IS A HARD-HITTING CONTRACTUAL TERM CONSTITUTIONALLY UNFAIR AND HENCE UNENFORCEABLE?

Mohamed's Leisure Holdings (Pty) Ltd v Southern Sun Hotel Interests (Pty) Ltd (183/17) [2017] ZASCA 176 (1 December 2017)

X had regularly, for 35 years, maintained rental payments under a lease. However, due to oversight on X's bank's side, rental was paid late on two occasions, a few months apart. The lease agreement allowed for immediate cancellation of the lease on breach, as the parties did not include a clause providing that an opportunity to rectify the breach must be given to the defaulting party. The landlord cancelled and the tenant disputed its right to evict it in the circumstances and called on considerations of ubuntu to be read into the agreement. The Supreme Court of Appeal found in favour of the landlord and the judgment gives a valuable insight into all the interests that must be balanced in such an enquiry.

The Judgment can be viewed here.

FACTS

The Garden Court Holiday Inn (the hotel) on Nelson Mandela Boulevard is a familiar sight and has been in operation for approximately 35 years. The premises from which the hotel operates are leased from Mohamed's Leisure Holdings (Pty) Ltd (MLH). In terms of the lease agreement between the parties, rental should be paid on or before the 7th of each month. It was also a material term of the agreement that should the hotel fail to pay the rental on due date, MLH would be entitled to cancel the lease and retake possession of the property.

The hotel maintained regular and prompt payment of the rental, having instructed its bank to attend to the monthly rental payments. However, in June 2014, the deadline of the 7th was missed. On 20 June 2014, when payment was still not forthcoming, MLH wrote to the hotel and afforded it a period of five days within which to remedy the breach. In that letter MLH pertinently warned the hotel that should it fail to pay rent on due date in the future, no notice to remedy the breach would be given and the agreement will be cancelled forthwith and the hotel will be required to vacate the premises with immediate effect. (The breach clause allowed for immediate cancellation of the agreement on breach and did not stipulate that the landlord had to provide notice or offer the tenant a period in which to rectify the breach.)

It transpired that the hotel's bankers encountered an error and that it was at fault in not transmitting the payment to MLH on the due date. The bank confirmed in writing that "non-

payment of the rental amount … was caused as a result of a change in … processes which impacted the payment run for 01 June 2014 and by no omission of the client."

Due to this error, for the next three months, the hotel monitored its bank statements by ensuring that future payments were debited from its account promptly by the 7th of each month. However, during October 2014, a similar error occurred, again through no fault of the hotel, and MLH was not paid on the due date. As a result of this breach, MLH invoked the provisions of the lease agreement and addressed a notice of cancellation of the lease agreement to the hotel on 20 October 2014 and afforded it until 31 October 2014 to vacate the premises.

The bank again accepted responsibility for the delay and explained that the funds were credited into a wrong account instead of to MLH's account. The rent was eventually paid on 21 October 2014, together with interest.

In response to the cancellation of the lease and the threatened eviction, the hotel informed MLH that cancellation of the lease was unreasonable because the breach occurred as a result of its banker's error. It contended that the purported cancellation was contrary to the concepts of ubuntu, good faith and reasonableness as enshrined in the Constitution. The Gauteng High Court agreed and accepted that the hotel had breached the agreement but declined to grant an order for eviction. It reasoned that implementation of the cancellation clause would be manifestly unreasonable, unfair and offend public policy and that the common law principle of *pacta sunt servanda* (direct simple translation: agreements must be honoured) should be developed by importing or infusing the principles of ubuntu and fairness in the law of contract.

The present judgment deals with MLH's appeal against that finding. It argued that:

(i) There was a material breach of the agreement.
(ii) MLH was thus entitled to cancel in terms of the breach clause.
(iii) After the first breach in June, MLH did not cancel the agreement. At the time it did however pertinently caution the hotel that a further breach would result in the cancellation of the agreement.
(iv) Although it was entitled to cancel the agreement forthwith after the breach in October, it waited 12 days to lapse before cancelling the agreement.
(v) If courts were to embark on the course of action claimed by the hotel, it would be imposing its own sense of fairness and make contracts for the parties.

The hotel, despite accepting that the payment was indeed late, disputed MLH's entitlement to cancel the agreement and seek an eviction. It argued:

(i) The breach clause should be interpreted to mean that parties to a contract ought to act in good faith which would render the clause flexible to accommodate the circumstances where a party is prevented by factors beyond his control from complying with the requirements of the clause.
(ii) Giving effect to the clause would be so manifestly unreasonable that it offends public policy (as constituted by the concept of good faith, ubuntu, fairness and simple justice between individuals) and secondly, the clause is unreasonable because it insists on compliance with its provisions regardless of the circumstances which prevented compliance thereof.
(iii) The Court is obliged to, in construing the impugned clause, to promote the spirit, purport and objects of the Bill of Rights. As such the principle of *pacta sunt servanda* is not a sacred cow that should trump all other considerations.

