

a **Firstrand Bank Ltd v Land and Agricultural Development Bank of South Africa**

b SUPREME COURT OF APPEAL  
MML MAYA, JB SHONGWE, KGB SWAIN, MJD WALLIS JJA AND  
MF LEGODI AJA

Date of Judgment: 18 SEPTEMBER 2014

Case Number: 436/2013

Sourced by: P ZACHIA

Summarised by: DPC HARRIS

c *Insolvency – Free residue in insolvent estate – Proper distribution of – Whether the preference afforded to the holder of a general notarial bond in terms of section 102 of the Insolvency Act 24 of 1936 extends only to such portion of the free residue as may consist of the proceeds of movable property – Such preference does not extend beyond the value of the movable assets hypothecated under the bond.*

d **Editor’s Summary**

As the holder of a general notarial bond over all the movable assets of an insolvent company (“Rubaco”), the appellant (“Firstrand”) claimed the entire balance of the free residue remaining in the insolvent estate of the company. It based its assertion on section 102 of the Insolvency Act 24 of 1936.

e The respondent (the “Land Bank”) was the largest concurrent creditor of Rubaco. It disagreed with the appellant, contending instead that Firstrand had no preferent claim to any part of the balance of the free residue arising from the realisation of assets not subject to its bond. It maintained that the bulk of the free residue arose from the disposal of immovable assets no preference in favour of Firstrand attached to it. Instead it had to be distributed among the concurrent creditors of Rubaco. The High Court upheld the respondent’s contentions but granted leave to appeal to this Court.

f The parties formulated the question for decision as being whether the preference afforded to the holder of a general notarial bond in terms of section 102 of the Insolvency Act extends only to such portion of the free residue as may consist of the proceeds of moveable property.

g **Held** – The effect of a general notarial bond over movables is such the bondholder does not acquire any real right over the hypothecated movables. Firstrand’s general notarial bond covered all of Rubaco’s movable assets. Prior to the liquidation of Rubaco it had obtained an order perfecting its security up to an amount of R5,5 million. The Land Bank’s argument was that prior to insolvency, Firstrand enjoyed no right of security over the immovable assets of Rubaco, which were not covered by the terms of the bond. Firstrand could perfect its security or enjoy a preference in the free residue under section 102 but only in respect of movable property. That statement was correct.

h Judicial opinion on the rights in insolvency of the holder of a general notarial bond over movables has consistently been that such a creditor enjoys a preference out of the free residue of the estate, but only up to the value of the assets hypothecated. The argument advanced by Firstrand flew in the face of accepted wisdom on the rights of the holder of a general notarial bond on insolvency, namely that once a provisional winding-up or sequestration order had been

granted the position of all creditors and their rights to claim that they enjoyed a security over assets or a preference in the liquidation and distribution of the assets of the estate was frozen. a

In interpreting section 102, the Court concluded that the effect of the interpretation contended for by Firstrand would be that the holder of a general notarial bond would acquire on liquidation greater rights than it enjoyed at the date of liquidation and its security would be enhanced. That was not a sensible construction of the section. b

Answering the question posed by the parties, as referred to above, in the affirmative, the Court found for the Land Bank. c

#### Notes c

For Insolvency see:

- LAWSA Second Edition (Vol 11, paras 199–387)
- PM Meskin, B Galgut, JA Kunst, PAM Magid, DA Burdette and A Boraine *Insolvency Law and its operation in winding-up* Durban LexisNexis 2012 d

#### Cases referred to in judgment

<i>Adolph Mosenthal and Company v The Master and Feinberg's Trustees</i>	
1931 CPD 155 – <b>Referred to</b> .....	430
<i>B Ebrahim Ismail &amp; Co v Khan's Trustee</i> 1930 NPD 136 – <b>Referred to</b> .....	433
<i>Barclays National Bank Ltd and another v Natal Fire Extinguishers Manufacturing Co (Pty) Ltd and others</i> 1982 (4) SA 650 (D) – <b>Referred to</b> .....	428
<i>Bothma-Batho Transport (Edms) Bpk v S Bothma &amp; Seun Transport (Edms) Bpk</i> [2014] 1 All SA 517 (2014 (2) SA 494) (SCA) – <b>Referred to</b> .....	436
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<i>Cooper NO en andere v Die Meester en 'n ander</i> [1992] 2 All SA 20 (1992 (3) SA 60) (A) – <b>Referred to</b> .....	433
<i>Gainsford NO and others v Tanzer Transport (Pty) Ltd; Gainsford NO and others v Tanzer Transport (Pty) Ltd and others</i> [2014] 3 All SA 21 (2014 (3) SA 468) (SCA) – <b>Referred to</b> .....	437
<i>Geyser NO v Fuhri</i> [1980] 1 All SA 99 (1980 (1) SA 598) (N) – <b>Approved</b> .....	433
<i>Grand Hotel and Theatre Co Ltd Liquidation, Ex parte</i> 1908 ORC 19 – <b>Referred to</b> .....	430
<i>Hare v Trustee of Heath</i> (1884–1885) 3 SC 32 – <b>Referred to</b> .....	430
<i>Insolvent Estate AR Cunningham</i> (1908) 29 NLR 469 – <b>Referred to</b> .....	430
<i>International Shipping Co (Pty) Ltd v Affinity (Pty) Ltd and another</i> [1983] 3 All SA 231 (1983 (1) SA 79) (C) – <b>Referred to</b> .....	433
<i>Natal Joint Municipal Pension Fund v Endumeni Municipality</i> [2012] 2 All SA 262 (2012 (4) SA 593) (SCA) – <b>Referred to</b> .....	436
<i>Ninian &amp; Lester (Pty) Ltd v Perry NO</i> [1991] 1 All SA 50 (1991 (1) SA 66) (N) – <b>Referred to</b> .....	433
<i>Russouw, In re</i> 1 Menz 479 – <b>Referred to</b> .....	430
<i>Sanvill Agencies (Pty) Ltd v Jordaan NO</i> [1975] 2 All SA 289 (1975 (1) SA 938) (T) – <b>Referred to</b> .....	438
<i>South African Airways (Pty) Ltd v Aviation Union of South Africa and others</i> [2011] 3 All SA 72 (2011 (3) SA 148) (SCA) – <b>Referred to</b> .....	436

