REPORTABLE

IN THE NORTH GAUTENG HIGH COURT,

PRETORIA (REPUBLIC OF SOUTH AFRICA)

CASE NO: 14408/2008

DATE:15/05/2012

In the matter between:

BUSINESS PARTNERS LIMITED PLAINTIFF/APPLICANT

(Registration number: 1981/000918/06)

And

SILVER STARS TRADING 245 CC 1st DEFENDANT/1ST RESPONDENT

HERMAN PAUL MULLER 2nd DEFENDANT/2nd RESPONDENT

JUDGMENT

KOLLAPEN, J

[1] This is an action in which the plaintiff seeks as against the first and second defendant payment of the following amounts:

1.1 In respect of claim A the sum of R164 283.67 plus interest at 10% per annum from 25 January 2012 to date of payment.

1.2 Claim B – the sum of R3 279.94 plus interest at 10% per annum from 25 January 2012 to date of payment.

1.3 Plaintiff also seeks costs in respect of both claims.

[2] The first and second defendant have instituted a counter-claim in respect of which they seek payment of the sum of R121 693.00 plus interest as well as costs.

Background

[3] The plaintiff is a corporate entity whose main business is that of providing business finance for small and medium businesses generally under circumstances where prospective lenders were unable to secure finance from established or commercial banks.

[4] In providing finance the plaintiff would seek to obtain security where this was possible but in addition would, in order to secure its investment and provide for a proper return, consider holding a share in the business to be financed or provide for the payment of a “royalty” to be paid by the borrower based on turnover.

[5] In 2004 the second defendant acting on behalf of the first defendant approached the plaintiff to seek financing for a bottle store it (the first defendant) intended purchasing. Following a formal application

submitted by the first defendant, finance was approved on 4 May 2004 which resulted in the parties concluding the following written agreements on or about 26 May 2004:

(a) A loan agreement for the principal debt of R500 100.00 and in terms of which the principal debt plus interest would be repayable by the first defendant over sixty instalments at R11 252.00 per month commencing on 1 July 2004.

(b) The loan agreement provided that in the event of the first defendant not making payment when due the full loan with interest and outstanding royalties would immediately become due and payable.

(c) A royalty agreement in terms of which the first defendant was to pay to the plaintiff a royalty of 1.4% on the higher of the projected or actual turnover of the business to be financed and to be know as East Lynn Discount Liquor.

(d) The royalty agreement provided *inter alia* that in the event of the borrower (the first defendant) –

    (i) repaying the loan prior to the lapse of the term of the loan;

(ii) sells or for any reason terminates the business for which the loan was granted; or

(iii) breaches the terms of the loan agreement or royalty agreement; or

(iv) is sequestrated or liquidated; or

(v) the loan agreement is cancelled prior to the lapse of the period of the loan, the borrower (the first defendant) shall immediately pay to Business Partners (the plaintiff) an amount equal to the royalty for the unexpired period of the full term of the loan together with outstanding royalties.

[6] The first defendant prepared a schedule calculating the royalty fee payable which schedule was annexed to and formed part of the royalty agreement. It is not in dispute that it was based on the projected turnover and that for the most part while the first defendant operated the business, the projected turnover exceeded the actual turnover.

[7] The second defendant bound himself in writing as surety and co-principal debtor for the first defendant's indebtedness to the plaintiff in an unlimited amount.

[8] The plaintiff advanced the monies in terms of the loan agreement for and on behalf of the first defendant.

[9] It is common cause that after a few months of operating the liquor store, the first defendant began defaulting on payments in terms of the loan agreement and in December 2004 wrote to the plaintiff setting out its difficulties with regard to maintaining payments and proposed various options, including the sale of the business to a third party.

[10] As a consequence of these difficulties the first defendant managed to obtain a buyer for the business, Redlex 283 (Pty) Ltd (Redlex) for a purchase consideration of R396 000.00. The plaintiff approved, as it was required to do in terms of the loan agreement, the sale of the business from the first defendant to Redlex.

[11] Various meetings in this regard were held prior to the conclusion of the sale agreement between the first defendant and Redlex and were attended by Mr Windell representing the plaintiff, the second defendant and Mr Bruwer representing Redlex.

[12] It was a term of the written agreement between the first defendant and Redlex that Redlex would pay the purchase price of R396 000.00 by way of thirty-six instalments of R11 000.00 each directly to the plaintiff.

