IN THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

REPORTABLE

Case no: 111/05

In the matter between

THE CITY OF JOHANNESBURG **Appellant**

and

HARRY KAPLAN NO (in his capacity as Liquidator

of KROKIPARK CC) (In Liquidation) **First Respondent**

FIRST NATIONAL MORTGAGES

NOMINEES (PTY) LTD (Reg No 65/02087/07) **Second Respondent**

Coram: HARMS, ZULMAN, STREICHER, HEHER JJA and CACHALIA AJA

Heard: 13 MARCH 2006

Delivered: 29 MARCH

2006

Summary: Local Government: Municipal Systems Act 32 of 2000, s 118 – municipal debts a 'charge on the property' – effect of Insolvency Act 24 of 1936, s 89 on the preference thereby conferred.

Neutral citation: This judgment may be referred to as City of Johannesburg v Kaplan NO [2006] SCA 45 (RSA).

JUDGMENT

HEHER JA

HEHER JA:

[1] This is an appeal against an order of Stockwell AJ in the Witwatersrand Local Division. He dismissed the appellant's application with costs including the costs of two counsel but granted leave to appeal to this Court.

[2] The appellant is a municipality as defined in s 1 of the Local Government: Municipal Systems Act, 32 of 2000 ('the Municipal Systems Act'). In terms of s 4, the appellant may finance the affairs of the municipality by charging fees for services and rates on property.

[3] The first respondent is the liquidator of Krokipark CC, a close corporation that was wound up on 16 May 2003. The corporation was the registered owner of Erf 406 Wynberg. The first respondent sold the property for a price of R700 000 on 26 August 2003. He abides the decision of the court. The second respondent is First National Mortgages Nominees (Pty) Ltd. It holds a participation mortgage bond over the property for an amount of R1 231 823,09 as at 16 April 2004.

[4] The estate is indebted to the appellant for rates, service fees, basic charges, 'sundry services' and interest. The liquidator paid an amount of R386 239,72 to the appellant in order to obtain a clearance certificate enabling him to transfer the properties. A balance of R469 404,71 remains due and payable.[1] The issue in the

1For the purposes of issuing the clearance certificate the appellant furnished an advice that the amount of total arrears of the corporation was made up as follows:

DescriptionServiceV.A.T.Sub-totalAssessment Rates

Sewerage & Basics
Water & Basics
Sundry Services

Interest Arrears448090.50

40575.89
52869.47
21469.62
279183.13
5680.58
7401.70
373.54448090.50
46256.47
60271.17

appeal is whether or not the municipality's preference arising under s 118(3) of the Act trumps the preference attaching to the second respondent's mortgage bond.

[5] The appellant sought an order in the court *a quo* in the following terms:

'1. Declaring that the amount due to the Applicant by the First Respondent on behalf of the present registered owner of the property known as Erf 406 Wynberg ("the property") for municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties on the property for the period prior to the two years preceding the date of application for the certificate referred to in Section 118(1) of the Municipal Systems Act No. 32 of 2000 ("the Municipal Systems Act") is a charge upon the property and enjoys preference in the distribution of the proceeds of the sale of the property over the Second Respondent's participation mortgage bond registered against the property.

2. Declaring that the aforesaid amount falls to be paid to the Applicant by the First Respondent as:

2.1 a secured claim falling within a class of security outside the ambit of the definition of "security" in the Insolvency Act;

2.2 alternatively, in satisfaction of a claim secured by the property as contemplated in Section 95(1) of the Insolvency Act;

2.3 further alternatively a cost of sequestration as contemplated in Section 97 of the Insolvency Act, and more particularly a cost of liquidation as contemplated in Section 97(2)(c) of the Insolvency Act.

3. That the First Respondent pays the costs of this application.'

[6] Section 118 of the Municipal Systems Act provides:

'(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 120 days from the date it has been issued.

