IN THE SOUTH GAUTENG HIGH COURT
JOHANNESBURG

CASE No. 36018/2009

DATE:01/04/2011

DELETE WHICHEVER IS NOT APPLICABLE

(1) REPORTABLE: YES / NO
(2) OF INTEREST TO OTHER JUDGES: YES / NO
(3) REVISED.

REPORTABLE

In the matter between:

SLIP KNOT INVESTMENTS 777 (PTY) LIMITED Applicant

and

PROJECT LAW PROP (PTY) LIMITED 1ST Respondent

IAN MEYER 2ND Respondent

PROJECTPROP DEVELOPMENTS (PTY) LIMITED

3RD Respondent

JUDGMENT

WILLIS J:

[1] The applicant has approached the court by way of motion proceedings for an order that the first and second respondents are jointly and severally liable, the one paying the other to be absolved, to pay the applicant an amount of some R15 million, together with interests and costs.

[2] The debt arises from a written agreement of loan concluded between the applicant and the first respondent secured by a written deed of suretyship signed by the second respondent. The third respondent is a nominal respondent only. The money was lent as so-called "short term bridging finance" in a property development scheme. In the papers this type of funding is called "mezzanine funding". The expression "mezzanine funding" has come to the fore in the

South Gauteng High Court relatively recently. Although there may be minor but nevertheless distinct differences between "short term bridging finance" and "mezzanine funding", for the purposes of this judgment these differences are unimportant.

[3] After several postponements at the request of the first and second respondents, the application came before Barrie AJ on 15 February, 2011. No affidavits were filed in behalf of the respondents. It would seem that Barrie AJ was troubled about the lawfulness of the rate of interest which the applicant had claimed. *Barrie* AJ suggested that an *amicus curiae* should be appointed to make submissions to the court on the issue. Mr *Moorcroft* was duly appointed as a*micus*. He has the distinction of being the author of *Banking Law and Practice*.[1] I am much indebted to Mr *Moorcroft* for his helpful submissions in the matter as I am to the Johannesburg Bar Council, which acting in accordance with the finest of its traditions, adopted a wise and obliging attitude in selecting his appointment.

[4] The borrower in a "mezzanine funding" transaction is typically a small developer requiring capital for which its own funding is insufficient and for which the commercial banks are unwilling to lend. The lender borrows the money from the commercial banks. The money is lent short-term. The risks but the rewards too are high for the lender.

[1] LexisNexis: Durban, 2009

Borrowers of "mezzanine funding" are typically experienced "players" in the property development market.

[5] The rate of interest charged to the first respondent was 1,25% per month until the first respondent fell into arrears and thereafter 1,5% per month. In an affidavit by Mr Duncan Campbell, the portfolio manager of the applicant, the change in interest rate after a debtor is in default in justified on two main grounds: (i) administrative costs in the monitoring and "follow-up" of the debt increase substantially once it is in default and (ii) the risk rises considerably.

[6] The first respondent fell into arrears on 12th October 2008. The applicant elected to cancel the agreement on 22nd May, 2009. The *amicus* and the counsel for the applicant agreed that the amount owing as at 6th March 2009 was R 11 337 822, 54.

[7] The *amicus* and counsel for the applicant agreed that the *in duplum* rule should be been applied to the calculations made. The manner of application of the *in duplum* rule in this case is consistent with the recent decision of the Supreme Court of Appeal ('the SCA") in the case of *Nedbank Ltd and Others v The National Credit Regulator and Another.*[2]

[2] [20011] ZASCA 35 (28 March 2011)

[8] Mindful of the fact the National Credit Act, No.34 of 2005, as amended ("the NCA") has repealed the Usury Act, No. 73 of 1968, as amended, the *amicus* and counsel for the applicant agreed that there are three issues that fall to be decided:

> (i) whether the applicant's calculations result in a contravention of the NCA;
>
> (ii) whether the loan is usurious to the extent that it is unlawful or *contra bonos mores*;
>
> (iii) whether the increase in the rate from 1,25% to 1,5% after the first respondent was in default constitutes an unlawful penalty in terms of the Conventional Penalties Act, No.51 of 1962, as amended.

