REPORTABLE

IN THE HIGH COURT OF SOUTH AFRICA

(WESTERN CAPE HIGH COURT, CAPE TOWN)

Case No: 9587/10

Before the Hon Mr Justice NJ Yekiso

In the matter between:

STRUCTURED MEZZANINE INVESTMENTS (PTY) LTD	Applicant

and

MOGAMAT ASHRAF DAVIDS	1st Respondent
SAMIER RINQUEST	2nd Respondent
SHALLDOWISELY 4 (PTY) LTD	3rd Respondent
KHANITA AHMED	4th Respondent

Coram:	**NJ Yekiso, J**
Judgment by:	**NJ Yekiso, J**
Counsel for Applicant:	**Adv J F Pretorius**
Attorneys for Plaintiffs:	Sim & Botsi Attorneys c/o E R Attorneys
1st to 4th Respondents:	**Unrepresented**
Date of Hearing:	**16 August 2010**
Date of Reasons:	**8 September 2010**

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KHANITA AHMED	4th Respondent

Coram: Yekiso J

Heard: 16 August 2010

Delivered: 8 September 2010

Summary: Lawfulness of interest rates agreed upon by the parties

- Not regulated by the Usury Act, 73 of 1968. Latter piece of legislation repealed by the provisions of section 174(4) of the National Credit Act, 34 of 2005
- Interest rate agreed upon not in conflict with the provisions of Section 1(1) of the Conventional Penalties Act, 15 of 1962
- Factors taken into account in the determination of lawfulness or otherwise of interest agreed upon.

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SHALLDOWISELY 4 (PTY) LTD	3rd Respondent
KHANITA AHMED	4th Respondent

JUDGMENT DELIVERED ON 8 SEPTEMBER 2010

YEKISO, J

[1] The applicant, Structured Mezzanine Investments (Pty) Ltd, a company with limited liability incorporated in terms of the company laws of the Republic of South Africa, having its principal place of business at 80 Bonza Bay Road, Beacon Bay, East London, instituted proceedings out of this court, on notice of motion, against the first, second, third and the fourth

respondents, jointly and severally, the one paying the other to be absolved, for payment of an amount of R3,803,572-42, together with interest thereon at the rate of 1,5% per week reckoned from 24 October 2008 up to date of payment. The claim arises out of monies lent and advanced to a company called Zapton Investments 786 (Pty) Ltd ("Zapton") at the latter's special instance and request on 25 April 2008. Each of the respondents bound themselves as sureties and co-principal debtors for due and punctual fulfilment by Zapton of its indebtedness to the applicant.

[2] The respondents referred to in the preceding paragraphs are:

[2.1.] Mogamat Ashraf Davids, an adult business man whose *domicilium citandi et executandi* is at 6 Moore Street, Kenilworth.

[2.2.] Samier Rinquest, an adult business man, whose *domicilium citandi et executandi* is at 6 Moore Street, Kenilworth.

[2.3.] Shalldowisely 4 (Pty) Ltd, a company with limited liability, duly incorporated in terms of the company laws of the Republic of South Africa,

having its registered office at 4 Glen Roy, Pinelands, Cape Town and whose *domicilium citandi et executandi* is at 6 Moore Street, Kenilworth.

[2.4.] Khanita Ahmed, an adult business woman, whose *domicilium citandi et executandi* is also at 6 Moore Street, Kenilworth.

[3] In terms of the loan agreement, concluded at Somerset West on 25 April 2008, the applicant agreed to lend, advance and make available to Zapton an amount of R3m on the terms and conditions set out in the loan agreement. The due date for repayment of the loan advanced was 24 October 2008. Interest payable was agreed upon at the initial rate of 1,25% per week reckoned from the date the loan was advanced of the loan (25 April 2008) until payment date (24 October 2008). The agreement stipulates that in the event the capital amount, together with interest at the agreed initial rate not being paid on due date, an alternative interest at the rate of 1,5% per week on the capital amount advanced would be charged. Zapton failed to pay the capital amount advanced on due date (24 October 2008) hence the institution of these proceedings for the recovery of the amount due inclusive of interest at the initial rate of 1,25% per week,

together with interest thereon at an agreed alternative rate of 1,5% per week reckoned from due date of payment.

[4] The notice of motion, for the recovery of the amount due, was subsequently served on each of the respondents who elected not to oppose the relief sought.

