THE CHARGING OF INTEREST AND THE VALIDITY OF VARIABLE INTEREST RATE CLAUSES

by

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"For I know the plans I have for you," declares the Lord,
"plans to prosper you and not to harm you, plans to give you hope and a future."

Jeremiah 29: 11 - 12

AFFIDAVIT

This serves to confirm that I,

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Abstract

The charging of interest and the variation thereof throughout the term of a credit agreement has, in a modern South Africa, become the rule rather than the exception. This is so because in a constant evolving economy it will not be viable for large financial institutions to commit themselves to fixed interest rates especially where a credit agreement such as a mortgage agreement may extend over many years. With this comes the question as to the extent of a credit provider's discretion to vary interest rates and the manner in which it purports to do so. Naturally where the National Credit Act finds application in respect of a credit agreement the provisions thereof relating to interest and the variation thereof will determine whether a clause allowing a credit provider to vary the interest rate unilaterally is valid and enforceable. However in instances where the National Credit Act is not applicable to a certain credit agreement, especially in the case where the consumer is a juristic person, the interest rate levied and the variation thereof will fall to be decided in terms of the common law. The application of the common law in this regard is not without difficulty and there have been many conflicting decisions of our courts in this regard. Whilst the supreme court of appeal has finally decided on the matter of discretionary interest rate clauses it is no doubt that this issue will surface for many years to come. This dissertation explains the comparative positions of interest rate and variable interest rate clauses in terms of the National Credit Act and the common law.

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CHAPTER 1

INTRODUCTION

1.1 *Background and introductory remarks*

At some point in each of our lives we will inevitably come across the concept of interest. This is so because in a modern South Africa it is most certainly the rule rather than the exception that people require and obtain credit in some form or another. These credit agreements which will present themselves in different forms depending on the transaction concluded may vary from the purchasing of immovable property, the purchasing of motor vehicles, personal or commercial loans, clothing accounts and really the list goes on. In principle almost anything can be purchased on credit. I have even come across plastic surgeons who are willing to perform surgeries for patients on credit, although the security which such person could offer would be quite another story. It follows that with the extending of credit the concept of interest comes to the fore and in this way credit providers, big and small, make a profit. The paramount importance of interest and the role which it plays in the economy of South Africa has been recognised for many years. In this regard interest was described by the appellate division (as it was known previously) as "...the lifeblood of finance".[1]

Although the appellate division made this statement more than 50 years ago it certainly rings true in modern South Africa. This truth is clearly evident from the Consumer Credit Market Report issued by the National Credit Regulator for the second quarter ending June 2014. In this regard the report showed the following statistics in respect of the current consumer credit market in South Africa:

(i) The total value of new credit granted to consumers increased from R105.60 billion to R107.19 billion for the quarter ending June 2014;
(ii) The number of applications submitted for credit increased from 9.67 million in March 2014 to 10.37 million in June 2014;
(iii) The banks' share of the total credit granted was R87.15 billion thus comprising 81.31% of the total credit granted; and

[1] See *Linton v Corser* 1952 4 SA 9 (A) 16.

(iv) The total outstanding gross debtors' book of consumer credit for the quarter ending June 2014 was R1.57 trillion of which mortgages accounted for R834.37 billion, secured credit agreement accounted for R340.36 billion, credit facilities accounted for R195.26 billion, unsecured credit accounted for R172.20 billion, developmental credit accounted for R26.10 billion and short term credit accounted for R704.99 million.

These figures are astonishing and really allude to the impact which the credit industry has within the economic markets of South Africa.

Naturally, with the provision or extending of credit and the charging of interest the question arises as to whether the interest rate initially agreed upon between the credit provider and the consumer will remain the same throughout the term of the credit agreement or whether it will fluctuate depending on certain economic circumstances. In this regard certain financial institutions permit the consumer to elect whether he or she or it would prefer to be bound by a fixed interest rate for the duration of the credit agreement, alternatively whether the interest rate will be subject to variation during the course of the credit agreement.

The provision of credit with a fixed interest rate would in most instances be found where the principal debt is payable within a short period of time and where the likelihood of fluctuations in the financial market is relatively low. Of course even in such instances the credit provider would ensure that it makes a profit despite a fixed interest rate being applicable. On the other hand one would, more often than not, find that credit agreements which endure for many years such as mortgage agreements contain a variable interest rate clause which empowers the credit provider to vary the interest rate applicable. Such variable interest rate clauses form part of credit agreements so as to protect the credit provider concerned from being forced to charge a consumer the same interest rate despite a perhaps drastic shift in the economic environment and thus reducing the credit provider's profit margin.

Of course there are instances where a credit provider such as a bank will permit a fixed interest rate to be applicable despite the credit agreement enduring for a long period of time but this would usually only be available to certain of its customers and most probably only to those which have long standing business relationships with the particular bank concerned. In such instances, however, I would imagine that the bank would nonetheless fix the interest rate

at a rate higher than that which it would normally have offered the consumer had he or she or it agreed to a variable interest rate.

Whilst at first glance the charging of interest and the variation thereof may seem pretty normal and simplistic there are various factors which need consideration especially when the varying of an interest rate comes to the fore. This is so because in certain instances the varying of an interest rate will have to comply with the provisions of the National Credit Act[2] (hereinafter referred to as "the NCA") and in other instances the common- law provisions will be applicable. This aspect is the crux of the discussion which follows.

1.2 *Purpose, problem statement and research methodology*

In order to fully understand the implications of variable interest rates and the validity of such clauses in credit agreements, I feel it necessary to investigate the concept of interest as this is an obvious point of departure.

As such I will firstly explore the concept of interest with specific reference to its history, origin and place in the common law. I will thereafter deal with early legislation in South Africa regulating interest and lastly turn to the provisions of the NCA. With regards to the NCA I will endeavour to explain its introduction into South African law, its purpose, scope of application and specifically its provisions and/or regulations relating to interest in general and the validity of variable interest rates clauses.

The common-law position regarding the validity or otherwise of variable interest rate clauses will also be discussed by referring extensively to the conflicting decisions of our courts as well as the academic commentary regarding such decisions. Once this has been highlighted I will explore a possible defence which a consumer may raise where it is found that a variable interest rate clause is valid and enforceable in terms of the common law despite such resultant interest rate being exorbitantly high.

[2] 34 of 2005.

In order to best comprehend the practical application of the NCA in respect of variable interest rate clauses and the comparative position under the common law, it is necessary to postulate two different scenarios which should be kept in mind when reading this dissertation.

The hypothetical scenarios are as follows:

(i) Showtime Flooring CC buys immovable property from Commercial Realtors (Pty) Ltd. Showtime Flooring CC intends conducting its business from such property and it obtains financing for such property from The Price is Right Bank Limited. In terms of the credit agreement between The Price is Right Bank Limited and Showtime Flooring CC, the initial interest rate applicable to the credit agreement is 15% per annum. The credit agreement however provides that The Price is Right Bank Limited may at any time during the currency of the credit agreement, in its discretion, reduce or increase the interest rate and adjust the instalments accordingly; and

(ii) John James buys a Mercedes Benz from Herman Nel Motors CC. The purchase price in respect of such vehicle is financed by The Price is Right Bank Limited and an instalment sale agreement is concluded. With regards to the charging of interest the instalment sale agreement provides that the interest rate applicable is 15% per annum but that The Price is Right Bank Limited may at any time during the currency of the instalment sale agreement increase or decrease the interest rate by the same margin as, and in accordance with, changes in the prime lending rate of The Price is Right Bank Limited.

The question to be answered in respect of the aforesaid hypothetical scenarios is whether the variable interest rate clauses as contained in the credit agreements concluded between the parties are valid and enforceable.

CHAPTER 2

THE CONCEPT OF INTEREST

2.1 *Introduction*

As far as attorneys and businessmen are concerned it is, or at least should be, common knowledge that in South Africa the charging of interest is regulated by the NCA. That being said it is to be noted that the NCA is a form of modern day consumer protection specifically aimed at the protection of consumers in so far as they enter into credit agreements and who are generally in a weaker position to the credit provider and therefore subject to abuse and malpractices. As pointed out by Otto[3] consumer credit legislation, like the NCA, is but one form of legislation aimed at consumer protection and which is often perceived as a modern phenomena. In this regard other examples of legislation which would qualify as consumer legislation will include, *inter alia*, the Consumer Protection Act[4], the Prevention of Illegal Eviction from and Unlawful Occupation of Land Act[5] and the Alienation of Land Act[6]. It is quite obvious that, in most instances, consumer protection is the driving force behind the promulgation of legislation such as those mentioned above. Legislation dealing with and regulating the levying of interest is no exception.

Thus when tasked with proposing new credit legislation to the South African law commission (as it was then known) Otto and Grové stated:

> "Down the ages different types of contract and commercial practices have led to so much exploitation and malpractice that even since ancient times lawmakers have had to lay down rules in order to regulate the relations among those subject to the law. It is necessary to take notice of the historical developments in this regard because they provide the social, economic and juridical background to the present as well as the future legislation."[7]

[3] Otto "The history of consumer credit legislation in South Africa" 2010 *Fundamina* 257.
[4] 68 of 2008.
[5] 19 of 1998.
[6] 68 of 1981.
[7] South African Law Commission *The Usury Act and Related Matters* Working Paper 46, Project 67 (1991) 18.

A prime example of the protection afforded to a consumer by the NCA is the codification and in fact the extension of the common law *ultra duplum* rule in section 103(5) which will be discussed in the paragraphs that follow.[8]

Whilst this seems all good and well, what does the concept of interest actually entail? Is it a new concept brought about by the promulgation and commencement of the NCA or does it find its origin elsewhere? What follows hereunder is a brief overview of the origins of the concept of interest and its subsequent regulation by early South African legislation.