(2) In the case of the transfer of property by a trustee of an insolvent estate, the provisions of this section are subject to section 89 of the Insolvency Act, 1936 (Act 24 of 1936).

(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.'

(Subsections (4) and (5) are not relevant to this appeal and all further references to s 118 are a reference to the quoted subsections.)

[7] The application was dismissed by Stockwell AJ on the ground that the time limit of two years imposed in s 118(1)(b) applied also to municipal debts secured under s 118(3) and the appellant was therefore debarred from claiming any preference over the second respondent's bond beyond that period.

[8] This Court has subsequently found (in a case that did not involve a liquidation or insolvency) the ground on which the judge *a quo* relied to be unsustainable: see *BOE Bank Ltd v City of Tshwane Metropolitan Municipality* 2005 (4) SA 336 (SCA), in which it was held that the only plausible interpretation of s 118(3) is that it is an independent self-contained provision (para 8 at 342A) not subject to the time limit contemplated in s 118(1) (para 11 at 343F). The correctness of that judgment was not challenged by the second respondent in the appeal.

[9] The second respondent, to defend the order of the court *a quo*, relied on the cross-reference in s 118(2) to s 89 and more particularly on s 89(4) of the Insolvency Act, a ground argued before the learned judge upon which he had not found it necessary to express an opinion. Section 89 provides-

'(1) The cost of maintaining, conserving and realizing any property shall be paid out of the proceeds of that property, if sufficient and if insufficient and that property is subject to a special mortgage, landlord's legal hypothec, pledge, or right of retention the deficiency shall be paid by those creditors, *pro rata*, who have proved their claims and who would have been entitled, in priority to other persons, to payment of their claims out of those proceeds if they had been sufficient to cover the said cost and those claims. The trustee's remuneration in respect of any such property and a proportionate share of the costs incurred by the trustee in giving security for his proper administration of the estate, calculated on the proceeds of the sale of the property, a proportionate share of the Master's fees, and if the property is immovable, any tax as defined in subsection (5) which is or will become due thereon in respect of any period not

exceeding two years immediately preceding the date of the sequestration of the estate in question and in respect of the period from that date to the date of the transfer of that property by the trustee of that estate, with any interest of penalty which may be due on the said tax in respect of any such period, shall form part of the costs of realization.

(2) If a secured creditor (other than a secured creditor upon whose petition the estate in question was sequestrated) states in his affidavit submitted in support of his claim against the estate that he relies for the satisfaction of his claim solely on the proceeds of the property which constitutes his security, he shall not be liable for any costs of sequestration other than the costs specified in subsection (1), and other than costs for which he may be liable under paragraph *(a)* or *(b)* of the proviso to section *one hundred and six*.

(3) Any interest due on a secured claim in respect of any period not exceeding two years immediately preceding the date of sequestration shall be likewise secured as if it were part of the capital sum.

(4) Notwithstanding the provisions of any law which prohibits the transfer of any immovable property unless any tax as defined in subsection (5) due thereon has been paid, that law shall not debar the trustee of an insolvent estate from transferring any immovable property in that estate for the purpose of liquidating the estate, if he has paid the tax which may have been due on that property in respect of the periods mentioned in subsection (1) and no preference shall be accorded to any claim for such a tax in respect of any other period.

(5) For the purposes of subsections (1) and (4) 'tax' in relation to immovable property means any amount payable periodically in respect of that property to the State or for the benefit of a provincial administration or to a body established by or under the authority of any law in discharge of a liability to make such periodical payments, if that liability is an incident of the ownership of that property.'

(Once again, any further mention of s 89 will be a reference to this section.)

[10] The case for the second respondent is this: section 118(3) provides security for municipal debts but, although it in its terms is not subject to a time limit under ordinary circumstances, once there is an insolvency or liquidation (s 89 applies to both instances) a two-year time limit is imposed by virtue of the concluding words of s 89(4), namely that 'no preference shall be accorded to any claim for such a tax in respect of any other period' (ie, a period exceeding two years immediately preceding the date of the sequestration).

