



Bulletin No 9

Bulletin No 9

Sale of properties in possession

Distribution:

Members of Banking Association of South Africa
Representative Bodies
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Press

26 January 2004

This Office recently received a complaint based on a property that was sold by a bank in execution of a judgment debt. The complainant was in arrears with his bond repayments and the bank then obtained judgment against him. At the auction the bank was unable to obtain the reserve price on the property. The bank then “bought in” the property for an amount of R100. Later the bank managed to sell the property privately. The bank however only credited the bond account with the R100 and not the price for which the property had ultimately been sold. The complainant was then held liable for the outstanding balance on the bond account.

The question arose as to whether or not the banks were entitled to only credit their client’s account with the price they had paid to “buy in” the property and not with the final purchase price.

We approached 4 of the major banks with the following scenario:

A client defaults on his/her bond account. The property is then supposed to be sold in execution but the bank does not get the reserve price at the auction. The bank buys the property for R100-00 (as an example) and sells it at a later stage for a much higher price. If the bank does not get the reserve price, does it credit its client’s account with R100-00 and/or the valuation of the property? If the bank sells the property at a later stage, does the bank credit its client’s account with the purchase price?

We received responses from four major banks. We then obtained a legal opinion from Professor WG Schulze on this issue. Professor Schulze provided an opinion on the case scenario mentioned above. The opinion is attached.

We are in agreement with the conclusions arrived at in Professor Schulze’s opinion, namely:

- Where the bank buys the mortgaged property for R100, 00 and later sells it for a higher price without crediting the mortgagor’s account with the balance after the deduction of the principal debt and holding costs, it amounts to a *pactum commissorium*, which is invalid.
- The bank is entitled to recoup the principal debt, interest and holding costs but is not allowed to make ‘a profit’ out of the resale of the property. Any such ‘profit’ must be credited to the mortgagor’s account.
- This approach would not only be in accordance with the common law, but would also accord with reasonableness and public policy as well as the principles of reasonableness and fairness accepted by member banks in the Code of Banking Practice.

Based on the responses we received to the original information notice, all the banks state that they comply with the law and principles as set out in the opinion.

In accordance with the legal principles as set out in the attached legal opinion and the provisions of the Code of Banking Practice, we recommend that the banks credit the account holder's account with either the full fair valuation amount or the final purchase price of the property in question. The banks are, however, entitled to add any charges as provided for in their contract with the client, as long as the amounts of such charges are reasonable. The basic principle is that the bank must not be enriched at the client's expense. Any complaint received, based on the principles as discussed, will be evaluated with due regard to this bulletin and any other relevant factors. Any complaint will be evaluated on its own merits.

Adv NJ Melville
Banking Ombudsman

LEGAL OPINION ON ‘PROPERTY IN POSSESSION’

1 Introduction

I have been asked to comment on the legal tenability of the following practice or scenario that occurs in the banking industry:

‘A client defaults on his/her bond account. The property is then supposed to be sold in execution but the bank does not get the reserve price at the auction. The bank buys the property for R100,00 (as an example) and sells it at a later stage for a much higher price. If the bank does not get the reserve price, does it credit its client’s account with R100,00 [only] and/or the valuation of the property? If the bank sells the property at a later stage, does the bank credit its client’s account with the purchase price?’

I have also been asked to comment on the legal tenability of practices or procedures followed in this regard by four individual banks.

In paragraph 2 of this opinion I will first give a general background to the applicable legal principles.

In paragraph 3 I will apply these legal principles to the above-described practice, while in paragraph 4, I will explain and comment on the validity of the procedures followed by the four individual banks.