[9] Referring to sections 1, 4(1) (b), 4 (2) (c), 7 (1) (b) and 9(4) of the NCA, the *amicus* and counsel for the applicant agreed that the provisions of the NCA were not applicable to this transaction because the principal debtor is a juristic person whose asset value or annual turnover at the signature date of the agreement exceeded R1 million and the agreement constituted a "large agreement" as envisaged in the NCA with its value exceeding the thresholds determined in terms of the NCA. I agree.

[10] The *amicus* and counsel for the applicant both submitted that insofar as the second respondent as surety was concerned, my sister Satchwell was correct in holding in *Firstrand Bank Ltd v Carl Beck*

Estates (Pty) Ltd[3] that sureties for agreements that fall outside of the NCA cannot invoke the provisions of the NCA as a defence. See, also: *Standard Bank of SA Ltd v Hunkydory Investments (Pty) Ltd and Another.*[4] As I said in *Stocker v Giddings and Another*, [5] a unanimous "full bench" appeal, it is trite that sureties are *promissores subsidiarii*, that their obligations are accessory to that of the principal debtor.[6] In that judgment I observed that this entails, *inter alia*, that a surety as the same defences *in rem* as the principal debtor. I repeat my summary that, in plain English, the Latin expressions in this paragraph mean that sureties have the same substantive defences as are available to the principal debtor, no more and no less. Accordingly, I agree with Satchwell J. The applicant succeeds on the first point to be decided.

[11] In determining whether a defence of extortionate rates of interest or usury can be sustained it is helpful to refer to the judgment of Innes J (as he then was) in *Reuter v Yates*[7] where he said:

> It comes to this - in deciding whether the defence of usury has been sustained, and whether the lender has taken such an undue advantage of the borrower, has so practised extortion and oppression, that his conduct, being akin to fraud,

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[3] 2009 (3) SA 384 (T)
[4] (1) 2010 (1) SA 627 (C) at paragraphs [13] and [14]
[5] GSJ Case No A3006/2010 delivered on 17 November, 2010 at paragraph [7]. Boruchowitz, Monama JJ and I dismissed an appeal from the judgment of Van Eeden AJ.
[6] See, for example, *Imperial Cold Storage and Supply Company Limited v Julius Weil and Co* 1912 AD 747 at 750 and *Trust Bank of Africa Ltd v Frysch* 1977 (3) SA 562 (A) at 584F-G.
[7] 1904 TS 855 at 858

> disentitles him to relief, the Court will examine all the circumstances of the case. It will not only look at the scale of interest which has been stipulated for, but will have regard to the ordinary rate prevalent in similar transactions, to the security offered and the risk run, to the length of time for which the loan was given, the amount lent, and the relative positions of the parties. Approaching the present dispute in that way, we find that the evidence given by the appellant was not very full. It certainly does not prove the existence of extortion or oppression. The rate agreed upon was high, but the parties were dealing at arms' length, the sum advanced was a small one for a short period, and there appears to have been no security.

Innes J found that the borrower was not justified in refusing to pay on the ground that a usurious rate of interest had been "stipulated for".[8] The court, sitting in an appeal from the magistrate's court in Johannesburg, affirmed the principles set out by Watermeyer J (as he then was) in *Dyason v Ruthven*.[9] In *Bekker and Another v Oos-Vrystaat Kaap Koöperasie Bpk*[10] the Supreme Court of Appeal confirmed that *Reuter v Yates* was correct in terms of the onus which a person claiming an unlawfully high rate of interest bears. With exquisite politeness, the *amicus* and counsel for the applicant requested me to deliver

[8] Ibid.
[9] 3 S.282
[10] [2000] 3 All SA 301 (A) at paragraph [9]

a "reportable" judgment because "those in the market" needed to know whether this was still good law in this division.