- a *Vrede Koöp Landboumaatskappy Bpk v Uys* [1964] 2 All SA 499  
(1964 (2) SA 283) (O) – **Referred to** ..... 433  
*Walker v Syfret* NO 1911 AD 141 – **Referred to** ..... 437  
*Ward v Barrett NO and another NO* [1963] 2 All SA 597  
(1963 (2) SA 546) (A) – **Referred to** ..... 437

**Judgment****WALLIS JA:**

- c [1] This is a case about money. More particularly it is about the proper disposition of the balance of the free residue remaining in the insolvent estate of Rubaco Boerdery (Edms) Bpk (“Rubaco”). The appellant, Firstrand Bank Ltd (“Firstrand”), claimed the entire balance of the free residue as the holder of a general notarial bond over all the movable assets of Rubaco. It said that this was the effect of section 102 of the Insolvency Act 24 of 1936 (the “1936 Act”). The liquidators, who have played no part in this litigation, agreed and in the Second and Final Liquidation and Distribution Account awarded Firstrand the whole of the free residue after paying prior preferent claims. The respondent, the Land and Agricultural Development Bank of South Africa (the “Land Bank”), which was the largest concurrent creditor of Rubaco, disagreed. It said that Firstrand had no preferent claim to any part of the balance of the free residue arising from the realisation of assets not subject to its bond. As the bulk of the free residue arose from the disposal of immovable assets no preference in favour of Firstrand attached to it. Instead it had to be distributed among the concurrent creditors of Rubaco, including Firstrand. An objection it lodged with the Master was rejected but a review to the High Court in terms of section 151 of the 1936 Act succeeded. Tuchten J upheld the respondent’s contentions and gave leave to appeal to this Court.
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- g [2] The parties formulated the question for decision as being:  
“Whether the preference afforded to the holder of a general notarial bond in terms of Section 102 of the Insolvency Act, 24 of 1936 extends only to such portion of the free residue as may consist of the proceeds of moveable property?”
- h Firstrand said that we should answer this in the negative and the Land Bank argued for a positive answer. Before addressing it something must be said about the order granted by the court below. It read as follows:
- i “1. That it is declared that the fourth respondent is not entitled to any allocation from the free residue of Rubaco Boerdery (Pty) Limited (in liquidation) (‘Rubaco’) in excess of the value of the nett proceeds of the goods mortgaged under notarial bond BN20986/97 (at pp22–32 of the papers) less the amount awarded to the fourth respondent as a secured creditor in relation to such goods.
- j 2. That for avoidance of doubt, it is declared that because the fourth respondent was awarded, as a secured creditor, the value of the full nett proceeds of such goods, the fourth respondent is accordingly entitled to no allocation at all from the free residue of Rubaco.
3. That the decision of the first respondent on 01 August 2011, in terms of which the first respondent rejected the objection by the applicant to the allocation of the amount of R1 905 836.76 in the free residue of

Rubaco to the fourth respondent as a preferred creditor, is hereby reviewed and set aside. a

4. That the objection of the first respondent is upheld. The amount of R1 905 836.76 in the free residue of Rubaco must be distributed among the concurrent creditors of Rubaco.
5. That the second and third respondents are directed to revise their second and final liquidation account of Rubaco in accordance with this order. b
6. That the fourth respondent must pay the applicant's costs which are to include the costs of both senior and junior counsel."

Paragraph 1 was a declaratory order in accordance with the Land Bank's contentions and paragraph 3 set aside the Master's decision. However, paragraphs 2 and 4 directed that Firstrand should receive no preference to any part of the free residue. This was incorrect. A portion of the free residue clearly arose from the disposal of movable assets subject to Firstrand's bond and it was entitled to a preference in relation to that portion. Furthermore, on any basis Firstrand would also be a concurrent creditor and entitled to share in the free residue after all preferent claims had been satisfied. Even if the Land Bank's contentions are upheld that must be corrected. c

- [3] The Land Bank's argument rested on three pillars. First, the effect of Firstrand having the preference that it claimed would afford it greater rights in the winding up and distribution of the estate of Rubaco on insolvency than it enjoyed by way of security while Rubaco was a trading entity. This was contrary to the principle that on insolvency a *concursum creditorum* comes into existence fixing both the claims against the insolvent estate and the security that creditors enjoy. Second, clear *dicta* from five different courts, including this Court, supported the Land Bank's contentions. Third, those contentions accorded with the views expressed, with but one exception, in the leading textbooks on the law of insolvency published since the enactment of the 1936 Act. Cumulatively, that was a powerful argument in its favour and it found favour with the court below. Against that Firstrand contended that the language of section 102 of the 1936 Act pointed to the opposite conclusion. d

