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THE NATURE AND EXTENT OF THE LANDLORD'S TACIT HYPOTHEC IN INSOLVENCY LAW AS DIFFERENTIATED FROM THE POSITION UNDER COMMON LAW

SUMMARY

The landlord's tacit hypothec over movable property on a leased premises secures the payment of outstanding rent owed by a tenant to a landlord. The hypothec forms part of Roman-Dutch common law and is also recognised by the *Insolvency Act* 24 of 1936 for purposes of a tenant's sequestration or winding-up. However, there are certain differences between the common law and the *Insolvency Act* when it comes to the nature and extent of the landlord's security. After discussing the role of "perfection" of the hypothec (through attachment or interdict) with respect to the nature of the landlord's security upon insolvency, the article investigates the ways in which the landlord's rights differ before and during the tenant's insolvency. These differences relate to the property covered, the nature of the debt secured, and the limitation of the amount of the landlord's preference. The article also raises the question as to whether a constitutional argument, based on the property clause, could be formulated to challenge the restrictions placed on the landlord's rights in terms of the *Insolvency Act*.

1. INTRODUCTION

A lease agreement is not terminated automatically by the sequestration[1] of the tenant (lessee), but the trustee may terminate the lease, by giving written notice to the landlord (lessor).[2] However, if the trustee does not, within three months of his or her appointment, notify the landlord

1 For ease of reference, the terms 'sequestration' and 'trustee' are used, but unless the context indicates otherwise, they should be read as including 'liquidation' (or 'winding-up') and 'liquidator', respectively.

2 *Insolvency Act* 24/1936:sec. 37(1). In the case of an insolvent company, the liquidator may, subject to the Master of the High Court's consent, terminate a lease agreement at any time before a general creditors' meeting has been convened for the first time: *Companies Act* 61/1973:sec. 386(2).

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of his or her intention to continue with the lease, the lease shall be deemed to be terminated at the end of such three months.[3] Any rent due for the period of occupation after the date of sequestration must be paid to the landlord as part of the costs of sequestration.[4] Regarding outstanding pre-sequestration rent, the landlord has a secured claim in terms of a hypothec over the movable property on the lease premises. This hypothec is the focus of this article.

The "landlord's legal hypothec" is included among the four security rights listed in the definition of "security" in sec. 2 of the *Insolvency Act* – also known as the "lessor's tacit hypothec".[5] The landlord's hypothec developed in Roman law and was received into Roman-Dutch law, rendering it part of South African common law.[6] Under the common law, the landlord's hypothec is a form of real security for a landlord in the event that the tenant falls behind with the obligation to pay rent[7] under the lease agreement, and the security right covers the movable property on the leased premises.[8] Although the hypothec comes into existence by operation of the law at the moment when (and remains in existence for as long as) rent is overdue, the security only becomes "perfected" – and thus effective against third parties – once the landlord has had the property attached or their removal interdicted.[9]

The purpose of this article, as expanded upon in section 2 below, is to consider the nature and extent of the landlord's hypothec in insolvency law – in other words, upon the sequestration or liquidation (winding-up) of a tenant who owes outstanding rent to his or her landlord when the relevant insolvency proceeding commences. This is done by differentiating the position under the *Insolvency Act* from the principles of common law. Unless otherwise indicated, everything discussed in this article about leases and the treatment of the landlord's hypothec upon the tenant's insolvency applies to both sequestrations in terms of the *Insolvency Act* and liquidations (winding-up) in terms of the *Companies Act*.[10] Since the *Companies Act* is silent on the landlord's hypothec, the relevant provisions in the *Insolvency Act* also apply *mutatis mutandis* to insolvent companies.[11]

3 *Insolvency Act*:sec. 37(2). On the impact of insolvency on lease agreements in general, see further Bertelsmann *et al*. 2019:260-263.
4 *Insolvency Act*:sec. 37(3).
5 See, for example, the term used in the *Security by Means of Movable Property Act* 57/1993:sec. 2.
6 On the history of the landlord's hypothec, see Van den Bergh 2009:155-167.
7 See section 4.3 below.
8 See section 4.2 below.
9 See section 3 below.
10 *Companies Act* 61/1973. Although the 1973 *Act* has been replaced by the *Companies Act* 71/2008, chapter 14 of the 1973 *Act*, which deals with the winding-up of insolvent companies, is still applicable: *Companies Act* 71/2008:sch. 5, it. 9.
11 *Companies Act* 61/1973:secs. 339, 342(1).

2. THE LANDLORD'S HYPOTHEC AS A REAL SECURITY RIGHT UNDER THE *INSOLVENCY ACT*

Sec. 2 of the *Insolvency Act* defines a "security" as "property … over which the creditor has a preferent right by virtue of any special mortgage, *landlord's legal hypothec*, pledge or right of retention" (emphasis added). In turn, "preference" (or preferent right) is defined in sec. 2 as "the right to payment of that claim out of the assets of the estate in preference to other claims". Therefore, with respect to the landlord's hypothec, "security" refers to the movable property on the leased premises, over which the hypothec operates for as long as the rent is outstanding. From these definitions, it is also clear that the holder of the hypothec has a right to receive payment from the proceeds of the relevant "security" (the movable property) before any other creditors are paid.

Sec. 95(1) of the *Insolvency Act* confirms and expands on the above by providing that "[t]he proceeds of any property which was subject to a special mortgage, *landlord's legal hypothec*, pledge or right of retention, after deduction therefrom of the costs mentioned in [sec. 89(1)], shall be applied in satisfying the claims secured by the said property, in their order of preference, with interest thereon …" (emphasis added).[12] The sec. 89(1) costs referred to are the expenses incurred by the trustee in realising, maintaining, and conserving the relevant property. After the latter costs are paid from the proceeds, the secured creditor – in this instance, the landlord – will be paid and the surplus will be available for other creditors. The landlord will have an unsecured claim for any shortfall.

It is important to note that the landlord's preference does not necessarily extend to all the proceeds of the relevant movables. In this regard, sec. 85 of the *Insolvency Act* provides as follows:

1. A tacit or legal hypothec (other than a landlord's legal hypothec or the hypothec mentioned in subsection (1) of section eighty-four) shall not confer any preferent right against an insolvent estate.
2. A landlord's legal hypothec shall confer a preference with regard to any article subject to that hypothec for any rent calculated in respect of any period immediately prior to and up to the date of sequestration but not exceeding-
    a. three months, if the rent is payable monthly or at shorter intervals than one month;
    b. six months, if the rent is payable at intervals exceeding one month but not exceeding three months;
    c. nine months, if the rent is payable at intervals exceeding three months but not exceeding six months;
    d. fifteen months in any other case.

12 The position is practically similar for insolvent companies: *Companies Act* 61/1973:sec. 342(1).

Sec. 85(1) provides that the landlord's legal hypothec and the instalment agreement hypothec (as contemplated in sec. 84(1) of the *Act*) are the only two tacit or legal hypothecs that will confer a preferent right against an insolvent estate. Therefore, this provision simply confirms the earlier repeal of all other tacit hypothecs that were known in Roman-Dutch law.[13]

Sec. 85(2), which limits the amount of the landlord's preference, raises several questions to be investigated in this article, particularly regarding the differences between the common law and the *Insolvency Act*. First, what exactly is meant by "landlord's legal hypothec", as used in sec. 85 and other places in the *Insolvency Act*? What is the nature of this security right and must it be "perfected" to grant the landlord a preference in insolvency? Secondly, what is the extent of this security right regarding both the property burdened and the debt secured? Moreover, is there a difference, for insolvency purposes, between a perfected and an unperfected hypothec? We also raise the question – without exploring it exhaustively – as to whether an argument can be made regarding the constitutional validity of the *Insolvency Act*'s restriction of the rights enjoyed by landlords under the common law, that is, whether it could amount to an arbitrary deprivation of property.