[12] Quite apart from any other consideration, this decision remains most emphatically good law in this division: it was decided by a full court having an area of jurisdiction coextensive with that of the present day North and South Gauteng High Courts. The principles in question cannot have been abrogated by disuse. I consider the case *Reuter v Yates* to be another of the little treasures in our legal attic.[11] That which Innes J said in the passage quoted above remains good law. Both the *amicus* and counsel for the applicant agreed that this was so. I am fortified in my conviction on this point by the fact that, in the shadow of Table Mountain, Yekiso J referred to the case with approval in *Structured Mezzanine Investments (Pty) Ltd v Davids and Others.*[12]

[13] For the sake of completeness I record that, on the clear authority of the cases of *Sasfin v Beukes*[13] and *Juglal NO v Shoprite Checkers (Pty) Ltd t/a OK Franchise Division*,[14] it cannot be found that the agreement was *contra bonos mores*: the first and second respondents were "no babes in the woods" and, accordingly, there are no considerations of protecting the poor or others in an inferior bargaining position such

[11] For another example of what I consider to be a treasure in our legal attic, see *Mineworkers Investment Co (Pty) Ltd v Modibane* 2002 (6) 512 (W) at paragraph [24].
[12] 2010 (6) SA 622 (WCC) at paragraphs [19] t0 [22]
[13] 1989 (1) SA 1 (A) at 8C-9G
[14] 2004 (5) SA 248 (SCA) at paragraphs [12]-[13]

that it would be unconscionable or immoral to enforce the agreements in question.[15] Against the background of the facts *in casu*, the second point must also be decided in favour of the applicant.

[14] On the question of whether the increase in the rate of interest from 1,25 to 1,5% after the first respondent was in default amounted to a penalty in contravention of the Conventional Penalties Act, the splendid unanimity of the *amicus* and counsel for the applicant fell apart. They did, however agree that, on this issue too, it would be important to have a "reportable" judgment. Relying on the provisions of section 1 of the Conventional Penalties Act, the *amicus* submitted that this was a penalty.

[15] This section provides as follows:

> (1) A stipulation, hereinafter referred to as a penalty stipulation, whereby it is provided that any person shall, in respect of an actor omission in conflict with a contractual obligation, be liable to pay a sum of money or to deliver or perform anything for the benefit of any other person, hereinafter referred to as a creditor, either by way of a penalty or as liquidated damages, shall, subject to the provisions of this Act, be capable of being enforced in any competent court.

[15] Since time immemorial, our common law has set its face against exploitation in the levying of interest. A most illuminating discussion on this aspect can be found in an historical survey by Grové, Die gemeenregtelike beheer van woeker in die Suis-Afrikaanse Reg, **De Jure**, 1989 (22), 233 and Die gemeenregtelike beheer van woeker in die Suis-Afrikaanse Reg (vervolg), **De Jure**, 1990 (23),118.

(2) Any sum of money for the payment of which or anything for the delivery or performance of which a person may so become liable, is in the Act referred to as a penalty.

On this issue, we authors on matters of banking part company amicably.[16] Section 1 of the Conventional Penalties Act does not so much define a penalty as that it provides that what is conventionally regarded as a penalty falls within the purview of the Act. In other words, one must first ask oneself whether the increase in the rate of interest is a penalty. In my view, it is not.

[16] As a former banker myself, I think I may fairly take cognisance of the fact that, as counsel for the applicant submitted, the commercial banks have, since time immemorial, charged a higher rate of interest once a debtor is in default for precisely the same reasons as those advanced by Mr Campbell. As Innes J said in the passage above in *Reuter v Yates*, risk is factor to relevant interest. Self-evidently, risk increases once a debtor is in default. Besides, these justifications by Mr Campbell for the increase in the rate of interest were undisputed.

[17] Even if I am wrong in regard to whether the increase in the rate of interest amounts to a penalty, the *amicus* and counsel for the applicant both agreed, entirely correctly, that the Conventional Penalties Act only affects the enforceability of a penalty if it is out of proportion to the prejudice suffered, if it is markedly greater than the prejudice and

[16] The amicus and I share a similar pastime: writing books on banking. Mine was *Banking in South African Law*, Juta's: Cape Town, 1981.

if the excess is such that it would be unfair to enforce the penalty.[17] They also agreed that the onus of proof is on the debtor to show that the penalty is out of proportion to the prejudice suffered.[18] Mindful of the recent judgments decided by Yekiso J in *Structured Mezzanine Investments (Pty) Ltd v Davids and Others*, referred to above and Bozalek J in *Plumbago Financial Services (Pty) Ltd t/a Toshiba Rentals v Janap Joseph t/a Project Finance,*[19] the interest claimed does not appear to be disproportionate to the prejudice which the applicant has suffered. The applicant succeeds on the third point as well.

