian security rights as Belgian law has always been “opposed to undisclosed security interests”.<sup>420</sup> According to Dirix,<sup>421</sup> recent legislation<sup>422</sup> has moved away from this traditional position. A pledge under the Act becomes a real security right and, in principle, effective against third parties on the moment of registration in the EPR.<sup>423</sup> There are certain exceptions to the rule. A pledge (security right) will be effective against third parties without registration in the following circumstances: (i) the creditor (security holder) has taken possession of the movable property;<sup>424</sup> or (ii) the creditor (security holder) has taken control of the movable property.<sup>425</sup> The difference between possession and control is that ‘possession’ means to be in physical control of the movable property, whereas to be in ‘control’ means when the security holder is obliged to notify the debtor of the encumbered claim”.<sup>426</sup>

The practical implication of the third party effectiveness of the pledge without possession may be illustrated as follows: X registers a pledge over Y’s vehicle. Y sells the vehicle to Z. X’s right of pledge will be effective against Z and he (X) is entitled to realise his security by selling the car should Y not pay his debt. Purchasers of movable things must, therefore, always consult the EPR before buying the thing so as to ensure that there is no right encumbering it.

### **7.5.6 Ranking of creditors**

Registration of a pledge in the pledge register also serves to determine the priority ranking of the security right. The pledge registered first enjoys preference over latter pledges.<sup>427</sup> This is in accordance with the principle of anteriority. The principle of anteriority also applies in the case of a conflict between a registered pledge and a

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420 Dirix 2014 *Int Insolv Rev* 173.

421 *Ibid.*

422 For example, Act on the Assignment of Claims (Act of 6 July 1994, Official Gazette 15 July 1994); art 10 Bankruptcy Act (Official Gazette, 28 October 1997); and Act on the Directive on Financial Collateral Arrangements (Official Gazette, 1 February 2005 (2 ed)).

423 Art 26 of the Belgian Pledge Act.

424 Art 39.

425 Art 60.

426 Dirix & Sagaert 2014 *EPLJ* 235.

427 Art 57 of the Belgian Civil Code.

possessory pledge. In terms of this principle the date of registration and the date of dispossession are compared and the earlier date prevails over the later one.<sup>428</sup>

There are certain exceptions to the 'first-in-time-rule'. Article 58 grants priority to an unpaid seller; a subcontractor; and creditors with claims regarding repairs.<sup>429</sup> The Act abolishes the agricultural privilege (*het voorrecht voor de zaden en oogsten*) and the hotel owner's right of preference (*het voorrecht van de hotelhouder*).

### **7.5.7 Court intervention**

The Act provides for limited court intervention in the enforcement of a pledge.<sup>430</sup> It is therefore possible for the creditor to enforce a pledge without prior court approval.<sup>431</sup> This does not apply to consumers. Parties do, however, remain free to determine enforcement measures in the pledge agreement or at a later stage.<sup>432</sup> Enforcement by a court can take place if one of the parties to the pledge agreement deems it necessary. Any party to the pledge agreement has the right to seek court intervention at any stage for the enforcement of the pledge.<sup>433</sup> This means that the pledgor, the pledgee, and any interested third party can bring any dispute relating to the enforcement of the pledge to the attention of a court at any stage. Court intervention has the effect of suspending the enforcement of the pledge until the matter has been dealt with by the court.

Should the pledgor default with payment, the pledgee can sell or rent the movable property that serves as security.<sup>434</sup> Any surplus amount from sale must be returned to the pledgor as the pledgee cannot acquire more than what is due to him by the pledgor. Prior notification to the debtor and other relevant creditors is required. The agreement on the form of realisation (sell or rent) of the security right can be reached when the security interest is created. The pledgee can also appropriate the property provided that the pledgor consents to this and an agreement on the valuation of the property has been reached.<sup>435</sup> The agreement on the valuation of the property by an

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428 Dirix & Sagaert 2014 *EPLJ* 248.