2 Applicable Law

2.1 Background

Although the real right of mortgage entitles the mortgagee to a secured claim on the mortgaged property, it does not enable the mortgagee to take the law in its own hands and sell the property out of hand, applying the proceeds towards the extinction of the principal obligation (that is, the debt owed by the debtor (mortgagor) to the creditor (mortgagee)).¹ As a result, mortgagees had over the years devised and included a number of clauses in the loan agreement that entitle them to sell the mortgaged property in the event of default by the mortgagor.²

The validity of these clauses that purport to give the mortgagee rights in terms of which the normal rules relating to the satisfaction of the principal obligation by a recourse to the mortgaged property are varied, have over the years been subjected to judicial scrutiny.³

In considering the applicable and relevant legal principles, one needs first of all to distinguish between three distinct legal concepts. These three concepts form the basis of the three most common clauses inserted by mortgagees in loan agreements to facilitate self-help in the case of default by the mortgager:

¹ See GF Lubbe (revised by TJ Scott) ‘Mortgage and Pledge’ in: *LAWSA* (‘Lubbe’) Vol 17 (First Reissue) (1999) 396-397.

² There are, of course, also a number of other clauses that mortgagees over the years devised and sought to include in loan agreements. Some of them had been declared invalid by our courts. I will restrict myself and mention only one of them here: The common law acknowledges every debtor’s right of redemption by discharging the debt. Any agreement purporting to curtail the right of the debtor to terminate the real right of security (for example, pledge or mortgage) was invalid by common law. The Appellate Division (now the Supreme Court of Appeal) accepted the common-law principle as valid, also for purposes of the modern South African law: see Lubbe *idem* at 396 and the authority referred to in note 3.

³ For a discussion of the different types of clauses one may encounter in mortgage-bonds agreements, see *Wille’s Law of Mortgage and Pledge in South Africa* 3rd ed by TJ Scott & Susan Scott (‘Scott & Scott’) (1987) at 111 et seq; Lubbe *idem* at 394.

- The right to dispose of mortgaged property (or a pledged article in the case of movables) without the intervention of a court order, commonly known as *parate executie* (see par 2.1.1 below);⁴
- The contractual right of taking over a mortgaged property (or pledged article) by the creditor (the mortgagee) (either for free or for a token price), commonly known as a *pactum commissorium* (see par 2.1.2 below);⁵ and
- The *quasi*-conditional sale whereby the creditor (mortgagee) may, upon default by the debtor (mortgagor) take over the mortgaged property (or pledged article) at a fair price (see par 2.1.3 below).⁶

These three concepts or clauses will be discussed in more detail below. One or more of these concepts are often included in the loan agreement and/or bond deed as a contractual clause in favour of the creditor (mortgagee).

2.1.1 *Parate Executie*

The principles concerning *parate executie* are trite. *Parate executie* involves a procedure (usually agreed upon by the creditor and the debtor at the time of the execution of the mortgage deed) in terms of which the creditor (mortgagee) is entitled to take *parate executie*, that is execution without recourse to the debtor (mortgagor) and/or the court by taking possession of the property and selling it privately.

Generally a clause that purports to allow the creditor to take *parate executie* is deemed to be invalid in so far as **immovable property** encumbered by mortgage is concerned.⁷ This prohibition also covers those contractual arrangements which, in writing or otherwise, and whatever their form and wording, are of a similar purpose and effect and giving the creditor the right to sell the mortgaged property without recourse to the debtor or the court.⁸

There are a few statutory exceptions to the prohibition on *parate executie*.⁹ None of them are relevant for present purposes and some of them have been declared invalid, as they did not meet the test of constitutionality.¹⁰

⁴ On *parate executie* in general, see Scott & Scott idem at 121 et seq; Lubbe idem at 397.

⁵ On *pacta commissoria* in general, see Scott & Scott idem at 124 et seq; Lubbe idem at 396.

⁶ These three concepts were most recently explained in *Anthony Simon Bock and Others v Duburora Investments (Pty) Ltd* (SCA 26 September 2003 (case no 228/2002) unreported) in paras 6 to 10 of the judgment.

⁷ But a clause for *parate executie* of **moveable property** which have been delivered by the debtor (pledgor) to the creditor (pledgee) is valid: see *Osry v Hirsch, Loubser & Co Ltd* 1922 CPD 531 at 541-547; *Iscor Housing Utility Co and Another v Chief Registrar of Deeds and Another* 1971 (1) SA 613 (T) at 616B (by way of an *obiter dictum*); and Scott & Scott op cit note 3 at 122.