3. THE NATURE OF THE HYPOTHEC UNDER INSOLVENCY LAW: IS PERFECTION NECESSARY?

The legal nature of the landlord's hypothec is a complex matter, especially regarding the impact of so-called "perfection". The general rule under common law is that the hypothec is created at the moment when rent becomes overdue and that nothing additional (such as attachment) is necessary as long as the movables remain on the leased premises.[14] However, although the hypothec is vested at rental default, an additional step is necessary for it to have third-party effect, namely "perfection".[15] Without perfection, the movables can be

13 The preferent rights conferred by the many other tacit hypothecs known in Roman-Dutch law (see, for example, Voet 20.2.8-20.2.31 (as discussed in Gane 1956:517-546); Grotius 2.48.10-2.48.21 (as discussed in Dovring *et al*. 1965:188-189) were revoked, at least for insolvency purposes, by pre-union legislation: *Tacit Hypothecations Act* 5/1861 (C):secs. 8-9; *Administration of Estates Proclamation* 28/1902 (T):secs. 130-132; *Law* 13/1887 (N):sec. 5. This was followed by the *Union Insolvency Act* 32/1916:sec. 86 in terms similar to the current *Insolvency Act*:sec 85(1). See Brits 2016:425; Van der Merwe 1989:696.

14 *In re Stilwell; Scheuble and Van den Burg v Durham* (1831) 1 Menz 537; *Dommisse v Theart* (1885-1886) 4 SC 92:94; *McLelland and Stokes NO v London and South African Exploration Company Limited* (1899-1904) 9 HCG 22:31; *Alexander v Burger* 1905 TS 80:82; *Webster v Ellison* 1911 AD 73; *Oliver and Havenga v Moyes* 1916 OPD 40:44; *Reddy v Johnson* (1923) 44 NPD 190:194; *Columbia Furnishing Co v Goldblatt* 1929 AD 27; *Kleinsakeontwikkelingskorporasie Bpk v Santambank Bpk* 1988 3 SA 266 (C):270.

15 There is a debate about exactly when the hypothec becomes a limited real right: At rental default when the hypothec "vests" or only upon "perfection"? The debate is illustrated by the majority and minority judgments in *Eight Kaya Sands v Valley Irrigation Equipment* 2003 2 SA 495 (T), which ignited academic responses by, for example, Sonnekus 2004:123-140; Knobel 2004:687-697; Kritzinger 2003:47-48.

removed from the property freely, in which case the hypothec will no longer cover such movables.[16] The *Magistrates' Courts Act*[17] provides landlords with two procedural mechanisms to protect (or "perfect")[18] their security against defeat by removal from the premises.[19] The landlord can either seek to have the movables attached on the premises (*in situ*, thus without removing them),[20] or issue and serve a summons that contains an automatic rent interdict.[21] Attachment provides stronger protection, because it prohibits all persons from removing the property, while the interdict only operates against persons with knowledge thereof.[22]

The question for our present purposes is whether the hypothec should have been perfected prior to insolvency for the landlord to enjoy a preferent right during sequestration proceedings. The view expressed in standard works on the laws of property (including real security),[23] lease,[24] and insolvency[25] is that, for the landlord to enjoy a preferent right in insolvency, the hypothec need not have been perfected prior to sequestration.[26] Over the years, the courts have also confirmed that attachment is only necessary to perfect the hypothec outside insolvency.[27] The reason for this position is not always clearly stated or explored in the literature or case law, but either or all of the following theories could explain why perfection is not required for the landlord to be a secured creditor upon insolvency.

16 After removal, a small window of opportunity remains within which the movables can be brought back to the leased premises. However, this is only possible while the movables are still in transit, not after they have arrived at their destination. See *Webster v Ellison*:81, 89-91, 96-97.

17 *Magistrates' Courts Act* 32/1944.

18 The minority judgment in *Eight Kaya Sands v Valley Irrigation Equipment*:514 questioned whether the notion of "perfection" is appropriate in this context, as it appears to have been borrowed from the general notarial bond context (see section 4.5 below). See also *Goldberg v Lubbers Trustee* 1911 TPD 254:258-259.

19 See Brits 2016:470-473.

20 *Magistrates' Courts Act*:sec. 32.

21 *Magistrates' Courts Act*:sec. 31.

22 *Magistrates' Courts Act*:sec. 31(3).

23 Dendy 2020:paras. 440, 441, fn 4; Muller *et al*. 2019:475; Sonnekus & Schlemmer 2019:343; Brits 2016:474; Van der Merwe 1989:706; Scott & Scott 1987:100.

24 Viljoen 2016:338; Glover 2014:464, 466; Kerr & Glover 2007:paras. 34-35; Wille 1948:202. See also Bradfield & Lehmann 2013:162 and Cooper 1994:198-199, neither of whom states that perfection is necessary for the landlord to enjoy a preference upon insolvency.

25 Bertelsmann *et al*. 2019:493. See also Boraine *et al*. 2020:par. 12.4.5; Sharrock 2008:par. 324, and Sharrock *et al*. 2012:185, who do not expressly state whether perfection is required but discuss the hypothec without any mention of it having to be perfected before insolvency.

26 See also Sonnekus 2004:126; Knobel 2004:695-696; Siphuma 2013:36.

27 *In re Stilwell; Scheuble and Van den Burg v Durham*; *WG Baker v Hirst & Co* (1880-1881) 2 NLR 55:57; *In re Insolvent Estate of LH Jamadar & Co* (1905) 26 NLR 113:116-117; *In re BSA Asphalte and Manufacturing Company (in Liquidation)* (1906) 23 SC 624:625; *Webster v Ellison*:86, 87; *Kleinsakeontwikkelingskorporasie Bpk v Santambank Bpk*:271-272; *Eight Kaya Sands v Valley Irrigation Equipment*:501; *Holderness NO v Maxwell* 2012 JDR 1302 (KZP):par. 20.

First, the *Insolvency Act* refers to the "landlord's legal hypothec" in the definition of "security" in secs. 2, as well as in 47, 85, and 95. Nowhere in the *Act* is this term defined or expressly limited to a *perfected* hypothec. In the absence of a statutory definition, one must resort to the common law meaning of the landlord's hypothec. As mentioned earlier, under the common law, the hypothec comes into existence when the rent falls in arears, not only once the hypothec is perfected. In other words, perfection does not create the hypothec, but merely renders it effective against third parties – preventing it from being defeated by removal of the movables from the leased premises. Therefore, the term "landlord's legal hypothec" referred to in the *Insolvency Act* is not limited to one that has been perfected pre-insolvency. Instead, the *Insolvency Act* apparently grants the landlord a preferent right without the need for any prior perfection of the hypothec. In this sense, one could reason, as the court did in *Holderness NO v Maxwell*,[28] that pre-sequestration attachment is unnecessary, because the hypothec vests statutorily by operation of sec. 85(2) of the *Insolvency Act*. The term "shall confer a preference" in sec. 85(2) supports the latter point. Moreover, the subsection merely states that the movable property must be "subject to" the hypothec. The hypothec comes into existence when the rent is in arrears, even if perfection is necessary for it to become a limited real right. Thus, when the *concursus creditorum* is created (when the debtor is placed in a formal state of insolvency through sequestration or winding-up), the movables on the premises are "subject to" the hypothec, whether or not the hypothec has been perfected (as understood under the common law) prior to sequestration.