[11] The appellant, however, submitted that the whole context of s 89 is concerned, as the sidenote to the section suggests, with costs to which securities are subject, and that the provision in question has no bearing upon the appellant's claim for payment of the municipal debts.

[12] The submissions of counsel tended to concentrate on the terms of the statutory provisions without due regard to their historical context. In my view an examination of the origins of s 118 and s 89 leads to the emergence of a coherent legislation intention concerning their purpose.

[13] The principal elements of s 118 are an embargo provision with a time limit (s 118(1)), a security provision without a time limit (s 118(3)), and a provision located between the two (s 118(2)) which subjects the provisions of s 118 as a whole to the terms of s 89.

[14] Embargo provisions have been the subject of repeated judicial pronouncement for at least a hundred years. In *Johannesburg Municipality v Cohen's Trustees* 1909 TS 811 Innes CJ said (at 817):

'Now reading that section in connection with other provisions of the statute, the intention seems to have been to give to the local authority a right to veto the transfer of property until its claims in respect of rates should be satisfied. The result, of course, was to create, in effect, a very real and extensive preference over the proceeds of rateable property realised in insolvency; and to compel payment of the burden thus imposed before a sale of such property could be carried through even in cases where insolvency had not supervened. The hold over the property thus given to the local authority is entirely the creation of the statute; its object was to ensure payment of the liabilities due by ratepayers as such, and one would therefore think that it was intended to continue until all liabilities arising out of rates had been discharged; in other words, that the account of the municipality against the property should be closed when transfer passed, and that transfer should not pass until it was closed.'

The court was there concerned with s 26 of the Local Authorities Rating Ordinance of 1903 (Transvaal) (which contained an embargo unfettered by a time limit). Similar provisions (but with a time limit of three years) were included in later Transvaal legislation: s 47 of the Local Government Ordinance 9 of 1912, s 49 of the Local Government Ordinance 11 of 1926 and s 50(1) of the Local Government Ordinance 17 of 1939 (which was repealed by the Local Government Laws Amendment Act 51 of 2002). It is clear that the legislature has transmuted

the last-mentioned section into s 118(1) with the time limit reduced from three years to two.

[15] The provenance of a security provision such as contained in s 118(3) in local government legislation is more recent. It was first included in s 50(2) of the 1939 Transvaal Ordinance at its promulgation in the following terms:

'2(a) All such charges and sums mentioned in paragraphs (a) and (b) of subsection (1) shall be a charge upon the premises or interest in land in respect of which they are owing and shall be preferent to any mortgage bond passed over such property subsequent to the coming into operation of this Ordinance.'

The introduction of s 50(2)(a) was probably a delayed reaction to the judgment in *Rabie NO v Rand Townships Registrar* 1926 TPD 286, which held that an embargo provision in s 47(b) of the 1912 Ordinance did not constitute a 'claim ranking in priority' over a mortgage bond. As will be seen, such security clauses had been assuming a prominence in legislative drafting during the years preceding 1936, when the present Insolvency Act replaced the statute of 1916.

[16] The effect of the words used in s 118(3) is to create in favour of a municipality a security for the payment of the prescribed municipal debts (municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties) so that a municipality enjoys preference over a registered mortgage bond on the proceeds of the property. The extent of that preference when the debtor is declared insolvent depends, as will be shown, upon the operation of s 118(2).

[17] As to s 118(2), the first matter to be noted is that it refers specifically to the transfer of property by a trustee of an insolvent estate. Does this exclude its application to a liquidator (of a company or a close corporation)? Such artificial persons are equally as liable to pay the charges referred to in s 118(1) as natural persons are. The municipality's need for protection is no more or less in one case

than in the other. I can think of no rational ground for applying s 89 to s 118 in the context of the sequestration of an individual but excluding it from a liquidation. To do so would lead to an absurdity so glaring that the legislature could not have contemplated it: *Venter v R* 1907 TS 910.