⁸ Lubbe op cit note 1 at 397.

⁹ See, for example, ss 50(1) and 55(2)(b) of the Land Bank Act 13 of 1944; s 37 of the Agricultural Credit Act 28 of 1966; and s 22(2) of the South African Transport Services Act 65 of 1981 (which allows the Transport Services to sell goods in respect of which freight is unpaid); and s 38(2) of the Northwest Agricultural Bank Act 41 of 1981 (NW). See further *Wasserzweig v The Land & Agricultural Bank of SWA & The Sheriff* 1936 SWA 19; and *Strydom v Die Land- & Landboubank van SA* 1972 (1) SA 801 (A). In the latter case the Court was at pains in pointing out that any statutory exception to the common-law prohibition on *parate executie* need to be interpreted and applied strictly. The *Strydom* case was, of course, decided more than 20 years before South Africa had a Bill of Rights.

¹⁰ In *Chief Lesapo v Northwest Agricultural Bank* 1999 (10) BCLR 1195 (B); 2000 (1) SA 409 (CC) the court was asked to consider the constitutionality of s 38(2) of the Northwest Agricultural Bank Act. This section gave the Bank the right, without recourse to a court of law, to require the messenger of the court to seize and sell by public auction a defaulting debtor's property. The Court held that because the Bank was able to use other, less restrictive and drastic powers (than *parate executie*) to achieve its purpose, s 38(2) was not a justifiable limitation of a debtor's right to access to a court of law. Section 38(2) was accordingly held to be unconstitutional: see FR Malan & JT Pretorius 'Contemporary Issues in South African Banking Law' (2001) 64

The reasons for the prohibition on *parate executie* turn on the need to protect debtors (mortgagors) against the future exploitation of their poor financial situation by creditors (mortgagees). To accord the creditor (mortgagee) the right to *parate executie*, so the argument runs, is tantamount to allowing it to take the law into its own hands. It has also been argued that hardship may arise where a creditor (mortgagee) acts in terms of a clause that gives it the right to *parate executie*. The creditor may labour under the honest but mistaken assumption that the debtor is in default, and sells and transfer the property to a *bona fide* third party.¹¹ It is clear that considerations of public policy underlie the prohibition on *parate executie*.¹²

However, there is an important distinction between the right to *parate executie* that was agreed upon in the **original** loan agreement or mortgage deed, on the one hand, and the right to *parate executie* that was agreed upon by the parties **after** the debtor's (mortgagor's) **default**, on the other hand. Put differently, in the first case the parties agree on *parate executie* **before** the debtor has fallen into default, while in the second case they agreed on *parate executie* only **after** the debtor has fallen into default. The former agreement is invalid, the latter not. The reason for this distinction lies in the fact that the creditor (mortgagor) does not act on the basis of the original agreement, but on the basis of a fresh and separate agreement that is not vitiated by the objections of public policy levelled against a clause providing for *parate executie in anticipando*.¹³

In conclusion: A clause in the loan or bond agreement that the mortgagor will have the right to *parate executie* will be invalid. However, a subsequent agreement (that is, after the debtor (mortgagee) has fallen into default) that the creditor (mortgagor) will have the right to *parate executie* is valid and enforceable.

2.1.2 *Pactum Commissorium*

A *pactum commissorium*¹⁴ is an agreement in terms of which the creditor (mortgagee) will be entitled, upon default of the debtor (mortgagor) to acquire ownership of the mortgaged property. Under Roman,¹⁵

Tydskrif vir Hedendaagse Romeins-Hollandse Reg 268 at 279-280; WG Schulze 'The Sources of South African Banking Law – A Twenty-first Century Perspective' (2002) 14 *SA Merc LJ* 438 at 444-445. See further *First National Bank of South Africa Ltd v Land and Agricultural Bank of Southern Africa*; *Sheard v Land and Agricultural Bank of South Africa* 2000 (3) SA 626 (CC) in which the Court considered the constitutionality of s 34 of the Land Bank Act. Section 34 empowered the creditor (the Land Bank) to require any sheriff or any other person designated by the Land Bank to attach and sell movable and immovable property in execution, without recourse to a court of law. Section 34 was held to be unconstitutional.