[13] This did not happen as Redlex paid its instalments directly to the first defendant in the sum of R11 000.00 per month as contemplated in the agreement between the first defendant and Redlex. The first defendant in turn paid the plaintiff by way of debit order and the amounts of such payments varied in accordance with the applicable interest rate. By way of example in April 2006 the amount was R11 007.90 when the interest rate was 11.5% per annum while in February 2008 it was R11 569.07 when the interest rate was 15.5%.

[14] The first defendant made up the difference between the amount it received from Redlex, (R11 000.00) and the actual amount that became due on a monthly basis to the plaintiff regard being had to the fluctuation in interest rates.

[15] Independently of payments on the loan account the first defendant effected ongoing and fairly regular payments on the royalty account. In this regard and following the conclusion of the sale of business to Redlex the plaintiff on 5 October 2005 calculated the royalties then outstanding and due as R249 115.00. The plaintiff agreed to write off R145 249.38 of such royalties leaving a balance of R118 406.81 in respect of which it required payment over thirty-six months at R3 289.08 per month.

[16] Redlex made all payments due over the thirty-six month period to the first defendant and the first defendant in turn serviced the loan account it had with the plaintiff over the same period.

[17] The first defendant stopped making payments on the loan account and the royalty account in August 2008 which coincided with the termination of the Redlex obligations to the first defendant.

[18] The plaintiff's claim against the first and second defendant in respect of the loan account represents, according to the plaintiff, the outstanding balance in respect of the loan account and the plaintiff relying on clause 25 of the standard terms and conditions of the loan agreement ,relies on the certificate of balance under the signature of its legal manager to this effect and which certificate dated 13 February 2012 reflects an outstanding balance of R164 283.27.

[19] The plaintiff similarly relies on a certificate of balance under the signature of its legal manager and dated 13 February 2012 reflecting an outstanding balance of R3 279.94 in respect of its claim relevant to the royalty agreement.

[20] The first and second defendant while admitting the contents of the written agreements entered into with the plaintiff, have raised the following defences:

In respect of the claim relevant to the loan agreement it pleads that it effected a compromise with the plaintiff at the time of the conclusion of the sale of business to Redlex in terms of which the plaintiff would accept in full settlement of its claim in respect of the loan agreement the sum of R396 000.00 which was payable over 36 months and which was in fact paid to the plaintiff and alternatively:

The plaintiff, first defendant and Redlex entered into a tripartite agreement in terms of which it was agreed between the parties that Redlex would pay the full outstanding indebtedness of the first defendant to the plaintiff; that the plaintiff provided Redlex with the outstanding amount of such indebtedness which was R396 000.00 and which Redlex then paid over 36 months to the plaintiff.

[21] The evidence on this issue consisted of three witnesses. Mr Windell the business development manager of the plaintiff, while confirming that the plaintiff gave its approval to the sale of business from the first defendant to Redlex as well as providing a settlement figure in the sum of R396 000.00, maintained that notwithstanding the sale of the business the first and second defendant would continue to remain liable for all outstanding amounts on the loan account even after the receipt of the thirty-six monthly payments. He denied that a compromise was effected or that a tri-partite agreement was entered into.

[22] Mr Muller, the second defendant in his evidence said that he believed that once he concluded the agreement of sale with Redlex and provided Redlex paid the settlement figure provided by the plaintiff, the first and second defendant would have no further indebtedness to the plaintiff arising out of the loan agreement.

[23] In cross-examination, however, he accepted that the original loan term was for sixty months which would ordinarily have ended in June 2009 and that the payments from Redlex would cease in August 2008 leaving an outstanding period in the timeline of the contract of some ten months.

[24] In addition Mr Muller testified that when the sale was discussed between Windell, Bruwer and himself he may have incorrectly formed the impression that the sale of business to Redlex and the payment of the purchase price would result in the termination of the first and second defendant's indebtedness to the plaintiff. He also conceded that there was no specific agreement reached between the first defendant and plaintiff in terms of which the plaintiff would write off any amounts due on the loan account after the thirty-six month period.

[25] On this aspect it is trite that the *onus* to prove a compromise is on the party alleging a compromise. See *Hubbard v Mostert* 2010 2 SA 391

(WCC) see also Christie: *The Law of Contract in South Africa* (6th edition) page 473.

