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The Impact of *Mitchell* and *Mathabathe* on S 118

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Introduction

The press has been abuzz with articles and opinions lauding the judgment in the *Perregrine Joseph Mitchell v City of Tshwane Metropolitan Municipal Authority* Case No: 50816/14, North Gauteng High Court, Pretoria (8 September 2014) ("the Mitchell case") and its effect on the law relating to clearance certificates in terms of section 118 of the Local Government: Municipal Structures Act ("the Act") as dealt with by the court in the *Tshwane Metropolitan Municipality v Mathabathe* 2013 (4) SA 319 (SCA) at 325 ("Mathabathe"). However, many are in fact inaccurately interpreting and commenting on the Mitchell case.

The aim of this article is to clarify the present legal position. But before we can explain the present legal position, we need to discuss the developments in the law that led up to it. This article is divided into four parts. The first explains the sections of the Act that are being considered and the practical effects of same. The second contains a brief look at the important cases that clarified and developed the law, bringing us up to the pre-Mathabathe position. The third deals specifically with the impact of the Mathabathe and Mitchell cases, and the fourth with the reasons for our conclusion that section 118(3) cannot survive transfer. The fifth sums up the legal position as it stands today.

Section 1: Section 118 and its Practical Effect

Section 118 of the Act reads:

"*(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.

(1A) A prescribed certificate issued by a municipality in terms of subsection (1) is valid for a period of 60 days from the date it has been issued.

(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 purpose of section 118

Essentially section 118(1) provides that no transfer of property can take place in the deeds office until a clearance certificate is issued by the municipality stating that all debts incurred in the two year period prior to

application for the clearance certificate, have been paid. Section 118(3) says that all kinds of municipal charges are "charge[s] upon the property" and they enjoy 'preference' over any mortgage bond.

Practical effect of section 118

Practically speaking municipalities issue two types of clearance certificates. A 118(1) or "two year" or "abridged" clearance, and a s 118(3) or "historical" or "full" clearance. The two year clearance is the minimum required by law to pass transfer, and this kind of certificate certifies that all charges incurred in the two year period prior to application for same, have been paid in full. The historical clearance is a certificate that certifies that all amounts owing, no matter when they were incurred, have been paid in full. There is no requirement in law that a property owner obtain a historical clearance when passing transfer of a property, where logically it is preferable that this be obtained in all cases.

The manner in which a municipality is entitled to recover amounts owing form property owners (and potentially purchasers), has been the subject of much legal debate over the years. What follows is a brief, but essential, background to the issue that currently plagues the legal landscape in relation to the legal force of section 118(3) of the Act.

Section 2: Important developments in the law pre-Mathabathe

In the case of ***Mkontwana v Nelson Mandela Metropolitan Municipality*** **(CCT 57/03) [2004] ZACC 9; 2005 (1) SA 530 (CC); 2005 (2) BCLR 150 (CC) (6 October 2004) ("Mkontwana")** the court held that debts owed to municipalities by tenants could lawfully be collected from the owners of the properties because of the wording of section 118(3) of the Act which provides that municipal charges are "charge[s] upon the property". The court came to this conclusion because it examined the relationship between the charges, the property, and the owner, and found that the relationship was sufficiently close to justify holding the owner liable for debts that his tenant incurred. Importantly, the court also said that municipalities cannot sit idly by allowing municipal debts to rack up – they must take appropriate measures to collect debts owed to them by tenants and owners alike, and where they failed, they could be held liable for that failure.

What does section 118(3) and "preference over any mortgage bond mean"?

This means that the municipality's claim for amounts owed to it by the property owner, ranks higher than the claim of a bank (or any other mortgagee) who has lent money to the owner of the property and registered a mortgage bond over the property to secure the repayment of the loan amount. So if the property was being sold in execution (by order of court) because the owner owed creditors large amounts of money, and if the purchaser price was insufficient to cover both the municipal charges owing and the amounts owing to the bondholder, the municipality would get first 'dibs' and would be paid in full, and the bondholder would then recover whatever was left in satisfaction of the loan. This was what the court decided in ***BOE Bank Ltd v City of Tshwane Metropolitan Municipality*** **(240/2003) [2005] ZASCA 21 (29 March 2005) ("BOE").**