[5] Once the *dies induciae* for the filing of notices of intention to oppose had expired, the matter was enrolled for hearing on 3 June 2010 on the unopposed motion roll in Third Division. On the day, the matter served before Binns-Ward J who raised concerns as regards the lawfulness of the interest rate agreed upon and subsequently charged and claimed. Counsel was directed to prepare and file full and comprehensive heads of argument in respect of the interest rate issue and the matter was postponed for that purpose. The matter was ultimately argued before me sitting in Third Division on Monday, 16 August 2010. After hearing argument I granted the order as prayed. I did not then give reasons for the order I gave but did indicate to counsel that reasons for the order I gave would be given on request provided such request would have had to be filed within the time limits provided for in the Uniform Rules of Court.

[7] The mezzanine funding, such as is provided by the applicant, is normally used by what is referred to as 'small developers'. These developers, despite their size, are major role players in their niche property development market or are owned by major role players in the property development industry who are able to provide bridging finance to smaller property development entrepreneurs, using mezzanine funding as a vehicle to provide such bridging finance. The individuals involved in these development entities are all experienced and astute business persons who have a wealth of professional knowledge, have been involved in the property and property development market for years with vast experience of market trends. They are individuals or legal entities normally with relatively large and substantial asset base.

[8] As has already been pointed out, the mezzanine funding market is a niche market which is structured to assist these developers, who make use of other people's money, in order to finance their developments. They thus expose other people's money to risks, thus enabling them to successfully commence or complete a project which is ultimately to their financial benefit. The vast majority of smaller developers normally do not

have sufficient own funding available which is normally required to be injected into a development project in order to meet commercial banks' requirement underpinning a development bond. It is for this reason that they make use of mezzanine funding which, as a general rule, involves the lending of money over a relatively short period of time (in the instance of this matter from 25 April 2008 to 24 October 2008) at such lending rates inherent to the risks involved and peculiar to the circumstances in the property development industry.

[9] Normally, mezzanine funding is used to bridge that relatively short period until the commercial banks will feel less exposed to risk and be prepared to lend and advance the money required. It is for this reason, so it is stated on behalf of the applicant in the supplementary affidavit, that mezzanine funding is also referred to as bridging finance. Before any of the commercial banks would be prepared to advance any funding in the property development project, they normally would need to be satisfied that 30% of the capital sum required to complete a development project would already have been spent and injected into the development. Typically, therefore, a commercial bank will only fund 70% of the total development costs whilst the developer is required to fund the other 30% either out of its

own funds or by way of a loan obtained elsewhere. Evidence tends to suggest that the conclusion of the loan agreement in the instance of this matter was preceded by intense negotiations as regards the terms of the agreement including those terms relating to the rate of interest to be charged.

[10] Whilst it appears that the profit margins of the mezzanine funders are high, it would appear that equally high is the risk involved. The risks involved would relate to misrepresentation to the mezzanine funder when applying for a loan; the development project overrunning in time and costs; and the potential array of problem areas such as disputes as regards the development itself which may arise during the course of such development. It would appear that the applicant, and I am told, like all other mezzanine funders, obtain its funds from the banks at a rate equalling that of the mezzanine funder plus a percentage points for its own profit margin which, at the time the loan agreement was concluded, was equivalent to a rate of 1% per month. Equally significant to the risk element is an increase in default of payment as has happened in the instance of this matter.

LAWFULNESS OF THE INTEREST RATE CHARGED

[11] Up until its repeal by the provisions of section 174(4) of the National Credit Act, 34 of 2005, interest rates and finance chargers were controlled and regulated by the provisions of the Usury Act, 73 of 1968. Since the repeal of the latter piece of legislation, lawfulness or otherwise of the rate of interest charged is regulated by such pieces of legislation as the National Credit Act, the Conventional Penalties Act, 15 of 1962 as also whether the rate of interest charged offends good morals or is contrary to public policy. The respondents elected not to challenge the merits of the claim, inclusive of the rate of interest charged, so that all that I am, therefore, required to determine is whether the rate of interest charged contravenes any provision of the National Credit Act, the Conventional Penalties Act or whether the interest charged offends good morals or is against public policy.

