REPORTABLE

THE REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA
(CAPE OF GOOD HOPE PROVINCIAL DIVISION)

CASE NO: 2879 / 2005

In the matter between:

PLUMBAGO FINANCIAL SERVICES (PTY) LTD
t/a TOSHIBA RENTALS Plaintiff

and

JANAP JOSEPH t/a PROJECT FINANCE Defendant

JUDGMENT : 15 JUNE 2007

BOZALEK J:

[1] This matter concerns a claim for arrear and future rentals and certain ancillary claims by the lessor of equipment arising out of the breach of the lease contract by the lessee. More particularly, it involves the interpretation of a particular disputed clause in the agreement and the question of whether, in terms of the provisions of the Conventional Penalties Act, 15 of 1962, certain of the amounts claimed by the lessor fall to be reduced by the court.

BACKGROUND

[2] In 2005 the plaintiff, a company carrying on the business of leasing out photocopier machines, obtained default judgment against the

> defendant, an adult business woman trading under the name of *Project Finance* in the amount R232 651, 35 for arrear and accelerated future rentals together with interest and costs. The defendant then launched a successful application for rescission of the default judgement and was granted 15 days within which to file a plea. In due course a plea was filed, the general purport of which was to put plaintiff to the proof of its case in which it had alleged breach of the contract through non-payment and a consequent entitlement to the various sums claimed. In addition, the defendant disputed the existence of a term in the contract relied upon by the plaintiff as entitling it, upon defendant's breach, to claim not only arrear rentals but immediate payment of all future rentals.

[3] The matter proceeded to trial but no further pleadings or notices were filed by the defendant. On trial day there was no appearance either by the defendant or on her behalf. Upon enquiry it transpired that the defendant's legal representatives had withdrawn as attorneys of record some ten days prior to trial and served a copy of such notice on the defendant's accountant at her place of business and on the defendant's son-in-law. Their attempt to serve the notice on the defendant's last known place of residence was unsuccessful. The defendant's erstwhile attorney advised the plaintiff's attorney that he was satisfied that the defendant had been made aware of the trial proceedings commencing on 12 April 2007 and of the fact that she would be unrepresented in court.

[4] The plaintiff had earlier obtained a substantial costs order against the defendant arising out of the rescission application and there were indications that the defendant was seeking to avoid the service of process in the matter. I was satisfied that the defendant was made aware of the trial proceedings and given every opportunity to contest the action. In the circumstances therefore, the action proceeded in her absence.

[5] The plaintiff's claim against the defendant is based upon rental

agreements relating to two photocopiers, which I shall also refer to as "the equipment", concluded in February and September 2004 respectively. In terms of the first agreement the defendant leased an *E-Studio 25* photocopier at an initial monthly rental of R995, 22 for a period of five years. In terms of the second agreement the defendant leased a *E-Studio 350* digital photocopier for a similar period at an initial monthly rental of R2120, 40.

[6] The terms and conditions of the two agreements were virtually identical and had the following salient provisions:

1. the rental was payable monthly in advance;
2. the monthly rentals increased annually on a cumulative basis at the rate of 15% per annum;
3. Defendant agreed that if she failed to effect any payment in terms of the agreement on the due date thereof, such overdue amounts would bear interest at a rate equal to 6% per annum above the prevailing publicly quoted base rate of interest per annum at which any one of the plaintiff's bankers would lend on overdraft;
4. Defendant further agreed that in the event of her breaching the agreement all costs and disbursements, including legal costs on the attorney and own client scale incurred by the plaintiff in recovering possession of the leased goods and in collecting or endeavouring to collect any amounts payable by the defendant to the plaintiff, would

be for the account of the defendant.

