

# DISPUTE RESOLUTION ALERT

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### PUBLIC POLICY TRUMPING PACTA SUNT SERVANDA ("AGREEMENTS MUST BE KEPT") RULE

Acceleration clauses are commonly found in commercial agreements where one party (the borrower) is afforded a period of time to make payment of an amount to the other party (the lender). This clause offers protection to the lender, affording the lender the option to demand the balance of the unpaid debt, upon failure by the borrower to pay any amount on the due date for such payment.

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The question the court was asked to determine was whether the enforcement of the acceleration clause in these circumstances was against public policy due to the severe consequences the enforcement would have for the borrower.

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Acceleration clauses have always been enforceable in our courts. However, in the recent judgment of *Combined Developers v Arun Holdings and others* [2014] JOL 31897 (WCC), the Western Cape High Court had to determine the legality and enforceability of an acceleration clause having regard to the dictates of public policy.

The parties in *Combined Developers* entered into a written loan agreement in terms of which Combined Developers, as lender, lent money to Arun Holdings, the borrower. The agreement contained an acceleration clause, which provided that if the borrower failed to pay the lender any amount when due, together with *mora* interest at the floating interest rate, to the lender within three business days after receipt of a written demand from the lender, an event of default would occur and the lender would be entitled to recover from the borrower all amounts owing under the agreement.

It was common cause that the borrower failed to pay an amount of R42,133.15 on or before the due date. The lender sent an email to the borrower, informing it of this failure. The borrower paid the amount of R42,133.15 but omitted to pay the *mora* interest, which amounted to an insignificant amount of R86.57.

The lender argued that the borrower’s failure to pay the *mora* interest constituted

an event of default as contemplated by the acceleration clause, which entitled the lender to claim from the borrower payment of the full outstanding amount of the loan, being R6.7 million and invoking the lender’s rights in terms of securities granted in its favour to secure payment in terms of the agreement.

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The lender, relying on the *pacta sunt servanda* (agreements voluntarily concluded should be adhered to) rule, argued that acceleration clauses are valid and strictly enforceable and that a court has no equitable jurisdiction to relieve a debtor from the automatic forfeiture resulting from such a clause.

The court rejected this argument and found that even if the rule is a key principle in our law, testing the contents of an agreement against public policy is still the default position.

The court confirmed that the test is an objective one of determining whether the values of the Constitution, which is an important source of public policy, would be breached by the lender’s interpretation of the clause.

# PUBLIC POLICY TRUMPING PACTA SUNT SERVANDA (“AGREEMENTS MUST BE KEPT”) RULE

CONTINUED

*Combined Developers is a warning to contracting parties that although an acceleration clause itself may not be against public policy, the implementation thereof may be.*



The judgment confirmed that although a contractual provision itself may not run counter to public policy, the implementation thereof may be so objectionable that it is sufficiently oppressive to constitute a breach of public policy, thus justifying non-enforcement.

The court found that the manner in which the lender wished to enforce the acceleration clause was contrary to public policy, due to the unconscionable result it had in demanding payment of R6.7 million for the borrower’s failure to pay R86.57. The court concluded that there was no reasonable commercial need in enforcing this debt against the borrower and this could have been dealt with amicably and expeditiously, without instituting litigious proceedings.

The reasoning in *Combined Developers* was recently confirmed by the Constitutional Court, evidencing that our courts are moving towards

a constitutionalised approach when interpreting contractual provisions. The Constitutional Court found that it would lead to a great injustice to enforce a contractual provision rigidly, indicating that the law of contract, based on the principle of good faith, contains the necessary flexibility to ensure fairness in commercial agreements. This confirmation opens the door to great uncertainty for contracting parties, whose rights and obligations will no longer be determined solely in accordance with the terms of their commercial agreements.

*Combined Developers* is a warning to contracting parties that although an acceleration clause itself may not be against public policy, the implementation thereof may be. Contracting parties, in particular lenders, should therefore always act in good faith when drafting and implementing commercial agreements.

*Lucinde Rhoodie and Mari Bester*

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