[26] On the evidence of the first and second defendant it is clear that no agreement of compromise was effected between the plaintiff and the first and second defendant regarding the indebtedness of the defendants on the loan account. At best the defendants may have formed the subjective impression that there was some form of compromise but Mr Muller's concession that such an impression was probably incorrect and not supported by the facts really disposes of this defence quite decisively.

[27] The defence of a compromise is simply not sustainable and the defendant has failed to discharge the *onus* of proving that a compromise was effected. On the probabilities there would be no reason why the plaintiff would write off an amount that would ordinarily be due to it in terms of its loan agreement.

[28] The only other aspect in issue was the correctness of the outstanding balance the plaintiff claimed. Mr Windell identified the signature of Mr Fray on the certificate of balance as the legal manager in support of this claim and Mr Mark Lewis a senior accountant with the plaintiff also confirmed the correctness of the balance which he was able to verify conducting his own independent calculation.

[29] That being the case the plaintiff in my view has proved its claim in respect of this part of the action and there is no reason why the plaintiff should not be entitled to judgment and other relief in respect of claim A. I intend to make such an order.

[30] I now proceed to deal with claim B as well as the counter-claim.

[31] The plaintiff's stance with regard to the agreement titled the "royalty agreement" and signed by the parties during May 2004 was that in view of advancing money to the first defendant and in respect of which the plaintiff carried a higher risk to the extent that it had very limited security for the money advanced, it, the plaintiff was entitled to a proper return on its money and the royalty agreement provided a basis for such return.

[32] Mr Windell's testimony was that the plaintiff worked towards a return of 28.6% on monies lent and that the interest payable in terms of the loan agreement together with the royalty agreement would together constitute such a return. His further evidence was that to the extent that the royalty calculation was based on the projected turnover of the business to be financed, these projected turnover figures were provided by the second defendant who was fully aware of the nature of the royalty agreement entered into between the parties.

[33] His further testimony was that when the first defendant sold the business to Redlex the plaintiff gave the first defendant a reduction in royalties and the amount then due and which was fully set out in a letter dated 5 October 2005 dispatched by himself on behalf of the plaintiff to the second defendant.

[34] In cross-examination he accepted that the “royalty” to be paid was actually interest on the monies lent to the defendants and beyond providing the loan to the first defendant the plaintiff did not provide any other service or make available any intellectual property or the like to the defendants.

[35] The business of the plaintiff in his view was to lend money and that is all that it did in relation to the defendants. He was also in agreement and to the extent that the calculation of the royalty was based on projected income that in truth and reality the actual income of the business was lower than the projected income.

[36] Finally he also confirmed that the plaintiff would generally seek to enforce the payment of the royalty for the full period of the loan even if the loan was paid earlier and in full. He confirmed in this regard that the first defendant had paid R121 693.00 to the plaintiff arising out of the royalty agreement. In this regard the evidence of Mark Lewis put this figure at R133 524.52.

[37] The defendants stance with regard to the royalty agreement was that at the time of signing of the agreement Mr Muller the second defendant believed that the agreement was in order. He had no legal background and was not advised by an attorney at the time he concluded the loan on loyalty agreements. He confirmed that he provided the projected turnover figures used in the royalty agreement but states that he simply took the figures from the records of the previous owner of the business. He understood the royalty agreement as providing a basis to pay additional interest relating to the loan given to him by the plaintiffs.

[38] His evidence was that he was subsequently advised by counsel that the royalty agreement may not have been lawful and based on the advice he received instituted a counter-claim. The position thus taken by the defendants is that the royalty agreement is *contra bonos mores*, in that it was a simulated transaction and an attempt by the plaintiff to charge additional interest.

Discussion / Analysis

[39] The payment of royalties is normally associated with a franchise agreement which was described by NUGENT AJA (as he then was) in *De Beer v Keyser and Others* 2002 1 SA 827 as “a system in which one organisation (the franchisor) grants the right to produce so or use a developed product service or brand to another organisation

(franchisee). Royalties based on turnover are usually paid by the franchisee." There is no dispute in these proceedings that notwithstanding its description as a "royalty agreement", the agreement was nothing less and nothing more than an agreement by the first and second defendant to pay interest to the plaintiff over the period of the loan.

[40] The question to be determined is whether the agreement can be said to be contrary to public policy and as such unenforceable.

[41] In *De Beer v Keyser supra* the court said as follows:

> "There might well be circumstances in which an agreement, unobjectionable in itself, will not be enforced because the object it seeks to achieve is contrary to public policy. Nevertheless a court should be cautious when it performs its role as arbiter of public policy."