THE NATIONAL CREDIT ACT

[12] Since the repeal of the Usury Act, certain maximum interest rates charged are regulated by the provisions of section 105 of the National Credit Act, which provides as follows:

> "105. Maximum rates of interest, fees and charges. –

(1) The Minister, after consulting the National Credit Regulator, may prescribe a method for calculating –

(a) a maximum rate of interest; and

(b) the maximum fees contemplated in this Part,

applicable to each subsector of the consumer credit market, as determined by the Minister.

(2) When prescribing a matter contemplated in subsection (1), the Minister must consider, among other things –

(a) the need to make credit available to persons contemplated in section 13((a);

(b) conditions prevailing in the credit market, including the cost of credit and the optimal functioning of the consumer credit market; and

(c) the social impact on low income consumers.

(3) When establishing regulations contemplated in this section, the Minister –

(a) must establish different maximums for credit agreements within each subsector of the consumer credit market; and

(b) may prescribe the method, consistent with section 101(3), for allocating service fees between the provision of credit and the provision of related financial services, in circumstances in which a credit provider offers multiple financial services under a single agreement."

[13] Arising from the provisions of section 105 of the National Credit Act, the prescribed maximum interest rates and the manner of calculation thereof are contained in regulations promulgated thereunder and, in particular, regulation 42 of the Regulations published in Government Notice R489 published on 31 May 2006 and subsequently amended by Government Notice R1209 published on 30 November 2006. Regulation 42, under the heading 'maximum prescribed interest and initiation fee' prescribes maximum interest rates that may be charged in respect of each sub-sector mentioned under Table A as well as maximum initiation fee that may be charged in respect of each sub-sector mentioned under Table B.

[14] The prescribed maximum interest rates referred to in the preceding paragraph do not apply to Zapton. Zapton, the principal debtor in the instance of this matter, is a juristic person. It is quite evident on the basis of the documentation prepared prior to the conclusion of the loan agreement, in particular, the mortgage bond registered in favour of the applicant, that the asset value of Zapton at the time of the conclusion of the agreement exceeded R1m. Based on this fact, Zapton is thus excluded from the application of the provisions of the National Credit Act in terms of

section 4(1) thereof. Section 4(1) of the National Credit Act provides as follows:

> "4. Application of Act – (1) Subject to sections 5 and 6, this Act applies to every credit agreement between parties dealing at arm's length and made within, or having an effect within, the Republic, except –
>
> (a) a credit agreement in terms of which the consumer is –
>
> (i) a juristic person whose asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds the threshold value determined by the Minister in terms of section 7(1);
>
> (ii) the state; or
>
> (iii) an organ of state;
>
> (b) a large agreement, as described in section 9(4), in terms of which the consumer is a juristic person whose asset value or annual turnover is, at the time the agreement is made, below the threshold value determined by the Minister in terms of section 7(1)"

The monetary asset value or annual turnover as determined by the Minister for the purposes of section 4(1) is the monetary value or annual turnover threshold of not more than R1m.

[15] In the alternative, the loan agreement concluded between Zapton and the applicant is a large agreement referred to in section 4(1)(b) of the National Credit Act. A large agreement is defined as follows in section 9(4) of the National Credit Act:

> "(4) A credit agreement is a large agreement it if is –
>
> (a) a mortgage agreement; or
>
> (b) any other credit transaction except a pawn transaction or a credit guarantee, and the principal debt under that transaction or guarantee falls at or above the higher of the thresholds established in terms of section 7(1)(b)"

[16] The respondents, by virtue of the suretyship agreements signed by each of them, are guarantors to the loan granted to Zapton by the applicant. Since the provisions of the National Credit Act do not apply to the principal debtor, Zapton, equally, such provisions do not apply to the respondents, as guarantors, by virtue of the provisions of section 4(2)(c) of the National Credit Act which provides:

> "(c) this Act applies to a credit guarantee only to the extent that this Act applies to a credit facility or credit transaction in respect of which the credit guarantee is granted."

[17] The suretyship agreements signed by each of the respondents constitute a credit guarantee as contemplated in section 8(5) of the National Credit Act which provides:

> "(5) An agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy on demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act applies."

Thus, since the provisions of the National Credit Act do not apply to the principal debtor, Zapton, such provisions equally do not apply to the respondents. This is so because the principal debtor in the instance of this matter is a juristic person as contemplated in the definition of the term 'juristic person' in section 1, and the loan agreement in question being a large loan agreement as contemplated in section 9(4) of the National Credit Act.