A second possible explanation for the secured status of a landlord under the *Insolvency Act* is that the commencement of the *concursus creditorum* can itself be regarded as a form of perfection, since the rights of creditors are crystallised at this moment.[29] From the commencement of the *concursum creditorum*, the tenant or a third party can no longer remove the movables on the leased premises, meaning that the hypothec can no longer be defeated. Only the trustee or liquidator can henceforth deal with the property.

A third possible way to explain the operation of the hypothec upon insolvency is that, under sec. 19(1) of the *Insolvency Act*, the deputy sheriff is instructed, upon receiving the sequestration order, to attach all movable property of the insolvent debtor, which necessarily includes any movables covered by an unperfected hypothec. Therefore, the hypothec is perfected because, instead of the landlord possessing the movables, the deputy sheriff and later the trustee exercise control.[30] This theory also accords with a remark by the Appellate Division in *Webster v Ellison*[31] that a general attachment in favour of the creditors under insolvency law is all that is necessary to afford the relevant benefits to the landlord upon the tenant's insolvency.[32]

28 *Holderness NO v Maxwell*:par. 20.
29 Kritzinger 2003:48. On the crystallising effect of a sequestration or winding-up order, see *Walker v Syfret NO* 1911 AD 141:160.
30 Brits 2016:474; Knobel 2004:696.
31 *Webster v Ellison*:87.
32 See also *In re Insolvent Estate of LH Jamadar & Co*:118.

Without making a finding, the court in *Barclays Western Bank Ltd v Dekker*[33] raised the question as to "whether any attachment by the deputy sheriff can be said to have perfected the hypothec by judicial process". The court, in *Kleinsakeontwikkelingskorporasie Bpk v Santambank Bpk*,[34] raised this prospect as justification for why, upon insolvency, the hypothec cannot cover property belonging to third parties.[35] Similar reasoning was employed by the majority judgment in *Eight Kaya Sands v Valley Irrigation Equipment*,[36] where the court also mentioned the fact that the property vests in the trustee in terms of sec. 20 of the *Act*.[37]

A counterargument might, however, be found in sec. 47 of the *Insolvency Act*, which provides as follows:

> If a creditor of an insolvent estate who is in possession of any property belonging to that estate, to which he has a right of retention or over which he has a landlord's legal hypothec, delivers that property to the trustee of that estate, at the latter's request, he shall not thereby lose the security afforded him by his right of retention or lose his legal hypothec, if, when delivering the property, he notifies the trustee in writing of his rights and in due course proves his claim against the estate ...

The normal rule is that the holder of a possessory security right (such as a right of retention or landlord's legal hypothec) will lose such right when he or she gives up possession of the property.[38] The purpose of sec. 47 is to confirm that this rule will not operate – that is, the right will not be lost – if possession is relinquished to the trustee, the trustee is notified of the relevant rights, and the secured claim against the estate is proved in due course. Therefore, sec. 47 assumes a landlord, who is in possession of the movable property, meaning that the hypothec would have been perfected through attachment before insolvency. Is this evidence that the landlord's hypothec contemplated in the *Insolvency Act* is limited to one that was perfected prior to insolvency? This reasoning applies to the right of retention, since possession is an absolute prerequisite for the existence of the right of retention.[39] However, the role of possession, in the case of the landlord's hypothec, is different from the right of retention. Unlike the right of retention, the landlord's hypothec does not come into (or remains in) existence only when (or for as long as) the creditor is in possession of the property but, as highlighted earlier, when rent becomes due. The landlord subsequently obtaining possession does not create the hypothec, but possession is optional under the common law to protect the hypothec against third parties. In this sense, sec. 47 caters for the situation

33 *Barclays Western Bank Ltd v Dekker* 1984 3 SA 220 (D):224-225.
34 *Kleinsakeontwikkelingskorporasie Bpk v Santambank Bpk*:272-273.
35 On the issue of third parties' property, see section 4.2 below.
36 *Eight Kaya Sands v Valley Irrigation Equipment*:501.
37 In the case of a winding-up of a company, the property does not vest in the liquidator, but the latter is placed in custody and control of the company's property: *Companies Act* 61/1973:sec. 361. For present purposes, the effect is the same.
38 *Mobilia non habent sequelam ex causa hypothecae*. See, for example, Voet 20.1.13 (as discussed in Gane 1956:498).
39 *Wightman t/a JW Construction v Headfour (Pty) Ltd* 2008 3 SA 371 (SCA):par. 29; *Van Niekerk v Van den Berg* 1965 2 SA 525 (A):539.

where the landlord obtained possession prior to insolvency and now gives up possession to the trustee without losing his preference. However, it is submitted that sec. 47 does not mean that such a perfected hypothec is the only one recognised by the *Act*. After all, the section refers to "if" not "when" the creditor is in possession. What is more, perfection does not always involve the landlord being placed in physical possession of the property, as is the case with the *in situ* attachment and automatic rent interdict provided for under the *Magistrates' Courts Act* (referred to above). In other words, sec. 47 would not even apply to such situations.

Therefore, it is reasonably settled law that it is not necessary for a landlord's hypothec to have been perfected before sequestration for the landlord to be a secured creditor under the *Insolvency Act*.

4. THE EXTENT OF THE LANDLORD'S PREFERENCE UNDER INSOLVENCY LAW

4.1 Introduction

Sec. 85(2) of the *Insolvency Act*, as quoted earlier, raises several questions regarding the extent of the landlord's rights, particularly because there are some differences between the common law and the provisions of the *Insolvency Act*. In what follows, three such differences are considered, namely the property burdened, the nature of the secured debt, and the amount of the preference.

4.2 The property burdened by the hypothec

In terms of the common law, the hypothec covers the physical movable things present on the leased premises. The term commonly used to describe these objects is the *invecta et illata*. Although the primary focus of the landlord's security is those movables belonging to the tenant as debtor, the hypothec potentially also covers movables that are on the premises but that belong to third parties. First, to the degree that a sub-tenant is behind with his rent towards the tenant, and after the tenant's movables have been exhausted, movables belonging to the sub-tenant are also covered by the landlord's hypothec.[40] Secondly, under certain circumstances, movables belonging to other third parties are also covered by the hypothec.[41] The extension of the hypothec to movables belonging to third parties is controversial and there is a debate as to the constitutional validity and doctrinal justification of this

40 *Friedlander v Croxford and Rhodes* (1864-1867) 5 Searle 395:397; *Smith v Dierks* (1884-1885) 3 SC 142; *Ex Parte Ægis Assurance and Trust Co Ltd* (1909) 23 EDC 363; *Ex Parte Adler* 1911 EDL 106; *Carstens v Basson* 1912 CPD 166.