[7] The terms of the breach clause are of particular importance . It reads, insofar as it is material, as follows:

"*8. If User defaults in the punctual payment of any monies as it falls due in terms of this agreement or any other agreement that it has with Hirer or any of its associates, holding or subsidiary or fellow-subsidiary company; or fails to comply with any of the terms and condition of, or its obligations under any such agreement; ..... then and upon the occurrence of any of these events Hirer may elect without prejudice to any of its rights to:*

8.1 ***Without terminating this agreement to treat as immediately due and payable all rentals which would otherwise have become due and payable in terms hereof over the then expired (sic) of the agreement and to claim and recover from the User forthwith the aggregate amount of such rentals as well as all rentals and other sums then in arrear in terms of this agreement.*** *The Hirer shall, pending payment of these amounts, be entitled to be possessed of the goods and to retain possession thereof on condition that against full payment, the Hirer shall return the goods to the User who shall not be entitled to any rebate of abatement of rentals or other amounts by reason of the User's loss of possession and enjoyment of the goods while the same will have been in the Hirer's possession; OR*

8.2 immediately terminate this agreement without notice, taking possession of the goods, retain all amounts already paid by User and claim all outstanding rentals, all legal costs

> *on the attorney and own client scale and, as a agreed, pre-estimated liquidated damages, the aggregate value of the rentals which would have been payable had this agreement continued until expiry of the Rental period stated in the equipment schedule."*

[8] The plaintiff's case is that when the defendant breached the agreements through non-payment of the monthly instalments, it made an election in terms of clause 8.1 to adhere to the contract but to take possession of the goods pending payment by the defendant of the arrear rentals and the accelerated future rentals.

[9] In opposing affidavits in the rescission application the defendant contended that the plaintiff could not rely on clause 8.1 in the light of the incoherence of the first sentence thereof (highlighted above). The same point was taken in the defendant's plea. It is necessary then, in the first place, to ascertain the meaning, if this is possible, of the sub-clause.

[10] Mr. Gess, who appeared on behalf of the plaintiff, argued that, applying the rules of contractual interpretation, the proper meaning of the first sentence of clause 8.1 was expressed when the word "expired" was replaced with the phrase "unexpired portion" so that the sentence as a whole reads:

> ''*Without terminating this agreement to treat as immediately due and payable all rentals which would otherwise have become due and payable in terms hereof over the then unexpired portion of the agreement and to claim and recover from the user forthwith the aggregate amount of such rentals as well as all rentals and other sums then in arrear in terms of this agreement"*.

Mr. Gess relied on the "golden rule" of interpretation as summarised by Joubert, JA in *Coopers and Lybrand v Bryant* 1995 (3) SA 761 (A) at 767E – 768E contending that if the clause were given its ordinary

grammatical meaning this would result in an absurdity inconsistent with the rest of the agreement. He submitted further that, looking at the context in which the phrase was used in its inter-relation to the contract, including the nature and purpose of the contract and the background circumstances, it was clear that the amended phrase expressed the intention of the parties when they concluded the agreement.

[11] It is so that when the phrase is re-written in the manner contended for the clause, both in itself and within the structure of the agreement as a whole, makes complete sense. Clause 8.1 clearly seeks to distinguish between arrear rental as it is commonly understood and future rentals which have become due and payable by reason of the acceleration provisions coupled with the lessee's default in making regular payment or by reason of a breach of its obligations in some other respect. "Expired" must mean "unexpired" since the clause already makes it clear that the lessee would be liable for arrear rentals. Similarly the phrase is meaningless without the addition of the word "portion" thereto.

[12] No other meaning of the clause was contended for by the defendant and its apparent lack of meaning seems to have been caused simply by the careless omission of the words which require to be read in. I find that clause 8.1 must be read in the manner contended for by the plaintiff, namely, as providing for the acceleration of future rental payments by the defaulting lessee.

THE RELIEF CLAIMED

[13] Following its election to pursue its rights in terms of clause 8.1 of the agreement after the defendant's default in payments, the plaintiff retook possession of both photocopier machines in March 2005. One of them was restored briefly to the defendant but removed again after further defaults in payments. Since then the defendant has not enjoyed the possession or use of the equipment.

[14] The plaintiff's total claim is for:

1.1 the sum of R228 391,05 which is made up of both arrear rentals and future rentals in respect of both machines in the amounts of R67 434,51 (the *E-Studio 25*-photocopier) and R160 956,54 (in respect of the *E-Studio 350*-photocopier). When summons was issued in April 2005 all but some R13 000,00 of this total sum related to future rentals.

1.2 interest on the aforesaid sum at a rate equal to 6% above the base overdraft rate quoted by the plaintiff's banker and calculated from 2 February 2005 to date of payment;

1.3 Costs of suit on a scale as between attorney and own client, including collection commission and;

1.4 an order directing the plaintiff to return the leased goods to the defendant for any remaining period of each agreement upon payment by the defendant to the plaintiff of all amounts claimed in respect of such machine.

