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# REAL ESTATE ALERT

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## Ranking of notarial bonds over moveable property

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Commercial demands have prompted divergent yet creative structures to be implemented for the lending and securing of debt. Whilst mortgage bonds continue to be a ubiquitous form of security, a lack of appreciation of notarial bonds as a viable form of security has caused security structures to be rather one-dimensional and, in some instances, to fall short of harnessing the full value of a borrower's assets. The following article aims to provide a framework for the intricacies of notarial bonds and how they may be best utilised to create a compelling and efficient form of security underpinning a commercial loan structure.

### Introduction

A notarial bond allows a borrower to hypothecate its moveable property as security for a debt without requiring delivery of the property to the creditor (Badenhorst, PJ, Juanita M Pienaar, and Hanri Mostert Silberg and Schoeman's 'The Law of Property' 5th ed. LexisNexis Butterworths, Durban, (2006) at 384). This creates an enabling environment in which

a borrower is able to offer its valuable property as security whilst still being in a position to operate its business with those assets and to produce income to service the debt.

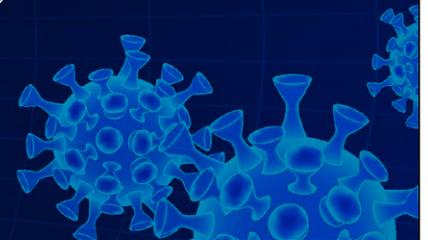
In this article, we briefly discuss the principle elements of notarial bonds and explain the differences between general notarial bonds (GNBs) on the one hand and special notarial bonds (SNBs) on the other. Understanding the differences between these two types of notarial bonds is crucial in determining the nature of the security each provides and how they may be utilised to secure the obligations of a borrower, surety or the like.

### Notarial Bonds: General Principles

A notarial bond is registered in the deeds registry's jurisdiction where the borrower resides as well as where he carries on business. If the borrower is a company or close corporation, a notarial bond is registered in the deeds registry area where the registered office of the company or close corporation is situated, in which case its registration will be effective for the whole of South Africa.

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## Ranking of notarial bonds over moveable property...continued

GNBs are registered in respect of all the movable property of the borrower and unlike SNBs, registration does not confer a real right on the bondholder in respect of the movable assets encumbered by the bond.

The following elements contained in a notarial bond are essential:

- **A valid causa for the registration of a notarial bond**

The causa or cause of debt refers to the circumstances necessitating the registration of a notarial bond. This emanates from an agreement, usually in the form of a suite of finance documents entered into by the borrower and a credit provider. Typical causes of debt include monies lent and advanced in accordance with the terms of a loan agreement or a guarantee provided for the debts of a third party in accordance with the terms of a guarantee agreement.

- **A power of attorney and draft notarial bond as an annexure**

The power of attorney is a unilateral document, signed by the borrower and two witnesses. A draft notarial bond is attached to the power of attorney as an annexure. By signing the power of attorney, the borrower authorises an agent, to appear before a notary public in his place and stead and to encumber his movable property in favour of the credit provider (the bondholder), in accordance with the terms of the draft notarial bond attached. In the event that the mortgagor does not wish to sign a power of attorney, the mortgagor may appear before the notary public and execute the notarial bond in the notary public's presence.

The power of attorney affords the bondholder a claim in personam to enforce registration of the notarial bond, but at this stage no right to the moveable property itself vests in the bondholder.

- **Necessary resolutions**

Copies of the relevant resolutions and the power of attorney are filed in the notary public's protocol for verification purposes.

- **Registration**

Registration is generally the catalyst for the creation and vesting of real rights or limited real rights. However, as discussed below, real rights are not created on the registration of a general notarial bond.

Section 61 of the Deeds Registries Act 47 of 1937, requires every notarial bond to be registered in a deeds registry within a period of three months after the date of its execution or within such extended periods as the court may on application allow.

### General notarial bonds

GNBs are registered in respect of all the movable property of the borrower and unlike SNBs, registration does not confer a real right on the bondholder in respect of the movable assets encumbered by the bond. Perfection of a GNB bond is crucial in creating a limited real right

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## Ranking of notarial bonds over moveable property...continued

Understanding the position of the bondholder prior to and upon perfection of a GNB is crucial to effectively utilising the security that the GNB purports to provide.

over the bonded property. Perfection entails a further step of taking possession of the moveable property pursuant to a court order.

Understanding the position of the bondholder prior to and upon perfection of a GNB is crucial to effectively utilising the security that the GNB purports to provide. There are two primary effects:

- **Ranking of claims**

A borrower is entitled to burden its moveable property with numerous GNBs. Where a borrower has granted more than one GNB over its moveable property, the date of perfection rather than the date of registration determines the ranking of the bondholder's claims. That is to say, irrespective of the sequence of the registrations of the GNB, the bondholder who successfully perfects its bond first in time, ranks first in law.

- **Insolvency of the Borrower**

Where a bondholder of a GNB perfects its claim prior to sequestration/liquidation of the borrower, the bondholder will enjoy a secured claim against the insolvent estate. If the GNB is unperfected at the time of liquidation/sequestration, then despite

the GNB having been successfully registered, the bondholder does not have a limited real right and therefore no secured claim against the insolvent estate (*Development Bank of Southern Africa v Van Rensburg* 2002 (5) 425 (SCA)). Further, to this point, the bondholder loses its ability to perfect the bond (*Trisilino v De Vries* 1994 (4) SA 514 (O)) and will be classed as a concurrent creditor with a preferential claim against the free residue of the insolvent estate.

### Special Notarial Bonds

SNBs are governed by the Security by Means of Moveable Property Act 57 of 1993. (Act). Section 1 of the Act provides that SNBs may be registered in respect of specific items of moveable property that must be described in the bond in such a manner that the property is readily recognisable.

The Act provides that moveable property encumbered by a SNB must be readily recognisable to a third party on the basis of the description in the bond alone, without recourse to extrinsic evidence (*Ikea Trading and Design AG v BOE Bank Ltd* 2005 (2) SA 7 (SCA)). If this requirement is not met, registration of the SNB will not confer a preference in favour of the bondholder.

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## Ranking of notarial bonds over moveable property...*continued*

Times have changed calling for more encompassing structures to secure loans. GNBs and/or SNBs can be utilised in addition to traditional securities like mortgage bonds, sureties or cessions.

As a result, it is thus critical to describe the moveable property encumbered with reference to inter alia serial numbers; engine numbers; vin numbers; model and make; and where necessary photographs and GPS co-ordinates.

Unlike GNBs, as provided for above, the bondholder is granted a limited real right simultaneously with the registration of a SNB. There is no additional step requiring the bondholder to take possession of the moveable property in order to create a limited real right. A SNB creates a deemed pledge of the moveable property bonded on registration, negating the need for the bondholder to perfect its bond as the law regards the bondholder to already be in possession thereof. The following principles are relevant to SNBs:

- **Ranking of claims**

Where more than one SNB is registered over a particular moveable, the competing claims of the bondholders will be ranked according to when the respective SNB was registered. Bondholders with prior registered SNBs have claims that trump subsequently registered SNBs. Furthermore, bondholders with prior-registered SNBs will be required to consent to further SNBs being registered over the bonded property, providing increased protection to the bondholder whose bond was registered first in time.

- **Landlord's tacit hypothec**

A registered SNB ranks superior to a landlord's tacit hypothec if that hypothec is unperfected (i.e. the landlord has not successfully effected the attachment of the moveable property) at the time of registration of the SNB.

- **Secured claim against insolvent estate**

The implication of the limited real right afforded to the bondholder of a SNB at the time of registration is that should the borrower's estate be liquidated/sequestered, the bondholder will have a secured claim against the insolvent estate in respect of the encumbered movable property.

### Conclusion

Times have changed calling for more encompassing structures to secure loans. GNBs and/or SNBs can be utilised in addition to traditional securities like mortgage bonds, sureties or cessions. Commercial enterprises may have moveable property that have not yet been effectively geared providing the perfect opportunity to unlock the full value of its corporeal assets. Our law has the required mechanisms to assist entrepreneurs, lenders and its credit committees to expose as much capital as possible to achieve maximum growth that South Africa needs now more than ever.

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