41 Voet 20.2.5 (as discussed in Gane 1956:512-514); *Bloemfontein Municipality v Jacksons Limited* 1929 AD 266:271. See further Brits 2016:445-466 and the other sources cited there.

rule.[42] However, for the time being, it is still possible for the hypothec to cover movables belonging to third parties, provided that the tenant's (and sub-tenant's) movables are insufficient to settle the landlord's claim.[43]

Sec. 85(2) states that the landlord's hypothec "shall confer a preference with regard to *any article subject to* that hypothec" (emphasis added). On face value, this subsection appears to indicate that the hypothec covers the same property both in and outside insolvency. If the movable property is "subject to" the hypothec in common law, the hypothec will also confer a preference with respect to that property upon insolvency. However, it is not that simple. As indicated earlier, in common law, the hypothec can burden more than simply the movables belonging to the tenant (debtor), since it can include movables belonging to sub-tenants and third parties. Although it may appear, from a literal reading of sec. 85(2), that these movables are also subject to the landlord's security upon insolvency, there are hindrances to this conclusion when considering the broader context and other provisions in the *Insolvency Act*.

First, property belonging to persons other than the insolvent debtor (the tenant, in this instance) does not form part of the debtor's insolvent estate[44] and, therefore, will not be administered and realised by the trustee for distribution to creditors of the estate. This conclusion is supported by the fact that the definitions of "security" and "preference" in sec. 2 of the *Insolvency Act* refer to "property of that estate" and "assets of the estate", respectively, meaning that property burdened with a security right for insolvency purposes does not include property falling outside the estate. Furthermore, sec. 19 of the *Insolvency Act*, which instructs the deputy sheriff to attach the movable assets of the insolvent estate (except those subject to a pledge or right of retention), does not authorise the attachment of the property not belonging to the insolvent debtor, such as third parties' property on leased premises.[45]

It has also been confirmed in case law that it is not the intention of sec. 85(2) of the *Insolvency Act* to confer a preference on the landlord with regard to property belonging to persons other than the insolvent tenant.[46] In fact, if a third party claims to be the owner of property in the insolvent's possession, it is presumed that the property does not belong to the estate, unless otherwise

42 For criticism of the hypothec covering movables belonging to third parties, see, for example, McLennan 2004:121-125; Smith 2011:308-330; Viljoen 2016:320-334; Sonnekus 2004:131. For a more sympathetic view, see, for example, Van der Walt & Siphuma 2015:518-546; Siphuma 2013.

43 Some categories of third-party property have been excluded statutorily from the reach of the landlord's hypothec. In terms of the *Security by Means of Movable Property Act* 57/1993:sec. 2, the landlord's hypothec does not extend to movable property burdened with a special notarial bond that complies with the requirements in sec. 1(1) of the latter *Act* or movables subject to an instalment agreement, as defined in the *National Credit Act* 34/2005:sec. 1.

44 *Insolvency Act*:sec. 20(1)(a); *Companies Act* 61/1973:sec. 336(1).

45 *Barclays Western Bank Ltd v Dekker*:224; *Eight Kaya Sands v Valley Irrigation Equipment*:501.

46 *Kleinsakeontwikkelingskorporasie Bpk v Santambank Bpk*:272; *Eight Kaya Sands v Valley Irrigation Equipment*:501.

proven.[47] It might happen in practice that a third party's property is sold as part of the insolvent estate, but if such a sale was in good faith, the third party will not be able to recover it, unless he had given written notice to the trustee demanding the return of the property.[48] Nevertheless, before the confirmation of the trustee's account, such third party may recover the net proceeds of the sale from the trustee.[49]

It is theoretically possible that, upon the tenant's insolvency, the landlord could seek attachment of, and execution against movables belonging to third parties that are subject to the hypothec, since these movables fall outside the estate and thus their attachment and sale are not prohibited by the sequestration order. The problem is that, although it might be possible to perfect the hypothec over such movables via attachment,[50] their sale in execution would be difficult, because it would not be possible to execute any judgment obtained before insolvency, unless the court directs otherwise.[51] We think it unlikely that a court will authorise the execution of a judgment (obtained against the tenant before sequestration) against property belonging to a third party but subject to the hypothec. We are not aware of precedent for such a course of action or case law in which it has occurred. The point is that, even if the hypothec could extend to movables falling outside the estate under the common law, for purposes of the administration of insolvent estates in terms of the *Insolvency Act*, the hypothec only grants a preference to movables belonging to the insolvent.

Regarding property covered by the hypothec, one should also consider that some assets are excluded or can be exempted from the insolvent estate and will, in this instance, not be subject to attachment and sale for the benefit of the creditors. For example, sec. 82(6) of the *Insolvency Act* provides that:

> From the sale of the movable property shall be excepted the wearing apparel and bedding of the insolvent and the whole or such part of his household furniture, and tools and other essential means of subsistence as the creditors, or if no creditor has proved a claim against the estate, as the Master may determine and the insolvent shall be allowed to retain, for his own use any property so excepted from the sale.

In a residential tenancy, the examples mentioned in this subsection could be relevant, since it is likely that objects such as bedding, wearing apparel, furniture, and tools will be on the leased premises. These will consequently be exempted (or partially exempted) from the administration of the estate and, in turn, from the operation of the hypothec. Another example is found in sec. 79 of the *Insolvency Act*, which provides that "[a]t any time before the second meeting of creditors the trustee may, with the consent of the Master, allow

47 *Insolvency Act*:sec. 24(2).
48 *Insolvency Act*:sec. 36(5).
49 *Insolvency Act*:sec. 36(6), read with sec. 112.
50 See *Eight Kaya Sands v Valley Irrigation Equipment*:501.
51 Upon sequestration, the execution of all pre-sequestration judgments is stayed, unless the court orders otherwise: *Insolvency Act*:sec. 20(1)(c). A comparable rule applies to liquidations: *Companies Act* 61/1973:sec. 359(1)(b).

the insolvent such … moderate quantity of goods out of the estate as may appear to the trustee to be necessary for the support of the insolvent and his dependants". Under this provision, therefore, it is possible that the tenant will be permitted to retain a small portion of the movables that otherwise would have been covered by the landlord's hypothec.

Outside insolvency, the *Magistrates' Courts Act* also exempts certain assets from attachment and sale in any execution processes.[52] Although there is some authority that the hypothec covers assets under the common law, even if they are exempt from attachment,[53] the hypothec cannot be perfected over them, and the proceeds of these assets will also never be available for the landlord.[54] The list of exempted assets in the *Magistrates' Courts Act* is longer than the list in the *Insolvency Act*. Accordingly, this is one instance where the hypothec appears to cover more assets in insolvency as opposed to outside insolvency.