### Background e

- [4] The effect of a general notarial bond over movables is clear in all respects, save that in issue in this appeal. The bondholder does not acquire any real right over the hypothecated movables. There is nothing to prevent the owner dealing freely therewith and the bondholder may not pursue them into the hands of a third party or prevent their attachment in execution. Under the perfection clause that is a common feature of such bonds, the bondholder will be entitled to take possession of the movables and thereby constitute a pledge over the movables. When that happens the bondholder acquires a real right of security over the movables. f

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<sup>1</sup> *Contract Forwarding (Pty) Ltd v Chesteftin (Pty) Ltd and others* 2003 (2) SA 253 (SCA) paras [3] and [4] [also reported at [2003] 1 All SA 267 (SCA) – Ed]; See also *Barclays National Bank Ltd and another v Natal Fire Extinguishers Manufacturing Co (Pty) Ltd and others* 1982 (4) SA 650 (D) at 655H–656D. g

- a [5] Firstrand's general notarial bond covered all of Rubaco's movable assets. Prior to the liquidation of Rubaco it had obtained an order perfecting its security up to an amount of R5,5 million. We do not know why it was limited to that amount as the limit of the bond was greater than that. Pursuant to that order the sheriff attached certain movables thereby converting Firstrand's security into a pledge in respect of the items attached.
- b When Rubaco was liquidated, Firstrand was therefore a secured creditor in respect of those assets.<sup>2</sup> In terms of section 83 of the 1936 Act they were realised and the proceeds paid to Firstrand in terms of encumbered asset account number 1, which formed part of the Second and Final Liquidation and Distribution Account. However, that left an amount of some R3,8 million owing to Firstrand. The free residue in the estate, after meeting disbursements, expenses and certain prior preferences, amounted to a little more than R1,9 million. Firstrand claimed to be entitled to all of this because section 102 of the 1936 Act provides that "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". It said that the bond secured its entire claim and, accordingly, that it was entitled to the entire balance of the free residue.
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- e [6] Although it initially contended that, because Firstrand had perfected its security prior to Rubaco's liquidation, it no longer had any claim against the free residue, whether a preferent or a concurrent claim, the Land Bank abandoned that stance. It accepted in argument in this Court that Firstrand was entitled to be paid out of the free residue as a preferent creditor to the extent that its claim was secured by its general notarial bond over movables. It also accepted that any balance owing thereafter was a concurrent claim. However, it said that Firstrand's bond only covered the movable assets of Rubaco and therefore its security for its claim was limited to the proceeds of those assets. The preference given by section 102 therefore only applied to that part of the free residue derived from the disposal of movable assets. As the bulk of the free residue came from assets not subject to that security its claim was to that extent both unsecured and not entitled to any preference.
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- g [7] These contrasting contentions can best be illustrated by examining the sources of the free residue in the estate. Most of it arose from the disposal of immovable assets not covered by the bond, namely registered mineral rights<sup>3</sup> and two erven mortgaged to the Standard Bank and sold for amounts exceeding the balance outstanding on the mortgage bonds. Together these accounted for nearly R2 780 000. The only part of the free residue flowing from the disposal of movables was R222 000 from the sale of livestock. The balance of some R645 000 represented interest on the investment of these amounts prior to the Second and Final Liquidation and Distribution Account. In total before any distribution the free residue came to somewhere between R3,6 and R3,7 million. The costs of sequestration, which enjoyed a prior preference in terms of
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j <sup>2</sup> See the definition of "security" in s 2 of the Act.

<sup>3</sup> Such rights fall within the definition of immovable property in s 2 of the 1936 Act.

section 97 of the 1936 Act, and some other prior preferences, came to a little over R1,75 million, leaving some R1,9 million available for distribution. a

- [8] The Land Bank contended that the accrued interest should be apportioned between the free residue arising from the disposal of movables and that arising from the disposal of immovables in the ratio that each contributed to the free residue. It said that the amounts paid from the free residue that enjoyed a prior preference to that under section 102 should similarly be apportioned between these two sources. The effect in round numbers would be that Firstrand would enjoy a preference in relation to about one-fifteenth of the free residue<sup>4</sup> and the balance would then fall to be distributed among concurrent creditors, including Firstrand in respect of the balance of its claim. In that event the Land Bank would receive a significant further dividend as it has by far the largest concurrent claim of some R8,6 million as opposed to the remaining concurrent claim of Firstrand which would be some R3,7 million. Instead of receiving R1,9 million Firstrand would receive about R130 000 and a small concurrent dividend. Hence the statement that this case is about money. b

- [9] Against that background, I turn to consider the legal arguments of the parties. Before analysing section 102 it is convenient to start by looking at the rights of the holder of a general notarial bond in respect of immovable property both before and after the coming into force of the 1936 Act. c

#### The common law and the Insolvency Acts d

- [10] Under the common law a mortgage could relate to specific property, as with a conventional mortgage over immovable property to secure a home loan or a notarial bond over specific movable assets, in which event it was called a special mortgage. Alternatively, it could hypothecate all the movable or immovable property of the mortgagor or all their movable and immovable property, in which event it was referred to as a general mortgage.<sup>5</sup> e

- [11] Prior to 1916 it was the practice to include in mortgages of specified movable or immovable property a general clause hypothecating all the movable (and sometimes all the movable and immovable) property of the mortgagor.<sup>6</sup> This practice conferred a preference in insolvency on the mortgagee in respect of the movable assets covered by such a clause.<sup>7</sup> f

<sup>4</sup> The approximate ratio between R222 000 and R2 780 000.

