

# WHY THE SECURITY RIGHT IN SECTION 118(3) OF THE LOCAL GOVERNMENT: MUNICIPAL SYSTEMS ACT 32 OF 2000 IS NOT ENFORCEABLE AGAINST SUCCESSORS IN TITLE – A FOLLOW-UP OCCASIONED BY THE SCA'S MITCHELL JUDGMENT\*

Reghard Brits  
BCom LLB LLD  
Senior Lecturer, Department of Mercantile Law, University of Pretoria

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## 1 Introduction

Section 118(3) of the Local Government: Municipal Systems Act 32 of 2000 (“LGMS Act”) provides that outstanding municipal debts form a “charge upon the property” to which the debts relate. The effect is that the municipality has a statutory real security right that “enjoys preference over any mortgage bond registered against the property”.

In *City of Tshwane Metropolitan Municipality v Mathabathe* (“*Mathabathe*”)<sup>1</sup> the Supreme Court of Appeal (“SCA”) implied that this charge will remain upon the land after it is transferred to a new owner. Shortly after, the Gauteng Division of the High Court in Pretoria decided in *Mitchell v City of Tshwane Metropolitan Municipal Council* (“*Mitchell*”)<sup>2</sup> that this rule, although apparently correct in private sales, does not apply when the property is transferred subsequent to a judicial sale in execution. However, a majority of the SCA in *Mitchell* recently upheld an appeal against the latter judgment.<sup>3</sup> Not only did the court reject the argument that the charge on the property falls away when the property is transferred after a sale in execution, but it also confirmed the general implication of *Mathabathe*, namely that the municipality’s real security right passes with the land when it is transferred regardless of the cause of such a transfer. In other words, the security right is enforceable against successors-in-title of the original owner – the latter being

\* An earlier draft of this article formed the basis of a presentation given at *Schindlers Attorneys, Conveyancers & Notaries* in Johannesburg on 3 March 2016 as well as of a seminar during the annual *alumni* week of the South African Research Chair in Property Law at Stellenbosch University on 11 August 2016. Thank you to Ernst Marais, Chantelle Gladwin and Gustav Muller for reading and commenting on earlier drafts as well as to the anonymous reviewers for their help in improving this contribution. All shortcomings are my own.

<sup>1</sup> 2013 4 SA 319 (SCA) para 12. See B Cloete “Clearance Certificates: Does the Municipality’s Lien Survive the Transfer?” (2013 Sep) 534 *De Rebus* 46.

<sup>2</sup> 2015 1 SA 82 (GP) paras 9-15.

<sup>3</sup> 2016 3 SA 231 (SCA). See T Mashile “Municipalities Have a Hypothec Over Debts for Rates” (2016 Jun) 564 *De Rebus* 30; C Gladwin “The s 118(3) Monster: *City of Tshwane Metropolitan Municipality v PJ Mitchell* (38/2015) [2015] ZASCA 1 (29 January 2016)” (11-02-2016) *GhostDigest* <[http://www.ghostdigest.com/articles/the-s118\(3\)-monster-ii/54981](http://www.ghostdigest.com/articles/the-s118(3)-monster-ii/54981)> (accessed 15-02-2016).

the person who actually incurred the relevant debt. Although the municipality can only obtain a judgment for the outstanding debt against its actual debtor, the apparent implication is that this judgment can be executed against the burdened property by having it attached in execution regardless of who the owner is.

Various authors have criticised this possible implication of *Mathabathe*,<sup>4</sup> but now the SCA's *Mitchell* judgment has necessitated a fresh look at this matter. This contribution does not discuss the details of the existing case law, since it is assumed that the reader is familiar with the decisions. Instead, the focus is on re-affirming<sup>5</sup> the contention that a section 118(3) charge, in its current form, cannot remain on the property subsequent to any kind of transfer (except perhaps when the doctrine of notice applies). Three lines of argument are presented, which – in my view – collectively provide a workable interpretation of section 118(3), namely (1) a contextual, historical and logical interpretation of the wording of the provision; (2) a theoretical argument regarding the effect of real security rights that are not supplemented by publicity; and (3) a constitutional perspective. After presenting these three arguments, this article also briefly discusses the impact of the interpretation of section 118(3) on the rights of mortgagees.

It should be noted that the Gauteng Division of the High Court in Pretoria recently held in *Jordaan v Tshwane City ("Jordaan")*<sup>6</sup> that section 118(3) of the LGMS Act is unconstitutional to the extent that the charge survives a transfer of ownership to someone who is not a debtor of the municipality. The Constitutional Court must still (and probably will) confirm this declaration of invalidity, but it is hoped that the court will also consider the other arguments made in this contribution, such as that section 118(3) can be interpreted to avoid constitutional invalidity.

## 2 Interpretation of section 118(3)

A strategic mistake in *Mitchell* was for council not to challenge the correctness of the *Mathabathe* judgment, in which it was assumed that a section 118(3) charge survives a transfer of the property. Instead of challenging this interpretation, as certain commentators have done,<sup>7</sup> the focus was on the

<sup>4</sup> See eg R Brits "The Statutory Security Right in Section 118(3) of the Local Government: Municipal Systems Act 32 of 2000 – Does It Survive Transfer of the Land? [Discussion of *City of Tshwane Metropolitan Municipality v Mathabathe* 2013 4 SA 319 (SCA)]" (2014) 25 *Stell LR* 536; H Delpont "The Implications of Section 118(3) of the Local Government: Municipal Systems Act 32 of 2000 for Purchasers of Immovable Property" (2015) 78 *THRHR* 219; MM Ratiba "The Municipal Debt Collection Beyond the Mathabathe Case – A Welcome Solution or Multiplication of Problems?" (2014) 35 *Obiter* 691; C Gladwin "Historical municipal debt" (23-01-2014) *GhostDigest* <<http://www.ghostdigest.co.za/articles/historical-municipal-debt/54489>> (accessed 29-08-2014); C Gladwin & D Hepburn "The impact of *Mitchell* and *Mathabathe* on s 118" (08-12-2014) *Johannesburg Attorneys Association* <<http://jaa.org.za/download/impact-mitchell-mathabathe-s118/>> (accessed 24-01-2015); I Miltz & J Bitter "Historical Debt" (2016) 16 *Without Prejudice* 45. See also JC Sonnekus "Sogenaamde Statutêre Retensieregte ten gunste van Plaaslike Owerhede vir Agterstallige Erfbelasting en Munisipale Rekeninge" (2016) 79 *THRHR* 443.

<sup>5</sup> The present author is one of the commentators who previously criticised *Mathabathe*. See the text to n 4 above.

<sup>6</sup> 2017 2 SA 295 (GP).

<sup>7</sup> See the text to n 4 above.

narrower issue of whether this supposedly correct interpretation is qualified in the case of sales in execution. For this prospect, council relied on a passage from Voet, in which it is stated that someone who acquires property through a sale in execution receives a “clean slate” free of any burdens.<sup>8</sup> Although the high court in *Mitchell* accepted this argument, the SCA rejected the relevance of Voet when interpreting this tacit statutory real security right. For present purposes, the passage from Voet and its modern-day application will not be analysed, since this contested principle only relates to sales in execution,<sup>9</sup> whereas the focus of this article is on the broader question whether the municipality’s security right is transferred with the property in any kind of sale. It is also assumed, but without taking a final position, that the principle enunciated by Voet might indeed not apply to modern-day statutory innovations. Therefore, the suggestion is that one must pause and question whether the *Mathabathe* court was correct when it assumed that the section 118(3) charge passes with the land.

The first main argument then is that, by considering the history, context and wording of section 118(3), a strong case can be made that it was never the intention that, after the property is realised and transferred, the charge should remain and thus be enforceable against successive owners. Section 118(1) and (3) provides as follows:

“118 Restraint on transfer of property

- (1) A registrar of deeds may not register the transfer of property except on production to that registrar of deeds of a prescribed certificate-
  - (a) issued by the municipality or municipalities in which that property is situated; and
  - (b) which certifies that all amounts that became due in connection with that property for municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties during the two years preceding the date of application for the certificate have been fully paid.
- ...
- (3) An amount due for municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties is a charge upon the property in connection with which the amount is owing and enjoys preference over any mortgage bond registered against the property.”