[18] Section 118(2) had its genesis in a proviso to s 50(1) (the embargo provision) of the 1939 Ordinance in the following terms:

'provided that in the case of transfer of immovable property the provisions of this section shall be read subject to the provisions of section eighty-nine of the Insolvency Act, No 24 of 1936, and the latter provisions shall apply'.

The words 'the provisions of this section' in the quoted proviso related to the whole of s 50 (ie to both embargo and security provisions). It would seem that the drafter of s 118 chose rather to treat what had formerly been a proviso as a substantive subsection (s 118(2)) but repeated its application to the whole of the section, although it would perhaps have been more logical to have inserted it after the security provision.

[19] The provisions contained in s 89(4) repeated the substance of s 88(4) of the Insolvency Act 32 of 1916, which provided:

'(4) Notwithstanding any law prohibiting the transfer of property upon which there are unpaid rates, taxes or licences, no trustee shall be prevented from transferring any property by reason of any unpaid rates, taxes or licences thereon which at the date of sequestration had been in arrear for longer than the calendar year current with the sequestration and the calendar year preceding.'

It will be observed that the significant addition (in s 89(4)) was the phrase 'and no preference shall be accorded to any claim for such a tax in respect of any other period'.

[20] The reason for the addition seems clear. Prior to 1936 a practice had grown up in South Africa (and Rhodesia) of creating statutory quasi-liens and statutory charges or preferences. See *Commissioner of Taxes v Master and Trustee in Insolvent Estate Collias* 1930 SR 12 at 16 and Mars (Hockly ed) *The Law of Insolvency* 3ed (1936) at 352-3, the last-mentioned being an apparent

contextualization of the change in the law brought about by s 89(4) in 1936. Reference to the examples in *Collias* and in Mars show that charges of such a nature usually carried no time limit on their operation. Section 118(3) represented a continuation of the practice. The security provided amounts to a lien having the effect of a tacit statutory hypothec: *Stadsraad van Pretoria v Letabakop Farming Operations (Pty) Ltd* 1981 (4) SA 911 (T) at 917A-H; *BOE Bank* supra at 341G-H; and no limit is placed on its duration outside of insolvency.

[21] In this context the logic of s 89(4) is plain: it was necessary to inform creditors and trustees of the rights and obligations attaching to the realisation of immovable property in an estate so that there would be no doubt as to what the trustee must pay before being permitted to transfer the property and what statutory restraints and claims would attach to the proceeds after transfer. In this way the limits of the costs of realisation of such property (in the context of s 89(1)) are also determined. The legislature had, in s 89(3), laid down that interest on a secured claim would be secured as if it were part of the capital sum for two years prior to the date of sequestration. The legislature, having provided in the first part of s 89(4) for a limitation on the effective duration of an embargo provision, saw the section as an appropriate vehicle to similarly limit the duration of preferences which arose from the quasi-liens and charges which were the vogue. Thus construed both s 89(3) and 89(4) serve a consistent purpose in providing a uniform duration (two years prior to the date of sequestration and from that date until the date of transfer) for interest on securities and on embargoes and claims for a tax (as defined in s 89(5)). See also *De Wet en andere v Stadsraad van Verwoerdburg* 1978 (2) SA 86 (T) at 101D.

[22] To the extent that the municipal debts described in s 118(3) qualify as a such tax or taxes the limitations of s 89(4), when applicable, likewise apply to the preference conferred by the first-mentioned section. In so far as they do not fall

within the scope of such a tax, s 89(4) has no bearing on the effect or duration of the preference. See also *Eastern Substructure of Greater Johannesburg Transitional Council v Venter NO* 2001 (1) SA 360 (SCA) at 369B-D.