<sup>5</sup> *Insolvent Estate AR Cunningham* (1908) 29 NLR 469 at 471–472.

<sup>6</sup> See *In re Carter* 2 Menz 353 at 358; *Ex parte Grand Hotel and Theatre Co Ltd Liquidation* 1908 ORC 19 and *Adolph Mosenthal and Company v The Master and Feinberg's Trustees* 1931 CPD 155 at 156 in the argument by RPB Davis KC subsequently Davis AJA. The wording of the general clause appears to have been along the following lines: “and generally his person and all his movable property and assets of every description, both such as he is at present and/or may in future be or become possessed of, of whatever nature and kind soever and wheresoever situate, nothing excepted”. See *Mosenthal* 157–8. g

<sup>7</sup> *In re Roussouw* 1 Menz 479, *Hare v Trustee of Heath* (1884–1885) 3 SC 32 at 33. h

- a However, it was nullified<sup>8</sup> by the provisions of section 87(1) of the Insolvency Act 32 of 1916 (the “1916 Act”), which provided that:
- b “No general bond registered after the commencement of this Act shall confer any preference in respect of immovable property, and no general clause in a special mortgage registered after the commencement of this Act shall confer any preference in respect of immovable property or of movable property which was not delivered to the mortgagee at the time of the mortgage and retained by him during the term thereof.”
- [12] This section did not affect the preference on insolvency over movables enjoyed by the holder of a notarial bond, but it had two other effects. It excluded from any preference on insolvency movable assets covered by a general clause in a special mortgage executed after 1916. A special mortgage was not defined but the court in *Adolph Mosenthal and Company v The Master and Feinberg’s Trustees*<sup>9</sup> held it to be a mortgage that took an asset out of the free residue of the estate, because the security it gave the mortgagee was a real right in the property hypothecated. Only a bond over specific immovable property had that effect. Such a bond was similar in effect to a pledge or tacit hypothec based on possession. The effect was to confine special bonds to bonds over immovable property. The bond in issue in that case was held to be a general bond and to enjoy a right of preference unaffected by section 87(1) of the 1916 Act. When the 1936 Act was passed the court’s conclusion was incorporated in the definition of a special mortgage in section 2.
- [13] The second effect of section 87(1) of the 1916 Act, and the one more important for present purposes, was that it prohibited a general notarial bond from creating any preference on insolvency in respect of immovable property. It did so by invalidating any clause in a general notarial bond purporting to extend its reach to immovable property. That remains the present position in terms of section 86 of the 1936 Act, which commences with the same words as section 87(1) of the 1916 Act, namely: “No general mortgage bond registered after the thirty-first day of December, 1916, shall confer any preference in respect of immovable property . . .” The year after the 1936 Act was passed provisions were inserted in the Deeds Registries Act 47 of 1937 to prevent bonds contravening section 87(1) from being registered. Section 53(1) of that Act prohibits registration of a notarial bond over immovables, as well as the registration of a mortgage or notarial bond containing the general clause purporting to bind all the immovable and movable property of the debtor.
- [14] The resulting proposition that a notarial bond does not provide any security over the immovable property of the debtor was fundamental to the argument on behalf of the Land Bank. It submitted that prior to insolvency Firststrand enjoyed no right of security over the immovable assets of Rubaco, which were not covered by the terms of the bond. Firststrand could perfect its security or enjoy a preference in the free residue under section 102 but only in respect of movable property. Thus far it was undoubtedly correct. It went on to contend that it would fly in the face of

<sup>8</sup> WH Mars KC “The Law of Insolvency in South Africa” (1ed) (1917) 206.  
<sup>9</sup> *Adolph Mosenthal and Company v The Master and Feinberg’s Trustees* 1931 CPD 155.

the established common law position, as amended by the 1916 Act and the 1936 Act, to construe section 102 in a way that conferred on the mortgagee under a general notarial bond over movables a preference in insolvency over the proceeds of immovable property, that being the very preference that the common law and our Insolvency Acts in 1916 and 1936 had been at pains to deny it.

### Judicial *dicta* and academic writing

[15] Section 102 was a novel provision introduced in the 1936 Act specifically affording a preference to the holder of a general notarial bond over movables.<sup>10</sup> The 1916 Act contained no corresponding section. From the outset, the leading textbooks on insolvency law expressed the view that its effect was no more than to state the common law position, namely that the holder of such a bond enjoyed a preference in the distribution of the free residue to the extent of the realised value of the movable assets covered by the bond. A brief consideration of their views is called for.

[16] In the edition of Wille and Millin's *Mercantile Law of South Africa*<sup>11</sup> immediately preceding the 1936 Act dealing with distributions of the free residue on insolvency it was said:

“General securities. The holders of general securities participate next in the free residue. The following are the forms of general securities which are effected today, and they confer a preference *to the extent mentioned*:

...

A general bond registered after 1916 confers a preference *over movable property only* (Section 87(1); *Sonday v McCarthy* NO 1932 CPD 336) . . .” (My emphasis.)

When the 10th edition of that book was published in 1941, after the 1936 Act had come into force, the quoted passage was repeated save that reference was made after the heading “General securities” to section 102. Professor Wille expressed the same view in his subsequent publications.<sup>12</sup> So did the author of Mars on *The Law of Insolvency in South Africa*.<sup>13</sup>

[17] It is fair to say that until recently this view could be taken as the received wisdom. It was repeated in every edition of *Mars* up to and including the eighth,<sup>14</sup> and similar statements are to be found in other

10 From the record of parliamentary debates it appears to have been introduced as an amendment inserted at the committee stage of the proceedings, but there is nothing in the record of the debates to indicate what prompted this. It was not a product of the Insolvency Conference that preceded the 1936 Act and involved a wide range of people.