In BOE, the court also looked at what the legal meaning of the word "charge" in section 118(3) is, and what the consequences of that word, in context, are. The court held that the word "charge" in section 118(3) indicates that the legislature intended to create a statutory hypothec. A 'hypothec' refers to any form of hypothecation in our law, where one person acquires rights in and to another's property, as security for payment of some debt or performance of some obligation. There are many different kinds of

hypothecs. Some create real rights (for example mortgage bonds, and real liens) and others create personal rights (for example, debtor and creditor liens). They all operate differently. Section 118(3) – having been created by statute – is a statutory hypothec – and has been described as being "sui generis" meaning "in its own class" because although it is comparable to other forms of hypothecation in certain senses, it has its own unique operation. It is the manner in which section 118(3) operates, that has caused a lot of controversy in property circles in recent times.

Although one can imagine that the banks might not have liked this ruling, they accepted it as correct in law. It is important to understand that this scenario only arises in sales in execution, where the claims of the municipality and the bondholder are competing.

Then came ***City of Johannesburg v Kaplan NO and Another*** **(111/05) [2006] ZASCA 39; 2006 (5) SA 10 (SCA) (29 March 2006) ("Kaplan").** In the case the court was called upon to consider how much of the debt owed to the municipality was covered or 'secured' by section 118(3). It is clear that section 118(1) has a time limit and that only amounts incurred in the two year period prior to application for clearance are covered by this section, but can the same be said for section 118(3) – is it also limited to amounts incurred in the two years prior to application for clearance or does it cover all historical debt no matter when incurred? The court held that section 118(3) is not limited debt incurred in the two years prior to transfer and that it 'covers' all historical debt owed to the municipality that remains unpaid at the date that the municipality enforces its rights in terms of section 118(3). The legal issue that then came to the fore as a result of this judgment, was what exactly a municipality could do, when enforcing its rights in terms of section 118(3). This was dealt with in the Mathabathe case that caused so much consternation in the media and amongst lawyers.

Section 3: Mathabathe and Mitchell

Mathabathe

In 2013 the Supreme Court of Appeal was called upon to decide whether the municipality, after being paid for all amounts owing to it and incurred in the two year period prior to transfer, was further entitled to refuse to issue the clearance certificate, until such time as it had been given security (usually from the proceeds of the sale of the property) for the payment of the historical debt that remained owing to the municipality after the two year clearance certificate had been obtained. So essentially what the municipality was trying to do, was to use section 118(3) as 'backdoor' to claim payment of all historical debt before transfer, and before a clearance certificate in terms of section 118(1) could be issued – which could potentially go very far beyond the two year period expressly provided for in section 118(1).

The court considered the purpose of sections 118(1) and 118(3), and ultimately determined that they are two very different sections with different purposes. It held that section 118(1) gave the municipality a 'veto' to 'block' transfer until all amounts incurred in the two year period prior to application for the clearance certificate had been paid. Section 118(3) is quite different. It does not give the municipality a 'veto' right to 'block' transfer, but rather a right of security (or a hypothec or lien) over the property that is subject to the right. This hypothec or lien has no time limit in the way that section 118(1) does – where it is limited to amounts incurred in the prior two years. The hypothec in section 118(3) is unlimited and thus secures all amounts incurred prior to application for clearance, regardless of how long ago they were incurred (subject to them not having prescribed, of course). The 'right'

that section 118(3) gives a municipality, is the right to sell the property in execution (following a judgment being granted for payment of the debt) to recover all amounts owed to it.

The court held that the municipality was not entitled to use section 118(3) to 'block' transfer before all historical debt was paid. Once the debt incurred in the two year period prior to transfer had been paid, the municipality was legally obliged to issue a clearance certificate in terms of section 118(1). Up to this point nothing in the judgment was considered controversial or far-reaching, as much of it had already been recognised as being the legal situation for some time already.

The big question that remained to be answered by the court at this point, was what the municipality's rights were in relation to the balance of the historical debt owed at transfer, specifically in terms of section 118(3) but also generally speaking? The court (unfortunately) dealt with its answer to that question only in passing, in only one sentence in paragraph 12 of the judgment. The court said that the municipality "was plainly wrong in its contention that 'upon registration [of transfer] . . . [it] loses its rights under Section 118(3) of the Act'." This has interpreted widely to mean that the municipality does not lose its right of security in terms of section 118(3) on transfer – namely the right to take judgment for amounts owing by the seller for historical debt, attach the property, and sell the property in execution to recover the amounts owed – and that such right continues to be available to the municipality even once the property has transferred to the purchaser.

The authors are of the view that the judge did not intend to convey this meaning at all, and that when viewing the sentence in the context of the judgment of a whole it becomes clear that the judge rather intended to convey that the municipality's superior rights to claim 'first dibs' on amounts owed from the proceeds of a sale in execution, before the bondholder, remained intact. Alternatively the court might have been intending to convey that the municipality retains its rights to pursue the seller in the ordinary course after transfer for any amounts still owing, but without using the property as security.

The authors are of the view that if the court really did intend to convey that the municipality's right to attach the property even after it has already been transferred to the purchaser, in order that the property could be sold to satisfy the purchaser's debts, then it was, with respect, plainly wrong. This is because there is clear authority to the effect that a lien (be it a real lien, or a debtor and creditor lien) cannot be enforced against an 'innocent' purchaser for a debt incurred by the seller, where the purchaser was not aware of that debt and the municipality took no steps to make the purchaser aware of that debt. In these circumstances the municipality 'loses' or waives its rights to enforce its lien, and it cannot exercise it against the new owner, who was 'innocent' of the debt.

However, many (and sadly, with respect, the court in the Mitchell case) did not fully consider or grasp the above, and the misinterpretation of the Mitchell judgment has only muddied the waters further on this (already) complicated issue.

Mitchell's first big decision – section 118(3) does not survive transfer in sales in execution

In this case the court held that the hypothec created by section 118(3) does not 'survive transfer' and thus cannot be enforced by a municipality against the purchaser of a property, but only where the property is being sold in execution. Mitchell is **not** authority for the general principle that the hypothec created in section 118(3) does not 'survive' transfer in other

situations, such as insolvency, or transfers in the ordinary course from willing buyers to willing sellers.

Moreover, the authors are of the view that the court in Mitchell applied law that relates to mortgage bonds (which are also hypothecs, but are very different in nature and operation) to the unique and *sui generis* section 118 hypothec, in order to come to its conclusion, and that this application is not correct (given the very different ways in which the two forms of hypothec operate). It is possible that the court in this regard failed to distinguish between the precise meanings of the phrases "mortgage bond", "lien", and "hypothec". The court in Mathabathe (to which the court in Mitchell referred) also used the words "lien" and "hypothec" interchangeably, perhaps introducing this confusion into our law. We are of the view that the words "lien" and "hypothec" can, when referring to section 118(3), be used interchangeably, so long as it is borne in mind that regardless of whether the right created by section 118(3) is termed a "lien" or a "hypothec" it must operate (unless otherwise expressly prescribed by the legislature) in accordance with the general precepts of hypothecs/liens and it must further be understood as being "*sui generis*" or "in its own class".

However, the authors are of the view that, because there is other legal authority (unfortunately not cited by the court in Mitchell) for the principle that the section 118(3) hypothec should not 'survive transfer', the court ultimately came to the right conclusion, albeit on slightly round about reasoning. Scott in LAWSA refers to the case of *Badroodien v van Lier* as authority for the principle that when immovable property subject to a lien (specifically, as opposed to a mortgage bond, as dealt with by Voet and quoted in Mitchell) is sold in execution to a purchaser who is unaware of the lien, the purchaser is not bound to respect it. We submit that this authority would have been more appropriate (and recent) and provided better support for the decision of the court in this regard.

Be this as it may, the (otherwise) reasoned, practical and well researched approach taken by the court in this matter is to be welcomed. A precedent has been set to dispel some of the prejudice suffered by purchasers (if only in relation to a certain class of property transfers – namely those sold in execution purtsuant to a judgment – as opposed to all properties transferred generally).

Mitchell's second big decision – purchasers cannot be held liable for seller's municipal debts

The Mitchell judgment also held that when one understands that section 118(3) does not transfer the debt owed by the municipality from the seller to the purchaser - it merely creates a right of security in favour of the municipality that can be used (only before transfer, in sales in execution) to attach the property and sell it to satisfy the seller's debts to the municipality – it becomes apparent that short of any law making a purchaser liable for a seller's debts (which section 118(3) does not do, and neither does any other law) and in the absence of agreement by the purchaser that it will be liable for the seller's municipal debts, there is no justification in law for a municipality recovering amounts owed by sellers from purchasers of properties. This is very important because hypothecs generally do not themselves create a debt that must be paid – they are simply mechanisms that exist and can be used to enforce payment of that debt. The are 'swords' and not 'shields'. They can be used to obtain possession of the property burdened by the hypothec, which property can be sold to satisfy the debt, but the debt remains the debt of the debtor and this debt does not transfer to a third party who subsequently becomes the owner of the property, even if the right of the creditor

to use the property as security for the debtor's debt, is in some instances enforceable against that third party.

Mitchell's third big decision – municipalities must supply services to purchasers if they apply

The third very important aspect of the Mitchell judgment was the ruling that a municipality cannot refuse to supply electricity or water, or enter into an agreement for the supply of electricity or water, to a purchaser of a property, merely as a result of the seller's unpaid municipal debts. Not much more need be said about this decision here, save that the court's well-reasoned judgment on this issue and the precedent that it sets is welcomed by the authors.

Section 4: Why Section 118(3) liens (or hypothecs) cannot survive transfer to purchasers in property transfer

Apart from what is said in Mitchell, there are other legal reasons why the section 118(3) lien/hypothec should not "survive transfer". Very briefly, these include:

1 Subject to certain recognised exceptions, a lien only operates against the property of the debtor. This is especially the case where a third party that subsequently takes transfer of the burdened property from the debtor whilst the lien is in existence, is unaware of the existence of the lien.

2 It is arguably a violation of the purchaser's rights to property in terms of our Constitution, to subject it to the lien securing the seller's debts, in the same way that the Constitutional Court found the statutory lien created by the Customs and Excise Act operating over all property in the possession of customs debtors, to be.

3 it is a requirement of a lien that the person enforcing it, be in possession of the property, to enforce it. Arguably until the municipality has attached the property for the debts owed by the seller, it has not exercised its lien and is not in possession of the property, meaning that if the municipality does not attach the property before transfer, it has waived its right to do so, and cannot after transfer exercise this right.

4 There is some debate as to whether the section 118(3) lien is a real lien (which gives rise to real rights) or a debtor and creditor lien (which gives rise to personal rights). Real rights bind the whole world, but personal rights only bind those who are party to the agreement in question. If the section 118(3) lien is a debtor and creditor lien, the personal rights created are 'trumpted' by the real rights that come into being when the seller transfers the property to the purchaser, because ownership is a real right, and real rights trump personal rights, meaning that the purchaser's right to his property is stronger than the municipality's right to use that property to pay the seller's debt.

5 Generally liens only operate in respect of charges owed by the debtor (ie the seller) to the creditor (ie the municipality) and not to secure claims against third parties (ie the purchaser). Once the property has transferred to the purchaser, then this principle is violated because the owner (ie the purchaser) is being held liable for someone else's debts, without having agreed to be liable for same.

6 Because the entire reason for rates clearance certificates is to ensure that the purchaser is not held liable for the seller's outstanding municipal debt, generally speaking, upholding the interpretation that section 118(3) liens "survive transfer" and can be enforced against the purchaser for the seller's debts, is against public policy, and can be found to be unlawful for this reason alone.

Section 5: The position in our law today

So, where does this leave us?

1. In sales in executions it is settled law that:
   1.1 A municipality can refuse to provide a seller with a rates clearance certificate in terms of section 118(1) but only until all amounts (for all municipal services as well as rates and taxes) incurred in the two year period prior to application for a clearance certificate, have been paid in full or satisfaction for their payment has been given to the municipality;
   1.2 the section 118(3) lien/hypothec does not survive transfer and cannot be enforced by a municipality against a purchaser, to attach and sell the property concerned (before transfer) to satisfy the seller's municipal debts to the municipality;
   1.3 if a municipality choses to enforce its section 118(3) hypothec and attach the property and sell it to satisfy the seller's debts to the municipality, this must be done before transfer, and in this event the municipality's claim will rank superior to the bondholder's, so the municipality gets 'first dibs' at the proceeds and the bondholder can take whatever is left over to satisfy its claims against the seller;
   1.4 purchasers are not liable for seller's municipal debts existing at the date of transfer;
   1.5 municipalities cannot refuse to supply electricity and/or water and/or refuse to enter into agreements for the supply of these services to purchasers because of the unpaid municipal debts of sellers, unless:
      1.5.1 the purchaser agrees to this; or
      1.5.2 the law changes to make purchasers jointly and severally liable with sellers for municipal debt existing at the date of transfer.
   1.6 After transfer the municipality's right to claim any amounts still owing by the sellers remain intact, and the municipality is entitled to take any legal action or institute any credit control measures that it is authorized to, in the ordinary course, to recover amounts owing from the seller.
2. In sales from insolvent estates (courtesy of Kaplan, the finer details of which, in relation to insolvency, have not been canvassed extensively herein, as they are not directly on point):
   2.1 A municipality can refuse to provide a seller with a rates clearance certificate in terms of section 118(1) but only until all amounts (for all municipal services as well as rates and taxes) incurred in the two year period prior to application for a clearance certificate, have been paid in full or satisfaction for their payment has been given to the municipality;
   2.2 If a municipality is owed more than the amount that it recovers when issuing the section 118(1) clearance certificate, then it can chose to enforce its rights in terms of section 118(3) (see below) or it can lodge an unsecured, by preferrent claim, against the insolvent estate, for the balance, in which event the remainder of its claim will be dealt with in the ordinary course of the winding up of the estate;
   2.3 If a municipality choses to exercise it, its right to enforce its hypothec in terms of section 118(3) and to attach the property and sell it to satisfy debts owed to it, only extends to amounts incurred for "taxes" in the two year period prior to sequestration and not to all

historical debt owed in relation to the property, as is the case in other scenarios. There is no limit to amounts incurred as services as secured by section 118(3);

2.4 If a municipality wants to enforce its hypothec in terms of section 118(3) to attach and sell the property and to use the proceeds to satisfy the debt, its section 118(3) hypothec ranks superior to the real right of security created by a mortgage bond and so the municipality gets first 'dibs' at the proceeds before the bank;

2.5 If a municipality is owed more than what it recovers from the sale of the property, it can lodge a claim against the insolvent estate or the balance, which claim will be unsecured but preferrent, and will be dealt with in the ordinary course of the winding up of the estate;

2.6 If the municipality fails to lodge its claim against the insolvent estate timeously, then its claim will lapse and will no longer be enforceable against the insolvent estate;

2.7 If a municipality lodges a claim against the insolvent estate and there are insufficient funds to settle the claim in full, the municipality's claim will be compromised by the amount received in the winding up, which will be received 'in full and final settlement' thereby extinguishing the municipality's claim for any further amounts;

2.8 Seeing that a municipality's remaining claim against the seller (the insolvent) will lapse if it is not lodged timeously, and if lodged, will be extinguished when the winding up is made final, the municipality's remaining claim is no longer enforceable against the seller, and therefore, even if section 118(3) liens survive transfer (which they do not), there would be nothing owed left to use to enforce section 118(3) against the purchaser for;

2.9 Purchasers are thus not liable for a seller's municipal debts when the property is sold from an insolvent estate and a municipality cannot refuse to supply or enter into an agreement to supply electricity or water to a purchaser because of a seller's debts.

3. In sales 'in the ordinary course' between a willing buyer and seller, on the open market:

3.1 A municipality can refuse to provide a seller with a rates clearance certificate in terms of section 118(1) but only until all amounts (for all municipal services as well as rates and taxes) incurred in the two year period prior to application for a clearance certificate, have been paid in full or satisfaction for their payment has been given to the municipality;

3.2 The municipality's claim for satisfaction of all amounts owed to it for all historical debt, ranks superior to a bondholder's claim, but this will only be the case if the municipality acts to perfect its rights in terms of section 118(3) and attaches the property before transfer – if it simply allows transfer to go through without attaching the property to exercise its rights in terms of section 118(3) then the municipality's claim will not be secured and the conveyancers will simply pay the proceeds over to the seller, and the seller will have to settle anything else owing (over and above what was paid for the clearance certificate) with the municipality.