2.2 *The history and origin of the concept of interest*

Whilst the concept of interest is part and parcel of everyday life in modern South Africa Otto points out that consumer credit legislation is not a modern invention and that when interpreting consumer credit legislation consideration must be had to the historical foundations thereof.[9] To this end, Otto and Grové have stated that:

> "Over the centuries there have been few commercial practices that have elicited as much comment from theologians, economists and jurists as the charging of interest. Although interest was usually at issue in the case of money lending, in time it also became an issue in other types of contract. Through the centuries, legislators in different parts of the world adopted legislation of one kind or another which imposed restriction on the charging of interest."[10]

From this it is evident that the concept of interest does not find its origin in the NCA (or even in the Usury Act[11] for that matter) but that it is a topic which has been debated for many centuries. With this in mind it is interesting to note that the charging of interest was even regulated in biblical times. On various occasions one can find the regulation of interest or usury in the Holy Bible. In the Old Testament the charging of interest was prohibited as between fellow citizens but was allowed to be levied against a foreigner whilst in the New Testament the making of a profit from money lent was permitted.[12] In this regard the

[8] See par 3.2 below.
[9] Otto (n 3) 257.
[10] South African Law Commission (n 7) 18.
[11] 73 of 1968.
[12] Otto (n 3) 260.

following texts from the Holy Bible provide evidence that the charging of interest was not unknown in such times:

> "36 Take thou no usury of him, or increase: but fear thy God; that thy brother may live with thee.
> 37 Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase."[13]

> "19 Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury."[14]

> "27 Thou oughtest therefore to have put my money to the exchangers, and then at my coming I should have received mine own with usury."[15]

The above texts make use of the word usury however it could be accepted that same was not used to mean excessive interest as we understand it today but rather any amount which was levied in respect of money lent.

Further to the above Otto highlights that Roman law and even Roman-Dutch law was not averse to the charging of interest but that the rates of interest which were allowed to be charged were limited to certain maximums.[16] Thus it is evident from the aforesaid that consumer protection is not a twentieth-century phenomenon and although the Romans did not necessarily use the term consumer protection they had solid rules in place which were aimed at protecting their citizens.[17]

With the aforesaid in mind it is easy to see that the concept of interest has been around for many years. In this regard Otto has noted that legislation curbing usurious interest rates has existed for 4000 years and that the first legislation regulating maximum interest rates was the Code of Hammurabi.[18] In terms of such code the interest rates differed depending on the type

[13] See Leviticus 25:36 – 37.
[14] See Deuteronomy 23:19.
[15] See Matthew 25:27. The edition consulted is *The Holy Bible: New King James Version* (1982).
[16] Otto (n 3) 260 - 261.
[17] Otto (n 3) 258.
[18] Otto (n 3) 260.

of transaction. For instance, Otto points out that the interest rate in respect of moneylending transactions was 5.5% whilst the interest rate in respect of vegetables lent was 100%.[19]

2.3 *The common-law principles relating to interest in South Africa*

As is commonly known in the legal field, South Africa has a mixed or hybrid legal system comprising of Roman law, Roman-Dutch law, English law, Indigenous law and legislation. In this regard, it is to be noted that the common law of South Africa derives its force from the Constitution of the Republic of South Africa[20] (hereinafter referred to as "the Constitution") and has been developed by the courts over the years in order to keep abreast of modern developments.

Whilst one may disregard the common-law principles when discussing interest rates it is to be noted, and as will become clearer in the chapters that follow, that in many instances the common-law position with regards to interest rates and variable interest rate clauses will still be applicable.

As a backdrop to this it is probably most important to note that in terms of the common law there is no such thing as a common-law interest rate and furthermore there is no maximum interest rate which a creditor may levy against a debtor.[21] Thus where the common law is applicable to a certain set of facts the creditor and the debtor are free to agree on the interest rate to be charged.

This freedom to agree on the interest rate applicable may of course lead to the conclusion of one-sided credit agreements with very high interest rates being charged and which would put the contractants on an unequal footing. In such instances the debtor (who is usually strapped for cash) will agree to a high interest rate being charged failing which the creditor will simply refuse to extend credit. There are of course various reasons which lead creditors to impose high interest rates and they presumably take various factors into consideration. These high interest rates may however lead to the debtor's financial demise.

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[19] Otto "Hemelhoë rentekoerse, die gemeenregtelike verbod op woeker en die ingrypingsbevoegdheid van howe indien die Nationale Kredietwet nie van toepassing is nie" 2012 *THRHR* 271 273.
[20] 1996. See s 8, 39 and 173 in this regard.
[21] JM Otto and R-L Otto *The National Credit Act Explained* (2013) 90.

Therefore in instances where a debtor claims that the interest rate levied against him, her or it, as the case may be, is too excessive or exorbitant, such debtor will have to prove same. This of course leads to a court having to weigh up certain well established principles of our law against each other. These competing principles are *pacta sunt servanda* (the sanctity of contract) and the principle of public policy which basically entails that a contractual provision which is contrary to public policy may be declared to be unenforceable.[22] In this regard it is to be noted that even if a court finds that the interest rate levied in terms of a credit agreement amounts to usury the court may declare such agreement only partially enforceable and allow the creditor to claim such interest which is not considered to be usurious.[23]

It is for these reasons that the defence of usury made its appearance many moons ago and, as will be seen in the paragraphs that follow, the principles relating to usury are still applicable in modern day South Africa.

2.3.1 Reuter v Yates[24]

Prior to the case of *Reuter v Yates*[25] two cases dealt with the concept of usury. These cases were *Dyason v Ruthven*[26] and *Taylor v Hollard*[27]. In the first of these cases the court had to determine whether an interest rate of 12% was considered usurious. The debtor in this matter was of the opinion that an interest rate of 12% was usurious due to the fact that the maximum interest rate at that time in the Cape colony was 6%. The court considered this and found that whilst an interest rate of 6% was the norm in respect of *mora* interest it was not the only interest rate to be imposed in the Cape colony. As such the court held that at common law there is no maximum interest rate which a creditor may charge and therefore the parties were free to agree to the interest rate to be levied.[28]

In the case of *Taylor v Hollard*[29] the plaintiff lent the defendant an amount of £7000 which amount was to be repaid to the plaintiff with an additional amount of £7000. In the event that the defendant defaulted in paying the plaintiff, interest at the rate of 8% would also be levied.

[22] Otto "Consumer credit" *LAWSA* (2004) 97.
[23] See n 22 above and also *Taylor v Hollard* 2 SAR 78 at p 85.
[24] 1904 TS 855.
[25] See n 24 above.
[26] 3 Searle 282.
[27] See n 23 above.
[28] Otto (n 19) 274.
[29] See n 23 above.

Although an English court granted the plaintiff the relief which he sought the judgment had to be executed in South Africa since the defendant was a South African citizen. Thus the defendant alleged in a South African court that the relief sought by the plaintiff amounted to usury. The South African court agreed with the defendant and ordered him to pay only an amount of £7000 together with 8% interest to the plaintiff.[30]

In *Reuter v Yates*[31] a sum of £65 was lent to the appellant with interest of £5. The duration of the loan was initially for one month but this was extended for a further four months against payment by the appellant of £5 per extension. As such the appellant had paid a total of £20 in respect of extensions. In the court *a quo* judgment was granted against the appellant for an amount of £70 (i.e. £65 (capital) + £5 (interest)).[32] On appeal Innes CJ[33] dismissed the appellant's defence of usury and referring to the decision made in *Dyason v Ruthven*[34] stated the following:

> "The court held the question whether any particular transaction was usurious or extortionate must be determined by the special circumstances of each case; that it was impossible to lay down any general rule on the subject; but that in order to sustain a defence of usury it must be shown that there was present in the transaction an element of extortion or oppression akin to fraud."[35]

In order to determine whether there is an element of extortion or oppression akin to fraud Innes CJ stated that the courts will consider the circumstances of each case and:

> "It will not only look at the scale at which the interest has been stipulated for, but will have regard to the ordinary rate prevalent in similar transactions, to the security offered and the risk run, to the length of time for which the loan was given, the amount lent and the relative positions and circumstances of the parties."[36]

[30] Otto (n 19) 275.
[31] See n 24 above.
[32] 855 - 856.
[33] Smith J and Mason J concurring.
[34] See n 26 above.
[35] 857.
[36] 858.

After this decision it would be more than a century before our courts would report on the defence of usury again but this time the criteria as laid down by Innes CJ would have to be examined in a modern commercial environment and in light of the Constitution which did not exist in 1905.[37] These cases will be discussed below.

2.3.2 Structured Mezzanine Investments (Pty) Ltd v Davids[38]

In *casu* the applicant by way of notice of motion claimed an amount exceeding R3 000 000 from the respondents. The applicant had lent money to a company called Zapton Investments 786 (Pty) Ltd (hereinafter referred to as "Zapton") and the respondents had bound themselves as sureties and co-principal debtors for the due and punctual fulfilment by Zapton of its indebtedness.[39] The terms of the loan agreement stipulated that interest at the rate of 1.25% would be levied per week and in the event of Zapton failing to pay the capital amount together with the interest thereon on due date an alternative interest rate of 1.5% per week would be levied.[40] It is important to note that the applicant was in the business of providing mezzanine funding, a form of bridging finance, which involved providing funding to property developers. As such the applicant would lend money over a short period of time and which would allow the property developers to commence or complete a project. This is of course a risky business taking into consideration the likelihood of non-payment and the possible delays which the property developers may experience.[41] Yekiso J recognised that the matter at hand fell outside the scope of the NCA and as such he relied on the common- law provisions relating to usury.[42] Yekiso J briefly referred to *Reuter v Yates*[43] and found that the interest rate agreed to by the parties (taking into account the inherent risks involved in transactions of such nature and the parties' circumstances) did not offend public morals nor was it against public policy and as such an order was made in favour of the applicant. [44]

[37] Otto (n 19) 271.
[38] 2010 6 SA 622 (WCC).
[39] 624 B – D.
[40] 624 E – H.
[41] 625 B – 626 D.
[42] 627 D – F.
[43] See n 24 above.
[44] 629 C – J.