11 George Wille and Philip Millin “*Mercantile Law of South Africa*” (8ed) (1934) 263.

12 George Wille “*Principles of the South African Law*” (2ed) (1945) at 231.

13 WH Mars “*The Law of Insolvency in South Africa*” (3ed) (1936) by HE Hockley at 343.

14 Elmarie de la Rey Mars “*The Law of Insolvency in South Africa*” (8ed) (1988) at 383.



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- a textbooks.<sup>15</sup> The most recently published, Meskin's *Insolvency Law* is clear that the holder of a general notarial bond enjoys a preference in relation to "the proceeds remaining in the free residue of the realisation of all the insolvent's movable property."<sup>16</sup>
- b [18] The only potentially dissenting voices are those of the authors of the most recent edition of *Mars*<sup>17</sup> who say that the issue is controversial, but who read the decision of this Court in *Cooper*<sup>18</sup> as saying that the preference is not limited to the proceeds of movable property. I am unable to find anything in the decision in *Cooper* that supports this view. The case was concerned with a special notarial bond, not a general notarial bond, and it held, contrary to earlier authority,<sup>19</sup> that outside the specific list of preferences contained in sections 96 to 102 of the 1936 Act there was no room for the recognition of any other preference even though such preference would have been recognised by the common law. The court did not express a view on the interpretation or effect of section 102. The effect of the decision was reversed by the Security by Means of Movable Property Act 57 of 1993 (the "Security Act") to which I will revert.
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- d [19] Judicial opinion on the rights in insolvency of the holder of a general notarial bond over movables has consistently been that such a creditor enjoys a preference out of the free residue of the estate, but only up to the value of the assets hypothecated. Friedman J, giving the judgment of the Full Court, in *Geyser NO v Fuhri*,<sup>20</sup> said:
- e "His claim will then be preferent to the extent to which he receives payment out of the proceeds of the movable assets covered by the general bond but his claim will be concurrent in respect of the difference and to the extent that a
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- f 15 George Wille "Wille's Principles of South African Law" (5ed) (1966) at 233 and (6ed) (1970) by JTR Gibson at 237; Wille and Millin's "Mercantile Law of South Africa" (18ed) (1984) Ed JF Coaker and DT Zeffertt at 389; Catherine Smith "The Law of Insolvency" (3ed) (1988) at 234; Elmarie de la Rey and Robert Sharrock Hockley's "Insolvency Law" (5ed) (1990) at 121; PJ Badenhorst, Juanita Pienaar and Hanri Mostert Silberberg and Schoeman's "The Law of Property" (5ed) (2006) para 16.6.1.1, at 385 and GF Lubbe (revised by TJ Scott) "Mortgage and Pledge" in Joubert *LAWSA* Vol 17(2) (2ed) (2008) para 517.
- g 16 Meskin's "Insolvency Law" and its operation in winding-up Eds Justice PAM Magid, Professor André Boraine, Jennifer A Kunst and Professor David Burdette (loose-leaf) para 12.4.10 Issue 26 the volume being up to date to May 2013 and Issue 40.
- h 17 Eberhard Bertelsmann and others "Mars the Law of Insolvency in South Africa" (9ed) (2008) para 22.11.
- i 18 *Cooper NO en andere v Die Meester en 'n ander* 1992 (3) SA 60 (A) [also reported at [1992] 2 All SA 20 (A) – Ed].
- j 19 *Vrede Koöp Landboumaatskappy Bpk v Uys* 1964 (2) SA 283 (O) [also reported at [1964] 2 All SA 499 (O) – Ed] following the approach in relation to the 1916 Act in *B Ebrahim Ismail & Co v Khan's Trustee* 1930 NPJ 136. See also Basil Wunsh "What Rights of Preference are enjoyed by a Special Notarial Bond" (1960) 23 THRHR 112, where it was argued, on the strength of s 88 of the 1936 Act, that the reference to a general mortgage bond included a bond specially hypothecating movables, and *Insolvent Estate AR Cunningham* (1908) 29 NLR 469 at 471–472.
- 20 *Geyser NO v Fuhri* 1980 (1) SA 598 (N) at 602A–B [also reported at [1980] 1 All SA 99 (N) – Ed]. See also *International Shipping Co (Pty) Ltd v Affinity (Pty) Ltd and another* 1983 (1) SA 79 (C) at 84C–E [also reported at [1983] 3 All SA 231 (C) – Ed] and *Ninian & Lester (Pty) Ltd v Perry NO* 1991 (1) SA 66 (N) at 72H–J [also reported at [1991] 1 All SA 50 (N) – Ed].

