Marlize Jansen

Security by means of general notarial bonds

Some general principles reviewed

**Introduction**

Textbooks seldom devote more than a few pages to explaining general notarial bonds. How do these bonds work, and are they a secure form of security? Recently, in *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 (2) SA 253 (SCA), the Supreme Court of Appeal dealt with general notarial bonds and how they are affected by the sequestration or winding-up of the mortgagor under the bond.

Eurotile CC passed four general covering notarial bonds over its movables. Of these, the bond in favour of the first respondent (‘Chesterfin’) was registered third in time. The bond in favour of the appellant (‘Contract Forwarding’) was registered last.

Contract Forwarding obtained a provisional order perfecting its bond and permitting it to take possession of Eurotile’s assets.

The sheriff executed the order on the same day by securing the premises of Eurotile, making an inventory of the movables, and handing the keys to Contract Forwarding’s attorneys. Those attorneys exercised effective control over the business, placing security guards around its premises and a candidate attorney in charge of the business.

Later, but before the return date of the provisional order, Eurotile applied for and obtained a provisional order for its winding-up. Because Contract Forwarding became a secured creditor after its bond was perfected through attachment, it was placed in a better position than the other bondholders. Chesterfin therefore applied for leave to intervene in Contract Forwarding’s application to perfect its bond. Chesterfin’s application was granted. So the order for the perfection of Contract Forwarding’s bond was set aside, and Contract Forwarding’s application was dismissed. Contract Forwarding thus lost its status as a secured creditor of the insolvent estate of Eurotile.

Contract Forwarding then appealed against this decision.

The legal question in this case can be formulated as follows: how does a supervening winding-up affect a provisional order that permitted a creditor to perfect a general notarial bond over movables?

Here I shall discuss the principles relating to general notarial bonds, the order of preference where there is more than one registered general notarial bond, and the effect of a provisional order on the perfection of a general notarial bond.

A general notarial bond may be perfected only if the bond agreement contains a perfecting clause.
Principles relating to general notarial bonds

Security to ensure performance can be obtained either by means of personal security or by means of real security. A notarial bond is a form of real security. Defined in section 102 of the Deeds Registries Act 47 of 1937, a notarial bond is a means by which a debtor may hypothecate movable property without delivering it to the creditor in whose favour the bond is passed. Because a notarial bond does not require the delivery of the bonded asset, it is not in itself a pledge.

Notarial bonds are either special notarial bonds or general notarial bonds. Special notarial bonds are regulated by the Security by Means of Movable Property Act 57 of 1993, and general notarial bonds by common law.

A special notarial bond is a bond registered after the commencement of the Security by Means of Movable Property Act over corporeal movable property where the property has been described so that it is readily recognizable. The property over which a special notarial bond has been registered is deemed to have been pledged to the bondholder, even though it has not actually been delivered to him or her (s 1(1)). The bondholder therefore obtains real security and thus acquires a real right to the bonded property.

A general notarial bond is a bond over property described generally, and not over a specific, identifiable thing. This type of bond applies to all property in the possession of the debtor at the time when the bond is passed, and it may include assets acquired after the passing of the bond (Elliot: The South African Notary 6 ed by MJ Lowe, MO Dale, A De Kock, SL Froneman, & AJG Lang (1987) 151; Philip Sacks ‘Notarial bonds in South African law’ (1982) 99 SALJ 605 at 607). A general notarial bond does not confer any real security unless the property subject to the bond has been perfected. To perfect a general notarial bond, the bondholder must obtain control of the bonded articles through attachment, in which event he or she will be treated as a pledgee. So the relevant real right of security is constituted only at perfection (Susan Scott ‘Summary execution clauses in pledge and perfecting clauses in notarial bonds’ (2002) 65 THRHR 656 at 659–660).

A general notarial bond does not, by operation of law, confer a right to take possession of the movables burdened by it. That right must be established in the bond itself by means of a perfecting clause. So it has become common practice to insert a perfecting clause in the bond to strengthen the right of security afforded by the notarial bond (TJ Scott ‘Mortgage and Pledge’ in WA Joubert (ed) The Law of South Africa vol 17 (1st reissue) (2002) para 512). The perfecting clause merely entitles the bondholder to take possession of the property after the consent of the mortgagor has been obtained, or in accordance with a court order.

Without perfection, the bondholder of a general notarial bond has only a preference over the movable property when the mortgagor is declared insolvent or is wound up. The bondholder obtains, as against the concurrent creditors, a preference on the free residue of the insolvent estate of the mortgagor (s 102 of the Insolvency Act 24 of 1936), provided that the bond is not a voidable preference (s 29(1) of the Insolvency Act 24 of 1936).

The notarial bonds in the present case were general ones. Because the general notarial bondholder does not have possession of the mortgaged movable, the same item can be mortgaged to several other mortgagees as well, as happened here. The question that then arises, and that formed an essential part of Contract Forwarding, is which of these bonds enjoys preference?

The order of preference in instances of more than one registered notarial bond

It is important to distinguish between two situations: the situation before any of the bonds have been perfected through attachment, and the situation after one or more of the bonds has been perfected through attachment.
Before the perfection of a registered notarial bond, the bondholder has only a personal right as against the other creditors before the sequestration or winding-up of the mortgagor, and a preferent right to the free residue after the sequestration or winding-up of the mortgagor. If there is more than one registered notarial bond, and none of them has been perfected, the bond registered first will take preference over the later bonds.

But once any of the bonds is perfected the bondholder of the perfected bond obtains a real right in relation to the movables over which the bond has been registered. A real right always enjoys preference over mere personal rights. The bondholders of the unperfected general notarial bonds have only personal rights. They are protected by means of the doctrine of notice.