HELD:

Was there merit in the hotel's argument, i.e. is the implementation of the breach clause manifestly unreasonable or unfair to the extent that it is contrary to public policy?

- To answer this question one must look at the objective terms of the agreement in light of the relative situation of the parties. This calls for a balancing and weighing-up of two considerations, namely the principle of *pacta sunt servanda* and the considerations of public policy, including, of course, constitutional imperatives.

- As background, note the following accepted (objective) principles underlying contractual obligations in our law. (i) Courts exercise the power to declare contracts contrary to public policy sparingly and only in the clearest of cases, lest uncertainty as to the validity of contracts result from an arbitrary and indiscriminate use of the power. This is because one must be "careful not to conclude that a contract is contrary to public policy merely because its terms (or some of them) offend one's individual sense of propriety and fairness." (ii) In addition, the privity and sanctity of contract entails that contractual obligations must be honoured when the parties have entered into the agreement freely and voluntarily. This notion goes hand in hand with the freedom to contract. It was said: "If there is one thing which, more than another, public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts, when entered into freely and voluntarily, shall be held sacred and enforced by the courts of justice." (iii) Parties enter into contractual agreements in order for a certain result to materialise. The fact that parties enter into an agreement gives effect to

their constitutional right of freedom to contract, and the carrying out of the obligations in terms of that contractual agreement relates to the principle of *pacta sunt servanda*. (iv) It is therefore accepted that judges must exercise 'perceptive restraint' lest contract law becomes unacceptably uncertain. The judicial enforcement of terms, as agreed to, is underpinned by 'weighty considerations of commercial reliance and social certainty'. In fact, the Constitution requires parties to honour contractual obligations that were freely and voluntarily undertaken.

- Against that background, our courts acknowledge that while it is necessary to recognise the doctrine of *pacta sunt servanda*, courts should be able to decline the enforcement of a clause if it would result in unfairness or would be unreasonable from a public policy point of view (such as where the contract was not freely and voluntarily concluded or there was an apparent disparity in bargaining power resulting in an unfair or unreasonable outcome.) This does not mean that the enforcement of a valid contractual term must be fair and reasonable even if no public policy consideration found in the Constitution or elsewhere is implicated. This is because "(s)elf-autonomy, or the ability to regulate one's own affairs, even to one's own detriment, is the very essence of freedom and a vital part of dignity." Without this principle, the law of contract would be subject to gross uncertainty, judicial whim and an absence of integrity between the contracting parties; and a legal system in which the outcome of litigation cannot be predicted with some measure of certainty would fail in its purpose.

- Once it is found that the objective terms of a contract are not inconsistent with public policy on the face of it, the further question will then arise which is whether the terms are contrary to public policy in light of the relative situation of the contracting parties.

Applying the theory to the facts of this matter

- The first enquiry: Pertinent to this matter, and against the above background, is that: (a) the terms of the lease agreement are not, on their face, inconsistent with public policy; (b) the relative position of the parties was one of bargaining equality; the parties could have negotiated a clause in terms of which the hotel should be given notice to remedy a breach before the landlord may cancel; and (c) the performance on time was not impossible because the hotel could have diarised well ahead of time to monitor this important monthly payment and it could have effected other means of payment such as an electronic funds transfer. Against this back-

ground, it cannot be against public policy to apply the principle of *pacta sunt servanda* in this case.

- The second enquiry: In this case there is no complaint that the impugned clause is objectively unconscionable or that the lease agreement was not concluded freely or that there was an unequal bargaining power between them. Evidently the hotel was at all material times aware or must have been aware of the implications of the cancellation clause, especially after the cancellation warning that followed after the breach in June 2014.

- It follows then that the appeal should succeed and the hotel evicted. It must be appreciated that the fact that a term in a contract is unfair or may operate harshly does not, by itself, lead to the conclusion that it offends the values of the Constitution or is against public policy. A person who promised to pay rental on a certain date and upon failure to do so, faces the possibility of an eviction, cannot be heard to say he was not warned; he should remember his obligation. In this case the hotel was forewarned in June that any default in payment would result in the cancellation of the lease and possible eviction. This notwithstanding it failed to comply with its obligation.

- The result is understandably unpalatable to the hotel. It must therefore bear the consequences of its agent's (the bank's) failure in paying the October rental on the due date. Its defence was clearly to restrict the lawful reach of the contract and to limit what can be regulated by way of a contractual agreement between parties, in circumstances where the terms of the contract were clear and unambiguous. In this case the parties freely and with the requisite *animus contrahendi* agreed to negotiate in good faith and to conclude further substantive agreements which were renewed over a period of time. It would be untenable to relax the maxim *pacta sunt servanda* in this case because that would be tantamount to the Court making the agreement for the parties.

In all the circumstances of this matter, the appeal was upheld and the hotel evicted.

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