Clearly, therefore, the provisions relating to the prescribed maximum interest rates as provided for in the National Credit Act, do not apply to Zapton and the respondents.

THE CONVENTIONAL PENALTIES ACT

[18] As a rule a penalty provision in the contract, is enforceable unless the results flowing from such enforcement are disproportionate to the loss suffered by the contracting party in whose favour the penalty provision is intended to operate. The nature of a penalty stipulation, for the purposes of the Conventional Penalties Act, appears in sections 1(1) and (4) of the aforementioned piece of legislation. In terms of section 1(1) a stipulation in terms of which a person is liable in respect of an act or omission in conflict with a contractual obligation to pay a sum of money is enforceable.

[19] The agreed alternative rate of 1,5% per week constitutes the basis of liability in the event of default or an omission to pay a debt on due date. It comes into operation and thus becomes enforceable on breach of the agreement. It is intended to compensate the credit giver in the event of a loss arising from non-performance. Due regard had to the amount of capital advanced and all the attendant risks involved, it cannot , in my view, be said either the initial rate of interest or the alternative rate of interest agreed upon is disproportionate to the attendant risks involved in advancing or making available the capital required or the loss suffered as a result of non-payment. It therefore follows, in my view, that the initial rate

of interest, as well as the alternative rate of interest agreed upon, is not in conflict with the relevant provisions of the Conventional Penalties Act. In any event, there also is no evidence to suggest that any one of the respondents ever complained about the rate of interest, both as regards the initial rate as well as the alternative rate agreed upon.

PUBLIC POLICY

[20] It is trite law that a court has the power to declare a contract void should it be determined as being against public policy or good morals [See *Sasfin (Pty) Ltd v Beukes* 1989(1) SA 1 (A); *Botha (now Griessel) v Finanscredit (Pty) Ltd* 1989(3) SA 773 (A)]. Although parties to a contract are at liberty to agree on a rate of interest peculiar to the risk involved and the peculiar circumstances of the parties, interest which is proved to be extortionate or usurious cannot be claimed by a creditor (See *Reuter v Yates* 1904 TS 855 at 859). The onus is on the debtor to prove that a particular interest rate is too high and should not be enforced by a court. (Jourbert: *The Law of South Africa* Vol 5 part 1 para 52)

[21] In determining whether a rate of interest is usurious and thus contrary to public policy, a court will take all relevant circumstances into

consideration, such as the rate of interest which is applied in the economy at the time, the risk involved in the transaction, the period of the loan, the amount lent, the relevant position of the parties and the circumstances existing at the time of the conclusion of the contract (See Joubert: *The Law of South Africa* para 52 *supra.* A court will not lightly interfere with an interest rate upon which the parties have agreed.

[22] In the instance of this matter, and as correctly submitted by *Mr Pretorius,* the parties to the loan agreement are all experienced business persons who appear to have enjoyed equal bargaining powers when the loan was negotiated and ultimately signed. There is no evidence to suggest that the applicant was in a better bargaining position than Zapton or that any of the parties, who voluntarily bound themselves as sureties in favour of the applicant, were misled or coerced in binding themselves.

[23] I am in perfect agreement with the submission by *Mr Pretorius* that having regard to the nature of the transaction in the instance of this matter, the niche market which the mezzanine funders serve and the market requirements having regard to the general economy, the interest rate

agreed upon in terms of the loan agreement, in the circumstances of this matter, does not offend good morals nor is it against public policy.

[24] It is for the reasons stated in this judgment that, when I granted the order I gave, I was of the view that the rate of interest charged, both at the initial rate agreed upon as well as the alternate rate, is not disproportionate to the risk undertaken by the applicant or, put differently, that the interest rate charged is commensurate to the risk undertaken.

[25] For sake of completeness, the order I gave is the following:

[25.1.] Judgment is granted in favour of the Applicant against the First to Fourth Respondents, jointly and severally the one paying the other to be absolved for:-

[25.1.1.] Payment of the sum of R3,803,571-42;

[25.1.2.] Interest on the aforesaid amount at the rate of 1,5% per week, calculated from 24 October 2008 until date of payment;

[25.1.3.] Costs of the application on an attorney and own client scale.

N J Yekiso, J