¹¹ Scott & Scott op cit note 3 at 123; Lubbe op cit note 1 at 397.

¹² See *Sasfin v Beukes* 1989 (1) SA 1 (A) at 14D-E. The *Sasfin* case dealt with a deed of cession that contained a number of clauses that were found to be so harsh and so unreasonable towards the cedent that it militated against public policy and as a result was declared to be contrary to public policy and therefore invalid.

¹³ See *Iscor Housing Utility Co v Chief Registrar of Deeds* supra note 7 at 616D-E; Scott & Scott *ibid*; Lubbe *ibid*. For a similar distinction in the context of the *in duplum* rule, see the *obiter* comments made in *F & I Advisors (Edms) Bpk v Eerste Nasionale Bank van Suidelike Afrika Bpk* 1999 (1) SA 515 (SCA) at 525G note 1. For a discussion of these *obiter* comments, see WG Schulze 'Can a Borrower Waive the Benefits of the *In Duplum* rule?' (1999) 11 *SA Merc LJ* 109 at 113 et seq. See further *Anthony Simon Bock v Duburoro Investments* supra note 6 in par 7 of the judgment where it is stated that 'after default the mortgagor may grant the bondholder the necessary authority to realize the bonded property ... [but] it is different with movables held in a pledge: a term in an agreement of pledge, which provides for the private sale of the pledged article and in the possession of the creditor, is valid but a debtor may "seek the protection of the Court if, upon any just ground, he can show that, in carrying out the agreement and effecting a sale, the creditor has acted in a manner which has prejudiced him in his rights"'.¹⁴

¹⁴ Closely related to the concept of a *pactum commissorium* is the concept of a *lex commissoria*. A *lex commissoria* is a resolutive condition (usually encountered in a contract of sale or of letting and hiring) to the effect that in the event of default at the expiry of an agreed term the other party shall be entitled to cancel (or resile from) the contract. A *lex commissoria* is regarded as a valid and enforceable term of a contract of sale or letting and hiring, as the case may be: see RH Christie *The Law of Contract in South Africa* 4 ed (2001) at 596.

¹⁵ Lubbe op cit note 1 at 396n6.

Roman-Dutch¹⁶ and modern South African law¹⁷ a *pactum commissorium* is regarded as invalid and therefore unenforceable against the debtor (mortgagor).¹⁸ Any clause with the same purpose and effect, irrespective of the wording of it, will also be invalid. For example, an agreement that the proceeds of the sale of the mortgage property are to go to the mortgagee, whether such proceeds are more or less than the debt, is illegal, as such an agreement is similar, if not identical to a *pactum commissorium*.¹⁹

An agreement in terms of which the mortgagee is granted an option to purchase the property for the amount of the principal debt, or for such an amount plus the value of the improvements up to a stated maximum limit too is invalid and unenforceable because it constitutes a *pactum commissorium*.²⁰

The reason for the prohibition on a *pactum commissorium* is to be found in considerations of public policy, and more specifically, consumer protection. There is always the inherent possibility that a prospective creditor (mortgagee) may exploit the weak financial position of a debtor (mortgagor) closely linked the latter's often misplaced optimism about his or her future financial prospects.²¹

