

Dispute Resolution

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SOUTH AFRICA

Transacting at arm's length



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Transacting at arm's length

The Supreme Court of Appeal (SCA), in the recent case of *Allied Steelrode (Pty) Ltd v Dreyer and Another* [2023] ZASCA 181, set aside an order of the Gauteng Division of the High Court, Johannesburg, after it had concluded that a loan agreement entered into between parties who shared a close bond and where no interest was levied against the borrower, was subject to the National Credit Act 34 of 2005 (NCA) and that a subsequent acknowledgement of debt (AOD) constituted a credit agreement under the NCA.

The loan in question was originally informal in nature and was entered into between the appellant and respondents, in terms of which the parties agreed that no interest would be charged. Later, that agreement was formalised in the form of the AOD, the terms of which included, *inter alia*, a grace period of six months before interest would accrue on *mora*.

The appellant claimed repayment of R15 million from the respondents, on the basis of the AOD signed by the parties on 1 October 2014. The respondents acknowledged the existence of the AOD but as part of their defence, invoked the applicability of the NCA. No evidence was led by the respondents, but they submitted that the dispute related to the loan rather than the AOD.

Before the High Court


The trial court, in addressing the issue, concluded that it was implausible to draw a distinction between the AOD and the underlying loan. It found that the invalidity of the underlying loan would implicitly taint the AOD as the AOD explicitly identified the loan as its foundation and that drawing a distinction between the loan and AOD was unsustainable.

The trial court then turned its attention to whether the AOD constituted a credit agreement under the NCA, and concluded that it did in fact fall within the scope of the NCA. The trial court stated further that the terms of the AOD included interest payable, payment that was deferred and extracted a maximum benefit for the appellant, and that this was consistent with an arm's length relationship as contemplated in section 4 of the NCA.

On the issue of whether the loan constituted an unlawful agreement under section 40(4) of the NCA, and was, for those reasons, void, the trial court found this argument to be unsustainable. Consequently, it was held that non-compliance with section 40(1) rendered the credit agreement unlawful and void under section 40(4) of the NCA.

Transacting at arm's length

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Tim Smit

On appeal to the SCA

This decision was taken on appeal and the SCA was thus faced with two issues – first, whether the order granted by the trial court was appealable and second, whether the transaction was concluded at arm's length and whether it constituted a credit agreement as defined by the NCA. We will deal with the first issue – the separation and appealability of the order – in a separate alert.

The SCA identified the actual issues in dispute as: whether the transaction between the parties was concluded at arm's length and whether it constituted a credit agreement under the NCA.

What was apparent from the evidence, according to the SCA, was firstly that a friendship developed between the appellant and the first respondent which resulted in them forming a "*close bond in personal matters outside the realms of business*". Secondly, the loan was offered as a gesture of friendship as it was not customary for the appellant to lend money, and this was a one-time occurrence. Thirdly, no interest was levied on the loan or the AOD, save in the event of *mora*.

For these reasons, the SCA found that the parties were not dealing at arm's length as provided for in section 4(2)(b)(iii) of the NCA. Additionally, the SCA found no evidence that the appellant sought to obtain the utmost advantage from the transaction and thus held that the agreement lacked the character of a credit agreement.

In a notional arm's length transaction, interest is typically insisted upon, and the borrower must pay that interest. In this instance, the SCA noted that interest was only payable in the event of default. This was indicative of the fact that the transaction was not an arm's length transaction. Further, according to the SCA, section 8(4)(f) of the NCA deems an agreement a credit agreement if it defers payment, and any charge, fee or interest is payable to the credit provider. Because only *mora* interest was payable between the parties, section 8(4)(f) of the NCA therefore could not find applicability. Notably, the application of section 40 of the NCA would thus only come into effect once it is established that a transaction falls within the purview of the NCA, which in this case, it did not.

Based on the evidence before the SCA, the matter was simple – the loan originated from an oral agreement, with no interest charged between the parties who had a familial relationship, which was conducted outside the scope of arm's length dealings. This makes it evident that neither the loan nor the AOD were subject to the NCA, and the trial court thus erred in its decision.

The SCA upheld the appeal concluding that the loan giving rise to the AOD upon which the appellant's cause of action was based was not subject to the NCA and that the AOD was not a credit agreement subject to the NCA.

Eugene Bester and Serisha Hariram



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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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