4.3 The debt secured by the hypothec

The debt secured by the hypothec is the outstanding rent payable under a lease agreement. The *Insolvency Act* confirms this by stating, in sec. 85(2), that the hypothec "shall confer a preference with regard to any article subject to that hypothec for any *rent*" (emphasis added). However, it is not settled that the hypothec is limited to outstanding rent under the common law, that is, when applied outside insolvency. For example, under Roman law, the hypothec also covered a deterioration of the property, due to the tenant's fault[55] – in other words, a claim for damages arising from damage caused to the property by the tenant. It seems that this approach was also followed in Roman-Dutch law,[56] but its application in modern South African law is uncertain. For example, in *Isaacs v Hart & Henochsberg*,[57] the court held that the hypothec covers outstanding municipal rates under circumstances where the tenant bound him- or herself to pay such amounts, whereas, in *Woodrow and Co v Rothman*,[58] the court held that the hypothec did not cover a debt owed for repairs that the tenant was obliged to make.[59]

52 *Magistrates' Courts Act*:sec. 67.
53 *Harris v Tomlinson* 1912 CPD 821; *Oliver and Havenga v Moyes*:44-45.
54 Brits 2016:442.
55 *Digesta* 20.2.2 (as discussed in Watson 1985:130).
56 Voet 20.2.2 (as discussed in Gane 1956:507) and other sources cited by Brits 2016:438, fn. 447.
57 *Isaacs v Hart & Henochsberg* (1887) 8 NLR 18.
58 *Woodrow and Co v Rothman* (1884-1885) 4 EDC 9.
59 The accuracy of this judgment has been questioned (Kerr 2004:391; Cooper 1994:180), but it has also been cited as authority that the hypothec covers rent only (Wille 1948:190).

Cooper argues that the extension of the hypothec to debts other than rent was abrogated through disuse in South Africa.[60] Although several other authors also limit the hypothec to rent,[61] Kerr argues that the hypothec should not be limited in this manner, but should also cover other debts such as a contracted duty to make repairs.[62] The question has not come up very often in case law,[63] but in 2016, in *Solgas (Pty) Ltd v Tang Delta Properties CC*,[64] the court held that the hypothec indeed covered a claim for damages. After considering the old cases and common-law authorities, the court held that the common-law rule had not been abrogated or overturned by any court. The judgment has been criticised[65] and, therefore, it is unlikely that the matter is settled. It should also be pointed out that the case dealt with contractual damages arising from the tenant's failure to fulfil a contractual maintenance duty and, as such, the judgment is not authority that all non-rent debts are covered by the hypothec.[66] In fact, it has been argued that the hypothec's reach should be limited, if not to rent, then at least to debts springing forth from the lease agreement itself, such as contractual damages, but excluding things such as delictual damages.[67]

It is not necessary, at this point, to take a final position on this matter as far as the common-law position is concerned. Our purpose is merely to highlight that there appears to be a difference between the nature of the claims covered by the hypothec under the common law as opposed to the *Insolvency Act*. Assuming that there is a possibility of the common law extending the hypothec to certain amounts beyond the rent (such as contractual damages), it is evident that the *Insolvency Act* is more restrictive, in that it expressly extends the hypothec to nothing other than the outstanding rent itself. In most instances, this might not be a significant restriction, but one could conceive of a situation where a landlord is owed a large amount in damages, in which case the claim for damages might be secured by the hypothec under common law but not upon the tenant's insolvency. In such a scenario, the claim for damages will be an unsecured concurrent claim under insolvency law, meaning that the landlord probably will not receive more than a meagre dividend from the free residue of the insolvent estate.

60 Cooper 1994:180. For this argument, Cooper relied on the fact that, in Natal, the *Hypothec Amendment Act* 13/1887 (N):sec. 5 limited the hypothec to rent and that the *Insolvency Act*:sec. 85 limits it to rent. He also cited *Waverly Trust and Trading Co v Depaux* 1902 TH 73.

61 See, for example, De Wet & Van Wyk 1992:365; Van der Merwe 1989:699; Scott & Scott 1987:99.

62 Kerr 2004:390-392. See also Kerr & Glover 2007:par. 32.

63 A rare recent example is *New Life Communal Property Association v Draigri Boerdery Bpk* [2007] ZAECHC 101 (22 November 2007):par. 15, where the court assumed, without deciding, that the hypothec only secured outstanding rent.

64 *Solgas (Pty) Ltd v Tang Delta Properties CC* 2016 JDR 1209 (GJ).

65 Sonnekus & Schlemmer 2019:335-336.

66 Brits 2016:439.

67 Brits 2016:439-440.

4.4 The limitation on the amount of the preference

In addition to limiting the secured debt to outstanding rent, the *Insolvency Act* also curbs the size of the secured claim. According to sec. 85(2), quoted earlier, the amount secured by the hypothec will not be more than the outstanding rent for three, six, nine or fifteen months, depending on how the payment of rent was structured in the lease agreement. Any amount in excess of these respective limits will be unsecured.[68] No such limitations exist outside insolvency in South African law, meaning that the extent of the security conferred under the common law is compromised by the *Insolvency Act*. Moreover, no other security right is limited by the *Insolvency Act* in a similar fashion.

In many instances, the limitation on the amount of the secured claim might not make a noteworthy difference. However, situations could arise where there are significant outstanding rental amounts, far beyond the permitted preference, and/or where the movables have a high enough value to cover all or most of the claim. In instances where the movables would otherwise cover the claim, we could foresee a dissatisfied lessor who only enjoys a limited preference and would have to share the remaining proceeds with the other unsecured creditors. At least in the commercial context, large unpaid rental amounts that accumulate over many months are probably rare. A commercial landlord would seldom allow the long-term accumulation of rent without taking legal steps to claim the relevant amounts or even evicting the tenant. Indeed, the restricted preference under insolvency could serve to discourage landlords from allowing rent to accumulate. However, this might be different in recent times where lockdown restrictions could have resulted in the accumulation of large outstanding rental debts (in both the commercial and residential contexts) along with limited debt collection and eviction prospects during much of the lockdown period(s). Unless outstanding rent is forgiven or a payment plan is agreed upon, the landlord will eventually insist on full payment, in which case the hypothec would secure the claim. Yet, as explained earlier, if the tenant is insolvent, the extent of the preference will be limited. This could have a significant impact on the amount received by a landlord with a large claim.

As remarkable as it may seem for the *Insolvency Act* to limit the preference of a secured creditor such as a landlord, it is not without historical precedent. The *Union Insolvency Act* of 1916, the predecessor of the current *Insolvency Act*, provided that the landlord's hypothec gave "a preference for current rent and for arrear rent for a period not exceeding six months".[69] In other words, the 1916 *Act* also limited the extent of the preference but set out one rule for all leases instead of the current approach whereby the limit depends on the payment intervals. Pre-union statutes in the Natal and Cape Colonies also limited the landlord's preference, namely to one year's rent.[70] References to

68 *Dommisse v Theart*.
69 *Union Insolvency Act* 32/1916:sec. 86.
70 *Tacit Hypothecations Act* 5/1861 (C):sec. 5; *Tacit Hypothecation Amendment Law* 20/1866 (N):sec. 2(a).

this limitation also appear in early case law.[71] In the Cape, it appears that there were no such limitations, at least in statute, before the enactment of the aforementioned law in 1861.[72] However, in a judgment handed down by the Supreme Court of the Cape of Good Hope in 1831, well before either of the aforementioned Cape and Natal statutes, reference is made to a preference for the current plus one year's rent.[73] The report indicates no authority for this limit, but it is probably based on Roman-Dutch authorities. For example, Voet explains that the landlord's preference was limited by statute in Holland to three years' rent and, in Amsterdam, the current plus one year's rent.[74] Van der Keessel similarly mentions several Dutch cities, in which the preference was limited to the current plus one year's rent.[75] The latter passage by Van der Keessel was also cited in *Isaacs v Hart & Henochsberg*,[76] in support of justifying the limited preference:

> On principle, I do not find it easy to perceive why, beyond a limited period, a landlord should be a preferential creditor. That may, on public grounds, and for a limited period (*V. D. Kees., Th.* 453), be desirable, in order that landlords should have less occasion for pressing tenants – often persons of small means – for payment of rent. But a hypothec for only arrears of rent, goes far for that purpose.