2.3.3 African Dawn Property Finance 2 (Pty) Ltd v Dreams Travel and Tours CC[45]

In this appeal the facts were briefly that the appellant was a short-term financer which included the provision of bridging finance.[46] As such the appellant lent the respondent an amount in excess of R5 000 000 after an application for such loan was refused by various financial institutions and a private financer. The terms of the loan agreement stipulated that the interest rate would be 5% per month (60% per annum), however should the capital amount and the interest thereon not be paid on due date then the interest rate would be 6.5% per month (78% per annum).[47] The respondent initially made substantial payments to the appellant but such payments were often made late and ultimately the respondent fell in arrears with the payments. As such the increased interest rate of 6.5% per month was levied by the appellant. In light of this the respondents (Dreams Travel and Tours CC and the sureties in respect of the loan agreement) brought an application in the South Gauteng high court for an order declaring the loan agreement to be unlawful, alternatively that those clauses dealing with the interest payable be declared unlawful and contrary to public policy, further alternatively, that the agreed interest rate be decreased in the court's discretion. The respondents' basis for such claim was that the interest levied by the appellant was usurious and not in line with the maximum interest rates as prescribed by the NCA and the repealed Usury Act[48]. The court *a quo* granted the relief sought by the respondents and found that the interest charged by the appellant was usurious and instead imposed an interest rate which it considered fair, to wit, 28% per annum.[49] On appeal to the supreme court of appeal Ponnan JA gave consideration to the ambit of the NCA and determined that same would not be applicable to the loan agreement concluded between the appellant and the respondent and that as such "there is no statutory limitation on the interest payable in terms of the agreement."[50] In addition to this Ponnan JA considered the common law in light of the Constitution and the decision in *Reuter v Yates*[51] and held that:

> "It bears restating that our Constitution and its value system do not confer on judges a general jurisdiction to declare contracts invalid on the basis of their subjective

[45] 2011 3 SA 511 (SCA).
[46] 513 I – 514 B.
[47] 515 D – F.
[48] See n 11 above.
[49] 517 H – J.
[50] 519 A – B.
[51] See n 24 above.

perceptions of fairness or on the grounds of imprecise notions of good faith. Nor does the fact that a term is unfair, or that it may operate harshly, of itself lead to the conclusion that it offends against constitutional principles. In my view it is essential that the law which makes a transaction usurious should be clear and explicit. The general rule endorsed by *Merry* does precisely that. It moreover restrains overzealous judicial intrusion into the sphere of contractual autonomy – a real and meaningful incident of freedom. It permits coercive interference by a court only in circumstances where a party to a contract can show either extortion or oppression, or something akin to fraud. That, I dare say, is consistent with the balance that has to be struck between, one the one hand, the liberty to regulate one's life by freely engaged contracts and, on the other hand, the striking- down of the unacceptable excesses of freedom of contract. It also accords with the notion that judges should approach with restraint the task of intruding upon the domain of the private powers of citizens. I therefore conclude that the common- law rule is not inimical to the values that underlie our constitutional democracy, and that if any stipulation for interest be attacked as being liable to reduction on the ground of usury, it can only be done by offering proof of extortion or oppression, or something akin to fraud."[52]

As such Ponnan JA[53] upheld the appeal and stated that:

"If the CC could point to any particular circumstances which showed that the transaction was not an ordinary one, those ought to have been given due weight. But it failed to do so. Under those circumstances no facts were disclosed which ought to have induced the High Court to afford the CC the relief it sought. Courts should not – as the High Court did – interfere with a bargain deliberately entered into by two parties dealing at arm's length with each other merely because it subjectively believes that the rate of interest stipulated was unfair. Amod is a man conversant with business. The rate of interest no doubt is high, but it may not be incommensurate with the risk that African Dawn ran in advancing its money to the CC. There are no circumstances here that show either extortion or oppression, or anything akin to fraud, and, therefore I do not believe that the High Court was entitled to say that the transaction is a usurious one."[54]

[52] 453 B – G.
[53] Tshiqi JA and Majiedt JA concurring.
[54] 526 F – I.

From the aforesaid discussion of the various decisions of our courts it is evident that interest levied by a creditor will only be seen to be usurious where there is an element of extortion or oppression akin to fraud and that there is no hard and fast rule which will determine whether a particular interest rate amounts to usury. Otto correctly points out that what constitutes "extortion or oppression akin to fraud" is a strict test and that there are various factors which a court will take into consideration when making such a decision. Such factors may, *inter alia*, include:

(i) The duration of the loan;
(ii) The security provided for the loan;
(iii) The interest rate agreed upon by the parties; and
(iv) The inherent risks involved in the loan for the credit provider.[55]

2.4 *Early legislation regulating interest in South Africa*

2.4.1 The Usury Act 37 of 1926

Within the context of South African law Otto and Grové note that maximum interest rates have not always been regulated by legislation or the common law. This they highlight was especially so in the Free State and Natal.[56] That being said the Cape colony did have consumer credit legislation in place and which was called the Cape Usury Act 23 of 1908. In terms of this act, the concept of interest was widely defined and for the first time different interest rates were imposed for different amounts lent.[57] Otto and Grové refer to such legislation as "first-generation consumer credit legislation" a salient feature of which was that there was no uniformity in relation to the levying of interest and that each colony regulated interest independently and in accordance with what was acceptable within such colony.[58]

With the above in mind Otto and Grové mention that the first consumer credit legislation regulating interest on a national level was the Usury Act 37 of 1926.[59] In this regard they note

[55] Otto (n 19) 279.
[56] South African Law Commission (n 7) 22.
[57] South African Law Commission (n 7) 23.
[58] South African Law Commission (n 7) 24.
[59] South African Law Commission (n 7) 24.

that this Usury Act[60] only applied to moneylending transactions[61] and prescribed different rates of interest depending on the capital amount loaned to a consumer.[62] That being said the act specifically did not apply to banks, hire-purchase contracts or in respect of commercial transactions to which a moneylender was not a party.[63]

Thus the Usury Act 37 of 1926 did not provide assistance in all instances. Because of its inefficiencies in this regard instalment transactions relating to movables or hire-purchase contracts were not regulated and so the Hire-Purchase Act 36 of 1942 was passed into law and which "functioned side by side [with the Usury Act] without having any influence on each other because they applied to different types of contract."[64]

The limited application of the Usury Act[65] as highlighted above was but one of the reasons for the promulgation of the Hire-Purchase Act.[66] This act was primarily introduced into South African law in order to protect the interests of purchasers to a hire-purchase contract. In this regard Otto states that "[t]he hire- purchase contract was, without doubt, the most important driving force behind consumer credit legislation all over the world"[67].

The hire- purchase contract made provision for the instance where goods were purchased on credit and allowed for the reservation of ownership. Thus, the seller of goods could deliver the goods to the purchaser, obtain regular payments by means of instalments and only transfer ownership in the goods once the full purchase price had been paid by the purchaser. In this way the seller was protected against the situation where the purchaser would take delivery of the goods sold (thus ownership being transferred immediately) and failing to pay the purchase price for the goods. On the other hand the purchaser of goods to a hire-purchase contract was subject to unfair treatment as they were not on an equal footing and were often subjected to abuse by the seller who would use the hire-purchase contract to include unfavourable and

[60] 37 of 1926.
[61] South African Law Commission (n 7) 26.
[62] South African Law Commission (n 7) 24.
[63] South African Law Commission (n 7) 24 – 25.
[64] South African Law Commission (n 7) 27.
[65] See n 60 above.
[66] 36 of 1942.
[67] Otto (n 3) 262.

objectionable clauses to the detriment of the purchaser. Thus the Hire- Purchase Act[68] sought to protect purchasers by limiting the rights of sellers.[69]

Due to the limited scope of application of the Usury Act[70] the minister of finance appointed a committee known as the Franzsen Committee to investigate the Usury Act[71] and provide recommendations on possible improvements which could be made thereto. After the completion of the report made by the Franzsen Committee, the Usury Act[72] was repealed and replaced with the Limitation and Disclosure of Finance Charges Act[73] and wherein the term interest was replaced with the concept of finance charges.[74] It is interesting to note that the Limitation and Disclosure of Finance Charges Act[75] applied in the territory of South Africa but also applied to the territory of South West Africa including the area known as the Eastern Caprivi Zipfel and also to all persons in that part of South West Africa known as the Rehoboth Gebiet.[76]

In addition to the aforesaid legislation in 1971 the Sale of Land on Instalments Act[77] was introduced into South African law. The purpose of this legislation was to afford protection to a purchaser of immovable property on instalments.

2.4.2 The Usury Act 73 of 1968

Otto points out that the 1980s were important years for the development of consumer credit law in South Africa. In this regard the Limitation and Disclosure of Finance Charges Act[78] was amended and renamed the Usury Act 73 of 1968 and the Hire-Purchase Act[79] was

[68] See n 66 above.
[69] Otto (n 3) 264.
[70] See n 60 above.
[71] See n 60 above.
[72] See n 60 above.
[73] 73 of 1968.
[74] Otto (n 3) 261.
[75] See n 73 above.
[76] See s 19. Also see Diemont and Aronstam *The Law of Credit Agreements and Hire- Purchase in South Africa* (1982) 288.
[77] 72 of 1971.
[78] See n 73 above.
[79] See n 66 above.

replaced by the Credit Agreements Act[80]. Further to this, the seemingly inadequate Sale of Land on Instalments Act[81] was repealed and replaced by the Alienation of Land Act[82].

As will be discussed later in this dissertation the NCA repealed and replaced the Usury Act[83] and the Credit Agreements Act[84] and sought to identify and address the shortcomings of such legislation. In this regard it would seem that the intention of the legislature was that all financial aspects pertaining to moneylending transactions, credit transactions and leasing transactions be regulated by the Usury Act[85] and that all contractual aspects pertaining to credit agreements relating to the sale and lease of movable goods be regulated by the Credit Agreements Act[86].

Thus taking into consideration the various provisions of the Usury Act[87] and the Credit Agreements Act[88] a party to an agreement had to consult two different pieces of legislation when determining his or her or its rights and obligations. Thus the facts of each particular case would determine if either one or both of the two pieces of legislation applied and then to what extent. This of course was a mammoth task and often led to ambiguity and uncertainty. Otto states that "[the acts] were supposed to co-exist and supplement each other, but this in fact caused an extremely difficult situation in the field of consumer credit law".[89] Otto and Grové expressed their views in this regard as follows:

> "This placed a very difficult burden on the shoulders of both businesspersons and lawyers. The definitions in the two Acts differ radically, there are about ten differences as regards the fields in which they apply and the sanctions attaching to contraventions do not always correspond either. In short, it is a confusing and unhealthy state of affairs."[90]

[80] 75 of 1980.
[81] See n 77 above.
[82] See n 6 above.
[83] See n 11 above.
[84] See n 80 above.
[85] See n 11 above.
[86] See n 80 above.
[87] See n 11 above,
[88] See n 80 above.
[89] Otto (n 3) 266.
[90] South African Law Commission (n 7) 50 – 51.