[15] During the course of the trial counsel for plaintiff amended the relief sought as interest, details of which I shall give later.

THE APPLICABILITY OF THE CONVENTIONAL PENALTIES ACT, 15 OF 1962

[16] At the commencement of the hearing I raised with plaintiff's counsel the potential applicability of the Conventional Penalties Act, 15 of 1962, in the light of the claim for accelerated future rentals and the claim for interest at the prime rate plus 6% on all rentals, both arrears and future.

[17] There is some debate as to whether a court has the power to act of its own accord in opposed proceedings in raising the question of whether an excessive penalty has been claimed.[1] Generally speaking the debtor has the *onus* to prove that the penalty is disproportionate relative to the prejudice suffered by the creditor.[2] In *Smit v Bester* the learned judge expressed the view that a court has the power to order a reduction of the penalty in appropriate circumstances of its own accord when it appears *prima facie* from the pleadings that the penalty is disproportionately severe.

[18] In the present matter the issue was not raised on the pleadings. To my mind this is no bar to it being raised by the Court in the circumstances of the present case. Although it was suggested in *Bank of Lisbon*

1 See *Bank of Lisbon International Ltd v Venter and Another* 1990 (4) SA 263 (A).
2 *Smit v Bester* 1977 (4) SA 937 (A) at 942 D - G.

> *International Ltd* that the Court should not consider a reduction of a penalty in an opposed matter unless it has been alleged and approved, a more flexible approach was advocated in *Courtis Rutherford and Sons CC and others v Sasfin (Pty) Ltd*, a full bench decision of this division. Van Zyl J observed that it is, and remains, the court's primary function to ensure that justice is done on the basis of what is just fair and reasonable under all circumstances. By implication, he expressed approval of a court dealing with the question of an excessive penalty even where that was not formally pleaded, subject to it being fully canvassed in evidence and argument.

[19] In my view, the circumstances of the present matter require such an approach. Although formally opposed, the lack of any appearance by either the defendant in person or on her behalf renders the matter in effect unopposed. I propose therefore, to fully consider the question. In this I have been considerably aided both by the argument and authorities quoted by Mr. Gess and by the evidence which he led on behalf the plaintiff from its managing director and shareholder Mr. Chris Du Toit ("Du Toit").

[20] The following emerged from Du Toit's evidence. Both machines leased to the defendant were, at the latter's insistence, new. The plaintiff's customers were generally required to sign a maintenance agreement in respect of any such photocopier, as was the defendant. In return for the equipment being maintained, the customer paid a fee calculated on the number of photocopies made. No claim was being brought against defendant in respect of the maintenance agreements since the plaintiff had incurred no expenses in that regard. The plaintiff purchased the equipment from the distributor either using its own monies or on finance it raised. The equipment would, in the ordinary course, remain on the plaintiff's balance sheet and be depreciated over 60 months. Where the plaintiff used finance to purchase the equipment a substantial period of the 60 months income was devoted to repaying the finance house.

[21] The rate of technological change in the photocopier industry is high and the value of five year old equipment is virtually nil. The profit margin is

really only made in the last third of a five year contract. When exercising what Du Toit described as the "softer option" in clause 8.1, the equipment which the plaintiff repossesses is not specifically set aside against the possibility of the defaulting customer paying the sums owing in terms of the contract. Instead the equipment is, where possible, re-leased or sold. In that event, should the defaulting customer make payment of the monies owing, equipment of the same make and model and in similar condition is restored to the customer. There was, however, a limit to the further income possibilities of repossessed equipment because most businesses wanted state of the art technology.

[22] As far as the equipment in question was concerned the defendant had rapidly fallen into default in respect of the *E-Studio 25* photocopier, the plaintiff having only received approximately one year's worth of rental in respect thereof. The position in respect of the *E-Studio 350* photocopier was similar with only some eight months of rental having been received. Du Toit was able, after consulting his records, to state exactly what had transpired with the repossessed machines. The *E-Studio 25* photocopier had been leased out for sixteen months from July 2005 at a monthly rental of R1035,00, excluding VAT. Thereafter it had earned no further income but had simply been used as a replacement when another machine was being repaired. The *E-Studio 350* machine had been sold outright in March 2005 for R99 825,00, excluding VAT. Details of the income earned from maintenance agreements in respect of the repossessed equipment were not available. However, since such income is offset, at least to some extent, by expenses it is reasonable to conclude that the two machines produced an income of not less than R116 085,00 after being re-possessed from the defendant.

THE CONVENTIONAL PENALTIES ACT

[23] Section 1(2) of the Conventional Penalties Act defines a "penalty" as "any sum of money for the payment of which or anything for the delivery or performance of which a person may ……become liable". A "penalty stipulation" is a stipulation "whereby it is provided that any person shall, in respect of an act or omission in conflict with the contractual obligation be liable to pay a sum of money or to deliver or perform anything for the benefit of any other person… either by way of a penalty or as liquidated damages". Such a penalty stipulation is capable of being enforced in any competent court but a creditor is not entitled to recover both a penalty and damages. Furthermore s 3(1) of the Act prohibits the recovery of a penalty which is out of proportion to the prejudice suffered by the creditor. In that instance the court may, if the penalty is excessive, reduce it to such extent as may be equitable in the circumstances.

[24] It has been held that the correct approach to these matters is firstly to enquire as to whether what is being complained is a "penalty". If not, the enquiry goes no further.[3] For a provision to constitute a penalty it must be one which derives from a breach of contract. If the penalty is out of proportion to the prejudice suffered by reason of the defendant's breach of contract the question arises as to whether it would be

3 *Sun Packaging (Pty) Ltd v Vreulink* 1996 (4) SA 176 (A) at 182 I to 183 D.

equitable for the court to reduce the penalty. If so the remaining question is to what extent must such penalty be reduced? See *Murica Land CC v Erinvale Country Estate Home Owners Association* 2004 (4) All SA 656 (C) especially at 659 C – D. Section 1(2) of the Act leaves the term "penalty" undefined and thus it must be taken in its common law sense as a provision intended to operate *in terrorem* of the offending party. See *Cape Municipality v F Robb and Company Ltd* 1996 (4) SA 329 (A) at 336 C – D.

DOES THE CLAIM CONSTITUTE A PENALTY AND IS A REDUCTION THEREOF JUSTIFIED?

[25] The plaintiff's claim against the defendant is based solely on the contract and arises from the defendant's breach thereof. The requirement that a penalty must derive from a breach of contract is thus satisfied in the present matter. However, the plaintiff's claim is made up of various components and the first question which much be addressed is whether the various components amount to a penalty or not. The plaintiff's claim is comprised of arrear rentals and accelerated future rentals and interest on both arrear rentals and future rentals. The claim for arrear rentals, *stricto sensu*, is clearly not a penalty, as the debtor is obliged to pay what he owes and nothing is added to his obligations by reason of his breach.[4]

4 *Western Bank v Meyer* 1973 (4) SA 697 (T) at 704A – B

[26] In the presentation of its case the plaintiff referred to those rentals which would ordinarily have fallen due between the date of breach and the court hearing as "arrear rental". This is a misnomer since they fell due pursuant to the acceleration clause with effect from the plaintiff's decision to exercise its rights in terms of clause 8.1 i.e. March 2005. Thus, notwithstanding the passing of some two years since the issue of summons, the bulk of the claim comprises future accelerated rentals.

[27] The provision in the contract which stipulates that upon default in respect of any one payment the defendant became liable for all future "rentals" (and forfeits, temporarily at least, the equipment), is clearly one which operates *in terrorem* of the offending party. Such a party obtains no additional benefit in return for having to make a lump sum payment of monies for which it would, in the ordinary course, only be liable to pay on a month-to-month basis, *pro rata*.