[42] The court also relied on the dicta in *Sasfin (Pty) Ltd v Beukes* 1989 1 SA 1 (AD) to the effect that the impropriety of the transaction should be convincingly established in order to justify the exercise of the court's power to declare it contrary to public policy.

[43] It is clear that if regard be had to the dicta in *De Beer* and in *Sasfin* then there is no doubt that a court should act cautiously in this regard and that in addition the doctrine should only be invoked in clear cases where harm to the public is substantial and does not depend on the idiosyncrasies of the judicial mind.

[44] In *Barkhuizen v Napier* 2007 5 323 (CC) the Constitutional Court also confirmed the approach to be taken in this regard indicated that the principle of contract, Pacta sunt Servanda is not a sacred cow that should trump all other considerations. The court indicated that the constitutional values of equality and dignity as well as the parties relative bargaining positions would be an issue in the court exercising the discretion it did have in dealing with contracts where a challenge was brought on the grounds of public policy.

[45] One is also mindful in this regard of the caution often expressed that courts should guard against creating uncertainty as to the validity of contracts as well to guard against the arbitrary and indiscriminate use of judicial power in setting aside such contracts. On the other hand it must also be apparent that if regard be had to the architecture of our constitutional order and in particular the values upon which it is premised in particular those of equality and human dignity then courts should also in appropriate cases not hesitate in striking down contracts that offend against the principles of public policy as encapsulated in the constitution.

[46] When one looks at the royalty agreement both on its own as well as in relation to the loan agreement then the following is evident:

(a) It is clear on the undisputed evidence that even though it was styled a “royalty agreement” it was not a royalty agreement but simply an agreement to pay interest in addition to the interest that the defendants would pay on the loan agreement.

(b) On the evidence of the plaintiff the composite interest charged if one has regard to both the royalty and loan agreement would have been close to 29%. It warrants mention that at the time in question when the contracts were concluded in May 2004 the interest rates applicable in terms of the Usury Act would have been 18% in respect of a loan up to R500 000.00 while there would be no maximum interest rate prescribed on a loan in excess of R500 000.00.

(c) The plaintiff contends that the Usury Act was not applicable as the loan was in excess of R500 000.00 namely R500 100.00. While this may be so the following is instructive:

(i) It appears that the loan amount was fixed as it were in order to ensure that it was brought above R500 000.00. Mr Windell who testified on behalf of the plaintiff was not

able to convincingly refute the suggestion that the manner in which the loan was structured was in order to avoid the application of the Usury Act.

(ii) when one looks at the loan amount of R500 100.00 and the manner in which it is made up and if one has regard to the fact that the second defendant's evidence was that he applied for a loan of R590 000.00 it does becomes strange and almost inexplicable that the loan is finally approved in the amount of R500 100.00.

(iii) there appears to be no mathematical or other basis why the loan was ultimately approved for R500 100.00.

(iv) absent a mathematical or other laudable explanation the only inference that can be drawn and that is supported by the facts is that the loan amount was fixed at R500 100.00 in order to avoid the provisions of the Usury Act.

[47] In the light of the uncontested evidence that the royalty agreement was simply an agreement to pay interest then there would be no good reason in fact or in law to treat them separately in determining the rate of interest that would then cumulatively have become applicable.

In this regard the amount of the interest payable would have been 28.6% on a loan of R500 100.00.

[48] The royalty agreement contains an express provision that notwithstanding a number of events including the payment of the loan prior to the lapse of the term of the loan, the royalty for the unexpired term and outstanding royalties will immediately become payable. Thus even though the royalty agreement is nothing more than an interest agreement the obligation to pay interest even after the loan has been settled is firmly entrenched in terms of clause 4.2 of the royalty agreement.

This provision should not in my view escape scrutiny in particular where the parties' bargaining power and positions were not equiposed. It is both onerous and oppressive in my view. Even if a higher rate of interest can be justified on the basis of a higher risk that is undertaken, I cannot see how this can be used to justify payment once the risk has passed (which would have happened if the loan was repaid earlier).

[49] When one considers the position of the defendants then the following is of importance. In an e-mail to Mr Bruwer of Redlex dated 5 November 2008 Mr Muller in effect says that he signed many documents and he is now compelled to accept the consequences thereof. Clearly the suggestion is that having signed many documents

he must now accept it does not portray the image of an individual who had equal bargaining power with the plaintiff as he testified in re-examination that he accepted the documents for signature as they were prepared by and on behalf of the plaintiff.