[18] At the time when I reserved judgment there was a not unimportant point which we all overlooked. It is that the applicant is not entitled to interest at the rate provided for in the agreement after that agreement had been cancelled. The reason lies in the doctrine of election as set out by Watermeyer AJ (as he then was) in the case of *Segal v Mazzur*.[20] An innocent party to a contract that has been breached by another party cannot blow hot and cold; he cannot approbate and reprobate the contract.[21] *Segal v Mazzur w*as expressly approved by the SCA in *S Du Plessis and Another NNO v Rolfes Ltd*.[22] The point is so

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[17] See *Western Credit v Kajee* 1967 (4) SA 386 (N) at 389H-391E; *Maiden v David Jones (Pty) Ltd* 1969 (1) SA 59 (N) at 63A-64A; *Van Staden v Central South African Lands and Mines* 1969 (4) SA 349 (W) at 351D-353E; *Bloemfontein Munisipaliteit v Ulrich* 1975 (4) SA 785 (O) at 789C-791B; *Santam Bank Bpk v Kellerman* 1978 (1) SA 1159 (C) at 1163B-C; *Murcia Lands CC v Erinvale Country Estate Home Owners Association* [2004] 4 All SA 656 (C)

[18] See, *Smit v Bester* 1977 (4) SA 937 (A) at 940H-943A; *Chrysafis v Katsapas* 1988 (4) Sa 818 (A) at 828H-J.

[19] 2008 (3) SA 47 (C)

[20] 1920 CPD 634 at 644-5

[21] RH Christie. 2006. *The South African* Law of Contract. 5th Edition. LexisNexis: Durban, p540.

[22] 1997 (2) SA 354 (SCA) at 364G-365A

clear that I have not invited counsel to come to court again to address me on it. The applicant cancelled the agreement on 22nd May, 2009. Interest for the period from 6th March, 2009 to 22nd May, 2009 amounts to R1 870 737. This is the period from the date upon which we all agreed the amount owing was R11 337 822 until the date of cancellation. The sum of R11 337 822 and R1 870 737 is R13 208 559. The applicant is entitled to payment of this sum.

[19] Mindful of sections 1 (1) and (2) of the Prescribed Rate of Interest Act, No. 55 of 1975, the new section 2A introduced by the Prescribed Rate of Interest Amendment Act, No. 7 of 1997and the helpful judgment by Thring J on the subject in the *MV Sea Joy* case,[23] it seems to me appropriate to order interest at the prescribed rate in terms of the Prescribed Rate of Interest Act, as amended, from 23rd May, 2009, the day after cancellation to the date of payment. The prescribed rate is 15,5% *per annum*.[24] The agreement between the applicant and the first respondent provides for costs on an attorney and client scale.

[20] The following is the order of the court:

The first and second respondents are ordered, jointly and severally, the one paying the other to be absolved, to make payment to the applicant of:

1. R13 208 559 (thirteen million, two hundred and eight thousand, five hundred and fifty-nine rands);

[23] 1998 (1) SA 487 (C at 505F-508I
[24] GN R1814 GG 15143 of 1st October 1993

2. Interest on the aforesaid sum at the rate of 15,5% *per annum*, calculated from 23rd May, 2009 to date of payment; and

3. The costs of the application, which costs may include the costs consequent upon the employment of two counsel and may be taxed on an attorney and client scale.

DATED AT JOHANNESBURG THIS 1st DAY OF APRIL, 2011

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N.P.WILLIS

JUDGE OF THE HIGH COURT

Counsel for the Applicant: Adv. *R. Stockwell* SC (with him, Adv *J. F. Pretorius*)
No Appearance for the Respondents
Amicus curiae: Adv *FJ. Moorcroft*

Attorneys for Applicant: Sim and Botsi Attorneys Incorporated

Dates of hearing: 30th March, 2011
Date of judgment: 1st April, 2011