For present purposes it is unnecessary to deal with the provisions of the Credit Agreements Act[91] as this piece of legislation dealt predominately with the contractual aspects pertaining to the sale and lease of movable goods. As regards the charging of interest and variable interest rates, the Usury Act[92] and its ambit is worth mentioning, *albeit* briefly, as this piece of legislation regulated the South African law in this regard for many years.

As previously indicated the Limitation and Disclosure of Finance Charges Act[93] later renamed the Usury Act[94] did not deal with the concept of interest but rather referred to finance charges. To this end, unlike the NCA which does not provide a definition for the term "interest," the Usury Act[95] provided a definition for finance charges in the following way:

> "'finance charges' means the total of any valuable consideration, which a borrower or credit receiver or lessee has given or is owing, whether as part of the principal debt or otherwise, directly or indirectly, to a moneylender or credit grantor or lessor or to or on behalf of any intermediary between himself and a moneylender or credit grantor or lessor in terms of a money lending transaction or a credit transaction or a leasing transaction, and includes, in the case of an agreement in terms of which goods are sold under a condition of repurchase of such goods at a higher price, the difference between the higher price at which the goods are repurchased and the lower price at which the goods are sold, but does not include--
>
> a) a ledger fee;
> b) any amount referred to in section 5(1)(b);
> c) the costs referred to in section 5(1)(e) or (f);
> d) the costs of repair and maintenance of the movable property leased in terms of a leasing transaction;
> e) any valuable consideration specifically included in the principal debt by this Act;
> f) any underwriting fee;
> g) any amount or costs referred to in section 5A(1)(a) or (c)."[96]

[91] See n 80 above. For a discussion on the Credit Agreements Act see South African Law Commission (n 7) 68 – 81.
[92] See n 11 above.
[93] See n 73 above.
[94] See n 11 above.
[95] See n 11 above.
[96] See s 1.

In addition to this the Usury Act[97] provided for maximum finance charges which may be levied in respect of money lending transactions, credit transactions and leasing transactions. To this end section two provided as follows:

> "1) a) No moneylender shall in connection with any money lending transaction stipulate for, demand or receive finance charges at an annual finance charge rate greater than the percentage determined by the Registrar by notice in the Gazette in accordance with the directions of the Minister.
>
> b) Different percentages may be determined under paragraph (a) for money lending transactions where the total amount of money lent by a moneylender to a borrower within any period of three months, including disbursements made by him within the said period and recoverable as part of the principal debt, is different.
>
> 2) a) No credit grantor shall in connection with any credit transaction stipulate for, demand or receive finance charges at an annual finance charge rate greater than the percentage determined by the Registrar by notice in the Gazette in accordance with the directions of the Minister.
>
> b) Different percentages may be determined under paragraph (a) for credit transactions of different money values of the principal debt.
>
> 3) a) No lessor shall in connection with any leasing transaction stipulate for, demand or receive finance charges at an annual finance charge rate greater than the percentage determined by the Registrar by notice in the Gazette in accordance with the directions of the Minister.
>
> b) Different percentages may be determined under paragraph (a) for leasing transactions of different money values of the principal debt."

As can be seen section 2 allowed for different interest rates to be levied depending on the different values of the transactions. Thus the maximum annual finance charge rate at which a creditor could stipulate, demand or receive finance charges varied according to the amount of the principal debt in question. These maximum annual finance charges rates were determined by the registrar in accordance with the directions of the minister of trade and industry and were published in the *Government Gazette*. In this regard Grové and Otto noted that

[97] See n 11 above.

maximum rates allowed in terms of the Usury Act[98] were varied frequently and sometimes drastically even over a short period of time.[99] At the time the Usury Act[100] was repealed the maximum annual finance charge rates as determined by the minister were as follows:

> "1) For the purpose of section 2(1), (2) and (3) of the Usury Act, 1968 (Act No. 73 of 1968), the different percentages contemplated in that section shall be calculated as follows:
>
> a) For transactions not exceeding R10 000, the Repo Rate plus one third thereof, plus 11 percentage points;
>
> b) For transactions exceeding R10 000, the Repo Rate plus one third thereof, plus 8 percentage points; and
>
> c) Where the percentage as calculated per paragraph 1(a) or 1(b) does not result in a whole number, such percentage must be rounded down to the closest whole number without any decimals."[101]

Although the Usury Act[102] stipulated the maximum annual finance charge rates which could be levied, same in no way precluded a creditor from imposing finance charges less than the maximum stipulated.[103]

For purposes of this dissertation it is important to note that the Usury Act[104] provided certain provisions with regards to variable interest or finance charge rates. These provisions provide as follows:

> "(1) No money lender, credit grantor or lessor shall conclude a money lending transaction, credit transaction or leasing transaction in connection with which finance charges are stipulated for, demanded or received at any other rate than a variable finance charge rate or a non-variable finance charge rate.

[98] See n 11 above.
[99] Grové and Otto *Basic Principles of Consumer Credit Law* (2002) 72.
[100] See n 11 above.
[101] GN 166 in *GG* 29661 (26 February 2007).
[102] See n 11 above.
[103] See s 3(5).
[104] See n 11 above.

(2) (a) If a moneylender, credit grantor or lessor and a borrower, credit receiver or lessee have at the conclusion of a money lending transaction, credit transaction or leasing transaction agreed in accordance with the provisions of this Act upon a non-variable finance charge rate, the moneylender, credit grantor or lessor may recover finance charges at the rate so agreed upon.

(b) The provisions of paragraph (a) shall also apply to a money lending transaction, credit transaction or leasing transaction already concluded at the commencement of the Usury Amendment Act, 1988.

(3) If a moneylender, credit grantor or lessor and a borrower, credit receiver or lessee have at the conclusion of a money lending transaction, credit transaction or leasing transaction agreed upon a variable finance charge rate, the moneylender, credit grantor or lessor may not for any period during the duration of the transaction concerned stipulate for, demand or receive finance charges at an annual finance charge rate exceeding the relevant rate determined for that period in terms of section 2(1), (2) or (3) in respect of the transaction concerned."[105]

From sub-section one above it is clear that in terms of the Usury Act[106] every transaction between a creditor and a debtor had to be financed either at a variable finance charge rate or a non-variable finance charge rate. In this regard where the transaction was financed at a fixed or non-variable finance charge rate which was either lower or equal to the maximum annual finance charge rate applicable the creditor would only be able to claim finance charges at the rate agreed upon regardless of any variations in the maximum annual finance charge rates in the future. On the other hand where the transaction provided for a variable finance charge rate the creditor would be able to vary and recover finance charges at any time during the term of the transaction provided such finance charge rate did not exceed the maximum annual finance charge rate applicable in respect of such period.[107]

As will be seen later on in this dissertation and in contrast to the NCA the Usury Act[108] whilst making provision for variable finance charge rates failed to set out any method for determining how or when a creditor may vary such variable finance charge rate and as such

[105] See s 2B.
[106] See n 11 above.
[107] Grové and Otto (n 99) 73.
[108] See n 11 above.

parties who disagreed in this regard had to rely on the common-law principles regarding variable interest rate clauses.[109] This aspect will be discussed in detail below.[110]

Whilst the provisions of the Usury Act[111] as discussed above seem to be without difficulty, Otto and Grové raised various concerns in respect thereof when proposing new credit legislation to the South African law commission (now known as the South African law reform commission). Some of their main concerns in respect of the Usury Act[112] and the Credit Agreements Act[113] were, *inter alia*, the following:

(i) The scope of application of the Usury Act[114] and the Credit Agreements Act[115]. Whilst these pieces of legislation were supposed to co-exist it became difficult to distinguish which act applied to a certain set of facts, if any. One of the reasons for the confusion was due to the fact that both acts contained definitions for credit transaction and leasing transaction but these definitions differed from one another;[116]

(ii) In terms of the Usury Act[117] it was difficult to calculate the finance charges payable by a consumer especially in the case of revolving credit;[118] and

(iii) Where a variable finance charge rate was applicable to an agreement there were problems regarding the extent to which a credit provider was entitled to vary finance charge rates unilaterally during the term of the agreement. [119]

[109] Grové and Otto (n 99) 73 – 74.
[110] See par 4.3 below.
[111] See n 11 above.
[112] See n 11 above.
[113] See n 80 above.
[114] See n 11 above.
[115] See n 80 above.
[116] South African Law Commission (n 7) 104 – 105.
[117] See n 11 above.
[118] South African Law Commission (n 7) 108.
[119] South African Law Commission (n 7) 109. Also see Kelly-Louw "Introduction to the National Credit Act" 2007 *Juta's Business Law* 147 – 149 for a discussion on the problems which necessitated the promulgation of the National Credit Act.

CHAPTER 3

THE NATIONAL CREDIT ACT

3.1 *The introduction of the National Credit Act in South Africa*

In 2006 the NCA was assented to by the president and repealed and replaced both the Usury Act[120] and the Credit Agreements Act[121] which jointly regulated the credit industry for many years in South Africa.[122] To this end, Scholtz has described the NCA as:

> "a far-reaching piece of legislation which forms part of a raft of contemporaneous legislation or proposed legislation aimed at protecting consumers and making credit and banking services more accessible. Cumulatively these measures constitute perhaps the most comprehensive change of the legal landscape (and the common law) since the adoption of the Constitution in 1996. Credit providers and consumers should not, therefore, see the Act as merely an amendment of the Usury Act and the Credit Agreements Act: it is a wholesale replacement of legislation that has regulated consumer credit for more than a quarter of a century."[123]

That being said the NCA was implemented in a piecemeal fashion during the period 1 June 2006 and 1 June 2007[124] and is a comprehensive piece of legislation consisting of 173 sections, schedules and regulations.[125] As pointed out by Otto[126] the NCA regulates various aspects of the credit industry including the financial aspects of credit agreements, the conclusion and termination of credit agreements, the contents of credit agreements and the enforcement of credit agreements. Thus, unlike its predecessors the NCA regulates both the financial aspects and the contractual aspects pertaining to credit agreements.

With regards to credit agreements it should be noted that the NCA divides credit agreements into four main categories, namely:

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[120] See n 11 above. .
[121] See n 80 above.
[122] JM Otto and R-L Otto (n 21) 3.
[123] Scholtz (ed) *Guide to the National Credit Act* (2008) par 2.1.
[124] JM Otto and R-L Otto (n 21) 8 and Kelly-Louw "Introduction to the National Credit Act" 2007 *Juta's Business Law* 156 - 157. Also see GN 22 in *GG* 28824 (11 May 2006).
[125] JM Otto and R-L Otto (n 21) 3.
[126] Otto (n 3) 272.

(i) A credit facility;[127]

(ii) A credit transaction;[128]

(iii) A credit guarantee;[129] and

(iv) A combination of the three credit agreements mentioned above.[130]

Whilst the aforesaid may seem relatively basic it should further be noted that in terms of the NCA a credit transaction is further divided into sub-categories which include a pawn transaction, discount transaction, incidental credit agreement, instalment agreement, mortgage agreement, secured loan, lease and any other credit agreement in terms of which payment is deferred and any charge, fee or interest is payable.[131] These forms of credit transactions are specifically defined in the NCA and in certain cases the ambit of the credit transactions overlap with the ambit of what constitutes a credit facility. Thus it is not always easy to distinguish which type of credit agreement you are dealing with and which sections of the NCA are applicable. It is clear from the many forms of credit agreements that the NCA covers a wider variety of agreements as opposed to the Usury Act[132] and the Credit Agreements Act[133].

That being said the NCA is not without fault and various definitions contained therein run counter to well known principles of South African law. For example, in terms of the NCA a lease is an agreement at the end of which ownership of the property (that is movable property) either passes absolutely to the consumer or upon fulfilment of specific conditions set out in the agreement. This of course is directly in conflict with what is generally understood to be a lease as the transfer of ownership would not be intended by the parties. That being said it is surprising that this definition was not amended by the National Credit Amendment Act[134] which was assented to by the president in May 2014 but which has yet to come into operation. The reason for this however is probably due to the decision in *Absa Technology Finance Solutions Ltd v Michael's Bid a House CC*[135] wherein the court held that a common law lease does not fall within the ambit of the NCA.

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[127] See s 8(3) for an explanation as to what qualifies as a credit facility.
[128] See s 8(4) for an explanation as to what constitutes a credit transaction.
[129] See s 8(5) for an description of what constitutes a credit guarantee.
[130] See s 8(1)(d) read with s 8(6).
[131] See JM Otto and R-L Otto (n 21) 32 for a schematic illustration of the various forms of credit agreements.
[132] See n 11 above.
[133] See n 80 above.
[134] 19 of 2014.
[135] 2013 3 SA 426 (SCA).

Over and above the aforesaid categorisation of credit agreements, the NCA further categorises credit agreements as small, intermediate or large agreements.[136] For present purposes it is sufficient to note that –

(i) A small credit agreement is a pawn transaction, a credit facility where the credit limit does not exceed R15 000 or a credit transaction where the principal debt does not exceed R15 000. It is important to note that a mortgage agreement and credit guarantee are specifically excluded from being a small credit agreement;[137]
(ii) An intermediate credit agreement is a credit facility where the limit of credit is above R15 000 and a credit transaction where the principal debt is more than R15 000 but less than R250 000. Again it is significant to note that a pawn transaction, mortgage agreement and credit guarantee are specifically excluded from being an intermediate credit agreement;[138] and
(iii) A large credit agreement is a mortgage agreement (regardless of the amount involved) or a credit transaction where the principal debt equals or exceeds R250 000. A pawn transaction and a credit guarantee are excluded from being a large credit agreement.[139]

In addition to the aforesaid, the NCA also introduces the concepts of over-indebtedness and reckless credit. These concepts were unknown to its predecessors and provide mechanisms in order to protect the interests of the consumer. In this regard a consumer is considered to be over-indebted if –

> "the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's-
>
> (a) financial means, prospects and obligations; and
> (b) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment."[140]

[136] See s 9.
[137] See s 9(2) read with GN 713 in *GG* 28893 (1 June 2006).
[138] See s 9(3) read with GN 713 in *GG* 28893 (1 June 2006).
[139] See s 9(4) read with GN 713 in *GG* 28893 (1 June 2006).

Furthermore, where a court is considering a credit agreement and it is alleged that the consumer is over-indebted, the court may either refer the matter to a debt counsellor for evaluation and recommendation or declare that the consumer is over-indebted.[141]

Where the court refers the matter to a debt counsellor and same concludes that the consumer is over-indebted the debt counsellor may issue a proposal to the magistrates' court that either one or more of the consumer's credit agreements be declared to constitute reckless credit or that one or more of the consumer's obligations be re-arranged.[142]

Where the court declares that the consumer is over-indebted the court may make an order declaring any credit agreement to be reckless or an order re-arranging any of the consumer's obligations or make an order for both.[143]

A credit agreement is considered to be reckless if –

> " at the time that the agreement was made, or at the time when the amount approved in terms of the agreement is increased, other than an increase in terms of section 119(4)-
>
> (a) the credit provider failed to conduct an assessment as required by section 81(2), irrespective of what the outcome of such an assessment might have concluded at the time; or
>
> (b) the credit provider, having conducted an assessment as required by section 81(2), entered into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that-
>
> (i) the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed credit agreement; or
>
> (ii) entering into that credit agreement would make the consumer over-indebted."[144]

Where a credit provider failed to conduct an assessment as required by section 81 or where the credit provider conducted an assessment in terms of section 81 and concluded a credit

[140] See s 79.
[141] See s 85.
[142] See s 86(7)(c).
[143] See s 85(b) read with s 87(1)(b).
[144] See s 80(1).

agreement with the consumer despite the fact that such assessment indicated that the consumer did not understand the risks, costs or obligations involved, the court may either set aside all or a part of the consumer's obligations under that credit agreement or suspend the force and effect of that credit agreement.[145]

In the instance where a credit provider conducted an assessment as required by section 81 and concluded the credit agreement despite the fact that such assessment indicated that the conclusion of the credit agreement would render the consumer over- indebted, the court must consider whether the consumer is over- indebted and if so, the court may either order that the credit agreement be set aside or be suspended.[146]

In light of these provisions it is evident that the NCA is preventative and rehabilitative in nature[147] and that non-compliance with the provisions thereof may have serious consequences for the credit provider.

3.2 *Purpose and interpretation of the National Credit Act*

Section 2 of the NCA provides that the provisions thereof "must be interpreted in a manner that gives effect to the purposes set out in section 3" and that "any person, court or tribunal interpreting or applying [the] Act may consider appropriate foreign and international law".

Thus in order to properly interpret any provision of the NCA it is essential that the purposes set out in section 3 are borne in mind. Something which is to be considered is that whilst the NCA purports to, *inter alia,* "[address] and [correct] imbalances in negotiating power between consumers and credit providers by- … (iii) providing consumers with protection from deception, and from unfair or fraudulent conduct by credit providers and credit bureaux…"[148] many provisions of the NCA do not apply to certain consumers.[149] This aspect will however be discussed in more detail in the paragraphs which follow and which will shed light on the

[145] See s 83(2).
[146] See s 83(3).
[147] Otto (n 3) 272.
[148] See s 3.
[149] See s 4 and s 6.

validity and enforceability of the variable interest rate clauses as set out in scenario one and two.[150]

Like many other pieces of legislation in force in South Africa the NCA, it would seem, is primarily focused on the protection of consumers. This is evident from the introduction of the concepts of over-indebtedness and reckless credit as discussed above.[151] Over and above such protection the NCA also affords a consumer protection in terms of section 103(5) which is a codification and extension of the common law *ultra duplum* rule. Section 103(5) provides that:

> "[d]espite any provision of the common law or a credit agreement to the contrary, the amounts contemplated in section 101(1)(b) to (g) that accrue during the time that a consumer is in default under the credit agreement may not, in aggregate, exceed the unpaid balance of the principal debt under that credit agreement as at the time that the default occurs."

The effect of this section is that the aggregate of all charges permitted in terms of section 101(1) which accrues whilst a consumer is in default under a credit agreement may never exceed the unpaid balance of the principal debt at the time during which the consumer is in default.[152]

That being said our courts have considered the interpretation of the NCA in light of the interests of both the consumer and the credit provider. In the case of *Standard Bank of South Africa Ltd v Hales*[153] Gorven J considered the purposes and interpretation of the NCA and stated that:

> "Ms Olsen also submitted that, since the preamble to section 3 refers to the protection of consumers, I should find that the sole, or at least the chief, purpose of the Act is to provide protection for consumers. Since section 3 lists a number of purposes, it cannot be that the protection of consumers is the sole purpose. Neither can it be said that this is the chief purpose. No prioritisation is provided. A number of the listed means by which the purposes are to be achieved include the protection of consumers but not all do so. Others include a balancing of

[150] See par 1.2 above.
[151] See par 3.1 above.
[152] See *National Credit Regulator v Nedbank Limited* 2009 6 SA 295 (GNP) and *Nedbank Limited v National Credit Regulator* 2011 3 SA 581 (SCA) for a discussion on the effects of section 103(5).
[153] 2009 3 SA 315 (D & C).

rights and responsibility of consumers and credit providers as well as enforcement of debt. Whilst consumer protection is a clear object, it is one factor, albeit a very important one, in the purposes of the Act."[154]

Likewise in *Firstrand Bank Ltd t/a First National Bank v Seyffert*[155] Willis J, when dealing with the interpretation of section 86(10) of the NCA, highlighted the following:

"I share the general frustration of my judicial colleagues around the country at the lack of clarity that features at least in the parts of the NCA with which one is concerned in cases of the kind now before me. A court is forced to go round and round in loops from subsection to subsection, much like a dog chasing its tail. Indeed, the language used in the Act from time to time suggests that foreign draftspersons rather than South African lawyers had a strong hand in preparing the text. Nevertheless, it is clear from reading s 3 of the NCA, which sets out the purposes of the Act, that it pursues varied objectives which must be held in balance. Certainly, the NCA is designed to protect consumers but it was not intended to make of South Africa a 'debtors' paradise'. Indeed a 'debtors' paradise' will not last for long. Very soon, credit would not be available to ordinary people. Sight must not be lost of the fact that among the purposes of the Act is the 'development of a credit market that is accessible to all South Africans'. It should be remembered that access to responsibly granted credit, on fair and reasonable terms, is an important means of social upliftment for ordinary citizens. It also needs to be borne in mind that responsibly granted credit has a 'multiplier effect' in an economy. For example, money lent to build a house is used not only to pay the wages of the builders but also to buy materials (and, in so doing, pays the wages of those who produced the materials). These payments by the borrower who is building a house find their way back into the banking system as deposits and are lent out again. Thus the system multiplies, depending on the reserve ratios that the banks, either voluntarily or by regulation, maintain. In other words, money-lending not only creates wealth but jobs as well. It is inconceivable that it could have been the intention of the legislature to facilitate the wholesale evasion of debt under the banner of 'consumer protection'. Moreover, s 86(5)(b) requires that, when it comes to debt review, consumers and credit providers are to act in good faith towards one another."[156]

[154] 322 A – D.
[155] 2010 6 SA 429 (GSJ).
[156] 434 B – H.

The approach adopted by the courts above was further confirmed by the supreme court of appeal in the case of *Rossouw v Firstrand Bank Ltd t/a FNB Homeloans*[157] where it was stated that:

> "It needs to be considered that whilst the main object of the Act is to protect consumers, the interests of creditors must also be safeguarded and should not be overlooked. This is evidenced by s 3(d) which provides that equity in the credit market and industry – which the Act significantly acknowledges must be competitive, efficient and sustainable – entails, inter alia, balancing the respective rights and responsibilities of credit providers and consumers."

Therefore it would be incorrect to state that the NCA provides protection only for consumers and that as such it should be interpreted at all times in the favour of consumers. Yes, this is a very important objective of the NCA but certainly not the only objective. After all, credit providers whose livelihood it is to advance money also require protection from consumers who despite not being in a good financial position apply for credit which they ultimately cannot repay and thus leaving the credit provider out of pocket.

3.3 *Scope of application of the National Credit Act*

As is the case with most consumer protection legislation, the NCA does not find application in all instances. In fact the NCA goes a long way in specifically excluding its application to certain classes of consumers. This is especially so where the consumer is a juristic person.

When determining whether the NCA is applicable to a certain set of facts one would, as a general point of departure, look to section 4 which deals specifically with the application of the NCA. In this regard section 4 provides that "Subject to sections 5 and 6, this Act applies to every credit agreement between parties dealing at arms length and made within, or having an effect within the Republic."

Specific instances where the provisions of the NCA will not apply are also set out in section 4. These are instances where:

[157] 2010 6 SA 439 (SCA). Also see *Desert Star Trading 145 (Pty) Ltd v No 11 Flamboyant Edleen CC* 2011 2 SA 266 (SCA).

(i) In terms of the credit agreement, the consumer is a juristic person whose asset value or annual turnover is at the time the agreement is concluded equal to or more than the threshold value determined by the minister[158] or where the consumer is the state or an organ of state;

(ii) The credit agreement amounts to a large agreement[159] and the consumer is a juristic person;

(iii) The credit provider to a credit agreement is the Reserve Bank of South Africa; or

(iv) The credit provider to a credit agreement is located outside of the Republic of South Africa and where the consumer has applied for exemption from the minister in this regard.

The provisions of section 4(1)(a) and 4(1)(b) of the NCA came under scrutiny in the case of *Firstrand Bank Ltd v Carl Beck Estates (Pty) Ltd*[160]. In this matter the applicant applied for summary judgment against the first and second respondents claiming payment in the amount of approximately R4 000 000 which was lent to the first respondent. The applicant held a mortgage bond over the first respondent's property by virtue of the money lent and advanced to the first respondent. The respondents opposed the application for summary judgment by claiming, *inter alia*, that the applicant failed to comply with the provisions of section 129 of the NCA which deals with the procedure to be followed before a debt may be enforced. Satchwell J considered the scope of application of the NCA in light of section 4(1)(a) and 4(1)(b) and held that:

> "In short, whatever the asset value or annual turnover of the first respondent, the provisions of the NCA do not apply to the credit agreement entered into between the parties. As a juristic person, the first respondent has entered into a large credit agreement. One of the exemptions must apply to the first respondent – either the value or turnover exceeds the threshold and subsection (a) exempts the application of the NCA to the agreement or the value or turnover is below the threshold and subsection (b) exempts the application of the Act."[161]

[158] The threshold determined by the minister is currently R1 000 000. When calculating this amount the combined asset value or annual turnover of all related juristic persons must be taken into account.
[159] See par 3.1 above.
[160] 2009 3 SA 384 (T).
[161] 389 D – E.

These provisions of section 4 were further considered in the case of *Standard Bank of South Africa Ltd v Hunkydory Investments 194 (Pty) Ltd (No 2)*[162]. The facts of this case were similar to those in *Firstrand Bank Ltd v Carl Beck Estates (Pty) Ltd*[163] in that the applicant applied for summary judgment against the respondents claiming certain amounts based on four mortgage bonds in favour of the applicant. Due to the nature of the credit agreements concluded between the applicant and the first respondent (i.e. the credit agreements were mortgage agreements and as such considered large credit agreements for purposes of the NCA) such credit agreements did not fall within the ambit of the NCA and thus the applicant was not obliged to comply with the provisions of section 129 before instituting legal proceedings against the respondents. In light of this the respondents alleged that the provisions of section 4 which sought to exclude the application of the NCA where the consumer is a juristic person were unconstitutional and that juristic persons should be afforded the same protection as that afforded to natural persons. In this regard O Rogers AJ dismissed the respondents' contention that section 4 was unconstitutional and referred to the case of *Standard Bank of South Africa Ltd v Hunkydory Investments 194 (Pty) Ltd (No1)*[164] where Steyn AJ considered the argument of unconstitutionality and found as follows:

> "There may be instances of discrimination which do not amount to unfair discrimination. In the final analysis it has been held that it is the impact of discrimination on a complainant that is the determining factor regarding the unfairness of the discrimination. To establish unfairness in this context various factors must be considered, including the position of the complainants in society and whether they have suffered in the past from patterns of disadvantage; the nature of the provision and the purpose sought to be achieved by it. If the purpose is aimed at achieving a worthy societal goal, this purpose may have a significant bearing on the question whether complainants have in fact suffered the impairment in question. There can be no doubt that there is a rational connection between the differentiation created by the relevant provisions of s 4 of the National Credit Act and the legitimate governmental purpose behind its enactment. I have not been persuaded, on a balance of probabilities, by the defendants, who bear the onus in this regard, that any differentiation or discrimination, even if it exists, is unfair. I have not been persuaded that the first defendant's exclusion from the protection of the relevant sections of the Act has any negative effect on it."[165]

[162] 2010 1 SA 634 (WCC).
[163] See n 160 above.
[164] 2010 1 SA 627 (C).
[165] 632 G – 633 A. Also see Kok "Not so hunky- dory: failing to distinguish between differentiation and discrimination Standard Bank of South Africa Limited v Hunkydory Investments 194 (Pty) Ltd (No 1) 2010 1 SA 627 (C)" 2011 *THRHR* 340 for a critical evaluation of the decision in this matter.

Although one might tend to agree that the provisions of section 4 of the NCA are not unconstitutional it may nevertheless be argued that such provisions are grossly out of step with the realities of a modern South Africa. It is to be thought that the reason for the legislature excluding juristic persons from the ambit of the NCA in terms of section 4(1)(a) is due to the fact that such juristic persons are converse with the implications and ultimate consequences of the transactions which they conclude and if not that they nevertheless have the resources available to advise them in this regard but is this really the case? In modern day South Africa the reality is that it is very seldom that one would come across a juristic person with an asset value or annual turnover less that R1 000 000. Otto makes the following remarks regarding this state of affairs:

> "Dit bly een van die talle eienaardighede van hierdie wet dat natuurlike persone, ongeag hulle vermoëns, beskerm word, maar dat relatief klein regspersone nie beskerming geniet nie. Immers, 'n omset van R1 miljoen per jaar vir enige besigheid is nie besonders groot nie. En 'n beskeie besigheidjie se gebou alleen kan meer as 'n miljoen rand werd wees. So, 'n relatief klein vennootskap geniet minder beskerming kragtens die Wet as die superryk natuurlike persone in die gemeenskap."[166]

In addition to this section 4 also requires that the parties to a credit agreement must be dealing at arms length. This would entail that the parties to a credit agreement are not:

(i) In the case of a juristic person, between such juristic person and a person who has a controlling interest in that juristic person;[167]

(ii) In the case of natural persons, where such persons are in a familial relationship where they are either co-dependent on each other or where one party is dependent on the other;[168] and

(iii) Generally independent of the each other and as such does not strive to obtain the utmost advantage out of the transaction.[169]

[166] Otto (n 19) 272.
[167] See s 4(2)(b)(i) – (ii) and Boraine and Renke "Some practical and comparative aspects of the cancellation of instalment agreements in terms of the National Credit Act 34 of 2005 (part 1)" 2007 *De Jure* 222 234.
[168] See s 4(2)(b)(iii).
[169] See s 4(2)(iv).