*distribution may be made out of the proceeds of immovable property forming part of the insolvent estate, he will only be paid a dividend on that difference.*" (My emphasis.) a

To similar effect is the statement by Harms JA in *Contract Forwarding*<sup>21</sup> that it is trite that:

"The rights of the bondholder are of importance mainly upon insolvency. The bondholder is not a secured creditor and is entitled to a preference over the concurrent creditors of the insolvent only with respect to the proceeds of assets subject to the bond." b

[20] All the judicial statements on the point were for one or other reason *obiter dicta*, and some of the earlier judgments may have been referring to both general and special notarial bonds, because, until *Cooper*, special bonds over movables were accepted as conferring a preference to payment out of the free residue up to the value of the goods hypothecated. However, they represent considered statements of the law and cannot be disregarded. Nor can the substantial and long-standing consensus among writers on insolvency law. The argument urged upon us on behalf of Firststrand flies in the face of accepted wisdom on the rights of the holder of a general notarial bond on insolvency. It is an argument described by one writer<sup>22</sup> in the following terms: c

"[W]hile the literal and textual reading of s 102 would then give to the limited general bond holder a right of preference in relation to the whole free residue . . . it is very unlikely that this would ever be held to be the intention of the Act." d

[21] It is appropriate therefore to approach the construction of section 102 with caution. In *Cooper*, this Court disregarded the accepted view and commercial practice in relation to the preference enjoyed by the holders of special notarial bonds. The disruptive and commercially unacceptable result of the decision led to a need for remedial legislation in the form of the Security Act. That is not a result to be lightly contemplated. e

### Section 102

[22] The 1936 Act distinguishes between secured claims and unsecured claims. Secured claims are those claims secured by special mortgages, a landlord's legal hypothec, a pledge or a right of retention.<sup>23</sup> Since 1936 special mortgages have included mortgages of immovable property and the diminishing class of notarial mortgage bonds registered prior to 1993 under the Notarial Bonds (Natal) Act 18 of 1932. Since 1993 they have also included notarial mortgage bonds hypothecating specially described property in terms of the Security Act.<sup>24</sup> General notarial bonds are expressly excluded. The assets held under securities recognised by the 1936 Act do not fall into the free residue of the estate.<sup>25</sup> Where the realisation of the security held by a secured creditor is insufficient to satisfy the claim, that creditor is an unsecured creditor in respect of the balance. f

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21 *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd*, *supra* para [3].

22 Philip Sacks "Notarial Bonds in South African Law" (1982) 99 SALJ 605 at 613.

23 See the definition of "security" in s 2 of the 1936 Act.

24 See the definition of "special mortgage" in s 2 of the 1936 Act.

25 See the definition of "free residue" in s 2 of the 1936 Act. g

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- a [23] Within the class of unsecured creditors there is a distinction between those creditors who enjoy a preference in the distribution of the free residue and those who do not. The preferences are those set out in sections 96 to 102 of the 1936 Act. In terms of the decision in *Cooper* that constitutes a closed list of preferent claims, each of which succeeds the previous one as one progresses from section 96 to section 102. All other creditors are concurrent creditors. In terms of section 103 of the 1936 Act, after the claims enjoying a preference have been satisfied, concurrent creditors share in the balance of the free residue in proportion to the value of their claims.
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- c [24] Preferent creditors are not necessarily paid in full from the free residue, but only to the extent of their preference. Thus funeral and deathbed expenses under section 96(1) are limited to R300. The taxed costs of execution, other than the fees of the sheriff are limited to R50 under section 98(1)(b) and the preference in respect of salaries or wages of former employees is limited in accordance with sections 98A(1) and 2(a). To the extent that they are not paid these preferent creditors are unsecured creditors in relation to the balance of their claims.
- d
- [25] That brings me to section 102 itself, which reads:
- e “Preference under a general bond.— 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 with interest thereon calculated in manner provided in subsection (2) of section *one hundred and three*.”
- f The critical words in this section are “any claims . . . which were secured by a general mortgage bond”. Do these words relate to the entire claim of the holder of a general mortgage bond, or do they relate only to that part of the claim that is in fact secured by the bond? In other words, do they apply only to the portion of the claim equivalent to the realised value of the hypothecated movables? The former construction favours Firstrand and the latter the Land Bank.
- g [26] Unfortunately in their initial arguments neither party to this appeal focussed their arguments on these critical words. Firstrand appeared to assume that they bore the former meaning and concentrated on the words “any balance of the free residue”, which are hardly controversial. The Land Bank’s argument was that the effect of Firstrand’s approach was to nullify section 86 and give rise to an absurdity flowing from the matters discussed above. This led to the broad submission that “section 102 must be interpreted to limit the preference enjoyed by holders of general bonds to a preference in respect of the free residue relating to the proceeds of the sale of movable property”. But while that may be the conclusion of a process of interpretation it is not the correct starting point. In the result, it failed to deal with the central issue in construing section 102 of the meaning of the expression “any claims . . . secured by a general mortgage bond”. Both parties delivered supplementary heads after the Court pertinently drew the point to their attention and invited argument on it. Firstrand’s supplementary argument merely traversed the ground covered in its original heads of argument, but it included one very important concession to which I will revert. The Land Bank contended in its supplementary argument that the second construction was correct.
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- [27] The process of interpretation is no longer one in which we seek out a notional plain meaning of the words used, ignoring context and the circumstances in which the document being interpreted, whether a contract or a statute or a patent specification, came into being.<sup>26</sup> Nonetheless, it must start with the actual words used. I pointed out in *Endumeni* that:
- “The ‘inevitable point of departure is the language of the provision itself, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.’”
- It is therefore incumbent on Counsel to identify the meaning for which they contend so that it can be tested against the language used, not simply to engage in generalities. The reason is simple. If the words are unable to bear the meaning contended for then that meaning is impermissible.<sup>27</sup>
- [28] The critical words “claims . . . which were secured by a general mortgage bond” may refer either to the whole of the bondholder’s claim or to the portion of the claim that is actually secured by the bond. The former meaning is supported by the fact that the bondholder is notionally entitled to recover its entire claim from the proceeds of the realisation of the hypothecated movables. This is so even if neither the bondholder nor the debtor actually contemplates when the bond is registered that realising the encumbered assets will suffice to discharge the debt. Thus for example they may value the movables at half a million Rand while the debt is for several million Rand. However, if it transpires that the movables include a valuable antique or work of art their realisation may produce sufficient to discharge the entire debt. But in that situation the debt is paid from the hypothecated property alone, which is not the present case.
- [29] In the context of insolvency the other meaning is also permissible and, in one sense, more realistic in that it properly reflects the security that the bondholder enjoys from the bond. Taking again the example of movable property valued at half a million Rand being hypothecated to secure a claim of several million Rand it is entirely appropriate for the bondholder to say that it has a secured claim of half a million rand and an unsecured and concurrent claim for the balance. That is after all the very situation in which any holder of security as defined in the 1936 Act finds itself if their security is insufficient to satisfy their claim. Section 83(12) says so expressly. Firststrand correctly point out that the holder of a general notarial bond does not hold security as defined in the 1936 Act, but it is nonetheless secured in the general sense that the bond provides it with some security for its claims. That is the sense in which section 102 uses the word “secured”.
- [30] The first meaning is perhaps the one that is the most obvious linguistically. Indeed, it is the one to which I initially inclined. But the latter one is certainly a tenable interpretation to give to the words used in