The Supreme Court of Appeal in *Graf v Buechel*²² recently affirmed the nature of and the legal principles underlying the concept of a *pactum commissorium*. Although the *Graf* case concerned a pledge of incorporeals (shares and loan accounts) the principles stated in that case are relevant also for purposes of the mortgage of corporal immovables. The Court in *Graf* confirmed that a *pactum commissorium* in a contract of pledge is invalid and unenforceable, even if the pledgor is not the pledgee's debtor. The result of this judgment is that a third party who receives rights from a creditor by way of a cession, is, like the creditor itself, not allowed to enforce the purported rights contained in a *pactum commissorium* between the original creditor and the debtor.²³ It further held that where the contract does not provide that a fair valuation of the object of the pledge will be at the time when the debt falls due, but provides merely that upon default the pledgee would be entitled to elect to acquire the goods, the contract cannot be construed as a permissible conditional sale.²⁴

2.1.4 Conditional Sale

Closely related to the concept of a *pactum commissorium*, is the concept of a conditional sale. Roman-Dutch writers distinguished between a *pactum commissorium*, on the one hand, and a conditional sale, that is, an agreement that the creditor would, in the event of default, obtain the mortgaged property at a fair valuation, on the other hand.

An agreement that 'the mortgagee may take over the mortgaged property at a fair valuation, on the mortgagor's default' is valid, as it is considered to be a conditional sale. It is fully enforceable by the mortgagee, provided that the fair valuation is determined at the time when the debt falls due.²⁵

16 Lubbe idem at 396n7.

17 Lubbe idem at 396n8. See further *Sasfin v Beukes* supra note 12 at 14C.

18 See Scott & Scott op cit note 2 at 124.

19 See Scott & Scott idem at 125n105 and the common-law authorities referred to there.

20 See *Abbott v Cawood* 1982 (2) SA 153 (NC); Lubbe op cit note 1 at 396n9. This prohibition applies to those cases where the mortgagee wishes to exercise the option to buy the mortgaged property **without default** on the part of the mortgagor.

21 Scott & Scott op cit note 2 at 124-125; Lubbe idem at 396-397.

22 2000 (4) SA 378 (SCA).

23 At 384H-385D.

24 Supra note 22 at 388B-C and 388H-389A.

25 See Scott & Scott op cit note 3 at 126.

The validity of such a conditional sale was first confirmed in *Mapenduka v Ashington*²⁶ and again in the recently reported decisions in *Graf v Buechel*²⁷ and *Anthony Simon Bock v Duburoro Investments*.²⁸ In the *Mapenduka* case the Court held that the value that has to be placed on the pledge (or mortgaged property in the case of immovable property) is not the value at the date when the pledge was given (or the bond registered over the immovable property) but at the date when the debt became due (or when the debtor falls in default).²⁹ In *Graf v Buechel*³⁰ the Court emphasised the fact that if the valuation exceeds the amount owing to the debtor, the excess belongs to the debtor (that is, the pledgor or mortgagor).³¹ The Court in *Graf* hinted, by way of an *obiter dictum*, that the agreement to a conditional sale could be given expressly or tacitly.³²

The main difference between a *pactum commissorium* and a conditional sale appears to be the element of a fair valuation or a fair price that is paid by the mortgagee in return for taking over the mortgaged property from the mortgagor. In the case of a *pactum commissorium* there is no (fair) price to be paid by the mortgagee for the property and it could therefore not be regarded as a type of sale. The reason for that is that one of the essentials of a contract of sale is that the parties have to agree that the one party (the buyer) undertakes to pay a certain price in return for the object of the sale. Without an agreement that a price will be paid, there can be no contract of sale. For the price element to be satisfied three requirements have to be met:

- The price must be serious;
- The price must be fixed, or capable of ascertainment; and
- It must be in current money.³³

Only the first of these requirements merits our attention for purposes of the present discussion. The requirement of a ‘serious price’ entails that the price must not be nominal or illusory, but it must bear some appreciable relation to the value of the article.³⁴ Where a bank (or other mortgagee for that matter) ‘buys’ a mortgaged property in terms of a *pactum commissorium* for, say, R100,00 while its value is in fact much higher, the bank or mortgagee will not be allowed to argue that its buying of a property in terms of a *pactum commissorium* amounts to a conditional sale. Because a price of R100,00 cannot be regarded as a ‘serious price’, a clause that allows for such a ‘sale’ is in the nature of a *pactum commissorium*, and not in the nature of a contract of sale, and will, as a result, be invalid.