This quote provides insight into why the landlord's hypothec is given preference in insolvency and why the preference is limited. Landlords are given this preference to discourage them from "pressing" tenants who are behind with their rent. In other words, if landlords know that they will enjoy a preferent right to payment of arrear rent, they will be more lenient towards tenants who default. Landlords might refrain from immediate legal action to enforce the debt and/or evict the tenant, because they know that they will be a secured creditor, should the tenant be sequestrated. For the same reason, the landlord will be less inclined to immediate legal action even if he or she expects impending sequestration. Put differently, if the landlord did not enjoy this automatic preference upon insolvency, he or she would be quick to take legal action for fear of possible future sequestration. If the tenant has fallen behind with rent and struggles to get up to date, there is a strong possibility that he or she is insolvent and will be the subject of sequestration proceedings in the near future. Such a situation could encourage landlords to take immediate legal action to avoid being left out in the cold during sequestration proceedings. The landlord deciding to take such legal action could have the negative side effect of driving the tenant out of business and/or further into

71 *WG Baker v Hirst & Co*:56, 59; *Dommisse v Theart*:94; *Isaacs v Hart & Henochsberg*:21; *London and South African Exploration Co v Official Liquidator of North-Eastern Bultfontein and The Registrar of Deeds* (1895) 12 SC 225:233-234, 238; *McLelland and Stokes NO v London and South African Exploration Company Limited*:28; *In re BSA Asphalte and Manufacturing Company (in Liquidation)*:625.

72 *In re BSA Asphalte and Manufacturing Company (in Liquidation)*:625.

73 *In re Stilwell; Scheuble and Van den Burg v Durham*.

74 Voet 20.2.3 (as discussed in Gane 1956:510). It appears that Voet drew no distinction between the preference in and outside insolvency.

75 Van der Keessel *Theses selectae* 453 (as discussed in Lorenz 1901:160).

76 *Isaacs v Hart & Henochsberg*:21.

insolvency. Conversely, if the landlord is guaranteed of his or her preference upon insolvency, he or she might be more patient with the tenant. This, in turn, could allow the tenant some time to get his or her affairs in order, restore his or her solvency, and/or avoid formal insolvency proceedings altogether. As indicated in the quote from *Isaacs v Hart & Henochsberg* earlier, this is particularly important for a tenant of "small means".

Notwithstanding the potentially positive consequences of guaranteeing the landlord's preference, it cannot be limitless either – as per the sentiment expressed in the quote from the abovementioned judgment. A limitless preference might discourage landlords from being vigilant, causing them to simply wait for insolvency to stake their claim. In our view, allowing a limitless automatic preference in a situation where there is no security agreement between the parties, where the creditor is not in possession of the property, and where there is no publicity of the security right, would have been highly exceptional – also considering that such a landlord with an unperfected hypothec would not have had any preference outside insolvency under the common law. In other words, a landlord with an unperfected hypothec is already in a very privileged position under the *Insolvency Act* and, therefore, there can be hardly any objection to reasonably limiting such privilege to a certain amount. In fact, sec. 85(2) is not truly a problem for a landlord with an unperfected hypothec, because the landlord would not have had an automatic preference in any event were it not for the tenant's sequestration.

However, if the hypothec had been perfected pre-insolvency, sec. 85(2) places a (potentially significant) limitation on the landlord's preference, as the extent of the secured claim is restricted to less than what it would have been outside insolvency. This would make no difference if the size of the claim is below the limit or if the value of the attached movables does not cover the restricted claim. However, if the claim is larger than the limit, and/or the value of the attached movables is enough to cover the entire claim, the restriction under sec. 85(2) could make a big difference to the amount eventually received by the landlord. In such a situation, one might even challenge the validity of sec. 85(2) for depriving the landlord of property. Before considering that aspect, it is necessary to investigate the difference (if any) that perfection makes for insolvency purposes.

4.5 Is a perfected hypothec stronger than an unperfected hypothec in insolvency?

As explained in section 3 above, the generally accepted position is that the hypothec need not have been perfected pre-insolvency for the landlord to be a secured creditor, subject to the limited extent of the preference as per sec. 85(2). The question, however, is whether pre-insolvency perfection makes any difference regarding the landlord's rights in sequestration proceedings. Perfection is not required to render the landlord a secured creditor in insolvency but is necessary to make the hypothec enforceable against third parties outside insolvency, meaning that the holder of an unperfected hypothec is in a stronger position upon the tenant's insolvency than before such insolvency. In

effect, the landlord becomes a secured creditor upon sequestration even if he or she was not one pre-insolvency, due to perfection not having taken place yet. The question is whether the landlord's security upon insolvency might be different in instances where the hypothec had been perfected pre-insolvency. For example, is a perfected hypothec also subject to the limited preference set out in sec. 85(2) or does the latter only apply to unperfected hypothecs?

One hypothesis might be that, also under the *Insolvency Act*, a perfected hypothec is stronger than an unperfected hypothec, because the former has an effect similar to that of a perfected general notarial bond. The registration of a general bond is provided for in the *Deeds Registries Act*,[77] which allows the registration of notarial bonds that either specially or generally encumber the movable assets of a debtor.[78] A notarial bond is "general" when it encumbers all movables belonging to the debtor in general. This differs from a "special" notarial bond that encumbers a specified movable object or objects. A special notarial bond that complies with the requirements set out in sec. 1(1) of the *Security by Means of Movable Property Act*[79] will create a real security right via registration alone, meaning that the bondholder will have a "special mortgage" for purposes of the *Insolvency Act* and thus be a secured creditor.[80]

Unlike the above special bond, the registration of a general bond does not create a real security right without more. Instead, the bond must be perfected by having the property attached on the authority of a court order,[81] at which point the creditor is placed in the position of a pledgee, due to having possession of the movables.[82] In other words, if the bond had been perfected before insolvency, the creditor would have a pledge over the movables and would thus be a secured creditor for purposes of the *Insolvency Act*.[83] A general bond that has not yet been perfected at the time of sequestration provides the holder of the bond with no security other than a statutory preference to the free residue of the estate.[84] In other words, the holder of a general notarial bond will be paid after all the other statutory preferent creditors have been paid but before the concurrent creditors are paid.

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77 *Deeds Registries Act* 47/1937.

78 *Deeds Registries Act*:sec. 102 (definition of "notarial bond").

79 The central requirement is that the (corporeal) movable property must be "specified and described in the bond in a manner which renders it readily recognizable".

80 *Insolvency Act*:sec. 2 (definition of "special mortgage"), read with *Security by Means of Movable Property Act*:sec. 4.

81 Perfection can also happen by voluntarily handing over the movables to the creditor. However, the bondholder may not take the law into his or her own hands and, therefore, needs a court order if no voluntary delivery is forthcoming.

