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CORPORATE & COMMERCIAL ALERT

IN THIS ISSUE

"I WILL ONLY MOVE WHEN YOU PAY ME MY DAMAGES"

In what circumstances can a party in breach justify its failure to adhere to the contract based on the other party's breach? This is one of the more interesting questions in contractual law. In *Ritz Plaza Proprietary Limited v Ritz Hotel Management Company Proprietary Limited 2018* JDR 0728 (WCC), a lessee attempted to use the lessor's alleged breach as a defence for its non-performance.

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The lessee operating the hotel refused to vacate the hotel and disputed the cancellation of the lease on the basis that the lessor allegedly breached an associated (legally binding) term sheet agreed between the parties.

The court rejected the lessee’s arguments and restated previous precedent (the so-called Academy of Learning tests named after the eponymous case) .

In what circumstances can a party in breach justify its failure to adhere to the contract based on the other party’s breach? This is one of the more interesting questions in contractual law. In *Ritz Plaza Proprietary Limited v Ritz Hotel Management Company Proprietary Limited* 2018 JDR 0728 (WCC), a lessee attempted to use the lessor’s alleged breach as a defence for its non-performance.

The facts applicable to the case are convoluted but boil down to a lessor’s attempted cancellation of a lease agreement for non-payment of rental in respect of a hotel. The lessee operating the hotel (The Ritz on the Atlantic Seaboard in Cape Town) refused to vacate the hotel and disputed the cancellation of the lease on the basis that the lessor allegedly breached an associated (legally binding) term sheet agreed between the parties, entitling the lessee to a damages claim. This breach, according to the lessee, relieved the lessee of its obligations to pay the rent.

The landlords in our audience just sat up a little straighter.

The court rejected the lessee’s arguments and restated previous precedent (the so-called *Academy of Learning* tests named after the eponymous case) in setting out the following three categories where a defaulting party’s breach of a contract would be obviated by the wrongful conduct of a counter-party of that contract:

1. Where the wrongful conduct of the lessor made the performance of the lessee impossible. The court noted that this situation constitutes the defence of supervening impossibility of performance in its own right. In order to succeed with this defence, the lessee would be required to prove that its performance became objectively, and not merely subjectively, impossible. Did the breach by the lessor make it impossible for the lessee to pay rental?
2. Where the lessor’s wrongful conduct constitutes a deliberate intention on its part to prevent the lessee’s performance. Did the lessor breach with the intention of preventing the lessee from paying rent?
3. Where the lessor’s conduct in itself constituted a breach of an express or implied term of the agreement in circumstances where the conduct of the lessor was required for the performance of the lessee. Did the lessor do something or withhold from doing something which was necessary for the lessee to be able to perform?

On the basis of logic and contractual equities, the first two categories do not seem especially controversial (which is not the same as saying they would be simple to apply to a set of messy real-life facts). It is the third category which seems the best available option for a defaulting party seeking to avoid being held liable for its breach, if only because it is more broadly stated. In the *Ritz* case, the lessee did indeed rely exclusively on the application of category three. The argument failed on

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the basis that the lessor's alleged breach was not a breach of a term of the lease or the associated term sheet which the lessee could rely on to avoid its liability. As such, the court ordered for the ejectment of the lessee from the premises.

However, consider what would have happened on a slightly altered set of facts: imagine for a moment that the lessor had in fact undertaken to fund the lessee in some way as a term of the lease and then breached that term. The lessee might then be entitled to argue that its non-payment of rental falls within the third category above and that therefore it cannot be held in breach on the basis that the lessor's funding was a necessary condition to the payment of the lessee's rental.

Our anxious landlords might then ask what would happen if we make a further factual tweak: what if the term the lessor negligently breached was not an obligation to fund the lessee directly (which simplified our previous example) but rather some other term of the lease which has caused the lessee damage which the lessee now alleges has led to it being unable to pay the rental? Is the lessor then able to evict the lessee for non-payment of the rental? And if the lessee is entitled to such relief, for how long and to what extent will it get that relief? Until the claim is decided by the courts?

Luckily the courts have effectively answered these questions in the *Academy of Learning* case where the court found it untenable that a counterclaim for damages could in all circumstances be a defence against a contractual breach claim. Accordingly, the circumstances in which a lessee might rely on a claim against a lessor attempting to evict it as a defence seem to have been appropriately limited by the courts.

David Pinnock and Boipelo Diale

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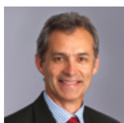

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