[28] Such a conclusion was reached in regard to similar provisions in *Claude Neon Lights (SA) Ltd v Schlemmer*.[5] In *Parekh v Shah Jehan Cinemas and Others*[6], however, Leon J held that an acceleration clause in a contract does not per se amount to a penalty stipulation. In the course of a comprehensive analysis of the Act and the authorities the learned judge dealt with the case of *Claude Neon Lights*. He distinguished it, however, on the basis that contrary to the facts in Parekh's case where payment of an existing debt was accelerated, *Claude Neon Lights* concerned the acceleration of several debts owing by the lessee. Referring to the facts in *Claude Neon* he stated as follows:

> "*What was there accelerated were several debts which had never previously been owing by the lessee to the lessor and which were reciprocal to the performance by the lessor of its obligations in terms of the lease. Any acceleration of payments not yet due gives an advantage to the lessor over and above what would be his normal remedy for the breach, namely*

5 1974 (1) SA 143 at 147C – E
6 1982 (3) SA (D+CLD) 618

> *cancellation and ejectment, or, in the case of a lease of movables, repossession. A right given to a lessor to require the lessee to pay, in accelerated form, the rent up to the terminal date of the lease being something additional to, and over and above, the normal remedy of a lessor might well be regarded as being in terrorem the lessee.*[7]"

I too consider that the two cases are distinguishable and draw support from the above remarks for my view that the acceleration provisions in clause 8.1 in the present matter constitutes a penalty within the meaning of the Act.

[29] The provision whereby the defendant becomes liable for interest on arrear and future rentals at a rate equal to 6% per annum above the prevailing prime overdraft is obviously designed to operate against the defaulting party *in terrorem*. This is a substantial premium over an already high base rate and clearly seeks to penalize a party who defaults in the payment of any instalment.

[30] I find then that in the present matter the claim for future rentals and the interest provisions in the contracts are penalty stipulations.

IS THE PENALTY DISPROPORTIONATE TO THE DEFENDANT'S PREJUDICE AND, IF SO, TO WHAT EXTENT SHOULD IT BE REDUCED?

[31] The next leg of the enquiry requires a determination of whether the penalty was out of proportion to the prejudice suffered by the

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7 At 628C - E

defendant. The best method of determining this is to compare what the plaintiff's position would have been had the defendant not defaulted in the contract as opposed to what the plaintiff's position would be should it obtain judgment in the full sum sought. Had there been no defaults on the part of the defendant the plaintiff would have received the monthly instalments in respects of the equipment month by month over a period of five years. At the end of that period the equipment would, to all intents and purposes, have been worthless to the plaintiff. In terms of the order now sought the plaintiff will receive in total the same rentals but according to figures prepared by the plaintiff, as at 1 May 2007, of the total sum claimed an amount of R136 050,56 would be received prematurely. This sum would otherwise only become due on an accruing monthly basis between 1 May 2007 and 28 February 2009 in respect of the *E-Studio 25* photocopier and 31 October 2009 in respect of the *E-Studio*-350 photocopier. In addition the plaintiff initially sought interest on virtually the entire aforesaid sum at prime plus 6% from the date of first default February 2005 to payment.

[32] In argument, however, Mr. Gess conceded that seeking interest at the rate of prime plus 6% on future rentals was a disproportionate and unfair penalty and he therefore limited the plaintiff's claim for interest on future rentals to interest at the prescribed rate i.e. 15,5% from date of judgment to date of payment. Such an interest rate is the same as

may be claimed by any judgment debtor and clearly cannot be seen as a penalty. However, I understood Mr. Gess to make this concession only in respect of rentals which would ordinarily have fallen due after the date of hearing i.e. on the basis of the plaintiff's extended (and incorrect) definition of arrear rentals. Nevertheless, not only do I consider the concession on interest claimed at the higher rate to be well made by Mr. Gess, but I have difficulty seeing why interest at that rate should be payable for any period. To require the defendant to pay interest at the punitive rate of 6% above prime on accelerated rentals for even a limited period is, in all the circumstances, disproportionate to the plaintiff's prejudice. In my view the plaintiff's prejudice is adequately met by awarding interest at the prescribed rate *a tempore morae*.

[33] In determining whether payment of future, or more accurately, accelerated rentals, amounts to a penalty disproportionate to the plaintiff's prejudice, clearly what also has to be brought into account is the income earned by the plaintiff from the sale of one of the machines and its leasing out the other i.e. a total of R116 385,00. Assuming, as I consider one must, that the plaintiff successfully executes on the judgment which it obtains, the aforesaid sum represents a windfall gain for the plaintiff since such income would never have been earned by it had the contracts in question run uneventfully to term. Mr. Gess urged that no "discount" be given in respect of future rentals in lieu of the additional income earned contending that the Court must also take into account the plaintiff's poor prospects of ever recovering any judgment in full or at all from the defendant as well as the legal costs which the plaintiff had incurred.