[50] Even though this may not be relevant to the attack on the agreement as being *contra bonos mores*, the plaintiff notwithstanding its characterisation of the royalty agreement as simply an interest agreement sought to levy value added tax on the interest payments that became due and which were then paid by the first and second defendants.

[51] When one thus has regard to the royalty agreement taken together with the loan agreement and considers its terms and purposes there is a compelling argument that the plaintiff was intent on ensuring the non-application of the Usury Act. The loan amount of R500 100.00 does not lend itself to a clear arithmetical breakdown that could suggest that the figure was not contrived. On the contrary and on what is before me every attempt was made to bring it just above R500 000.00 and it was finally pegged at R500 100.00. In this regard and included in the loan amount was an amount for due diligence which was simply due to the plaintiff on account of it approving the loan and taking whatever steps it may have taken administratively to place itself in a position to approve the loan.

[52] If the ultimate loan amount was R100.00 less then clearly there could have been no argument that the Usury Act would not have been applicable and that interest on the loan agreement taken together with the interest on the royalty agreement would have led to the conclusion that the effective rate of 28.6% would have been in conflict with the Usury Act. If this has happened there would have been no basis on which the plaintiff would have been entitled to claim interest in excess of the Usury Act.

[53] I accordingly cannot be convinced that in the context of this matter the additional R100.00 to take the loan over R500 000.00 was justified on any other basis other than the desire to avoid the provisions of the Usury Act. Clearly the first and second defendant even though they may have been aware that they were paying a higher rate of interest could hardly be said to be in agreement to construct an agreement that would avoid the provisions of the Usury Act.

[54] The provision of finance is important in facilitating business growth and development and is correctly seen as an important precondition and a catalyst in this regard. However, the grant of finance under onerous and oppressive conditions also has the potential to cause considerable harm to emerging businesses.

[55] Public policy not based on the individual idiosyncrasies of members of the judiciary as was cautioned against in *Brisley v Drotsky* 2002 4 SA 1 (SCA) but on the values of the constitution in particular freedom, equality and human dignity must mean that while courts should not readily interfere in the domain of contractual freedom. In instances, however, where the facts and circumstances warrant interference it could be said that in order to give effect to the public policy imperatives of our constitution such interference by our courts may not only be desirable but necessary as well.

[56] In my view and having regard to the facts of this case it would not have the unacceptable result of creating widespread uncertainty with regard to contractual issues nor would it constitute the exercise of arbitrary and indiscriminate power. If one has regard to the salient features of the facts and evidence then the following is clear.

(a) On the face of it the royalty agreement was a simulated agreement and was nothing other than an agreement to pay interest.

(b) The loan amount of R500 100.00 was contrived to avoid the provisions of the Usury Act.

(c) The interest payable of 28.6% was considerably higher than the maximum permissible on loans of R500 000.00 in terms of the Usury Act.

(c) The terms of the royalty agreement were in my view oppressive and harsh to the extent that it created the obligation to pay interest even after conditions that ordinarily in contract would result in the cessation of interest payments (the full amount of the loan being paid) would be met.

[57] For those reasons this would be an appropriate case for such interference and in my view the royalty agreement would such an agreement that undermines public policy in that the objective it seeks to advance is a calculated avoidance of the Usury Act and a desire to levy interest beyond that permissible in law.

[58] The plaintiff's claim with regard to count B should be dismissed and the defendant's claim on account of those considerations should be upheld.

I accordingly make the following order:

1. In respect of claim A the plaintiff's claim is upheld in the sum of R164 283.67 plus interest thereon at the rate of 10% per annum from 25 January 2012 to date of payment.

2. Defendants are ordered to pay the plaintiff's costs in relation to claim A.

3. In respect of claim B the plaintiff's claim is dismissed with costs.

4. The defendant's counter-claim in the sum of R133 254.52 is upheld with interest a tempore morae from date of judgment to date of payment

5. Plaintiff is ordered to pay the defendants' costs in respect of the counter claim.

N KOLLAPEN

JUDGE OF THE NORTH GAUTENG HIGH COURT

14408/2008/sg

Heard on: 7 March 2012

For the Plaintiff:Adv J E Ferreira

Instructed by: Messrs Strydom Brits Mohulatsi

For the Defendants: Adv C J Van Coller

Instructed by: Messrs Jacques van der Merwe Attorneys

Date of Judgment: