WERKSMANS
ATTORNEYS

CORPORATE MERGERS & ACQUISITIONS

Constitutional Court clarifies when a contract and its enforcement will be invalid for being contrary to public policy

5 August 2020 *6 min read*

by Pieter Steyn, Director

In a recent judgement involving Beadica 231 CC and others and the Oregon Trust, Sale's Hire CC and the National Empowerment Fund, the Constitutional Court resolved the uncertainty resulting from its 2014 decision in the Botha v Rich case and settled the law as to when a contract (or its enforcement) will be invalid for being contrary to public policy.

In Botha v Rich, the Constitutional Court had noted that the cancellation of a contract for the sale of land would be a disproportionate sanction and penalty for a breach of the contract by the buyer and would thus be unfair. This decision led to perceptions of differing approaches between the Constitutional Court and the Supreme Court of Appeal ("**SCA**") to the key issue whether a contract (or its enforcement) would be invalid merely because it was unfair, unreasonable or "disproportionate".

The Beadica case involved a broad-based black economic empowerment initiative in terms of which the National Empowerment Fund had provided funding to certain former senior employees of Sale's Hire CC to establish franchised businesses. Franchise agreements were concluded with Sale's Hire CC for ten years and lease agreements were concluded with the Oregon Trust for an initial five year period with an option to renew the leases for a further five year period. In terms of the franchise agreements, the franchised businesses had to be conducted from approved premises, namely the premises owned by the Trust. The sole member of Sale's Hire CC was also one of three trustees of the Trust. The franchisees failed to exercise their renewal rights timeously and the Trust subsequently gave them notice to vacate the leased premises. The Western Cape High Court held that the lease agreements had been validly renewed on the basis that otherwise the franchise agreements would be terminated (thereby causing the collapse of the franchised businesses and the failure of a broad-based black economic empowerment initiative) and that this would, having regard to the Constitutional Court's decision in the Botha case, be a disproportionate sanction. This decision was overturned by the SCA and was appealed to the Constitutional Court.

The Constitutional Court confirmed that a Court may not refuse to enforce a contract merely because the contract (or its enforcement) is, in the subjective view of the judge, unfair, unreasonable or unduly harsh. It reaffirmed that:

- the rule of law requires that the law be clear and ascertainable and provide reasonably predictable outcomes for contracting parties;
- freedom of contract is based on the constitutional values of freedom and dignity and is vital for economic development to achieve the constitutional vision of South African society.

The Constitutional Court clearly stated that its decision in the Botha case did not change our law to allow a Court to refuse to enforce a contract merely because the Court believed it to be "disproportionate", unfair or unreasonable. The Botha case dealt with the right (in terms of section 27 of the Alienation of Land Act) of a buyer of land to have the land registered in the buyer's name if the buyer has paid at least half of the price. Ms Botha had paid 80% of the price, but then defaulted and the seller cancelled the sale and claimed forfeiture of the amounts paid. The case accordingly dealt with the interpretation of section 27 and whether Ms Botha could exercise her section 27 right even though the seller had cancelled the sale. The Court's statements regarding disproportionality were made in the context of interpreting the statutory scheme created by section 27 and finding that Ms Botha retained her section 27 right. The Court accordingly made it clear that there had been no divergence between its approach and that of the SCA.

In Beadica, the Constitutional Court again emphasised that the party seeking to attack the contract or its enforcement bore the onus of proof that this would be contrary to public policy. On the facts, the franchisees had failed to explain why they had not exercised their renewal rights timeously. The only explanation given was that they were not sophisticated business people and weren't fully informed of their rights. The SCA rejected this explanation and found that the relevant individuals had operated franchises, been store or regional managers and were accordingly not ignorant. The Constitutional Court found that:

- the wording of the renewal right was in "simple, uncomplicated language which an ordinary person could reasonably be expected to understand";
- the franchisees had "simply neglected to comply" with the renewal clause in circumstances where they could have done so;
- the conduct of the Trust was not considered to be "snatching at a bargain or exploiting a mere technical slip";
- the termination of the franchise agreements did not automatically follow from the expiry of the lease agreements and it was possible that Sale's Hire CC could allow the franchisees to operate their business from different premises. The Court noted that if Sale's Hire CC refused to approve different premises and then terminated the franchise agreements, the exercise by Sale's Hire CC of that contractual power could possibly be challenged;
- the possible failure of a commendable broad-based black economic empowerment initiative was "attributable entirely to their unexplained failure to comply with the renewal clauses" and could not, in the absence of an explanation, form a sufficient basis for finding that the enforcement of the renewal clauses would be contrary to public policy.

A Court accordingly has the power to invalidate or refuse to enforce a contract if the contract (or its enforcement) is contrary to public policy. The Constitutional Court endorsed the SCA's approach of "perceptive restraint" (namely that a Court will use this power sparingly and only in the clearest of cases) but noted that Courts should not rely on this principle to "shrink from their constitutional duty to infuse public policy with constitutional values". The sanctity of contracts was not privileged over other constitutional rights and values and a careful balancing exercise was required to decide whether a particular contract (or its enforcement) would be contrary to public policy. Furthermore, it is not necessary to show substantial and incontestable "harm to the public" before a Court may refuse to enforce a contract on public policy grounds.

Pieter Steyn

Director

View Profile

Keep us close