Apart from the presence of a ‘fair price’ that the mortgagee pays for the mortgaged property in the case of a conditional sale, there is also another important reason why conditional-sale agreements are valid and *pacta commissoria* not. The considerations of public policy militating against the enforceability of a *pactum commissorium* are absent in the case of a conditional sale where, the debt having fallen due, the creditor agrees to take the encumbered asset as a substitution of the mortgage debt, also known as *datio in solutum*.³⁵

26 1919 AD 343 at 352.

27 Supra note 22 at 388B-F and 388H-389A.

28 Supra note 6 in par 9 of the judgment.

29 At 352 where De Villiers AJA relied on Voet in stating that such an agreement (as is the case with the policy followed by Banks C and D: see further paras 4.4 and 4.5 below) is a type of conditional sale.

30 Supra note 22.

31 Supra note 22 at 389B.

32 Ibid.

33 See Harold Graham Mackeurtan *The Sale of Goods in South Africa* (1921) at 13.

34 Ibid.

35 See Lubbe op cit note 1 at 397.

It has been argued that the court in *Mapenduka v Ashington* had apparently limited the enforceability of a conditional-sale agreement to the extent that such an agreement may only be entered into after the debt has become due or, where such an agreement has been entered into before the debt became due, that the debtor is still willing to part with his or her property in this way after he or she has fallen into default.³⁶

An important point was raised in this regard in the recent decision in *Anthony Simon Bock v Duburoro Investments*. There the Court held that a conditional sale does not differ much in kind from a *lex commissoria* or forfeiture clause which, typically, permits a creditor to keep what was received from a debtor in the event of the cancellation of an agreement. The effect of a forfeiture clause may be alleviated under the Conventional Penalties Act.³⁷

2.2 The Application of the Constitution

In a number of recently reported cases the constitutionality of clauses permitting summary execution or self-help by the creditor came under fire. The gist of the arguments advocating the alleged unconstitutionality of clauses permitting summary execution turns on the fact that these clauses are in conflict with s 34 of the Constitution. Section 34 guarantees the right to have a dispute resolved by the application of law before a court of law. In arguing the unconstitutionality of clauses permitting summary execution, heavy reliance is usually placed on *Chief Lesapo v North West Agricultural Bank* and *FNB v Land and Agricultural Bank of SA*.³⁸ For a short while the decision by Froneman J in *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd*³⁹ opened a loophole for defaulting debtors. The Supreme Court of Appeal has now closed this loophole. More about this later.

In the *Findevco* case the facts were as follows: in terms of a perfecting clause in a notarial bond, the bondholder applied to the court for an order entitling it to perfect its security by taking possession of the debtor's movables and to dispose of these movables by public auction, public tender or otherwise. The Court thought it fit to intervene *mero motu* and to raise the issue of whether such a clause meets the test for constitutionality. Not surprisingly, the Court held that the clause was indeed unconstitutional.

Serious doubts were expressed about the correctness of the reasoning in the *Findevco* case.⁴⁰ First, so it is argued, the Court in *Findevco* wrongly equated perfecting clauses in notarial bonds with summary execution clauses (*parate executie* clauses) in a pledge.⁴¹ Secondly, it failed to distinguish between:

- statutory measures empowering the state to seize, without the intervention of the courts, movable and immovable property from unwilling debtors;
- perfection clauses; and
- summary execution clauses in pledge agreements.

It falls outside the scope of the present discussion to go into any depth as far as the alleged flaws in die *Findevco* decision are concerned except to remark that the criticisms against the *Findevco* are well-founded and that the decision in the *Findevco* case, namely that self help clauses in notarial bonds are

36 See Scott & Scott op cit note 2 at 125.

37 15 of 1962.

38 Supra note 10.

39 2001 (1) SA 251 (E).