In addition to the limitations set out above, section 5 and 6 go one step further in limiting the application of the NCA. In this regard section 5 provides that certain sections of the NCA will not be applicable where the credit agreement amounts to an incidental credit agreement. An incidental credit agreement is defined in the NCA as:

> "... an agreement, irrespective of its form, in terms of which an account is tendered for goods or services that have been provided to the consumer, or goods or services that are to be provided to a consumer over a period of time and either or both of the following conditions apply:
>
> (a) a fee, charge or interest became payable when payment of an amount charged in terms of that account was not made on or before a determined period or date; or
>
> (b) two prices were quoted for settlement of the account, the lower price being applicable if the account is paid on or before a determined date, and the higher price being applicable due to the account not having been paid by the date."[170]

Likewise, and more important for the discussion at hand, are the provisions of section 6 which provide that certain sections of the NCA will not apply in cases where the consumer to a credit agreement is a juristic person. Thus when section 4 and section 6 are read together it is apparent that either the NCA will in certain instances not be at all applicable to a credit agreement or at the very least certain provisions of the NCA will not be applicable.

A juristic person for purposes of the NCA "includes a partnership, association or other body of persons, corporate or unincorporated, or a trust if- (a) there are three or more individual trustees; or (b) the trustee is itself a juristic person, but does not include a stokvel."[171]

Section 6 stipulates that the provisions of the NCA dealing with credit marketing practices, over-indebtedness, reckless credit, negative option marketing agreements, the requirement that variable interest rates must be linked to a reference rate and provisions relating to the consumer's liability, interest charges and fees will not apply to a credit agreement where the consumer is a juristic person. These exclusions have a huge impact on credit agreements where the consumer is a juristic person as it effectively means that a juristic person cannot have its debt rescheduled (as a natural person can), cannot rely on the fact that credit was extended recklessly by a credit provider and most importantly cannot rely on the maximum interest rates which a credit provider may charge. It thus means that the interest rates payable

[170] See s 1 and JM Otto and R-L Otto (n 21) 21 – 24 for a discussion on incidental credit agreements.
[171] See s 1.

by a juristic person, as consumer, to a credit provider will be purely based on their agreement in this regard and the common-law principles relating to usury. The further effects of this is that when a juristic person concludes a credit agreement with a credit provider, the credit provider may vary the interest rates payable by the juristic person without complying with the provisions of section 103 (4).

In light of the aforesaid it is most certainly a reality that certain juristic persons will not be afforded the full protection of the NCA or at all as discussed above.

3.4 *Interest rates in terms of the National Credit Act*

The NCA sets out various costs which a credit provider may levy against a consumer by virtue of the credit provider extending credit to the consumer. Such costs of credit, as it is referred to in the NCA, can be found in section 101(1) which provides the following:

> "1) A credit agreement must not require payment by the consumer of any money or other consideration, except-
>
> a) the principal debt, being the amount deferred in terms of the agreement, plus the value of any item contemplated in section 102;
>
> b) an initiation fee, which-
>
> i) may not exceed the prescribed amount relative to the principal debt; and
>
> ii) must not be applied unless the application results in the establishment of a credit agreement with that consumer;
>
> c) a service fee, which-
>
> i) in the case of a credit facility, may be payable monthly, annually, on a per transaction basis or on a combination of periodic and transaction basis; or
>
> ii) in any other case, may be payable monthly or annually; and
>
> iii) must not exceed the prescribed amount relative to the principal debt;
>
> d) interest, which-
>
> i) must be expressed in percentage terms as an annual rate calculated in the prescribed manner; and
>
> ii) must not exceed the applicable maximum prescribed rate determined in terms of section 105;
>
> e) cost of any credit insurance provided in accordance with section 106;
>
> f) default administration charges, which-

i) may not exceed the prescribed maximum for the category of credit agreement concerned; and

ii) may be imposed only if the consumer has defaulted on a payment obligation under the credit agreement, and only to the extent permitted by Part C of Chapter 6; and

g) collection costs, which may not exceed the prescribed maximum for the category of credit agreement concerned and may be imposed only to the extent permitted by Part C of Chapter 6.

2) A credit provider who is a party to a credit agreement with a consumer and enters into a new credit agreement with the same consumer that replaces the earlier agreement in whole or in part may charge that consumer an initiation fee contemplated in subsection (1)(b) in respect of that second credit agreement, only to the extent permitted by regulation, having regard to the nature of the transaction and the character of the relationship between the credit provider and consumer.

3) If a credit facility is attached to a financial services account, or is maintained in association with such an account, any service charge in terms of that account-

a) if that charge would not have been levied if there were no credit facility attached to the account, is subject to the prescribed maximum contemplated in subsection (1)(c); and

b) otherwise, is exempt from the prescribed maximum contemplated in subsection (1)(c)."

From the above it is apparent that the NCA allows a provider of credit to impose various charges on a consumer when extending credit. No other charges may however be levied. One of the charges, and probably the most important, which a credit provider may levy is interest. However unlike the other charges listed in section 101(1) the term interest is not defined in the NCA nor can a definition thereof be found in the regulations to the NCA. The term interest is defined in the Oxford English Dictionary as "… money paid regularly at a particular rate for the use of money lent, or for delaying the repayment of a debt…"

Like the Usury Act[172] the NCA provides for maximum interest rates which a credit provider may charge. In this regard section 101(1)(d) provides as follows:

[172] See n 11 above.

"(1) A credit agreement must not require payment by the consumer of any money or other consideration, except-

(d) interest, which-

(i) must be expressed in percentage terms as an annual rate calculated in the prescribed manner; and

(ii) must not exceed the applicable maximum prescribed rate determined in terms of section 105"

Section 105 of the NCA provides, *inter alia*, that the minister may prescribe the method for calculating the maximum rate of interest. In this regard the regulations to the NCA provide the maximum prescribed interest rates which a credit provider may levy against a consumer. To this end table A of regulation 42 provides as follows;

Sub-sector	**Maximum Prescribed Interest Rate**
Mortgage agreements	[(RR x 2 .2) + 5%] per year
Credit facilities	[(RR x 2.2) + 10%] per year
Unsecured credit transactions	[(RR x 2.2) + 20%] per year
Developmental credit agreements: • for the development of a small business • for low income housing (unsecured)	 [(RR x 2.2) + 20%] per year [(RR x 2.2) + 20%] per year
Short term credit transactions	5% per month
Other credit agreements	[(RR x 2.2) + 10%] per year
Incidental credit agreements	2% per month

In terms of the table above, the maximum interest rates are calculated by using as a basis the ruling South African Reserve Bank Repurchase Rate (RR). This basis is then multiplied by a factor of 2.2. The resultant of this is then added to a maximum percentage as prescribed by the minister. As pointed out by Otto[173] the minister provides maximum interest rates which are payable in respect of transactions which are not defined in the NCA namely an unsecured credit transaction and a short term credit transaction. These forms of transactions are however defined in the regulations to the NCA.[174]

[173] JM Otto and R-L Otto (n 21) 102.
[174] See regs 39(2) and 39(3) respectively.

CHAPTER 4

THE VALIDITY OF VARIABLE INTEREST RATE CLAUSES

4.1 *Introduction*

This dissertation, whilst concerned with the concept of interest, its origins, its development and regulation by legislation is primarily concerned with the validity of variable interest rate clauses. This is so because as indicated previously most credit agreements in a modern South Africa will contain a variable interest rate clause allowing the credit provider to increase or decrease the interest rate applicable to the credit agreement during the duration of their relationship. Whether a clause purporting to do so is valid will ultimately depend on whether the credit agreement falls within the ambit of the NCA or whether recourse must be had to the common law.

4.2 *Variable interest rate clauses in terms of the National Credit Act*

Unlike section 2B of the Usury Act[175] the NCA specifically regulates the way in which a credit agreement may provide for a variable interest rate. As such where a credit provider wishes to increase or decrease the interest rate applicable to a credit agreement during the term of the credit agreement the credit provider is obliged to comply with the provisions of section 103(4). Naturally, if the NCA does not apply to a credit agreement or where it specifically excludes the application of section 103(4) the common-law principles regarding variable interest rate clauses will be applicable.[176]

Section 103(4) of the NCA provides as follows:

> "A credit agreement may provide for the interest rate to vary during the term of the agreement only if the variation is by fixed relationship to a reference rate stipulated in the agreement, which reference rate must be the same as that used by that credit provider in respect of any similar credit agreements currently being issued by it."

[175] See n 11 above.
[176] See par 4.3 below.

As such it is evident that where the provisions of the NCA are applicable to a certain credit agreement the clause within such credit agreement which purports to empower the credit provider to vary the interest rate applicable must comply with the provisions of section 103(4) in that the variation of the interest rate must be by fixed relationship to a reference rate. Otto suggests that a suitable clause which would comply with section 103(4) would be one which bears reference to changes in a bank's prime lending rate, changes in the prescribed rates in terms of the NCA or changes in the Reserve Bank's repurchase rate. [177]

Further to this section 103(4) also prescribes another requirement in order for a variable interest rate clause to be valid. This is namely that the "reference rate *must* be the same as that used by that credit provider in respect of any similar credit agreements currently being "issued" by it".[178] This additional requirement is prescriptive and as such a credit provider would have no choice but to ensure that the same reference rate is used for all customers in determining an increase or decrease in the interest rate of a particular class of credit agreement. This I think would serve to prevent a credit provider from using different reference rates in respect of different customers and thereby ensuring that customers are generally treated equally. After all one of the purposes of the NCA is to "[promote] the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions."[179]

Where a variable interest rate clause does not comply with the provisions of section 103(4) such clause is unlawful and void from the date that such clause purported agreement to take effect.[180]

In this regard, where a clause contained in a credit agreement is unlawful the court must in terms of section 90(4):

> "(a) sever that unlawful provision from the agreement, or alter it to the extent required to render it lawful, if it is reasonable to do so having regard to the agreement as a whole; or

[177] JM Otto and R-L Otto (n 21) 97.
[178] italics added.
[179] See s 3(a).
[180] See s 90(2)(o) and 90(3).

(b) declare the entire agreement unlawful as from the date that the agreement, or amended agreement, took effect,

and make any further order that is just and reasonable in the circumstances to give effect to the principles of section 89(5) with respect to that unlawful provision, or entire agreement, as the case may be."

Thus it is evident that a contravention of the provisions of clause 103(4) may have far reaching consequences for the credit provider and therefore credit providers should go a long way in ensuring that their variable interest rate clauses are in line with section 103(4).