The first step in interpreting section 118(3) is to understand its historical and contextual background. South African law has a long tradition of allowing municipalities to enjoy a form of security to assist them in enforcing outstanding municipal debts. In fact, prior to the enactment of the LGMS Act, various provincial ordinances provided such security rights. The most prominent example was the Local Government Ordinance 17 of 1939 (“Transvaal Ordinance”), which applied in the former Transvaal Province. Initially it only included a so-called “embargo” power in terms of which the municipality had to issue a clearance certificate before any property could be transferred. The certificate had to declare that all municipal debts, which were owed for a specific period prior to the application (three years in this case), were fully paid. The effect of this embargo was that any transfer of

<sup>8</sup> Voet 20 1 13.

<sup>9</sup> Cf JC Sonnekus “Sub Hasta-Veilings en die Onderskeid Tussen Oorspronklike en Afgeleide Wysens van Regsverkryging” (2008) *TSAR* 696.

the property was prevented if these debts were still unpaid. The current section 118(1) contains a similar mechanism, except that the period has been reduced to two years. Naturally, this is a powerful mechanism through which municipalities can ensure that the debts owing for the period in question are paid.

Despite the value that this right held for municipalities to restrain transfer, it transpired that, as a security mechanism, it was not sufficiently robust on its own to provide a secured claim against the proceeds of the property. The municipality did not have a real security right that could be enforced through a sale in execution, but a mere passive right (or power) to prevent transfer which gave the municipality a *de facto* preference in the event that the owner desired to transfer the property. In practice this meant that, when enforced, the municipality's right could be subject to that of the holder of a mortgage bond. After early case law confirmed this position,<sup>10</sup> the law was amended to introduce an additional form of security that was meant to be a real security right in the true sense of the term – hence a “charge” (or burden) upon the property.<sup>11</sup> Under the aforementioned Transvaal Ordinance this charge only covered the debt that was owing for the previous three years – the same debt that was covered by the embargo power. The original intention was not that the charge would remain on the land after it was transferred; it was solely aimed at giving the municipality a right to directly enforce its claim for the three-year debt against the debtor's property by having it sold in execution and to enjoy a true (and not a mere *de facto*) preference to the proceeds thereof. Moreover, this preferent claim to the three-year debt was meant to be a security right that outranked the rights of other conventional secured creditors, such as the holders of mortgage bonds.

Unfortunately, the wording of section 118(3) of the LGMS Act does not seem to follow the same structure as the charge that was originally introduced in the Transvaal Ordinance. As mentioned, originally, the charge was limited to the three-year debt, but under section 118(3) there is no equivalent time limit (for example, two years), hence it secures the payment of what has become known as the “historical debt” – effectively those debts older than two years, which are potentially unlimited except for the operation of prescription. Although it has been argued that section 118(3) should be interpreted to include the same time limit as section 118(1),<sup>12</sup> the courts regrettably rejected such an interpretation.<sup>13</sup> As will become clear below, this distinction between

<sup>10</sup> *Brakpan Municipality v Chalmers* 1922 WLD 98; *Rabie NO v Rand Townships Registrar* 1926 TPD 286. Cf also *Nel NO v Body Corporate of the Seaways Building* 1996 1 SA 131 (A) 134-135; *First Rand Bank Ltd v Body Corporate of Geovy Villa* 2004 3 SA 362 (SCA) 369-370 regarding a similar embargo power in section 15B(3)(a)(i)(aa) of the Sectional Titles Act 95 of 1986.

<sup>11</sup> *Pretoria Stadsraad v Geregsbode, Landdrostdistrik van Pretoria* 1959 1 SA 609 (T) 613-614; *Nasionale Behuisings-kommissie v Swaziland Trustees & Executors Ltd* 1962 3 SA 816 (T) 820; *Stadsraad van Pretoria v Letabakop Farming Operations (Pty) Ltd* 1981 4 SA 911 (T) 918; *City of Johannesburg v Kaplan NO* 2005 2 All SA 25 (W) 32; *City of Johannesburg v Kaplan NO* 2006 5 SA 10 (SCA) paras 16, 26.

<sup>12</sup> See eg the convincing arguments in *City of Johannesburg v Kaplan NO* 2005 2 All SA 25 (W) 32-35.

<sup>13</sup> *BOE Bank Ltd v City of Tshwane Metropolitan Municipality* 2005 4 SA 336 (SCA) paras 7-11; *Steve Tshwete Local Municipality v Fedbond Participation Mortgage Bond Managers (Pty) Ltd* 2013 3 SA 611 (SCA) para 12; *City of Johannesburg v Kaplan NO* 2006 5 SA 10 (SCA) paras 8, 13.

subsections (1) and (3), namely that the former is limited to two years while the latter is not limited in time, is in fact one of the major problems with section 118 and probably the main cause of the present consternation.<sup>14</sup>

Assuming the general theory that the primary purpose of the “charge” is (or at least was) to strengthen the embargo power, and not to create an extra security right for the entire debt, the effect would naturally be that the charge can never remain on the land when it is transferred. The reason for this is that the relevant debt (for the previous two years) would have to be paid before transfer is permitted. Consequently, the charge covers only this debt, and will thus be extinguished together with the embargo power. Alas, as stated above, this is not how the section is currently interpreted. It must be stressed that if the courts interpreted section 118(3) in accordance with the original purpose of such charges (and not in accordance with the current broad understanding in terms of which the entire historical debt is covered), the current controversy would have been avoided.

Apart from these historical arguments, one can also resort to the actual wording of section 118(3) to arrive at the logical conclusion that the charge is not intended to remain on the land after transfer. The main reason for this contention is that the subsection expressly states that the charge “enjoys preference over any mortgage bond registered against the property”. This implies that the municipality’s secured claim *must* be satisfied before any mortgagee’s claim can be satisfied. This rule is a double-edged sword, however. It could be highly problematic for mortgagees if a potentially large historical debt owed to the municipality must be paid from the proceeds of the property before the mortgagee receives its money. In the worst-case scenario, the historical debt could be so large that there is hardly anything left from which the mortgagee could satisfy his or her claim. In the event that the mortgagee’s claim cannot be satisfied to the extent that it otherwise would have been, there could be serious problems with the constitutionality of section 118(3). Since this article expands on the mortgagee’s rights in part 5 below, we can for the moment accept the rule that the municipality’s charge (its entire claim) must be satisfied before the mortgagee’s claim can be entertained.

Another effect of this rule is that, whenever property is realised (either through a normal sale or through a sale in execution) and the proceeds of such realisation must be distributed, the statutory ranking of creditors entails that the municipality must be paid before the mortgagee. In other words, the mortgagee cannot be paid before the municipality’s claim is satisfied. The trite practice that a mortgage bond must be cancelled (and thus the mortgagee’s secured claim satisfied) before the property is transferred,<sup>15</sup> implies that the mortgagee must be paid at or before transfer. Consequently, the municipality must also have been paid before transfer. The obvious implication is that, when the property is transferred, both the mortgagee and the municipality should already have been paid from the proceeds. If the proceeds are insufficient

<sup>14</sup> Cf the analysis of L du Plessis “Observations on the (Un-)constitutionality of Section 118(3) of the Local Government: Municipal Systems Act 32 of 2000” (2006) 17 *Stell LR* 505.

<sup>15</sup> S 56(1) of the Deeds Registries Act 47 of 1937 (“Deeds Registries Act”).

to settle either or both of their claims, the relevant creditor(s) will have a personal right against the debtor for the shortfall, but no real security right will remain against the land to cover this shortfall. As this rule is trite in the case of conventional mortgages,<sup>16</sup> it would be illogical to suggest that this rule does not also apply with regard to this particular statutory security right. In the absence of an express provision with such an effect, the wording of section 118(3) is, in my view, not open to such an interpretation.