40 See Susan Scott 'Summary Execution Clauses in Pledge and Perfecting Clauses in Notarial Bonds. *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)' 2002 (65) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 656 at 657 et seq and the criticism levelled against the *Findevco* case there.

41 See Scott *ibid*.

unconstitutional, were patently wrong.⁴² The crisp reason for this is that the two cases Froneman J in the *Findevco* relied on as authority for deciding that self-help clauses in notarial bonds are unconstitutional are simply not authority for reaching the decision that the Court in *Findevco* did. The two cases that Froneman J relied on (*Lesapo* and *FNB v Land and Agricultural Bank*) both dealt with statutory measures empowering the state to seize, without the intervention of the courts, movable and immovable property from unwilling debtors. In terms of the *stare decisis* principle, these two cases were neither relevant nor applicable to the facts in *Findevco*.⁴³

The reason why I referred to the *Findevco* case here is to point out that unwilling debtors will in all probability be quick to rely, and wrongly so I should hasten to add, on the judgment in *Findevco* in arguing that self-help clauses in respect of mortgages as well as pledges are unconstitutional. It is clear from the criticism expressed against the *Findevco* case that it cannot be regarded as authority for the statement that self-help or perfection clauses in a pledge agreement are unconstitutional. The reason for this is simple: In ‘a summary execution clause in a pledge of movables there is no spoliation (no self-help), since the pledgor (debtor) has already voluntarily parted with his/her possession and has authorised the pledge to sell the property at an execution sale’.⁴⁴

The Supreme Court of Appeal has now in an as yet unreported decision (*Anthony Simon Bock and Others v Duburoro Investments (Pty) Ltd*)⁴⁵ decided that the *Findevco* case was wrongly decided. In deciding so the Court referred with approval to the criticisms expressed by Scott against the *Findevco* case, the gist of which I have referred to above.

But the question whether self-help clauses (for example, *parate executie* and a *pactum commissiorum*) in a mortgage bond (which concerns immovables) meet the test of constitutionality as laid down in s 34 of the Constitution is a different question altogether. Because the debtor (mortgagor) is usually still in possession at the time of the execution of the self-help clause by the creditor (mortgagee), there is spoliation by the mortgagee and the mortgagor does not voluntarily parted with his/her property. In these circumstances there will be self-help by the mortgagee and I believe such conduct will be unconstitutional. This constitutes an example of the horizontal application of the constitution. The authority for this statement is to be found in the provisions of s 34 of the Constitution and the common-law principles of the law of things, and not in the *Findevco* decision.⁴⁶

2.3 The Application of the Code of Banking Practice

There are a number of provisions contained in the South African Banking Code that are of direct relevance to the present discussion.

In paragraph 1 (‘Fundamental Principles’) member banks undertake to ‘act fairly and reasonably in all

⁴² See Scott *idem* at 660 et seq.

⁴³ Scott *idem* at 659.

⁴⁴ Scott *idem* at 662.

⁴⁵ *Supra* note 6 in par 15 of the judgment.

⁴⁶ See Scott *idem* at 659 where she argues that the *Lesapo* and *FNB v Land- & Agricultural Bank* cases concerned a vertical application of the Constitution and that ‘there is no indication in either of these two cases that they should apply horizontally to perfection clauses and agreements in terms of which the debtor *voluntarily* hands possession of a movable to his/her creditor with the further agreement that, should the debtor fail to pay the principal debt, the creditor may sell the property in execution [my emphasis]’. However, she concedes that the Constitution may have limited horizontal application, that is, where the spoliator is not the state acting under legislation empowering it to seize a debtor’s property against his/her will and without recourse to the court, but a natural or juristic person (subject of the state) which acts in terms of a contractual arrangement against another subject of the state.

[their] dealings with [their clients]' and further also to 'ensure that all services and products comply with relevant laws and regulations'.

In paragraph 2.4 ('Mortgage loans') member banks undertake to 'explain to [their clients] the operation and repayment of [their] mortgage, including all the charges and costs ... and the steps required in law should we have to repossess it if [the client is] unable to meet [his/her] repayment obligations.'