The doctrine of notice entails that a later bondholder who knows of the existence of a prior registered notarial bond will not be entitled to perfect the later bond in disregard of the prior bond. Constructive notice is not enough to bring the doctrine into play; the creditor must actually know that the other registered notarial bonds exist (Contract Forwarding supra at 257). A party is deemed to have constructive notice if a real right is registered in the Deeds Office.

As there was no evidence that Contract Forwarding actually knew about Chesterfin’s prior bond, even though it was registered, Chesterfin’s prior general notarial bond was not protected by the doctrine of notice.

The effect of a provisional order on the perfection of a notarial bond

Contract Forwarding obtained a provisional order under which it was allowed to perfect its general notarial bond. The court of first instance spent some time on whether this provisional order was final or interim: it did so because it felt that to confirm an interim provisional order would have amounted to a disposition by the company after the grant of a provisional winding-up order, contrary to section 341(2) of the Companies Act 61 of 1973. Section 341(2) states:

‘Every disposition of its property (including rights of action) by any company being wound-up and unable to pay its debts made after the commencement of the winding-up, shall be void unless the Court otherwise orders’.

The court of first instance concluded that the provisional order was an interim order, and that its confirmation would indeed amount to a disposition contrary to section 341(2) of the Companies Act, because the application for the winding-up was lodged and provisionally granted before the provisional order was confirmed. As the provisional order was an interim order, the court had to approach the issues on the return day as a fresh issue.

However, as the Supreme Court of Appeal recognized (Contract Forwarding supra at 258), section 341(2) provides that a company may not dispose of its assets after the commencement of a winding-up. Nevertheless, in the present set of facts, it was not the company that disposed of its assets. The disposal of the assets was an act in accordance with an order of court, and that step does not amount to a disposition (s 2 ‘disposition’ of the Insolvency Act). The court of first instance probably had the provisions of sections 348 and 359(1)(b) of the Companies Act in mind: they provide that any attachment or execution put in force after the commencement of a winding up is void.

Under section 348, ‘[a] winding-up of a company by the Court shall be deemed to commence at the time of the presentation to the Court of the application for the winding-up’.

In Contract Forwarding the application was presented to the court only after the provisional order was given. So the winding-up commenced after the provisional order was given.

Section 359(1)(b) provides (as relevant to these facts) that ‘[w]hen the Court has made an order for the winding-up of a company or a special resolution for the voluntary winding-up of a
company has been registered in terms of section 200 … any attachment or execution put in force against the estate or assets of the company after the commencement of the winding-up shall be void.’

As the provisional order was given before the winding-up commenced, and the movables were attached on the same day, it is clear that the attachment was put in force before, and not after, the winding-up of the company commenced.

According to the Supreme Court of Appeal, it was irrelevant whether the provisional order was interim or final (Contract Forwarding supra at 259). Even if it were only interim, it still permitted Contract Forwarding to take possession of the pledged goods pending the return day. By taking this step, Contract Forwarding perfected its bond.

On the return day of the provisional order, the court was required to re-examine the original order to determine whether it had been granted properly. If it had not been granted properly, then Contract Forwarding’s possession would not have created any security and would have had no legal effect. Only in this sense was the order indeed interim. But if the order had been granted properly, its confirmation would confirm the fact.

According to the Supreme Court Appeal, the provisional order could be discharged only on grounds that went to the root of the creditor’s entitlement to possession. Therefore the only ‘new facts’ that the court would consider had to be those concerned with the creditor’s entitlement to possession. But no such new facts were introduced here.

The next question that needed to be answered was whether Contract Forwarding had obtained possession lawfully. This question returns us to the general principles relating to general notarial bonds.

A general notarial bond may be perfected only if the bond agreement contains a perfecting clause. From the decision of the court of first instance (Chesterfin (Pty) Ltd v Contract Forwarding (Pty) Ltd & others 2002 (1) SA 155 (T) at 164) it is clear that this bond did contain a perfecting clause. Such a clause must be enforced by means of the relevant court order, which will essentially be an order for the granting of specific performance. This order should not merely confer constructive possession, but actual possession (see now Development Bank of Southern Africa v Van Rensburg & others NNO 2002 (5) SA 425 (SCA)). Contract Forwarding had obtained actual possession over the bonded assets, and in this way perfected its material bond.

Thus, because Contract Forwarding obtained possession lawfully and had obtained actual possession, and because no new facts were introduced to discharge the provisional order on the return date, the initial provisional order perfected Contract Forwarding’s bond. Accordingly, Contract Forwarding became a secured creditor of Eurotile before the latter’s winding-up commenced.

The intervening winding-up of Eurotile did therefore prevent a confirmation of the provisional order, because the provisional order had already perfected Contract Forwarding’s general notarial bond.

**Conclusion**

The position regarding general notarial bonds can accordingly be summed up as follows: before a general notarial bond will confer real security on the bondholder, the bond has to be perfected. Without perfection, the general notarial bond will become effective only on the sequestration or winding-up of the debtor, and in that event confer a preference on the creditor. Upon the sequestration or winding-up of the mortgagor, the creditor obtains, as against the concurrent creditors, a preference in respect of the free residue of the insolvent estate, provided that the bond does not constitute a voidable preference.

If a general notarial bond is to be perfected and thus furnish real security, the bond itself must
contain a perfecting clause. This clause can be enforced only by means of a court order for specific performance. Attachment of the movables should follow the court order. Constructive possession of the movables is insufficient: actual possession must be obtained. A mere provisional order for the perfection of the bond is sufficient to furnish real security for the bondholder, and a subsequent order for the sequestration or the winding up of the mortgagor will not affect the secured status of the bondholder.

Marlize Jansen: University of South Africa