[23] It follows from the foregoing that I disagree that the purpose of s 89(4) is limited to the regulation of the costs to which securities are subject in insolvency and that it has no bearing on the operation of s 118(3). Counsel also placed much stress on a submission that a creditor in an insolvent estate 'takes his debtor as he finds him', meaning thereby that the second respondent was obliged to accept that the first respondent was burdened by the preference created by the charge on the property before insolvency intervened. Like most legal generalisations that statement is only as valid as the legislature permits it to be. In this case the creditor's pre-insolvency rights have been expressly curtailed by the operation of s 118(2) read with s 89(4).

[24] It will be noted that the two year period in s 89(1) differs from that appearing in s 118(1): two years prior to the date of sequestration as against two years preceding the date of application for a clearance certificate. When a trustee makes application for a certificate the two year period under s 118(1) will effectively be less than the two year period under s 89(1), because the date of application is necessarily later than the date of sequestration. The first part of s 89(4) means that when an embargo period laid down in any other law is effectively shorter than the two year period in s 89(1) the first-mentioned period continues to apply after sequestration. So the operation of s 118(1) is not affected by s 89(4). When, however, the embargo provision in any other law is effectively longer than that in s 89(1) then, by reason of the provisions of s 89(4), the period in s 89(1) will override the period in the other law.

[25] Before proceeding, it may assist in providing a clearer appreciation of the

conclusions at which I have thus far arrived if I summarise the operation of s 118(1) and (3) in situations where the municipal debtor is not subject to a sequestration or liquidation order and to compare that with the position after the making of such orders.

[26] When such a debtor is not subject to such an order-

1. No property may be transferred unless a clearance certificate is produced to the registrar of deeds that certifies full payment of all municipal debts as described in s 118(1) which have become due during a period of two years before the date of application for the certificate.
2. Any amount due for municipal debts (ie not limited by the aforesaid period of two years) that have not prescribed is secured by the property and, if not paid and an appropriate order of court is obtained, the property may be sold in execution and the proceeds applied in payment of the debts. In such event the proceeds will be applied to payment of the municipal debts in full. Only after satisfaction of such debts will the remainder, if any, be available for payment of the debt secured by a mortgage bond over the property.

[27] Once a debtor has been sequestrated or liquidated the position is, to the extent that the municipal debts are ‘taxes’ within the meaning of s 89(5), (but not otherwise) the following-

1. No property may be transferred unless the clearance certificate certifies full payment of municipal debts that have become due during a period of two years before the date of application for the certificate.
2. The preference accorded by s 118(3) in favour of the municipality over that of a holder of a mortgage bond is limited to claims which fell due during the period laid down in s 89(1), ie two years prior to the date of sequestration or liquidation up to the date of transfer.
3. Interest charged on the secured claim of the municipality is secured as if it

were part of the claim.

[28] After sequestration or liquidation those municipal debts that are not ‘taxes’ within the meaning of s 89(5) continue to attract the benefits of s 118(3) without being affected by s 89 of the Insolvency Act.

[29] The question which now requires to be addressed is the subject matter of the municipality’s claim. The appellant’s counsel submitted that the effect of s 118(3) is to bring about an innominate lump sum preference under which the separate elements are subsumed and no part can be identified by its original elements. I do not agree. The charge upon the property giving rise to a preference is merely a description of a right arising from one or more of the particular causes of indebtedness mentioned in s 118(3). The existence of the right to security depends upon the existence of those elements, which do not forego their identity by reason of being labelled ‘a charge on the property’.