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<sup>26</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para [18] [also reported at [2012] 2 All SA 262 (SCA) – Ed]; *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk* 2014 (2) SA 494 (SCA) paras [10]–[12] [also reported at [2014] 1 All SA 517 (SCA) – Ed].

<sup>27</sup> *South African Airways (Pty) Ltd v Aviation Union of South Africa and others* 2011 (3) SA 148 (SCA) paras [25]–[30] [also reported at [2011] 3 All SA 72 (SCA) – Ed].

- a section 102. In that situation context and background are the safest guides to selecting which is more appropriate. As the earlier discussion shows, both are overwhelmingly in favour of the second meaning. In addition, there are I think certain factors that are decisive in its favour.
- b [31] The first of these is the principle that once the company is placed in liquidation a *concursum creditorum* arises effectively freezing the rights of creditors as at the date of liquidation. Not only are claims fixed at that date, but the security rights of creditors claiming to hold security in the broadest sense for their claims are fixed at that date. As Innes CJ said:<sup>28</sup>
- c “[T]he hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order.”
- d A commitment to provide security that has not been implemented prior to liquidation cannot be implemented thereafter and, if it is, the resultant security is null and void.<sup>29</sup> The effect of the interpretation of section 102 contended for by Firstrand would be that the holder of a general notarial bond would acquire on liquidation greater rights than it enjoyed at the date of liquidation and its security would be enhanced. I do not say that the Legislature could not do that, but in the absence of any clear indication that this was the purpose of section 102 it is not a construction that should be favoured.
- e [32] Then there is a practical issue. Under section 51(1)(b) of the Deeds Registries Act, if a notarial bond is to cover not only existing but also future debts, a sum must be fixed in the bond as an amount by which future debts “shall not be secured by the bond”. That was the case with this
- f bond and many, if not most, notarial bonds limit the extent of the debt covered by the bond. In other words, the claim is secured generally but only to a limited extent. What then is to happen if after liquidation the amount of the claim exceeds the sum secured by the notarial bond? Can it be that the creditor will enjoy a preference in the distribution of the free residue of the insolvent estate in an amount greater than the amount
- g secured by the bond? The obvious answer is that the creditor does not receive such a preference, and Firstrand conceded as much in its supplementary heads of argument. The reason why that concession is correct must be that the claim is only, in the words of section 102, secured by a general mortgage bond to the extent stated in the bond and is unsecured
- h and therefore concurrent to the extent that it exceeds that amount. But, if that is the case, there is no reason not to treat the situation where the amount of the claim exceeds the value of the movables hypothecated under the bond in the same way. In other words, although there is a single claim, for example, for money lent and advanced, only a part of it is

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28 *Walker v Syfret* NO 1911 AD 141 at 166 most recently cited by this Court in *Gainsford NO and others v Tanzer Transport (Pty) Ltd; Gainsford NO and others v Tanzer Transport (Pty) Ltd and others* 2014 (3) SA 468 (SCA) para [1] [also reported at [2014] 3 All SA 21 (SCA) – Ed].

j 29 *Ward v Barrett NO and another NO* 1963 (2) SA 546 (A) at 552E–553A [also reported at [1963] 2 All SA 597 (A) – Ed].

secured by the general mortgage bond and the amount of the claim that is secured is determined by the value of the assets hypothecated. a