429 *Ibid.*

430 Art 46 of the Belgian Pledge Act.

431 *Ibid.*

432 Art 54 of the Belgian Pledge Act.

433 *Ibid.*

434 Art 47 of the Belgian Pledge Act.

435 See 4.3.2 above.

expert is reached at the moment of appropriation.<sup>436</sup> Article 47 prescribes that “foreclosure must take place in an economically sound manner”.<sup>437</sup>

### **7.5.8 Consumer pledgor**

If the pledgor is a consumer (*consument*) certain exceptions to the above rules apply. Firstly, a pledge agreement between a consumer pledgor and a pledgee must be in writing. Secondly, the pledgee may not realise his security without a court order should the consumer pledgor default. Thirdly, the value of the pledged object may not be more than twice the debt secured.<sup>438</sup>

### **7.5.9 Registration**

In order to vest a pledge without possession enforceable against third parties, the pledge must be registered in the EPR. Only if the pledge is registered will it be enforceable against third parties. A pledge agreement is required for registration and advance filing is therefore not possible.<sup>439</sup> This register encompasses principles similar to those enunciated in the Draft Common Frame of Reference (DCRF).<sup>440</sup> Access, fees, and any other matter relating to registration may be set by Royal Decree after consultation with the Commission on Privacy.<sup>441</sup>

I now consider the registration process and certain functions of the EPR. These are only guidelines as the final regulations will be determined by the Royal Decree.<sup>442</sup> The EPR is organised on a national level and will be placed in the service of the *Hypotheek van de algemene administratie van de Patrimoniumdocumentatie van Financiën* (hypothecs of the general administration of *Patrimoniumdocumentatie*)<sup>443</sup> of

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436 Art 53 of the Belgian Pledge Act.

437 Dirix 2014 *Int Insolv Rev* 178-9.

438 <http://www.peeters-law.be/documents/analyse-items/70-securities-on-movables.xml?lang=nl> (date of use: 1 August 2016).

439 *Ibid.*

440 See, eg, Hamwijk *Publicity in Secured Transactions* for a thorough discussion of notice filing in terms of article 9 of the Uniform Commercial Code.

441 Art 34 of the Belgian Pledge Act.

442 Advies Nr 15/2014 van 5 februari 2014 *Commissie voor de Bescherming van de Persoonlijke Levenssfeer*.

443 Patrimonial documents are controlled by the *Federale Overheidsdienst Financiën*. Available at [http://financien.belgium.be/nl/over\\_de\\_fod/structuur\\_en\\_diensten/algemene\\_administraties/patrimoniumdocumentatie](http://financien.belgium.be/nl/over_de_fod/structuur_en_diensten/algemene_administraties/patrimoniumdocumentatie) (date of use: 25 July 2016).

Finance). The register is a computerised system directly accessible for online registration, renewal, and deletion of a pledge.<sup>444</sup>

Access to the register is subject to authentication of the user. The precise rules for authentication are yet to be determined. Consultation of the EPR shall be free for the pledgor, pledgee, and a list of individuals as indicated in the Royal Decree. It is possible, depending on the Royal Decree decision, that persons other than pledgees and the individuals listed, may need to pay a fee to access EPR.

The pledgee who wishes to register a pledge must provide the following details: the identity of the pledgor (or his legal agent); the security object and the guaranteed obligation; and the maximum amount for which the obligation is guaranteed. The security objects must be described accurately.

The Act places the responsibility on the pledgee to ensure that correct information is recorded in EPR.<sup>445</sup> The pledgee will be liable against third parties who acted on the incorrect information in the EPR. He must inform the pledgor in writing once the pledge has been registered and also of any amendments. Once the pledgor receives the notification he has a chance to request the pledgee to remove or correct any inaccurate or incorrect data entries. Should the pledgee fail to do so, the pledgor may approach the *Dienst Hypotheken* who will check the accuracy of the data and make any necessary corrections.

Third parties may access the EPR and view all the details provided by the pledgee. A registration number and date of registration will also be available. Specific rules pertaining to privacy are to be established by the Royal Decree.

The pledgee may amend details in the EPR if details in the pledge agreement are amended, or if some details in the EPR are incorrect. The initial details and the amended details will show in the EPR.

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444 Eg, renewal or deletion of any information that relates to registration. This National Pledge Register is said to encompass principles similar to those enunciated in the Draft Common Frame of Reference as far as the online search and registration are concerned.

445 Art 31 of the Belgian Pledge Act.

The registration of the pledge will lapse after ten years.<sup>446</sup> If the pledgee wishes to renew the pledge he must do so before the registration lapses. Once the pledgor has settled the debt, the pledgee must remove the registration from the register. The pledgee and pledgor may agree that the registration be removed from the register before the debt has been settled. The pledge will then no longer be enforceable against third parties.

A transfer of the pledge together with the principal obligation must be recorded in EPR. The registration must be done by the transferor and the identity of the transferee should be recorded. How this is to be done is yet to be determined.

As stated above, the registration of the pledge renders it enforceable against third parties. Errors in the register will influence the effectiveness against third parties. The incorrect description of the pledgee, pledgor, or pledged object renders the pledge unenforceable against third parties, unless the incorrect information would not send a reasonable person on the wrong track. The incorrect description of the guaranteed obligation and the maximum amount secured by the pledge will not render it unenforceable against third parties.<sup>447</sup>

From the above it is evident that clear guidelines are in place for the regulation of the EPR. I conclude this discussion with the following remark by Dirix:<sup>448</sup>

Furthermore, it remains uncertain whether the new Act will attain fully the economic objectives of the reform. The answer to that question also depends on the manner in which the pledge registry is organised and the cost of establishing security rights and access to the registry.

## 7.6 Summary

Initially, the Belgian Civil Code required the pledgor (debtor) to give possession of his property to his creditor in order to vest a security interest (right of pledge) enforceable against third parties. Once in operation, the new Belgian Pledge Act will provide an alternative simplified process for the creation of a pledge without possession. In terms of the Act, a pledge is created by a simple pledge agreement followed by

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446 Art 35 of the Belgian Pledge Act.

447 <http://www.peeters-law.be/documents/analyse-items/70-securities-on-movables.xml?lang=nl>  
(date of use: 1 August 2016).

448 Dirix & Sagaert 2014 *EPLJ* 248.

registration on the EPR which is publicly accessible for consultation. This pledge is enforceable against third parties upon registration. Registration of the pledge in the EPR is intended to comply with the publicity principle. The Act makes provision for debtors and creditors to create a pledge by means of delivery of the pledge object to the pledgee should they prefer.

To summarise, I refer briefly to the most noteworthy aspects of a pledge under the new Pledge Act. A pledge agreement vests a pledge between the parties, but the pledge is only effective against third parties once it has been perfected. There are two methods by which to perfect a pledge: either by giving possession to the pledgee; or by registering the pledge on the EPR. The pledge agreement must be in writing if the pledgor is a consumer. The agreement may be entered into by a representative of the pledgee. Generally speaking, all movable assets may be pledged. This includes corporeal and incorporeal property and property acquired in the future. The property must, however, be determined or determinable and tradable. Ships are excluded, and in the case of a consumer pledgor, the maximum value of the pledged object may not exceed twice the value of the debt. A pledgee may realise his security without a court order. He has three options: sell the thing; rent the thing; or appropriate the thing. Prior notice must be given to the pledgor and his other interested creditors. If the pledgor is a consumer, the pledgee may only realise his security by means of a court order. The EPR is not yet in operation and the implementation of the register has been postponed to January 2018. The exact operation of the register is to be determined by Royal Decree. Certain guidelines, such as the authentication of users, the information required, the pledgee's duty to ensure correctness of information; and the renewal or termination of a pledge, are available.

In the concluding chapter of this dissertation I provide a comparative summary of the legal position under South African and Belgian law. Noteworthy aspects relevant to security over movable property in both legal systems are highlighted and certain recommendations are made.

## CHAPTER 8

### COMPARATIVE SUMMARY, RECOMMENDATIONS AND CONCLUDING REMARKS

#### 8.1 Introduction

Despite the enactment in South Africa of the SMPA, there is still a need for the reform of the general principles of pledge of movables (corporeal and incorporeal).<sup>449</sup> The SMPA has contributed to positive development of security over movable property, but has not addressed all problematic aspects. In Belgium, the legislature has introduced a simpler form of security over movable property in the form of a pledge registered in the EPR. In principle, the Belgian Pledge Act provides for vigorous development of the law of real security over movable property. The Act has, however, not yet been implemented and its efficacy has not been tested.

What follows is a comparative summary of the pledge without possession in both legal systems with particular reference to the security object, the different types of pledge (notarial bonds in South African law), the summary execution procedures, the forms of realisation, and the preference enjoyed by the right holder.

#### 8.2 Comparative summary

##### 8.2.1 Introduction

South African law acknowledges a pledge without possession in the form of a special notarial bond. Special notarial bonds are governed by the SMPA.<sup>450</sup> Belgian law acknowledges a pledge without possession in the form of a register pledge (*registerpand*) regulated under the new Belgian Pledge Act.<sup>451</sup>

The SMPA abolished the Notarial Bond (Natal) Act.<sup>452</sup> The Belgian Pledge Act replaced articles 2071-2084 of the Belgian Civil Code. I now consider some of the most noteworthy aspects of non-possessory pledges in both legal systems.

