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LEGAL UPDATE

Acceleration clause – Contra Bonos Mores?

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An acceleration clause

When a party to a contract defaults on one of their payments, one of the questions that arises is whether the creditor to the transaction is entitled to accelerate payment for the entire amount.

An acceleration clause is typically phrased in a manner that makes the full amount of a loan immediately due and payable in the event that the debtor defaults on payment. Any security that the creditor may hold also becomes immediately executable.

In terms of the principles of the law of contract, a breach by any party to a contract affords the innocent party a right to either cancel the contract or claim for specific performance. This principle is well established in our law.

In the *Combined Developers and Arun Holdings & Two Others* 2013 JDR 2017 (WCC) judgment, handed down by Davis J of the Western Cape High Court, the abuse of such clauses became apparent.

In this case, the debtor paid monthly instalments of R42 133.15 for the repayment of a loan. The debtor defaulted on payment of one of the instalments. The creditor sent an email to the debtor requesting payment of the overdue amount, which the debtor subsequently paid within three days of receipt of that email. On the date on which payment was made, the debtor neglected to pay the *mora* interest of R86.57.

The creditor used the **unpaid *mora* interest** as a basis to trigger the acceleration clause and demanded repayment of the full loan amount, in the sum of R7 665 040.14. The creditor was also upon default entitled to enforce its right to execute the security which it held.

The applicant relied heavily on the unanimous decision of *Chatrooghoon v Desai* 1951 (4) SA 122 (N). In this matter, the applicant sought to enforce an acceleration clause and did so successfully. However, the facts of the two cases are distinguishable; the applicant in the *Chatrooghoon* matter clearly set out the principal amount and interest due in their demand.

Public policy: the dominant argument by the respondent

Public policy was the dominant argument made by the respondent. The amount of the monthly instalment – relative to the interest payable – was unreasonable in the circumstances. The recurring theme of unequal bargaining power between the debtor and the creditor came up, as the applicant was the drafter of the agreement and consequentially, drafted the agreement in its own favour. Accordingly, the more vulnerable party suffered when the drafter decided to enforce the well-devised acceleration clause.

The respondent argued that the applicant did not make a demand, but merely gave the respondent notice. Counsel relied on the South African Concise Oxford Dictionary that defined demand as an 'insistent and peremptory request made as of right' and that the word peremptory was defined as 'not open to appeal or challenge'. Based on this definition, it was said that the email the applicant sent to the respondent amounted only to a formal request or an enquiry. The email ought to have set out the amount payable and the consequences that would follow should the respondent fail to comply with the demand. The applicant failed to do so.

Section 39(2) of the Constitution of the Republic of South Africa Nr. 108 of 1996

The court looked at section 39(2) of the Constitution of the Republic of South Africa Nr. 108 of 1996, which places a duty on the judiciary to develop the common law and promote the spirit, purport and objects that the Bill of Rights upholds. As the law of contract forms a part of the

common law, the court had to decide whether the aforesaid provision of the Constitution was applicable. The court focused its judgment on issues of public policy and whether those issues were in accordance with the normative framework of the Constitution.

The court made reference to the *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A) case, which emphasised that determining whether a contract is contrary to public policy must be done sparingly and objectively. It further went on to state that individual ideas of fairness and proprietary should not be taken into consideration when affirming questions of public policy. Alternatively, the underlying values instilled in the supreme law should always take precedence. The spirit, purport and objects of the Constitution must be upheld alongside the values of Ubuntu.

Further reference was made to the case of *Juglal v Shoprite Checkers (Pty) Ltd* 2004 (5) SA 248 (SCA), where it was held that no party can give effect to the provisions of a contract in a manner that the court deems to be unconscionable, illegal or immoral. Any attempt will find its enforcement being refused.

Examining the Everfresh case

Another judgment the court made reference to was the *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC), which stated that when a party to a contract acts *mala fides*, the far-reaching effects have the potential to impact on the lives of many laymen. Insofar as bargaining power is concerned, the court places a burden on the more powerful party to act in good faith when enforcing a claim (C Lewis, *Bargaining Power* 2013 (76) THRHR 80 at 94). From the aforesaid, it is clear that the court holds public policy as paramount.

Justice Davis J concluded that the application could not be granted for two primary reasons. Firstly, the Judge was not convinced that the respondent would have refused to pay such a small amount had the arrears been properly bought to its attention. Secondly, the nature of the acceleration clause and the manner in which the applicant intended it to be strictly constructed resulted in the clause being contrary to public policy. The application was accordingly dismissed. The decision is reportable.

Conclusion

The judgment aside, it begs the question of what is to be made of the Roman-Dutch law principle of caveat subscriptor. Should signatory beware be applied in the future? The hand of the respondent was not forced in the present case. It is undisputed that the contract was drafted to favour the applicant, but all banking institutions and bodies that advance loans reserve such rights. Furthermore, if the respondent believed the agreement was unfair and unreasonable, it had the freedom to find a loan elsewhere. The applicant in this matter was simply enforcing a right that it had in terms of an agreement, which had the needed animus contrahendi and consensus.

This legal brief was co-authored by Candidate Attorney Khathu Neluheni.

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