[34] Although I am aware that judicial opinion differs in regard to the question of whether weight should be given to the prospects of recovering on any judgment given[8], it appears to me to be invidious

8 See Premier Finance Corporation (Pty) Ltd v Rotainers (Pty) Ltd and Another 1975 (1) SA 79 (TPD)

> and illogical to do so. Such an exercise is essentially speculative. Furthermore, any judgment must be, and is, given on the basis that it is at least potentially recoverable from the party against whom it is ordered. In these circumstances if no abatement is made the possibility exists of an unfair judgment being granted against a defendant simply because that party's ability to meet the judgment is underestimated. If, however, account is taken of such windfall earnings and the claim is abated, either partly or wholly thereby, the plaintiff becomes entitled to no more than is due to it in equity. If the judgment debt is irrecoverable in total or in large part the question of what abatement is made in arriving at the judgment sum is largely academic. Similar provisions apply to the question of costs particularly where the costs orders, as in this case, are, in terms of the contracts, made on the attorney and client scale.

[35] The provisions of clause 8.1 are highly favourable to the plaintiff as lessor. They enable it to claim a sum no less than what it would be able to prove at common law as damages for breach of the contract plus interest at a rate well above the prevailing prime overdraft rate. At the same time, the lessee is deprived of the use of the equipment until it makes payment of all sums owing including accelerated rentals. In the present case the defendant enjoyed the use of the equipment for a very limited period in relation to the full term of the contracts. In these circumstances to award the plaintiff arrear and future rentals and disregard the additional income it earned would result in the defendant being visited with a penalty out of all proportion to the prejudice suffered by the plaintiff.

[36] In my view this would be the case even if the repossessed equipment earned no additional income. However, since the defendant earned

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at 83H;

But cf Western Bank Ltd v Lester and Mc Lean and Others 1976 (3) SA 457 at 464F – H.

substantial income from the sale of the one machine and the lease of the other, I consider that to give the benefit of this income to the defendant in the form of an abatement of the accelerated rentals would, together with interest thereon but at a reduced rate, constitute an equitable reduction of the penalty stipulations as a whole.

[37] In arriving at this conclusion I have taken into account the plaintiff's rightful interests including the prejudice it suffered in not receiving the rentals it contracted for and its interest in enforcing the terms of the contracts it concludes with its customers. I have also had regard to the fact that the plaintiff was and remains liable to restore the equipment at any time during the term of the contracts upon payment of all arrear and future rentals. Contrary to Mr. Gess's submission, if one has regard to the sums owing and the remaining terms of the leases, I see no danger in the present matter of the defendant "snatching at a bargain" at the expense of the defendant if she were to pay all arrear and future rentals abated by the additional income earned and interest, albeit reduced to the extent discussed above. Instances of such a bargain may well arise in similar contractual situations where the defaulting party can obtain repossession and use of equipment for a much reduced sum because the original equipment was profitably sold or leased by the lessor in mitigation of its losses. In such an event that factor may be taken into account by the court in determining the extent of reduction, if any, in the penalty provisions.

[38] As far as costs are concerned, the contracts provide for costs orders on an attorney and client scale and in circumstances of this matter I can see no reason not to grant such an order. Having regard as a whole to the relief which I propose to grant, however, I consider that awarding the plaintiff collection commission would tilt the balance reached as regards the fairness of the penalty provisions and I therefore decline to make any such award.[9]

[39] In the result judgment is granted in favour of the plaintiff against the defendant in the following terms:

(a) Payment in the sum of R112 006,05 (R228 391,05 less R116 085,00);

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9 See in this regard Claude Neon Light (SA) Ltd supra at 152A - H

(b) Interest on the aforesaid sum at the rate of 15,5% per annum from 2 February 2005 to date of payment;
(c) The plaintiff is directed, upon payment in full by the defendant of all amounts awarded to the plaintiff in terms of prayers (a), (b) and (d), to return the goods leased by the defendant from the plaintiff in terms of the first and second rental agreements or, failing that, equipment of the same make and in similar condition to such equipment when it was repossessed, for the remaining period of the lease agreements.
(d) Costs of suit on the attorney and client scale.

LJ BOZALEK, J