Accordingly, the logical conclusion is that the charge does not survive transfer of the land, because the secured claim would have had to be settled during the realisation process.<sup>17</sup> Any shortfall will then be an unsecured personal claim against the debtor. Although the minority judgment in *Mitchell* seemed to recognise this logic, particularly in the case of sales in execution,<sup>18</sup> the majority judgment of the SCA did not consider this argument. Nevertheless, it would be highly irregular to suggest that a municipality can forsake its place in the ranking of creditors, only to retrieve it at some arbitrary later stage against a subsequent owner. The situation might be different if, say, the municipality – as secured creditor – was not afforded the opportunity to share in the proceeds when there actually was sufficient money to satisfy its claim. Even so, the municipality's claim in such a case should not be against the subsequent owner but against the person(s) who negligently failed to honour its (their) rights as secured creditor(s).

What is more, municipalities would presumably always be aware that property under its jurisdiction is being sold and transferred, and consequently the onus should, in my view, be on the municipality to proactively rely on its security during the realisation process. If it elects – either consciously or through negligence – not to enforce its security during this realisation process, of which it is (or should be) well aware, then it would be illogical to permit the municipality to have a second chance to enforce its security, but this time against a subsequent owner after the property has been transferred. It is unprecedented for any creditor to have this privilege and I therefore doubt that it could ever have been the legislature's intention. Such a drastic departure from normal principles would firstly have to be expressed in clear language, which is not the case. Secondly, even if this was intended, it would amount to an intolerable abuse of the state's legislative power and, as explained below, an arbitrary deprivation of property. In the next two sections, I explain why the interpretation of section 118(3) presented here is supported both in theory as well as from a constitutional perspective.

### 3 Theoretical argument

My hypothesis is that a statutory real security right cannot be enforceable against successors in title unless it is accompanied by a recognised form of

<sup>16</sup> S Scott & E Dirix "Calling Up a Mortgage Bond of Immovable Property" (2009) 73 *THRHR* 575-590; PJ Badenhorst, JM Pienaar & H Mostert *Silberberg and Schoeman's The Law of Property* 5 ed (2006) 380; TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* 3 ed (1987) 190.

<sup>17</sup> Cf also Miltz & Bitter (2016) *Without Prejudice* 47.

<sup>18</sup> *Tshwane City v Mitchell* 2016 3 SA 231 (SCA) paras 48-56.

publicity (physical control or registration) or, in the absence of publicity, if there is another overriding policy reason why the security right should have such an absolute real effect. This reason must moreover be proportionate to the negative effects on successors in title and other outsiders, and there should be safeguards in place to prevent as much prejudice as possible. In this part of the article, I provide reasons for this argument, which I then expand and fortify with the constitutional analysis that follows in the next part. As a basic premise, it should also be considered that, since statutory security rights arise by operation of law and not as a result of a voluntary real agreement, and because they impose burdens upon property rights (as explained in part 5 below), such burdens should be interpreted restrictively<sup>19</sup> – unless good reasons exist for doing otherwise.

The municipality's security right is described in section 118(3) as a "charge upon the property". Theoretically, therefore, the municipality's security right is a limited real right to the land in question, sometimes referred to as a tacit statutory lien or hypothec.<sup>20</sup> Based on this limited real right, a demand can be made against the owner in his capacity as owner of the land burdened (charged) with the debt, and not against the owner in his personal capacity as debtor. Of course, a judgment for the outstanding amounts can only be obtained against the actual debtor, but the implication of *Mathabathe* and *Mitchell* is that such a judgment can be executed against the relevant property regardless of whether it is still owed by the actual debtor.<sup>21</sup> However, it needs to be questioned whether this blunt assumption truly explains how real security rights operate.

As with all limited real rights, the municipality's security right is enforceable not only between the parties (*inter partes*) but against the world at large (*erga omnes*). A general consequence of this is that the limited real right is enforceable against successors in title. For example, in the event of a servitude, which is also a limited real right enforceable against the whole world, it is trite that the burden remains on the land when it is transferred and subsequent owners are bound by the rights of the servitude holder.<sup>22</sup> Overall, this is unproblematic due to the fact that the limited real right is registered against the title deed of the servient land, hence fulfilling the publicity principle. Because limited real rights are enforceable against persons other than those who created them, they are justifiable on the basis that outsiders have had reasonable opportunity to acquaint themselves with such rights. Registration generally fulfils this function in the case of land.

<sup>19</sup> CfL du Plessis *Re-interpretation of Statutes* (2002) 147, 154–156; *S v Mhlungu* 1995 3 SA 867 (CC) para 36; *Tshwane City v Uniqon Woningen (Pty) Ltd* 2016 2 SA 247 (SCA) para 24; *City of Cape Town v Real People Housing (Pty) Ltd* 2010 5 SA 196 (SCA) para 9; *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 552 regarding the presumption that statutes that limit existing rights must be interpreted restrictively.

<sup>20</sup> *BOE Bank Ltd v City of Tshwane Metropolitan Municipality* 2005 4 SA 336 (SCA) para 7; *City of Johannesburg v Kaplan NO* 2006 5 SA 10 (SCA) para 20; *Vosal Investments (Pty) Limited v City of Johannesburg* 2010 1 SA 595 (GSI) para 17; *City of Tshwane Metropolitan Municipality v Mathabathe* 2013 4 SA 319 (SCA) para 10; *Tshwane City v Mitchell* 2016 3 SA 231 (SCA) para 8.

<sup>21</sup> *Tshwane City v Mitchell* 2016 3 SA 231 (SCA) para 23.

<sup>22</sup> Badenhorst et al *Property* 322; CG van der Merwe *Sakereg* 2 ed (1989) 462.

When it comes to real security rights (a subcategory of limited real rights) the point of departure is therefore also that the right is enforceable against the whole world. It is enforceable against successors in title and thus the right remains a burden on the property even after it is transferred. This characteristic is usually described as the secured creditor's right to "follow" the property into the hands of third-party acquirers.<sup>23</sup> But what happens if the third party is innocent and acquires the property without knowledge (or the ability to become aware) of the real security right? The general rule is that the secured creditor's right to "follow" the property is absolute and thus protected regardless of whether the third party acquires the property in good faith (*bona fide*) or not.<sup>24</sup> As already stated, this rule is justified by compliance with the publicity principle. The preference of one creditor over others is justified by the fact that the preference is publicised to outsiders who can then arrange their affairs accordingly. However, it is important to consider that this absolute effect of the real security right is tempered in various ways so as to achieve an equitable balance between the interests of debtors, creditors and third parties.

In the case of movable property, innocent third parties are protected by the maxim *mobilia non habent sequelam ex causa hypothecae*<sup>25</sup> (the "mobilia rule"). Simply put, if a pledgee of movable property allows the movable to leave his physical control, he loses his security and therefore cannot follow the property if an innocent third party acquires it. The pledged object can be retrieved if it is lost involuntarily (for example, through spoliation), at which point the pledge will revive.<sup>26</sup> However, if the pledgee lost control voluntarily, the object cannot be retrieved from whoever controls it. In this sense, the control requirement combined with the *mobilia* rule therefore serves as protection for outsiders against the harsh effect that the real security right of pledge would otherwise have. In the case of a non-possessory pledge created through the registration of a special notarial bond<sup>27</sup> the property can also be followed into the hands of third parties.<sup>28</sup> Although the *mobilia* rule probably does not apply, since the bondholder's rights are not dependent on physical control,<sup>29</sup> notification through registration is in theory sufficient to warn outsiders of the existence of the notarial bond.

South African law also recognises certain non-possessory statutory pledges that come into being, not through delivery or registration, but by operation of law. According to the hypothesis stated above, the existence of these "silent" pledges must be based on convincing policy reasons to justify the potential negative consequences that can occur due to the lack of publicity. The two

<sup>23</sup> Van der Merwe *Sakereg* 629-632, 661-662.

<sup>24</sup> The innocent third party might be able to rely on the doctrine of estoppel.

<sup>25</sup> De Groot *Int* 2 48 29; Van Leeuwen *CF* 1 4 7 6.

<sup>26</sup> See eg *Charles Crabb v Joseph Jones* 1906 27 NLR 311; *Gosani v Kreusch* 1908 25 SC 350; *Theron v Gerber* 1918 EDL 288.

<sup>27</sup> S 1 of the Security by Means of Movable Property Act 57 of 1993 ("Security by Means of Movable Property Act").

<sup>28</sup> *Bokomo v Standard Bank van SA Bpk* 1996 4 SA 450 (C) 454. See also *Milne NO and Du Preez NO v Diana Shoe and Glove Factory (Pty) Ltd* 1957 3 SA 16 (W) 19.

<sup>29</sup> R Brits "Two Decades of Special Notarial Bonds in terms of the Security by Means of Movable Property Act" (2015) 27 *SA Merc LJ* 246 258.

most notable examples of such statutory pledges in South African law are found in section 30 of the Land and Agricultural Development Bank Act 15 of 2002 (“Land and Agricultural Development Bank Act”) and schedule 1 part 4 item 4 of the Co-operatives Act 14 of 2005 (“Co-operatives Act”).<sup>30</sup> Case law dealing with the concept of a statutory pledge in these and other<sup>31</sup> statutes has confirmed that even in these instances the pledgee is entitled to follow his security into the hands of innocent (*bona fide*) third-party acquirers.<sup>32</sup> Hence, the pledge still burdens the movable when it is transferred even if the new owner does not know or has no reasonable way of knowing that such a burden rests on the property.

The major justification for allowing these unpublicised pledges is that they facilitate affordable and flexible credit granting and thus they function as a “vital cog” in the very important agricultural industry.<sup>33</sup> Adding a publicity requirement (delivery or registration) would arguably have made these pledges too cumbersome to achieve their intended purpose, and therefore one can generally accept their legitimacy. Broadly speaking, the need for and importance of a non-possessory and unregistered “silent” pledge in these circumstances outweighs the prejudice that some outsiders might suffer due to a lack of publicity. One can probably assume that a good degree of proportionality is achieved in most instances. Although these pledges are not immune from criticism, for the moment they can be accepted as examples of instances where a statutory security right is permitted to be enforceable against successors in title in the absence of conventional publicity. The reason for this is that strong policy considerations (as well as carefully tailored legislative provisions that attempt to mitigate the negative consequences) override fairness concerns, and generally a just balance is achieved. The question is whether the same can be said for the unpublicised section 118(3) charge.

A mechanism comparable to the section 118(3) charge, is the charge in section 31 of the Land and Agricultural Development Bank Act, which vests by operation of law a security right over land for the payment of certain advances made to the owner of the land, particularly to finance the construction of structures such as amongst others fences, bore holes and silos. The major difference between this charge and the one in the LGMS Act is that a form of publicity accompanies the former. Before the bank makes any payments with regard to such an advance, it must notify the registrar of deeds in writing of the date and amount of the advance; the person to whom the advance is

<sup>30</sup> Cf also s 96 of the Co-operative Societies Act 29 of 1939; s 173 of the Co-operatives Act 91 of 1981.

<sup>31</sup> See eg also the War Measure 108 of 1944; s 51(1) of the Bophuthatswana Co-operatives Act 20 of 1977.

<sup>32</sup> See eg *State Advances Recoveries Office v Theron* 1949 1 SA 903 (O); *Edwards v Van Zyl* 1951 2 SA 93 (C) 226; *Heenop v Magaliesbergse Koringkooöperasie Bpk* 1962 4 SA 97 (T) 102; *Van Zyl v Burger* 1965 3 SA 221 (O) 226; *Oranje Kooöperasie Bpk v Krapohl* 1988 3 SA 763 (NC) 767-768; *Krapohl v Oranje Kooöperasie Bpk* 1990 3 SA 848 (A) 862-865; *Lesedi Secondary Agricultural Co-operative Ltd v Vaalharts Agricultural Co-operative* 1993 1 SA 695 (NC) 699. Compare also *Bokomo v Standard Bank van SA Bpk* 1996 4 SA 450 (C) 454.

<sup>33</sup> *Scott & Scott Mortgage and Pledge* 108; SA Law Commission *The Giving of Security by Means of Movable Property Project 46 Report* (1991) paras 5.10.3-5.10.7; M Kelly-Louw “Investigating the Statutory Preferential Rights the Land Bank Requires to Fulfil its Developmental Role (Part 1)” (2004) 16 *SA Merc LJ* 211 234-235.

made; and the property in respect of which it is made.<sup>34</sup> The registrar must then endorse the records of the relevant land to this effect. The outcome of the endorsement is that a charge is created upon the property in favour of the bank until the advance, along with interest and costs, has been repaid.<sup>35</sup>

Therefore, the potential effect of this charge on outsiders is justified by the fact that it is made known in the deeds registry. Moreover, even if there was no sufficient publicity, one could argue that the charge would nevertheless be justifiable due to the fact that these charges serve the same important policy goals as the silent non-possessory pledges mentioned above, namely the facilitation of affordable credit in the agricultural industry. Another justifying factor might be that the secured debt factually improved the market value of the property by virtue of the improvements made (fences, water pumps *etcetera*). It is doubtful whether the same can be said for the assumption of municipal debts, although an argument might be made that, but for the provision of municipal services, the value of the property would have decreased. Although this is not a particularly strong argument, it would depend on the facts of the case and, what is more, section 118(3) is presently not sufficiently nuanced to accommodate such equitable and economic considerations.

This agricultural charge, which is publicised through an endorsement, indicates furthermore that it is possible to create a system through which a statutory charge is accompanied by adequate publicity, which means that it should not be impossible to achieve something similar if the legislature intends to render the section 118(3) charge enforceable against successors in title. If someone takes transfer of property and the title deed is endorsed with a warning that the property is burdened with a charge relating to historical debts, the fact that the transferee would acquire the property subject to the municipality's security right would be justifiable. Hence, creating publicity through such a mechanism would certainly lead to greater fairness, but the fact that formal publicity is currently lacking without good reason, contributes to the irrationality of rendering the section 118(3) charge enforceable against successors in title.

Another comparable form of real security that needs to be mentioned is the common-law right of retention (*lien*), which also has the potential of being enforceable against successors in title of the original owner of the property. More specifically, an enrichment *lien* (which secures the claim for useful and necessary expenses spent on the improvement of property) is in mainstream case law regarded as a limited real right,<sup>36</sup> although, for instance, *Sonnekus*<sup>37</sup>

<sup>34</sup> S 31(2)(a)-(c) of the Land and Agricultural Development Bank Act.

<sup>35</sup> S 31(3).

<sup>36</sup> *United Building Society v Smookler's Trustees and Golombick's Trustee* 1906 TS 623 630, 632; *Kommissaris van Binnelandse Inkomste v Anglo American (OFS) Housing Co Ltd* 1960 3 SA 642 (A) 649, 657; *Brooklyn House Furnishers (Pty) Ltd v Knoetze and Sons* 1970 3 SA 264 (A) 271; *D Glaser & Sons (Pty) Ltd v The Master and Another* NO 1979 4 SA 780 (C) 786-787; *Syfrets Participation Bond Managers Ltd v Estate and Co-op Wine Distributors (Pty) Ltd* 1989 1 SA 106 (W) 110; *Goudini Chrome (Pty) Ltd v MCC Contracts (Pty) Ltd* 1993 1 SA 77 (A) 84-85.

<sup>37</sup> JC Sonnekus "Retensieregte – Nuwe Rigting of Misverstand *Par Excellence*?" (1991) *TSAR* 462 464-470; JC Sonnekus & JL Neels *Sakerieg Vonnisbundel* 2 ed (1994) 769-774; JC Sonnekus "Hipoteek, Insolvensie, Verryking en Retensie – Verwarring *Par Excellence*?" (2002) 35 *De Jure* 122 124-126; JC Sonnekus *Unjustified Enrichment in South African Law* (2008) 215-222 (translated by JE Rhoadie).

and Wiese contest this point.<sup>38</sup> Therefore, in principle the lien remains a burden on the property even after it has been transferred. Of course, in the case of liens the secured creditor (lienholder) must remain in physical control of the property in order to exercise his lien when the owner tries to vindicate his property.<sup>39</sup> Therefore, this physical control serves as sufficient publicity to inform outsiders of the fact that someone other than the owner has a limited real right with regard to the property. However, a distinction should be drawn between movable and immovable property in this context.

In the case of movable property, the situation is relatively unproblematic, since a successor in title would not be able to acquire the property without the lienholder's co-operation. The lienholder must either release the asset, in which case the lien is extinguished, or he must agree to henceforth hold the asset on the new owner's behalf. The latter form of transfer of ownership (attornment) requires that the transferor, the transferee and the person in control (lienholder) must co-operate in the transfer of ownership,<sup>40</sup> which means that the new owner will necessarily be (or become) aware of the lien. Hence, prejudice will be avoided.

In the case of an enrichment lien over land, the situation is more complex than with movables. Although the lien is exercised through physically controlling the immovable object, it is not generally accepted that physical control of land is sufficient to either vest or retain a real right with regard to land. Instead, the normal rule is that real rights in land can only be created or transferred through registration.<sup>41</sup> Of course, there are certain exceptions, such as the original acquisition of the land through prescription, but this process is carefully tailored to avoid undue prejudice and is in any event justified by certain policy considerations.<sup>42</sup> The point is that it is highly exceptional for a limited real right to vest over land through physical control and not through registration. Nevertheless, the general approach seems to be that physical control is sufficient to render the lien enforceable against successors in title, except if the lienholder knows of the impending sale and fails to inform the purchaser;<sup>43</sup> or if, in the case of a sale in execution, the purchaser has no actual knowledge of the lien.<sup>44</sup>

<sup>38</sup> M Wiese *Die Aard en Werking van Retensieregte: 'n Regsvergelykende Studie* LLD dissertation, Unisa (2012); M Wiese "The Legal Nature of a Lien in South African Law" (2014) 17 *PELJ* 2526.

<sup>39</sup> *Ex parte Levin* 1904 21 SC 453; *Savory v Baldochi* 1907 TS 523; *Scholtz v Faifer* 1910 TS 243 246-248; *Du Preez v Laird* 1927 AD 21; *Assurity (Private) Ltd v Truck Sales (Private) Ltd* 1960 2 SA 686 (SR) 689; *Van Niekerk v Van den Berg* 1965 2 SA 525 (A) 539-541; *De Jager v Harris NO and the Master* 1957 1 SA 171 (SWA) 179-180; *Erasmus v Minister van Wet en Orde* 1991 1 SA 453 (O) 459; *Rekdurum (Pty) Ltd v Weider Gym Athlone (Pty) Ltd t/a Weider Health & Fitness Centre* 1997 1 SA 646 (C) 652-653.

<sup>40</sup> In general, see eg *Caledon & Suid-Westelike Distrikte Eksekuteurs-kamer Bpk v Wentzel* 1972 1 SA 270 (A); *Air-keel (Edms) Bpk h/a Merkel Motors v Bodenstien* 1980 3 SA 917 (A); *Barclays Western Bank Ltd v Ernst* 1988 1 SA 243 (A).

<sup>41</sup> S 63(1) of the Deeds Registries Act.

<sup>42</sup> In general, see AJ van der Walt & EJ Marais "The Constitutionality of Acquisitive Prescription: A Section 25 Analysis" (2012) *TSAR* 714.

<sup>43</sup> *South African Association v Van Staden* (1891-1892) 9 SC 95 98; *Cornelissen v Petersen* 1913 CPD 329; *Badroodien v Van Lier* 1928 CPD 311 314-315.

<sup>44</sup> *Badroodien v Van Lier* 1928 CPD 311 314-315; *Levy v Tyler* 1933 CPD 377; *Lubbe v Volkskas Bpk* 1991 1 SA 398 (O) 409.

It is possible that these exceptions to the real effect of enrichment liens are sufficient to protect innocent acquirers in most instances. What is more, even though the form of publicity (control instead of registration) is not ideal, the principles of unjustified enrichment (which determine the existence and extent of the secured debt) should provide an equitable balance. Consequently, even if an enrichment lien can be exercised against a successor in title, there are certain exceptions and equitable rules in place to ensure that no undue prejudice is suffered. The court even has an equitable discretion to deny the lien in circumstances that indicate that upholding the lien would be unfair.<sup>45</sup> However, no such discretion and hardly any safeguards currently exist with regard to the alleged successor-in-title effect of the section 118(3) charge.

In the case of a conventional mortgage bond registered over land, the general rule is also that the mortgagee may “follow” the property into the hands of *bona fide* acquirers.<sup>46</sup> In theory, therefore, a mortgage still burdens the land after it is transferred. However, in practice this almost never happens due to the requirement that a mortgage bond must be cancelled before the land is transferred.<sup>47</sup> Also, the general rule is that a mortgagor may not alienate the encumbered property without the mortgagee’s consent.<sup>48</sup> Yet, there is support in case law for the principle that, even if a particular transfer slips through the cracks without the mortgage bond first having been cancelled, the mortgagee will retain his right to the land.<sup>49</sup> Furthermore, even if no endorsement concerning the existence of a mortgage bond was made on the encumbered property’s title deed, the mortgagee’s rights will survive.<sup>50</sup> In both of these instances an innocent third party might suffer prejudice due to the fact that they were held bound to the mortgagee’s superior rights. However, in both instances a registered mortgage bond did exist (or was cancelled mistakenly) and therefore the mortgagee’s strong rights could be justified, even though there were some oversights in the transfer process.

Notwithstanding the fact that a mortgage is in principle enforceable against successors in title, the chances of third parties suffering prejudice due to gaps in the registration system are negligible. The South African deeds registry system is well-designed and operates to render the transfer of property and the (de)registration of bonds sufficiently secure, so that mortgages will seldom pass with the land in the absence of publicity, if ever. A mortgage of land will almost always be accompanied by publicity and the identifiable

<sup>45</sup> *United Building Society v Smookler’s Trustees and Golombick’s Trustee* 1906 TS 623 631; *Fletcher and Fletcher v Bulwayo Waterworks Co Ltd; Bulwayo Waterworks Co Ltd v Fletcher and Fletcher* 1915 AD 636 648; *Ras v Vermeulen* 1927 OPD 5 7-8, 12; *Eduan Hoogtes (Pty) Ltd v Charin Electronics (Pty) Ltd* 1973 2 SA 795 (T) 796; *Grobler NO v Boikhutsong Business Undertaking (Pty) Ltd* 1987 2 SA 547 (BG) 577-578.

<sup>46</sup> *Badenhorst et al Property* 365, 472; *Van der Merwe Sakereg* 629-632.

<sup>47</sup> S 56(1) of the Deeds Registries Act.

<sup>48</sup> Ss 65(3), 75(3) and 76(2). See also *Stewart’s Trustee & Marnitz v Uniondale Municipality* 1889 7 SC 110 113.

<sup>49</sup> *Barclays Nasionale Bank Bpk v Registrateur van Aktes, Transvaal* 1975 4 SA 936 (T) 940-942. See also *Mutual Life Assurance Co v Hudson’s Trustee* (1884-1885) 3 SC 264.

<sup>50</sup> *Standard Bank van SA Bpk v Breitenbach* 1977 1 SA 151 (T) 154-156. See also *Nedbank Ltd (formerly known as Nedcor Bank t/a Perm) v Sekoboane* (1831/2011) 2013 ZANWHC 24 (07-03-2013) SAFLII <<http://www.saflii.org/za/cases/ZANWHC/2013/24.htm>> (accessed 04-07-2016) para 11.

instances where *bona fide* third parties suffer undue prejudice are so rare that the potential consequences of the mortgagee's general right to "follow" the encumbered property should not be overstated. In the vast majority of cases, the system works so well that prejudice for third parties is almost completely excluded. Without belabouring the point any further, the same cannot be said for the potential consequences of interpreting section 118(3) of the LGMS Act to say that the charge remains on the land when it is transferred.

On examination of the most notable forms of real security in South African law, it becomes clear that a limited real right of security is almost always only permitted to have an effect on outsiders if the publicity principle is fulfilled. If not, there are usually good policy reasons (or other safeguards in place) to ensure that prejudice to successors in title is avoided as far as possible. The result is a system of real security rights that is more nuanced than what is suggested by the common assumption that such rights have a real effect in an absolute sense. The real effect of such rights is regulated and qualified in various ways in order to achieve a delicate balance between the interests of debtors, creditors and third parties. In my view, the same cannot be said for the way in which section 118(3) is currently interpreted by the SCA. Moreover, as explained below, a re-interpretation (or amendment) of the section is also constitutionally mandated.

#### 4 Constitutional perspective

An interesting part of the majority judgment in *Mitchell* is that the judge mentions in passing that the constitutionality of section 118(3) was not challenged in the case.<sup>51</sup> This comment seems like an invitation to bring such a challenge – most probably based on section 25(1), the property clause, of the Constitution of the Republic of South Africa, 1996 ("Constitution"). This subsection provides that no one may be deprived of property except in terms of a law of general application and that no law may permit arbitrary deprivation of property. As mentioned in the introduction above, the high court in the *Jordaan* case recently declared the successor-in-title effect of the section 118(3) charge unconstitutional for contravening section 25(1) of the Constitution,<sup>52</sup> a conclusion which must still be confirmed by the Constitutional Court. Neither a detailed discussion of this case, nor a full analysis of exactly what section 25(1) entails is possible or necessary here.<sup>53</sup> Instead, to illustrate the relevance of the property clause for present purposes, two important Constitutional Court cases, that both deal with the constitutional effect of statutory security rights, will be discussed briefly followed by reflections on how section 25(1) applies under these circumstances. The ultimate question is whether, as the court in the *Jordaan* case found, the real burden imposed on the land of a subsequent owner (to secure the payment of a previous owner's historical

<sup>51</sup> *Tshwane City v Mitchell* 2016 3 SA 231 (SCA) para 23.

<sup>52</sup> *Jordaan v Tshwane City* 2017 2 SA 295 (GP).

<sup>53</sup> On s 25(1) in general, see AJ van der Walt *Constitutional Property Law* 3 ed (2011) 190-333.

debt) amounts to an arbitrary deprivation of property, and would consequently be unconstitutional.

In *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* (“FNB”)<sup>54</sup> the Constitutional Court had to decide upon the validity of section 114 of the Customs and Excise Act 91 of 1964 (“Customs and Excise Act”). Essentially, this section provides for a statutory lien that vests over the movable property of a customs debtor or any such property found on his or her premises, as security for the payment of his or her outstanding customs debts. The lien vests as soon as the relevant movable is detained in accordance with the procedures set out in the Customs and Excise Act. The problematic aspect of the provision was that the property of persons other than the customs debtor could also be detained under the lien and sold in execution of the customs debts if such property was found on the premises of the custom debtor. This effect was challenged on the basis that in terms of section 25(1) of the Constitution, such detention amounted to an unconstitutional imposition on the non-debtor’s property rights.

The court gave an authoritative interpretation of various concepts encountered in section 25(1), such as the meaning of “property”, “deprivation” and “arbitrary”. For present purposes, it is important to consider that the imposition of a statutory real security right by operation of law (and the attachment in execution of the property burdened by such a right) was regarded as a “deprivation of property”.<sup>55</sup> The reason for this is that the burden and consequent execution against the property amounted to a significant enough restriction on the owner’s use and enjoyment of his property.<sup>56</sup> The crux of the section 25(1) test is to determine whether the deprivation of property is arbitrary, in the sense the concept is employed in the subsection. The court found that a deprivation would be arbitrary if the law does not provide a sufficient reason for it or if the deprivation is procedurally unfair. For present purposes, the procedural aspect of the test falls outside the scope of this article (although a brief reference is made below), since the substantive sufficient-reason test is more relevant to the kind of deprivation imposed under section 118(3).

The court in *FNB* set out a detailed test<sup>57</sup> for determining when there would be such insufficient reason, but the essence is that the deprivation is only valid if there is a sufficient nexus between the deprivation itself, the purpose of the deprivation, and its effects on the affected property holder (a means-ends test). Depending on these factors, as well as the facts of a particular case, the substantive non-arbitrariness enquiry will require either rationality- or proportionality-type reasons, these being two points on a continuum. The court ultimately held that there was insufficient reason to deprive the non-debtor of his property under these circumstances. There was no relationship

<sup>54</sup> 2002 4 SA 768 (CC).

<sup>55</sup> Para 108.

<sup>56</sup> Para 57.

<sup>57</sup> Para 100.

between the debt and the property, between the property and the debtor or between the debt and the owner of the property.<sup>58</sup> Therefore, section 114 of the Customs and Excise Act was declared invalid to the degree that it causes a deprivation of property of someone other than the customs debtor. The section was subsequently amended to include safeguards that would prevent non-debtors' property from being burdened by the lien.

From this case, it is clear that the statutory imposition of real security rights in order to achieve certain important goals, such as the payment of tax debts, is not unconstitutional *per se*. However, the state's power to impose such burdens is not unlimited either. If the effect of the statutory security right effectively is to make one person liable for another's debt, it can only be upheld if there is a very good reason for it and if a high degree of proportionality exists between the effect on the non-debtor and such goal.

Another relevant case is *Mkontwana v Nelson Mandela Metropolitan Municipality; Bissett v Buffalo City Municipality; Transfer Rights Action Campaign v Member of the Executive Council for Local Government and Housing, Gauteng* ("Mkontwana"),<sup>59</sup> in which the Constitutional Court had the opportunity to consider the effect of section 118(1) of the LGMS Act. As mentioned in part 2 above, the subsection empowers municipalities to prevent the transfer of land if there are municipal debts outstanding for the previous two years. It is generally accepted that a restriction on someone's entitlements to dispose of their property amounts to a deprivation of property, but as with the *FNB* example above, this is not problematic in itself as long as the deprivation is not arbitrary. The specific problem in this case was not the mere fact that transfer was restrained but that persons other than the owner, namely unlawful occupiers, incurred the debt, which was secured by this restraint.

On face value, it seems that *FNB* should be strong authority for finding that this effect of the restraint cannot be constitutionally valid, but the Constitutional Court did not see it that way. Simply put, the court applied a less stringent test and found that it was justifiable to exercise the embargo power as security for debts incurred by the unlawful occupiers because there was a sufficiently intimate relationship between the debts and the property. Although non-owners incurred the debts, the debts served the property itself and therefore the owner could be held liable. In addition, the restriction was not regarded as sufficiently serious to lead to constitutional invalidity; it was not a complete or permanent deprivation. Moreover, the owner had a duty to prevent and/or remedy the unlawful occupation of his land. There are various problems with the court's treatment of this matter,<sup>60</sup> but its correctness can be assumed for present purposes. In general, the fact that the debts benefited the land (and therefore also its owner), even though the current owner did not

<sup>58</sup> Paras 108-109.

<sup>59</sup> 2005 1 SA 530 (CC) paras 44-54.

<sup>60</sup> AJ van der Walt "Retreating from the *FNB* Arbitrariness Test Already? *Mkontwana v Nelson Mandela Metropolitan Municipality; Bissett v Buffalo City Municipality; Transfer Rights Action Campaign v MEC for Local Government and Housing, Gauteng*" (2005) 122 *SALJ* 75; CL Gladwin *The Constitutionality of Municipal Policy Regarding the Opening of Municipal Service Accounts with Specific Reference to Mkontwana v Nelson Mandela Metropolitan Municipality 2005 1 SA 530 (CC)* LLM thesis, Unisa (2013).

incur these debts, may render it more justifiable to allow a real security right that renders the owner effectively liable for another's debt. This view is at least arguable in the event that the facts support it and if there is a sufficient nexus between the impact on the non-debtor and the benefit he enjoyed.

It may also be mentioned that a similar controversy has been brewing in the context of the landlord's tacit hypothec for unpaid rents. At common law, it is possible for property that does not belong to the tenant to be burdened by the landlord's security right provided that certain strict requirements are met.<sup>61</sup> There have been suggestions that – due to its similarity with the problem in *FNB* – this effect of the landlord's hypothec violates section 25(1) of the Constitution and should therefore be abolished.<sup>62</sup> However, due to the strict requirements for the third-party effect of the hypothec as well as the fact that certain significant categories of property have already been statutorily excluded from the hypothec's reach,<sup>63</sup> it might survive constitutional scrutiny.<sup>64</sup> The interesting point for present purposes is that the law surrounding the landlord's hypothec has certain strenuous safeguards in place to ensure that, when the hypothec does apply to property belonging to a non-debtor, this would in all likelihood be justifiable on the basis of estoppel and/or tacit consent.

Returning to section 118(3) of the LGMS Act, what can be learned from the constitutional perspective and case law discussed above? In the first place, it is constitutionally legitimate for the state to impose certain burdens on property in order to secure the payment of certain debts. Although these limitations amount to deprivations of property, they are valid unless they can be shown to be arbitrary – without sufficient reason. However, in the second place, whenever the effect of such a statutory security right is that someone other than the debtor is indirectly held liable for the debts of another, one must very carefully scrutinise the relationship between the deprivation, its purpose, and its effects on the property holder. If *FNB* is anything to go by, such situations would require a high degree of proportionality and will very likely be unconstitutional. Yet, from *Mkontwana* one can assume that, if the incurred debts service the property itself, the court is inclined to judge it more justifiable to permit the enforcement of the security right against a non-debtor owner. However, each situation must be evaluated on its own facts,<sup>65</sup> and the question is whether section 118(3) is tailored narrowly enough to satisfy this

<sup>61</sup> See especially *Bloemfontein Municipality v Jacksons Limited* 1929 AD 266 271.

<sup>62</sup> D Smith "The Constitutionality of the Lessor's Hypothec: Attachment of a Third Party's Goods" (2011) 27 *SAJHR* 308. See also JS McLennan "A Lessor's Hypothec over the Goods of Third Parties – Anomaly and Anachronism" (2004) 16 *SA Merc LJ* 121.

<sup>63</sup> S 2 of the Security by Means of Movable Property Act.

<sup>64</sup> NS Siphuma *The Lessor's Tacit Hypothec: A Constitutional Analysis* LLM thesis, Stellenbosch University (2013); AJ van der Walt & NS Siphuma "Extending the Lessor's Tacit Hypothec to Third Parties' Property" (2015) 132 *SALJ* 518.

<sup>65</sup> For other cases in which the arbitrariness was applied – with varying degrees of stringency – see eg *Reflect-All 1025 CC v MEC for Public Transport, Roads and Works, Gauteng Provincial Government* 2009 6 SA 391 (CC); *National Credit Regulator v Opperman* 2013 2 SA 1 (CC); *Cool Ideas 1186 CC v Hubbard* 2014 4 SA 474 (CC); *Shoprite Checkers (Pty) Limited v Member of the Executive Council for Economic Development, Environmental Affairs And Tourism, Eastern Cape* 2015 6 SA 125 (CC); *City of Tshwane Metropolitan Municipality v Link Africa (Pty) Ltd* 2015 6 SA 440 (CC).

test. Furthermore, if the alleged effect on successors in title is found to be unconstitutional, can section 118(3) be interpreted to avoid this effect? In part 2 above, it was explained that it can, and in my view a constitutional approach supports this interpretation.

Therefore, the question is whether the reason for introducing the section 118(3) charge is sufficient to justify the effects thereof on a subsequent owner who did not incur the secured debt him- or herself. The purpose of the section is well known, namely to assist the municipality with retrieving the debts incurred for municipal services and taxes, in order to facilitate the efficient provision of such services. In *FNB* it was confirmed that the enforcement of a debt is indeed a legitimate purpose for imposing a real security right.<sup>66</sup> Therefore, if the person who actually incurred the debt is the owner upon whose land the charge is vested, the burden is justified. (The municipality's preference over existing registered mortgages is, however, another matter, to which I return in part 5 below). The more specific question is whether this debt-enforcement purpose is strong enough to justify enforcing the security right against a subsequent owner, who is a non-debtor.

The municipality's supposed security right over the land of a subsequent owner covers debts incurred prior to two years before the new owner acquired ownership of the land. This is because the previous owner would have had to pay the debts for the previous two years in order to have obtained the clearance certificate to transfer the property. In other words, the debts secured by the charge were incurred more than two years before the new owner took transfer. The municipal services rendered more than two years before the new owner took transfer, can hardly be said to have benefited the new owner in any material manner. The link between the benefits enjoyed by the new owner and the debts incurred more than two years before he took transfer is too tenuous (if it exists at all) to justify holding the latter liable for these historic debts. Some of these debts might be decades old, since there is nothing in section 118(3) that limits the debt covered by the security right. The previous owner and/or occupants of the land enjoyed the benefits of services rendered. To say that a subsequent owner enjoys any material benefit from services rendered so long ago, is unrealistic unless it really can be shown on the facts. The problem in this regard is that section 118(3) makes no provision to accommodate a factual test. The alleged successor-in-title effect of the charge is too blunt and wide to take fairness considerations in individual cases into account. It also incorporates no equitable discretion for a court that is called upon to enforce the security. This factor strongly indicates procedural arbitrariness.<sup>67</sup>

When a new owner takes transfer of the land, he will not be aware of the existence of any charge in the municipality's favour through any formal mode of publicity. To hold him liable under a security right that he cannot be expected

<sup>66</sup> *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* 2002 4 SA 768 (CC) para 108. Cf also *Jaftha v Schoeman; Van Rooyen v Stoltz* 2005 2 SA 140 (CC) paras 37-40.

<sup>67</sup> *National Credit Regulator v Opperman* 2013 2 SA 1 (CC) para 69; *Mohunram v National Director of Public Prosecutions (Law Review Project as Amicus Curiae)* 2007 4 SA 222 (CC) para 121; AJ van der Walt "Procedurally Arbitrary Deprivation of Property" (2012) 23 *Stell LR* 88 94.

to be aware of, violates one of the most fundamental principles of real security law. Normally formal publicity (or actual knowledge in terms of the doctrine of notice) is a strong justification for the limitation imposed by a real security right. Indeed, the fact that someone knows (or should reasonably have known) of a burden when he or she elects to acquire the property, is sufficient reason to hold him to it. Even if he or she is not the original debtor, it can be said that he or she tacitly accepted the burden. However, as argued in part 3 above, in the absence of formal publicity (or actual knowledge), the imposition of the burden would only be justifiable if there is another overriding policy reason that is sufficiently proportionate to the effects of the burden. Therefore, this theoretical argument that was forwarded in part 3 above neatly ties into the constitutional standard of non-arbitrariness.

For me it is difficult to see how the purpose and policy behind section 118(3), as important as these may be, can ever be sufficiently strong to justify the effects on a *bona fide* subsequent owner whose property might be sold in execution to settle the debts incurred by a previous owner. What is more, the general failure of many municipalities to enforce their debts timeously and efficiently against their actual debtors, is a factor that seriously diminishes the social morality of any claim it might have over the property of non-debtor owners. It is patently irrational to permit municipalities, who forsake due diligence in debt collection (which can be the only reason why a historical debt is still owing), to enforce these debts against non-debtors. This would be a draconian abuse of the state's legislative powers and therefore if section 118(3) can in any way be interpreted to avoid this consequence, which I believe it can, such interpretation must be preferred.<sup>68</sup>

In my view, the only possible instance for allowing enforceability against successors in title is if the new owner enjoys a tangible benefit as a result of the old debts – namely a benefit akin to unjustified enrichment at the municipality's expense. In such an instance, the municipality's security would be comparable to an enrichment lien and equitable considerations arguably justify the new owner's liability even if there was no publicity of the charge. However, this argument is untenable for various reasons. Firstly, it would have to be shown that, when the new owner acquired the property, the alleged benefit was not taken into consideration – hence that he was enriched. Secondly, although the equitable basis for allowing a charge under these circumstances could be accepted in principle, there is nothing in section 118 that provides for such a nuanced approach to determine the scope of the municipality's security right.

## 5 Impact on mortgage bonds

It has been pointed out that the secured claim of municipalities in terms of section 118(3) enjoys a preference over all mortgage bonds registered with regard to the relevant property. This feature of the security right is subject to

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<sup>68</sup> Section 39(2) of the Constitution requires that legislation must be interpreted to promote the spirit, purport and objects of the Bill of Rights, which includes the property clause.

criticism for various reasons.<sup>69</sup> The *prior in tempore potior in iure* (the prior-in-time) rule, which applies to competing real rights, is clearly violated if the municipality's claim enjoys a preference over a mortgage bond that had been registered before the municipality's charge vested.