82 On the nature and operation of general notarial bonds, see, for example, *Firstrand Bank Ltd v Land and Agricultural Development Bank of South Africa* 2015 1 SA 38 (SCA):par. 4; *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 2 SA 253 (SCA):paras. 3-6; *Development Bank of Southern Africa Ltd v Van Rensburg* 2002 5 SA 425 (SCA):par. 20. See further Brits 2016:197-227 and other sources cited there.

83 See the reference to "pledge" in *Insolvency Act*:sec. 2 (definition of "security"). See also Brits 2016:227; Scott 1995:676-677.

84 *Insolvency Act*:sec. 102.

A possible argument is that a perfected landlord's hypothec is, similar to a perfected general bond, in the nature of a pledge and thus, in such a case, the landlord should be treated as the holder of a "pledge" in insolvency law, not as the holder of a mere "landlord's legal hypothec". If this argument were correct, this perfected hypothec, being a "pledge", would not be hit by the restriction in sec. 85(2) and, therefore, the landlord's full claim would be secured. However, there is no authority for this argument, while equating the effect of a perfected hypothec with that of a perfected bond does not survive scrutiny either. The two security devices differ significantly. For one, a general bond entails a consensual agreement to burden (pledge) the debtor's movables, while perfection of the bond is merely the specific enforcement of that agreement.[85] The same cannot be said for a landlord's hypothec or its perfection. The hypothec is not based on a security agreement between the parties, but is implied by law.[86] Furthermore, perfection of the hypothec does not entail the specific performance of a security agreement but is a procedural mechanism (attachment or interdict) to guard the hypothec against being defeated through removal of the movables, or to enforce the security through sale in execution.

Therefore, the perfection of a landlord's hypothec is not the same as the perfection of a general bond. Perfection of the hypothec does not turn the hypothec into a pledge; it merely gives third party effect to the hypothec. A general bond is a pledge agreement from its inception, albeit one that will only create a limited real right when the creditor receives possession. Perfection then merely entails the performance of the agreement by placing the creditor in the possession necessary to vest him or her with a limited real right of pledge.

Whatever the legal effect of pre-insolvency perfection might be, there is nothing in the *Insolvency Act* or case law to indicate that a perfected hypothec is saved from the limitation imposed by sec. 85(2) in the case of the tenant's sequestration. Arguing otherwise would be an artificial attempt at escaping the effect of sec. 85(2). In our view, the only difference for insolvency purposes between a perfected and an unperfected hypothec is that secs. 83 and 47 of the *Insolvency Act* apply to a situation where the hypothec has been perfected, that is, where the landlord is in possession of the movables. Sec.

85 See, for example, *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd*:par. 10; *Boland Bank Ltd v Vermeulen* 1993 2 SA 241 (E):243; *International Shipping Co (Pty) Ltd v Affinity (Pty) Ltd* 1983 1 SA 79 (C):84; *Barclays National Bank Ltd v Natal Fire Extinguishers Manufacturing Co (Pty) Ltd* 1982 4 SA 650 (D):654-655. See further Brits 2016:215.

86 It appears that, historically, when the landlord's hypothec first developed in Roman law, it was based on an express clause in the lease agreement (comparable to a pledge). As the law developed, the hypothec came to be regarded as tacitly agreed upon by the parties to a lease agreement. Eventually, the hypothec evolved even further so that it became implied by law, as is the case today, instead of being based on express or tacit consensus. See Van den Bergh 2009:157-161. See also Knobel 2004:692-693, who argues that the hypothec forms part of the *naturalia* of the lease agreement.

47, quoted earlier,[87] provides that the landlord will not lose his or her security when handing the movables over to the trustee, while sec. 83 deals with the realisation of movables in the possession of a secured creditor.

4.6 A possible constitutional argument?

As pointed out earlier, a landlord whose hypothec has been perfected before insolvency (under the common law) will, upon the tenant's sequestration, be subjected to a number of limitations on the security that he or she would have enjoyed outside insolvency: (1) the hypothec is limited to rent and excludes other debts such as damages;[88] (2) the hypothec is limited to movables belonging to the tenant and excludes movables of sub-tenants and third parties otherwise included,[89] and, most significantly, (3) the amount of the preference is limited.[90] The first two limitations are not so significant because, first, the application of the hypothec to debts other than rent is tenuous at best under common law[91] and, secondly, the extension of the hypothec to movables belonging to third parties is controversial and will probably not stand the test of time. Conversely, the third limitation could make a substantial difference regarding the amount paid to the landlord from the insolvent estate. Depending on the size of the claim and the value of the movables in the landlord's possession, the size of the landlord's secured claim could be far smaller than what it would have been outside insolvency.

The question is whether this restriction imposed in terms of the *Insolvency Act* on a landlord's common-law rights is justifiable. In our view, a constitutional argument could possibly be formulated to challenge the current position regarding the treatment of a perfected hypothec in terms of the *Insolvency Act*. In this respect, the limitation imposed by the *Insolvency Act* on the landlord's preference could entail a deprivation of property as contemplated in sec. 25(1) of the *Constitution of the Republic of South Africa*, 1996 (hereafter the *Constitution*), which provides that "[n]o one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property". A full analysis of this argument and its validity is not possible, due to space constraints, but in what follows we briefly set out the basic features of how such an argument could be like, along with our preliminary views on the prospects of success.[92]

87 See section 3 above.
88 See section 4.3 above.
89 See section 4.2 above.
90 See section 4.4 above.
91 The second limitation could be more serious if it is confirmed that, under the common law, the hypothec is extended to debts other than rent, such as a claim for damages. In such an instance, the possible constitutional argument formulated below might similarly be used to challenge the validity of the way in which the *Insolvency Act* limits the preference to rent and excludes damages.
92 For a general discussion on the impact of the *Constitution*:sec. 25 on insolvency law, see Brits 2021:34-53.

Although the *Constitution* does not define the term "property",[93] it is generally understood as a broad concept that includes all traditional objects of property such as corporeal movable and immovable things[94] and rights in property such as limited real rights,[95] as well as incorporeal assets such as intellectual property[96] and certain personal rights.[97] A real security right such as the landlord's hypothec, being a right in property, therefore qualifies as "property" for constitutional purposes, while the debt secured by that right is similarly regarded as "property".

The *Constitution* does not attribute a meaning to "deprived" or "deprivation", but the Constitutional Court has confirmed that "any interference with the use, enjoyment or exploitation of private property involves some deprivation in respect of the person having title or right to or in the property concerned"[98] and that the interference must be "significant enough to have a legally relevant impact on the rights of the affected party"[99] for it to qualify as a deprivation.

In our view, a landlord who has perfected his or her hypothec pre-insolvency is "deprived of property" upon the tenant's sequestration, due to the operation of sec. 85(2) of the *Insolvency Act*, because the latter limits the preference, which is the essence of the security right, that the landlord would have enjoyed, were it not for the tenant's sequestration. Interfering with a creditor's preference is not necessarily problematic or exceptional. For example, all secured creditors must accept that the costs of maintaining, conserving, and realising the burdened property will be paid before their preferent right is honoured.[100] In fact, there is also nothing constitutionally troublesome with a deprivation of property *per se*. The prospect of constitutional invalidity only arises when the deprivation does not comply with the requirements of sec. 25(1). The requirements are, first, that the deprivation must be in terms of (or authorised by) "law of general application" and, secondly, that the deprivation should not be "arbitrary". Assuming that the *Insolvency Act* qualifies as "law of general application", the pertinent question is whether the deprivation of

93 Except for stating that it is "not limited to land". See *Constitution*:sec. 25(4)(b).

94 *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* 2002 4 SA 768 (CC):par. 51.