In paragraph 2.9.1 ('Mortgage loans') member banks undertake to explain to [their clients] the requirements imposed by law in the event of the bank having to repossess [the client's] home due to [the client's] non-adherence to the conditions of the contract.

From these few extracts from the Banking Code it is clear that banks acknowledge their duty to follow the necessary legal steps ('steps required in law') when repossessing mortgaged property. This implies that self-help in the case of mortgaged property is not a valid option to the banks. Banks further undertake to explain the operation and repayment of their mortgage, including the steps involved when repossessing the property. This would surely entail that those member banks that follow a procedure that may lead to the scenario described in paragraph 1 above (in terms of which the bank may buy the property for as little as R100,00) are under an obligation to inform their clients about this possibility. It is a vexed question whether those member banks that follow the procedure described under paragraph 1 above comply with this obligation.

3 Application of General Legal Principles to Scenario

'A client defaults on his/her bond account. The property is then supposed to be sold in execution but the bank does not get the reserve price at the auction. The bank buys the property for R100,00 (as an example) and sells it at a later stage for a much higher price. If the bank does not get the reserve price, does it credit its client's account with R100,00 [only] and/or the valuation of the property? If the bank sells the property at a later stage, does the bank credit its client's account with the purchase price?'

Comment:

First, one needs to distinguish whether the bank sells the property under *parate executie* or not. A clause in a mortgage deed that purports to give the mortgagee the right to *parate executie* is invalid. However, if the mortgagor agrees to *parate executie* **after** he or she has fallen into default, the mortgagee is entitled to take *parate executie*.⁴⁷ It has been held that a clause in a mortgage bond permitting the bondholder to execute without recourse to the defaulting mortgagor or the court by taking possession of the property and selling it is void. The situation is, of course different, where, after the debtor's default, the mortgagor grants the mortgagee the necessary authority to realise the bonded property.⁴⁸

I don't believe that a subsequent agreement to *parate executie* (that is, **after** the mortgagor has fallen into default) is unconstitutional, or in contravention of the provisions of the Banking Code.⁴⁹

If the mortgagor does not consent to *parate executie* (after he or she has fallen into default) the bank will have to get judgment against the mortgagor and sell the property in terms of a court order.

⁴⁷ See again par 2.1.1 above.

⁴⁸ See *Iscor Housing Utility Co and Another v Chief Registrar of Deeds and Another* 1971 (1) SA 613 (T) at 616D-G; and *Anthony Simon Bock and Others v Duburaro Investments (Pty) Ltd* supra note 6 in par 7 of the judgment.

⁴⁹ See again paras 2.2 and 2.3 above.

Secondly, and quite distinct from the question whether the bank sells the mortgaged property under an agreement to *parate executie* or in terms of a court order, is the question what amount the bank as mortgagee is entitled to. I have indicated above that an agreement that the proceeds of the sale of the mortgage property are to go to the mortgagee, irrespective of whether such proceeds are more or less than the principle debt, is illegal, as such an agreement is similar, if not identical to a *pactum commissorium*.⁵⁰

Thus, where the bank buys the mortgaged property for R100,00 and later sells it for a higher price without crediting the mortgagor's account with the balance after the deduction of the principal debt and holding costs, it amounts to a *pactum commissorium*, which is invalid. It goes without saying that a similar practice, but in the absence of an express agreement to that effect (that is, in the absence of an express *pactum commissorium*) remains invalid.

In conclusion, the bank is entitled to recoup the principal debt, interest and holding costs but is not allowed to make 'a profit' out of the resale of the property. Any such 'profit' must be credited to the mortgagor's account. This approach would not only be in accordance with the common law, but would also accord with the guidelines of reasonableness and public policy laid down in *Sasfin v Beukes*,⁵¹ as well as the principles of reasonableness and fairness accepted by member banks in the Code of Banking Practice.⁵²

By

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⁵⁰ See again note 19 above.

⁵¹ See again note 12 above.

⁵² See again note 19 above.