- [33] On Firstrand's approach the bondholder in this latter case would be entitled to a preference in respect of its entire claim against the free residue because its claim was one secured by a general mortgage bond. But that heaps absurdity upon absurdity. Not only would the preference not be confined to the value of the property hypothecated, but it would not be confined by the express terms of its bond that limited the extent of the security that it provided. It is inconceivable that this can be the effect of section 102 and Firstrand rightly conceded that this was not correct. It is one thing to afford a creditor that has taken security in this form a preference in respect of the proceeds of that security. It is another matter entirely to afford it a preference that ignores and goes beyond the terms of that security. There is nothing in section 102 or the 1936 Act to suggest that its purpose was to provide a windfall gain on insolvency to this particular class of creditor. b
- [34] One further matter illustrates why the contentions by Firstrand cannot be correct. Take the situation where the movable assets prove worthless or perhaps have been destroyed. Any free residue would then be derived entirely from the realisation of immovable property in the estate. To afford the bondholder a preference to that free residue would afford it something to which it was never entitled before insolvency, would breach the *concursum creditorum* principle, and would give rise to an absurdity. One does not adopt interpretations that are inconsistent with basic principles of law and are not commercially sensible, particularly in a field that is entirely concerned with commercial dealings. c
- [35] The apparent purpose of section 102 was to deal with a contention that had been raised under the 1916 Act – which did not refer to any preference being afforded to the holders of notarial bonds over movables, whether special or general – that all these common law preferences had been removed. While the argument had been rejected<sup>30</sup> no doubt those who drafted the Act thought it appropriate to put the matter beyond question by expressly providing for such a preference in section 102. It may be that they chose language that was inapt to include special notarial bonds, as was held by this Court in *Cooper*, but that is the obvious purpose underpinning this provision. There is nothing to support the notion that the Legislature was concerned to afford holders of notarial bonds a special preference. d
- [36] Firstrand sought support for its contentions in the proposition that the bond covered all movable property including cash. Relying on the judgment in *Sarwill Agencies (Pty) Ltd v Jordaan NO*<sup>31</sup> it argued that once the assets in the estate, including the immovable assets, were realised, the proceeds of the realisation became movable property subject to their bond. It is unnecessary for present purposes to decide whether *Sarwill* was e

<sup>30</sup> *B. Ebrahim Ismail & Co v Khan's Trustee* 1930 NLR 136.

<sup>31</sup> *Sarwill Agencies (Pty) Ltd v Jordaan NO* 1975 (1) SA 938 (T) [also reported at [1975] 2 All SA 289 (T) – Ed]. f

- a correctly decided because it dealt with an entirely different situation. The liquidator of a company had, during the course of the liquidation, acquired certain movable assets to enable him to sell a business as a going concern. When he did so the question was whether those assets had, after their acquisition, become subject to the creditor's notarial bond over movables on the basis that the bond was a continuing security. But that is not the same as this case where the immovable properties have been realised by the liquidator as required by the provisions of section 82 of the 1936 Act. To say that the proceeds of that realisation then fall within the terms of a notarial bond is to create, by the ordinary and obligatory processes of liquidation, a security and a right to a statutory preference in direct conflict with the existence of a *conkursus creditorum*.
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- c [37] Firstrand also submitted that the matter was resolved in its favour by virtue of the provisions of section 1(3) of the Security Act, which reads as follows:
- d "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)."
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- f [38] The submission was not developed but emphasis was placed on the words "the entire free residue of the insolvent estate". However, for two reasons I do not think that assists Firstrand. First, the section was enacted to remedy the situation of existing holders of special notarial mortgage bonds after the decision in *Cooper*. It does not apply to bonds executed subsequently to the commencement of the Security Act. They are dealt with in section 1(1) of that Act and bondholders are given the status in insolvency of the holder of a pledge. In other words, they are secured creditors and look to the movable property specified in the bond to satisfy their claim even though it is not in their possession. Such assets do not on realisation fall into the free residue unless there is a surplus after paying the secured claim. This reversed the common law position as it had existed since 1830 and the decision in *In re Russouw*. By contrast existing holders of special bonds were given what, prior to *Cooper*, it had been thought they enjoyed, namely a preferent claim. This is said to be a preference in the entire free residue, but that language simply makes it clear that their preferent claim is not confined to the particular assets subject to their bond. That distinguishes it from the rights that such a bondholder will have under section 1(1). It does not, however, mean that their right to a preference from the free residue is unrestricted.
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- i [39] Second, and decisively, the extent of the preference conferred by this section is the same as that conferred on a mortgagee by a general bond in terms of section 102. One cannot then determine the effect of section 1(3) unless one has first determined the extent of the preference enjoyed by the holder of a general bond. If the preference of the mortgagee under a general bond is limited to the value of the property hypothecated under that bond, in other words to the value of the movables, then the
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preference conferred by section 1(3) will be similarly limited. The fact that in principle a preference may be available in respect of the entire free residue does not alter this. The reference in section 1(3) to the entire free residue does not mean that the preference of a general bondholder under section 102 is a preference against the entire free residue. To hold otherwise is to engage in circular reasoning.

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### Conclusion

[40] In the result, I would answer the question posed by the parties and set out in paragraph 2 in the affirmative. As already mentioned, the order granted by Tuchten J did not properly reflect his conclusions because it excluded Firstrand from any preference in the free residue remaining when section 102 was reached and also excluded it from any claim as a concurrent creditor against the free residue. That was erroneous because on the facts a portion of that free residue represented the proceeds of the realisation of movables. The problem can be remedied by deleting from the order paragraphs 2 and 4 thereof. The following order is made:

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1. The order of the court below is amended by the deletion of paragraphs 2 and 4 and the renumbering of paragraphs 3, 5 and 6 as paragraphs 2, 3 and 4 respectively.
2. The appeal is otherwise dismissed with costs, such costs to include those consequent upon the employment of two Counsel.

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(Maya, Shongwe, Swain JJA and Legodi AJA concurred in the judgment of Wallis JA.)

For the appellant:

*L Meintjies* (the heads of argument having been prepared by *DM Leathem SC* and *L Meintjies*) instructed by *Rorich Wolmarans & Luderitz Incorporated*, Pretoria and *Symington & De Kok*, Bloemfontein

For the respondent:

*DM Fine SC* and *JM Hoffman* instructed by *Mkhabela Huntley Adeyeye Incorporated*, Pretoria and *McIntyre & Van der Post*, Bloemfontein