[30] What then is the nature of the appellant’s claims under s 118 in the present case? Do they fall within the ambit of s 89(5) or not? It will be recalled that s 89(4) places a time limit on a preference arising from a claim for a ‘tax’ as defined in s 89(5) while, on the other hand, the preference created by s 118(3) is in respect of municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties. No evidence was adduced establishing whether the amounts claimed all fell under either provision and counsel seem to have regarded it as a non-issue. There may well be conflicting views on whether service charges, basic fees and refusal removal fees are charges ‘periodically payable’ ‘in respect of’ property and whether the liability to pay them is ‘an incident of ownership’ (using the terminology of s 89(5)): see *Greater Johannesburg Transitional Metro Council v Galloway NO and others* 1997 (1) SA 348 (W) and cf *Eastern Substructure of Greater Johannesburg Transitional Council v Venter NO* supra at

368J-369D and *Mkontwana v Nelson Mandela Metropolitan Municipality and Another*; *Bissett and Others v Buffalo City Municipality and Others*; *Transfer Rights Action Campaign and Others v MEC, Local Government and Housing, Gauteng and Others (Kwazulu-Natal Law Society and Msunduzi Municipality as Amici Curiae)* 2006 (1) SA 530 (CC) at paras 39-42. This is, however, putting the cart before the horse. As Brand JA pointed out in *Barnard NO v Regspersoon van Aminie en 'n ander* 2001 (3) SA 973 (SCA) at 984B-984E the starting point is to determine whether the claim is for a 'tax' in its ordinary sense and only if the answer is positive to apply the restrictive provisions of s 89(4). While it is clear that property rates are such a tax and that service charges which are a *quid pro quo* for a measured consumption are probably not, the status of the appellant's other claims remains uncertain and the determination may be affected by the local by-laws or regulations which govern them and in respect of which we have not been addressed. Nor have we been told what the expression 'sundry services' means.

[31] As I have noted the real issue between the parties was the application and effect of s 89. Having decided that issue, it is possible to grant declaratory relief and to leave the unresolved issues to resolution by the parties. The lien which the appellant holds confers a right of retention within the terms of s 95(1) of the Insolvency Act and justifies the declaratory relief claimed in paragraph 2.2 of the notice of motion.

[32] The effect of the order which I propose, although not in the precise terms initially claimed by the appellant, represents substantial success for the appellant and should carry an appropriate order for costs in both courts. Despite the fact that the appellant has been unsuccessful in resisting reliance on s 89(4) it seems to me that the second respondent has won a pyrrhic victory: the result is an extension of the period of the appellant's preference beyond that provided in s 118(1) in so far as the municipal debts equate to s 89(5) taxes, and in relation to all debts that do

not so equate the period of preference is limited only by prescription.

[33] In relation to the proceeds of the property remaining after the clearance certificate was obtained I would accordingly make the following order:

1. The appeal succeeds with costs including the costs of two counsel.

2. The order of the court *a quo* is set aside and replaced by the following order:

    1. It is declared that the amounts due by the first respondent to the applicant on behalf of the registered owner of Erf 406 Wynberg in respect of municipal debts which are taxes within the meaning of s 89(5) of the Insolvency Act 24 of 1936 are a charge upon the property and enjoy preference in the distribution of the proceeds of the sale of the property over the second respondent's participation mortgage bond registered over the property for a period of two years prior to the date of liquidation of Krokipark CC and from that date until the date of transfer of the property.

2. It is further declared that the said amounts fall to be paid to the applicant by the first respondent in satisfaction of a claim secured by the property as contemplated in s 95(1) of the Insolvency Act 24 of 1936.

3. It is further declared that to the extent that any of the applicant's claims do not fall within the meaning of 'tax' in s 89(5) of the Insolvency Act 24 of 1936 the amounts of such claims-

    3.1 are a charge against the property and enjoy preference over the participation mortgage bond registered against the property in favour of the second respondent;

    3.2 are not subject to the terms of s 89(4) of the Insolvency Act 24 of 1936;

    3.3 fall to be paid by the first respondent in satisfaction of a claim secured by the property as contemplated by s 95 of the Insolvency Act 24 of 1936.

4. The second respondent is to pay the costs of the application including

the costs of two counsel.

J A HEHER
JUDGE OF APPEAL

HARMS JA)Concur
ZULMAN JA)
STREICHER JA)
CACHALIA AJA)