95 *Agri SA v Minister for Minerals and Energy* 2013 4 SA 1 (CC) (mineral rights); *Jordaan v Tshwane Metropolitan Municipality* 2017 6 SA 287 (CC):paras. 58, 61 (security rights).

96 *Laugh It Off Promotions CC v SAB International (Finance) B/V t/a Sabmark International* 2006 1 SA 144 (CC) (trademark).

97 *National Credit Regulator v Opperman* 2013 2 SA 1 (CC):paras. 57-65 (enrichment claims); *Cool Ideas 1186 CC v Hubbard* 2014 4 SA 474 (CC):par. 38 (enrichment claim); *Chevron SA (Pty) Ltd v Wilson t/a Wilson's Transport* 2015 10 BCLR 1158 (CC):par. 16 (money in hand); *Shoprite Checkers (Pty) Ltd v MEC for Economic Development, Eastern Cape* 2015 6 SA 125 (CC):paras. 61, 68, 139, 143 (liquor-trading licence).

98 *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance*:par. 57.

99 *National Credit Regulator v Opperman*:par. 66.

100 *Insolvency Act*:sec. 89(1), read with sec. 95(1).

property imposed by sec. 85(2) is "arbitrary". The Constitutional Court has confirmed that a deprivation will be arbitrary if it is procedurally unfair or if there is insufficient reason for the deprivation.[101]

Whether a deprivation is procedurally unfair depends on the context of each case,[102] but possible indicators could include a court's discretion being ousted,[103] the affected party being denied an opportunity to be heard,[104] unreasonable timelines, and so forth. In the insolvency context, there is probably little scope for arguing that a deprivation caused by a sequestration or winding-up order is procedurally unfair. Not only is it authorised by a court but affected creditors will be able to oppose the application and make representations to the court.

The "insufficient reason" component of arbitrariness is referred to as "substantive" arbitrariness, which is a complex and context-sensitive concept. However, at its core, it entails a means-ends analysis – comparing the purpose of the deprivation with the manner and extent thereof to determine whether there is a sufficient relationship between the means and ends. Depending on various factors and all the circumstances of the case, sometimes a mere rational connection between the means and ends will be sufficient, while at other times a stricter relationship will be necessary, closer to the proportionality standard required by sec. 36(1) of the *Constitution*.[105] Space does not allow a comprehensive arbitrariness analysis of the deprivation in terms of sec. 85(2) of the *Insolvency Act*. We thus limit the discussion to a couple of reasons as to why, in our opinion, it will be difficult to convince a court that the limitation embodied in sec. 85(2) entails an arbitrary (and thus unconstitutional) deprivation of the landlord's property.

First, it does not appear arbitrary to place a reasonable restriction on the secured portion of a rental claim in a situation where the security right came into existence not by agreement but by operation of the law. In other words, restricting the extent of a right that is already a legal privilege is not unreasonable. Indeed, there seems to be a good (enough) reason for restricting the landlord's preference. As indicated in section 4.4, a limitless preference might discourage landlords from being vigilant in enforcing their claims in the

101 *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance*:par. 100.

102 *Mkontwana v Nelson Mandela Metropolitan Municipality; Bissett v Buffalo City Municipality; Transfer Rights Action Campaign v Member of the Executive Council for Local Government and Housing, Gauteng* 2005 1 SA 530 (CC):par. 65; *Reflect-All 1025 CC v MEC for Public Transport, Roads and Works, Gauteng Provincial Government* 2009 6 SA 391 (CC):par. 40.

103 See, for example, *National Credit Regulator v Opperman*:par. 69; *Chevron SA (Pty) Ltd v Wilson t/a Wilson's Transport*:par. 40.

104 This links to the right of access to courts in the *Constitution*:sec. 34 and, under appropriate circumstances, the right to just administrative action in the *Constitution*:sec. 33.

105 The test is set out in *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance*:par. 100. For more detail, see Muller *et al*. 2019:631-637; Van der Walt 2011:237-270.

normal course. In addition, if landlords enjoyed an unlimited preference, the unsecured creditors (who already must accept receiving a relatively small portion of their claims) would have received even less. Therefore, placing a reasonable limit on the landlord's preference to ensure that unsecured creditors' losses are kept to a minimum does not appear irrational.

Secondly, the limitation in sec. 85(2) has existed for many years. In its current permutation, it has existed since 1936, before which a comparable restriction was present in the 1916 *Act*. Moreover, pre-union legislation as well as Roman-Dutch authorities also placed a limitation on the landlord's preference. The fact that the limitation has been part of South African law for so long makes it very difficult to argue that it is arbitrary, since no landlord can reasonably claim not to be aware of this limitation on his or her rights upon the tenant's insolvency. Matters might have been different if we were discussing a newly introduced limitation on a creditor's otherwise-unrestricted preference.

Therefore, although a more detailed analysis could indicate otherwise, the *Insolvency Act* probably does not arbitrarily deprive the landlord of his or her property. Yet, it is possible that cases could arise indicating more problematic consequences of sec. 85(2), in which case landlords dissatisfied with their restricted rights might want to challenge the validity of sec. 85(2). In our view, the chances of success are small, but it might be worthwhile raising the argument to get legal certainty.

5. CONCLUDING REMARKS

As with most real security rights created under common or statutory law, the landlord's hypothec is also recognised upon a tenant's insolvency. However, in this article, we explored the ways in which a landlord's preferent right differs pre and post the tenant's insolvency. The conclusions drawn from the analysis can be summarised as follows.

Although the landlord's security only becomes enforceable against third parties under common law once the hypothec has been perfected through attachment or interdict, pre-sequestration perfection is not necessary for the landlord to be a secured creditor in terms of the *Insolvency Act*. Furthermore, had the hypothec been perfected pre-sequestration, this makes no difference regarding the landlord's right (or the limitations thereof) in insolvency.

Despite the landlord enjoying an automatic preference upon the tenant's insolvency without the need for pre-sequestration perfection, the preference is limited in certain respects. First, under common law, the hypothec can cover movables not belonging to the tenant, but under the *Insolvency Act*, the security is restricted to assets that form part of the estate. Secondly, although the common law potentially allows the hypothec to secure debts other than rent (such as damages), the *Insolvency Act* only affords a preference to outstanding rent. Thirdly, and most significantly, the amount of the landlord's secured claim is limited by the *Insolvency Act*, which is not the case under common law.

Finally, the article raised the prospect of analysing the limitations imposed by the *Insolvency Act* on the landlord's rights in terms of the property clause in the *Constitution*. We briefly explained that the limitation of the landlord's rights could amount to a deprivation of property, but that such deprivation will likely not be arbitrary for constitutional purposes. In fact, it is not necessarily a problem for insolvency legislation to adjust the pre-insolvency rights of affected parties to administer the affairs of an insolvent person in the most fair or orderly way possible. If such changes are reasonable, rationally connected to the goals of insolvency law and not grossly disproportionate, they are probably constitutionally valid.

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