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449 Scott 2010 *CILSA* 110-11.

450 57 of 1993.

451 Act of 11 July 2013.

452 18 of 1932.

### **8.2.2 Security object**

The SMPA prescribes that a special notarial bond may only vest over corporeal movable property that can be described in a manner that renders it readily recognisable. There seems to be no sound reason for the exclusion of incorporeal movable property from special notarial bonds. According to Scott<sup>453</sup> the exclusion may be the consequence of the 'hasty' implementation of the Act. Be it as it may, there is a dire need for the inclusion of incorporeal movable property as security object of a special notarial bond. Incorporeal movable property forms part of most people's estates and may allow them access to credit secured by the incorporeal property.

Furthermore, the strict application of section 1(1) of the SMPA results in revolving assets not being available as security object. These assets are often the only 'object' that business may have to offer as security. Their exclusion from the operation of the SMPA as they cannot be described as required in section 1(1) may be circumvented by more innovative methods of describing the assets. In this regard Sonnekus<sup>454</sup> offers the solution of the use of a specific mark or through entries in an inventory.

The Belgian Pledge Act includes all movables as possible security objects. Even property acquired in the future can be the object of a register pledge. According to the legislature, the inclusion of the pledge in the EPR offers sufficient protection for the creditor and third party creditors, and the type of security object is unlimited. If this approach is followed in South African law, it will be possible to use incorporeal property, revolving assets, and future assets (governed by general notarial bonds in South African law) as security objects.

Brits<sup>455</sup> state that the description requirement in section 1(1) of the SMPA that appears strict is actually vague in that there are no exact guidelines as how sufficiently to describe movable property. The Deeds Registries Act<sup>456</sup> gives specific guidelines on how to describe immovable property in a deed. The Belgian Pledge Act requires that the security object be described in the register. It will be interesting to see what requirements are set for the description of the movable property.

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453 Scott 1995 *THRHR* 672-84.

454 Sonnekus 2005 *De Jure* 143.

455 Brits 2015 *SA Merc LJ* 268-9.

456 47 of 1937.

### **8.2.3 Types of pledge/notarial bond**

South African law provides for a common-law pledge where the pledged object is delivered to the pledgee. In terms of the Deeds Registries Act<sup>457</sup> a general notarial bond may be registered over all movable property of the debtor. This does not constitute a right of pledge. Only once the bond has been perfected does the creditor obtain a right of pledge over the movable property. The special notarial bond, governed by the SMPA, grants a real security right on registration. This right is referred to as a fictitious pledge. Although it is in principle the same as a pledge, there are minor differences.<sup>458</sup>

The Belgian Pledge Act replaced the provisions in the Civil Code governing a right of pledge. In terms of the new provisions a debtor and creditor can elect to use a possessory pledge in terms of which the pledged object is given to the pledgee. The legal position of such a pledge is, however, also governed by new title XVII of the Belgian Civil Code. This new title also makes provision for the registered (non-possessory) pledge. The Act abolishes the business pledge and as regards a non-possessory pledge, the only option is a general registered pledge. There are different legal consequences for consumer and non-consumer pledgors.<sup>459</sup>

### **8.2.4 Summary execution procedures**

The validity of summary execution clauses in a pledge agreement in South African law has been questioned by academics. Some academics<sup>460</sup> and certain cases<sup>461</sup> argue that a summary execution is invalid in the light of section 34 of the Constitution. It is not possible to sell another person's thing without either his consent or a court order. Other academics<sup>462</sup> argue that a pledge agreement containing a summary execution clause can be seen as the pledgor giving the pledgee authority to sell the thing should he be in default. Both the pledgor and pledgee may consult a court at any time and summary execution clauses are, therefore, valid and do not impinge on constitutional principles. In considering the influence of the National Credit Act on

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457 *Ibid.*

458 See 6.3.2 above.

459 See 7.5.8.

460 See Cook & Quixley 2004 *SALJ* 719.

461 *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E). See also *Bock v Duburoro Investments (Pty) Ltd* 2004 (2) SA 242 (SCA).