It is not unknown that the prior-in-time rule is departed from for certain purposes. A good example is enrichment liens, where the lienholder's claim is preferred over all other mortgagees, even if the lien vested after the registration of the mortgage.<sup>70</sup> Although this principle has been criticised,<sup>71</sup> it can generally be justified on the basis that the lienholder's enrichment claim relates to improvements that increased the market value of the property, and hence the mortgagee's rights are not diminished by the lienholder's preference.<sup>72</sup> Indeed, in such circumstances it would even be inequitable for the mortgagee to enjoy a preference with regard to the value that was added by the lienholder's improvements. However, unlike this equitable exception to the prior-in-time rule, section 118(3), as presently interpreted, is a dramatic and potentially disastrous departure from the normal rule. Unless the municipal services added value to the land, which would unjustifiably enrich the owner, there can hardly be any justification for the municipality's preference over mortgagees – except if this claim is limited to reasonable proportions. For instance, preferences that are statutorily permitted to jump the queue (usually for a good reason) are normally restricted in order to mitigate the negative effect on other creditors.<sup>73</sup> However, section 118(3) is unrestricted except for the operation of prescription. No matter how large the historical debt is, it would have to be satisfied before any mortgagee can be paid. In extreme cases, the mortgagee's security (and effectively its claim for repayment) could become almost worthless, and this as a result of something over which he or she has no control. The situation would be even worse if the municipality's security right is held to be preferred over the claim of a subsequent mortgagee – hence if the charge is enforceable against successors in title.

A mortgage is a limited real right in property, and hence it also qualifies as “property” worthy of protection under section 25(1) of the Constitution.<sup>74</sup> Therefore, the same reasoning discussed in part 4 above, applies here. The municipality's security right, being preferred over a mortgagee's right, has the effect that the exercise of the mortgagee's property right is interfered with and

<sup>69</sup> See eg also M Kelly-Louw “Municipalities Versus Bondholders – Who Won?” (2006) 20 *Speculum Juris* 160; M Kelly-Louw “Municipal Debts – Are They Killing Mortgage Bonds?” (2005) 13 *JBL* 121; M Kelly-Louw “The Preferential Right of the Local Government or the Body Corporate Above That of the Mortgage Bondholder During Insolvency Proceedings” (2004) 18 *Speculum Juris* 168.

<sup>70</sup> *Brown's Assignees v Pote* (1884-1885) 4 EDC 50; *United Building Society v Smookler's Trustees and Golombick's Trustee* 1906 TS 623 631, 633-634; *Crooks & Co v Agricultural Co-Operative Union Ltd* 1922 AD 423 444-445; *Phillips & Gordon v Adams* 1923 EDL 104; *D Glaser & Sons (Pty) Ltd v The Master and Another NO* 1979 4 SA 780 (C) 791-792; *Lubbe v Volkskas Bpk* 1991 1 SA 398 (O) 407-409.

<sup>71</sup> GM Nienaber “Verbandreg en Retensiereg” (1981) *Responsa Meridiana* 173.

<sup>72</sup> Van der Merwe *Sakerereg* 724 n 930; GF Lubbe & TJ Scott “Mortgage and Pledge” in LTC Harms & JA Faris (eds) *Law of South Africa XVII* 2 ed (2008) para 374 n 15; JC Sonnekus “Terughoudingsbevoegdhede en Oënskynlike Spanning met Saaklike Sekerheidsregte en Pandingsregte” (2015) *TSAR* 1 3-4.

<sup>73</sup> See eg s 89 of the Insolvency Act 24 of 1936.

<sup>74</sup> For more detail, see R Brits *Mortgage Foreclosure under the Constitution: Property, Housing and the National Credit Act* LLD thesis, Stellenbosch University (2012) 333-334.

significantly limited – hence a “deprivation” of property. If the deprivation was itself limited to, say, the debts for the previous two years, it might be justifiable to allow the deprivation in view of its purpose to help ensure the payment of municipal debts and facilitate the efficient delivery of municipal services. However, placing an unlimited claim ahead of the mortgagee’s claim, without adding any safeguards to maintain a fair balance, could be intensely disproportionate and could derogate to such an extent from the mortgagee’s rights that the deprivation of property in this instance can readily be classified as arbitrary. Enforcing municipal debts is not a sufficient reason to potentially destroy the value of the mortgagee’s security right. This is true for current mortgages but even more so for subsequent ones that secure the mortgage debt of a new owner. Therefore, the fact that the extent of municipality’s security right is unlimited, has a negative impact on the constitutional rights for both subsequent owners as well as current and future mortgagees. In my opinion, this state of affairs can no longer be tolerated.

## 6 Conclusion

This article argues that the security right given to municipalities in section 118(3) of the LGMS Act does not continue to burden the property transferred on account of any kind of sale (ordinary or in execution), despite what the SCA has found in *Mathabathe* and *Mitchell*. The strongest argument in favour of this hypothesis is that it would in all likelihood be unconstitutional to allow a situation where a security right can be enforced against property that belongs to someone who is not the municipality’s debtor. Such a situation can only be justifiable if a form of publicity accompanied the security right, if the doctrine of notice operates and/or if strong overriding policy reasons exist for permitting this effect of the security right. The above overview of how other real security rights operate supports this argument. However, in my view it is difficult to square the purpose of section 118(3) with the alleged unqualified effect on successors in title. There is simply no sufficient nexus between the means employed and the ends sought to be achieved.

Yet, in this article it is stressed that it is unnecessary to interpret section 118(3) to mean that the charge passes with the land. The fact that the municipality’s claim enjoys a preference over the claims of all mortgagees, as problematic as this may be in and of itself, logically implies that the municipality’s claim must be settled from the proceeds of any sale, after which no charge can remain on the land when it is transferred. Any remaining claim that could not be satisfied from the proceeds (for instance because the proceeds were insufficient) will continue to be a personal right against the debtor, but the real security right will extinguish. If this logic is followed, as it is with the realisation of conventional real security rights, the unconstitutionality described above will cease. However, unfortunately section 118(3) is presently not sufficiently clear on this point, and courts apparently do not accept this logic when interpreting section 118(3). Therefore, an amendment of the section might be necessary.

In conclusion, it is suggested that the lack of a time limit in section 118(3) should be reconsidered by the legislature or re-interpreted by the courts. If the

embargo power in section 118(1) and the charge in section 118(3) were both applicable to the same debt (relating to a limited time period), as was the case with similar security mechanisms prior to the LGMS Act, the controversies surrounding the section 118(3) charge would practically all but disappear. Not only would this security device operate more reasonably towards property owners and mortgagees, but it would encourage more vigilance on the part of municipalities. Alternatively, or additionally, the section should be amended to make provision for a form of publicity to accompany the charge so that successors-in-title can be adequately warned of their potential liability for historical debts.

Although a constitutionally-compliant interpretation of section 118(3) is therefore possible, the SCA's recent line of judgments leaves us with an unsustainable state of affairs that can only be overturned by the Constitutional Court (for instance, when it hears the *Jordaan* matter) or the legislature. In any event, it is hoped that the legislature will give urgent attention to the entire system of municipal debt enforcement and that the resultant amendments will then be in line with practical realities, legal theory and constitutional imperatives.

### SUMMARY

Section 118(3) of the Local Government: Municipal Systems Act 32 of 2000 ("Municipal Systems Act") provides a security right for municipalities by imposing a charge upon any land to which outstanding municipal debts relate. In recent years, the Supreme Court of Appeal has confirmed in at least two judgments that this charge passes with the land when it is transferred to a purchaser. The effect is that the municipality can enforce its security right against a successor in title – someone who is not the original debtor. This article forwards three lines of argument why this problematic interpretation of the provision is not (and cannot be) correct. Firstly, in view of its historical context, the wording of the provision clearly implies that the municipality's secured claim must be settled before any mortgagees are paid and hence it must logically be discharged before the land is transferred to a purchaser. Secondly, a case is made that real security rights cannot be enforceable against successors in title unless the publicity principle is fulfilled through registration or delivery, or if another good policy consideration justifies the lack of publicity and if the statute in question is designed to avoid as much prejudice as possible. Thirdly, the charge in question, which is imposed upon the land against the owner's will, amounts to a deprivation of property in terms of section 25 of the Constitution. This means that it must satisfy the non-arbitrariness test. It is argued, however, that the purported effect of the municipal charge, as currently interpreted by the SCA, is not sufficiently nuanced to satisfy this test, and would therefore not pass constitutional scrutiny. In view of these arguments, it is contended that section 118(3) should be re-interpreted or amended to be more in line with legal theory and constitutional requirements.