462 Scott 2002 *THRHR* 658 and 660.

summary execution clauses, Brits<sup>463</sup> concludes that proper analyses of the NCA lead to the view that summary execution clauses can only be valid in pawn transactions.<sup>464</sup> In terms of the SMPA a notarial bondholder may realise his security under section 83 of the Insolvency Act.<sup>465</sup> The notarial bondholder does not have to acquire physical control of the thing but the procedure prescribed in the Insolvency Act must be followed in realising the security.

The position of summary execution clauses in Belgian law is the opposite of that under South African law. The Roman-Dutch law principle of summary execution clauses has in recent years been interpreted more strictly and its application limited. The Belgian Pledge Act now grants the pledgee the right to sell, rent, or appropriate the security object without court intervention. Court intervention is only required if the pledgor is a consumer.<sup>466</sup> It appears that the realisation of a pledged object is less limited in Belgium than in South Africa. This is interesting as access to courts in South African law is cumbersome, expensive, and time consuming. The purpose of the new Belgian Pledge Act is to simplify the creation and realisation of pledge without possession.

### **8.2.5 Realisation of security**

In South African law the security must be realised through public sale. In the case of pawn transactions which allow summary execution, the security may be realised through private sale. The legal position before the new Belgian Pledge Act was that a pledgee could realise his security by court order and public sale, or a court could grant an order awarding the pledged object to the pledgee. If the court ordered appropriation the court had the full discretion to determine the value of the object pledged. The new Belgian Pledge Act follows a broader approach. The security object may be realised by private sale, rent, or appropriation without a court order. As stated above, a court order will only be required if the pledgor is a consumer.

As regards the option which allows the pledgee to appropriate the thing, it is important to note that the parties must agree to this and to the valuation of the property. Reference should be made to the *pactum commissorium* (agreement that

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463 Brits 2013 SA Merc LJ 561.

464 See 4.3.2 above.

465 24 of 1936.

466 See 7.5.7 above.

pledgee may keep the thing) which is in principle void in both legal systems. Belgian law does allow appropriation but only if the parties agree to it and a fair value for the pledged object is determined. This is also possible in South African law after default by the pledgee. In essence it entails that the pledgee 'retains' the thing after paying a 'fair price' to the pledgor.<sup>467</sup>

### **8.2.6 Preferential rights**

A possessory pledge (including a perfected general notarial bond) and a special notarial bond are preferential rights in South African law. Section 2 of the SMPA grants specific preference to a special notarial bondholder over the tacit hypothec of a lessor. The new Belgian Pledge Act grants preference to the possessory and registered pledge. Preference is granted to an unpaid seller or a subcontractor and creditors with claims for repairs.<sup>468</sup>

### **8.3 Recommendations**

From the above it is clear that the Belgian legislature adopted a functional approach when it drafted the new Belgian Pledge Act. The Act is written to address practical problems with regard to security over movable property. To give effect to the functional approach the EPR plays a vital role. Although the register is not yet operational, the guidelines for its operation may be of assistance in reforming South African law.

Reflecting on the purpose of publication, which is required for the vesting of a real security right, persuasive arguments are formulated indicating that delivery of a movable thing does not necessarily inform third parties of the right vested in that specific movable thing.<sup>469</sup> In South African law, registration of real rights as a form of publication has been questioned by many academics. In my view the registration itself is not the problem. The register is the problem. As indicated, using a registration system specifically designed for registration of rights in immovable property is problematic.

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467 See 4.3.2 and 7.4.1.3 above.

468 Art 58 of the new Belgian Pledge Act.

469 See 3.3.2 above.

The time has come for the South African legislature to develop a registration system designed specifically for registration of real security rights in movable property. In order to provide proper notice as required by the publication principle, the registration system must be easily accessible and inexpensive. Regulations must be in place to ensure exactly how the security object must be described, who is responsible for registration, and for amendments to and cancellations of the registered rights.

The South African law is currently awaiting public feedback on the e-Deeds Bill.<sup>470</sup> The objective of this Bill is to

3.1 facilitate the enactment of electronic deeds registration provisions in order to effect the registration of large volumes of deeds as necessitated by the government's land reform initiatives; and to

3.2 expedite the registration of deeds by decreasing the time required for the deeds registration process.

However, this Bill does not address the issue of registration of real rights in movable property, although it does pave the way for the development of the online registration of rights.

The guidelines for the Belgian EPR and the recommendation for online registration in the Belgian Pledge Act are a good starting point for the introduction and development of a register for real security rights in movable property. A proper online registration system will satisfy the publicity principle and should ultimately do away with the distinction between general and special notarial bonds as it will allow for the registration of real security rights in current and future movable property. It will also allow registration of real security rights over incorporeal movables and revolving assets which have proven to be the object of the strongest criticism of the SMPA.

#### **8.4 Concluding remarks**

The principle of publicity as a cornerstone of real security rights, firstly requires that the existence of a real security right be made known to the public (third parties and/or potential purchasers). This means that third parties must be aware of, inter alia, the

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470 Available at <http://www.ghostdigest.com/articles/e-deeds-bill-published/55006> (date of use: 6 August 2016).

content of the right (including the nature of the real right and the principal debt secured by the right) and the security object. Secondly, the registration of the real right must be easily accessible and inexpensive. I am of view that third party potential purchasers and/or creditors will be effectively protected if this route is followed. In order words, sufficient compliance with the publicity principle will ensure effective protection for third parties. Non-compliance with the publicity principle does not accord with the basic principles of real security rights and third parties are therefore left in the dark as regards the existence of a real security right.

My study has revealed that the legal position of notarial bonds in South African law does not meet the above requirements. Despite the introduction of the SMPA, the legal position of notarial bonds in South African law remains inadequate. The SMPA only regulates special notarial bonds (corporeal movable property) specifically described and identifiable and does not apply to general notarial bonds (all the debtor's assets, including incorporeal property) and revolving assets. I agree with Scott's argument that the exclusion of incorporeal property from the legislation that regulates security over corporeal movable property is impractical and inconvenient for debtors.<sup>471</sup> The description and identification requirement of the corporeal movable property, as set out in *Ikea Trading* case, has been criticised by Sonnekus<sup>472</sup> as rendering the security right expensive and inaccessible when compared to the identification requirement as provided for by the Notarial Bond (Natal) Act. According to Sonnekus, the description requirement under the Notarial Bond (Natal) Act is less strict than that under the SMPA. Sonnekus is of the view that describing the movable property by making use of a special mark on the property is sufficient. Sonnekus's view offers a solution to the description requirement, although doors remain open for the legislature to provide guidelines on how the property should be described. Brits,<sup>473</sup> in criticising the description requirement and acknowledging Sonnekus's proposition, holds that special notarial bondholders often prefer to include a perfecting clause in the notarial bond, despite the fact that registration gives them a real security right. This is due to the difficulties in describing the movable property in such a way that it is readily identifiable from the bond itself. Creditors therefore prefer to take possession of the property upon default by the

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471 Scott 1995 *THRHR* 673.

472 Sonnekus 2005 *De Jure* 143.

473 Brits 2015 *SA Merc LJ* 268-9.

debtor in order to protect their security right from being realised in cases where the property is not specifically described in accordance with the SMPA. This may be ascribed to South Africa's ineffective registration system. The ineffective registration system as adopted in South African law adds to the shortcomings in the SMPA. A registration system will meet the publicity principle if it is easily accessible and inexpensive. The e-Deed Bill does not resolve the hassles of the registration system. The Bill introduces a move away from the manual system of registration to a computerised system in recognition of new technological advances without any reference to the shortcomings in the SMPA. A new registration system specifically designed for the registration of real security rights over movable property must be considered. In the process of reforming the law on real security rights over movables South Africa must consider the Belgian approach to reform even though the Belgian system has not yet been tested. A centralised electronic register which can be easily accessed by third parties at minimal costs must be put in place.

A look at the Belgian registration system reveals that South African law can learn from the system with regard to the accessibility. The system of registration in Belgian law is available online and any other dealings with regard to registration may be done online. Belgian law allows a pledge creditor to make entries directly on the pledge register subject to notification to the debtor. This is currently not the case in South African law. This is an aspect worth reconsidering.

## LIST OF ABBREVIATIONS

CILSA	Comparative and International Law Journal of Southern Africa
DCFR	Draft Common Frame of Reference
EPR	Electronic Pledge Register
EPLJ	European Property Law Journal
Int Insolv Rev	International Insolvency Review
NCA	National Credit Act
PELJ	Potchefstroom Electronic Law Journal
SALJ	South African Law Journal
SA Merc LJ	South African Mercantile Law Journal
SMPA	Security by Means of Movable Property Act
SPV	Special Purpose Vehicle
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg
TSAR	Tydskrif vir die Suid-Afrikaanse Reg
e-Deeds	Electronic-Deeds

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