4.3 *Variable interest rate clauses in terms of the common law*

It is trite that South Africa's legal system is a mixed system of law which includes Roman law, Roman-Dutch law, English law, Indigenous law and legislation. This, of course, includes the common law and which offers great assistance where South African legislation is left wanting. As in many other instances resort to the common law is necessary when dealing with the issue of discretionary interest rate clauses. This is so because as indicated the NCA will not always find application and in certain circumstances the NCA will only have limited application. As such I will deal with the requirement that performance in terms of an agreement must be determined or determinable as well as the common-law position regarding discretionary interest rate clauses and which will entail an in-depth exploration of South African case law in this regard.

4.3.1 Performance must be determinable

One of the requirements for a valid and enforceable agreement is that the obligations imposed on each of the parties must be determined or at least determinable. An agreement will be void for vagueness where an essential or material aspect has not been agreed upon between the parties. Thus in order to determine whether the parties have reached agreement on a specific aspect the express terms and tacit terms of the agreement must be considered together with the *naturalia* of the agreement, relevant trade usages and the general principles of contract. [181]

[181] Van der Merwe, Van Huyssteen, Reinecke and Lubbe *Contract General Principles* (2012) 194.

Therefore in order to prevent an agreement from being void for vagueness the parties to such agreement need to ensure that there is certainty regarding the legal consequences of the agreement. Thus the agreement between the parties needs to define the relationship between them in such a way that the obligations are capable of being enforced by the courts. In certain instances the parties to an agreement go a long way to expressly and exhaustively set out each of their obligations and the consequences of the agreement. That being said it may however happen that in certain instances the consequences of an agreement are not specifically set out at the conclusion of the agreement but that same are left for determination at a later stage by the parties using a defined or determinable mechanism. The parties may for instance in such cases agree that an external standard be used to determine the consequences of the agreement or that a specified formula be used or that the consequences of the agreement be left to be decided by a third party.[182] These methods for determining the consequences of an agreement are usually utilised where, for business reasons, it is not practical or desirable for the parties to fully set out the consequences of the agreement at the conclusion thereof. This will not render the agreement void for vagueness provided that the obligations or consequences of the agreement are objectively ascertainable.[183] According to Van der Merwe *et al*[184] "objectively ascertainable" means that "the arrangement adopted [by the parties] must be capable of providing certainty by itself, without the need for further agreement between the parties or the exercise of an unfettered discretion by one of them". Therefore where parties have made provision for certain performances to change during the course of the agreement same are valid in so far as they provide an objectively workable method for determining the performance.

A case much in point is that of *De Beer v Keyser*.[185] In this matter the court had to determine whether there was certainty as to the consequences of a franchise agreement where the franchise agreement provided that the franchisor would provide the franchisees with "die tegniese hulp en administratiewe bystand verleen soos gereël met die vergunde."[186] This the franchisees alleged rendered the franchise agreement void for vagueness as it provided the franchisor with an unfettered discretion to unilaterally determine the nature and extent of its obligations,. The court considered this and held the following:

[182] Van der Merwe, Van Huyssteen , Reinecke and Lubbe (n 181) 197 – 198.
[183] Van der Merwe, Van Huyssteen , Reinecke and Lubbe (n 181) 192 – 193.
[184] (n 181) 198.
[185] 2002 1 All SA 368 (A).
[186] See p 372.

"It has been held in a number of cases that an agreement that confers an unfettered discretion upon a party to determine the nature or extent of his own obligations is void for vagueness. More recently, the soundness of that rule has been questioned (*Benlou Properties* (*Pty*) *Ltd v Vector Graphics* (*Pty*) *Ltd* 1993 (1) SA 179 (A) at 185A–186J) but it is not necessary in the present case to consider whether its soundness is indeed open to question. The construction that was relied upon by the respondents is not the only construction of which the clause is capable nor, in my view, is it the correct one, bearing in mind that in case of doubt as to the meaning of a clause in an agreement it is well established that a construction will be chosen that leads to validity rather than invalidity. In my view the words "soos gereël met die vergunde" do not qualify the nature or extent of the appellant's obligations: their true function is to cater for the changing circumstances in which those obligations will have to be fulfilled over the ensuing years and for the fact that what might be required by a particular franchisee may not coincide with what is required by another. Read as a whole, and subject to a tacit term as to reasonableness, the clause requires the appellant to furnish all technical assistance and administrative support that is reasonably necessary to place the franchisee in a position properly to establish and thereafter conduct his business, but only if the franchisee has made arrangements with the franchisor to provide it. That construction is quite capable of being enforced with the assistance of extrinsic evidence to determine what assistance and support is reasonably required for the establishment and conduct of a business of that nature. In my view the clause is not void for vagueness. It is significant, too, that the respondents have been able to establish and conduct their respective businesses without any apparent difficulty as to the meaning of the clause."[187]

Difficulties arise where a clause in an agreement allows one of the parties to determine or vary the performance due either by it or by the other party. Most variable interest rate clauses are worded in such a way so as to vest the credit provider with the power or discretion to vary the interest rate applicable to the agreement. In this regard it may be alleged that such contractual power or discretion renders the credit agreement void for vagueness as the parties, whilst agreeing that the interest rate may vary, have not agreed at the conclusion of the credit agreement on the formula or criteria for a variation of such interest rate.

[187] See p 375.

As a general point of departure our courts consider that an agreement which is made to depend solely upon the will of one of the parties what he should perform is not enforceable.[188] Van der Merwe *et al* suggest that this rule originates from D 18.1.35.1 wherein it was stated that a transaction is not binding "when the seller says to the intending purchaser: 'you shall have the thing for what you please', 'for what you think fair', 'for what you think it is worth'."[189] In this regard the underlying objective of such a rule would seem to be the prevention of an abuse of power of the party to whom the contractual power or discretion is afforded. Of course such a party has a vested interest in the agreement and thus may make unassailable decisions which may be to the detriment of the other party. For instance Otto[190] expresses that "[d]it staan vas dat sekere afsprake nie gedoog word nie, soos byvoorbeeld bedinge wat aan 'n kontraksparty absolute vryheid verleen om na willekeur of te presteer of nie te presteer nie." Furthermore where a party is allowed to determine what performance is due by the other party the latter party may be subjected to an excessive performance which he or she or it may not want or be able to perform. This is the very aspect which gives rise to problems when dealing with variable interest rate clauses.

That being said it should be remembered that certain credit agreements like a mortgage agreement may extend over many years and so in order for the parties to make provision for future developments, discretionary variable interest rate clauses are of the utmost importance. Such variable interest rate clauses are most certainly the norm. In this regard Otto expresses that "[b]y langtermynkontrakte sou dit selfs ongewoon wees om iets anders as 'n wisselende koers aan te tref…"[191]

Thus, as will be seen in the paragraphs that follow, the requirement of public policy which is based on the principle of good faith is the appropriate mechanism against which the validity of such clauses can be measured. Furthermore in light of the decision in *NBS Boland Bank v One Berg River Drive CC; Deeb v ABSA Bank Ltd; Friedman v Standard Bank of South Africa Ltd*[192] which will be discussed in more detail hereunder the prohibition on contractual powers or discretions will only be employed where the power or discretion granted to a contractant is unlimited by objective considerations. Therefore clauses which limit the

[188] See *Shell SA (Pty) Ltd v Corbitt* 1986 4 SA 523 (C) 525 I – J.
[189] Van der Merwe, Van Huyssteen , Reinecke and Lubbe (n 181) 202.
[190] Otto "Kontraktuele bedinge wat eensydige rentekoersvasstellings deur banke magtig" 1998 *TSAR* 603 604.
[191] Otto (n 190) 610.
[192] 1999 4 SA 928 (SCA).

exercising of a discretionary power by objective considerations will be acceptable.[193] Whilst the case *NBS Boland Bank v One Berg River Drive CC; Deeb v ABSA Bank Ltd; Friedman v Standard Bank of South Africa Ltd*[194] dealt specifically with discretionary interest rate clauses it would seem that the principle enunciated by Van Heerden DCJ can be applied in the case of all other types of discretionary clauses.[195]

4.3.2 Case law

Prior to the supreme court of appeal making a final determination with regards to discretionary interest rate clauses, various conflicting decisions from different divisions of the high court of South Africa were made and which led to confusion regarding the position which credit providers and consumers found themselves in *vis- n- vis* variable interest rate clauses. In the following paragraphs I shall explore each case and the decisions made by the respective high courts. I shall then turn to the decision of the supreme court of appeal and shall consider the commentary made by academic writers. In addition to this I shall refer to the concept of usury to see if herein lies a solution to the problems which credit providers and consumers find themselves in when dealing with the issue of discretionary interest rate clauses.

4.3.2.1 Early case law

In the case of *Nedbank Ltd v Capital Refrigerated Truck Bodies (Pty) Ltd*[196] the court had to consider whether a clause in an overdraft agreement permitting the credit provider to increase the rate of interest from time to time but subject to the maximum interest rate permitted under the Usury Act[197] was valid and enforceable. The clause in question was set out along the following lines:

> "Plaintiff would also be entitled to debit such account with interest on any debit balance from time to time at a rate fixed by plaintiff from time to time at its discretion, provided such rate

[193] Van der Merwe, Van Huyssteen , Reinecke and Lubbe (n 181) 206.
[194] See n 192 above.
[195] See *Engen Petroleum Ltd v Kommandonek (Pty) Ltd* 2001 2 SA 170 (W) where Blieden J applied the principle in respect of a contractual clause in a lease agreement which allowed the lessee to vary the rental payable to the lessor where its continued performance in terms of the lease agreement was no longer economic. Also see Cornelius "Discretionary clauses in contracts: the next episode in the ongoing saga" 2003 *TSAR* 388.
[196] 1988 4 SA 73 (N).
[197] See n 11 above.

would not be greater than the maximum permissible rate prescribed from time to time by the Usury Act 73 of 1968, such debit balance being comprised of capital debts, disbursements, charges and interest previously debited, which interest would be calculated on daily balance."[198]

After considering various case law and academic writings, Milne JP made the following ruling:

"The principle appears to me to be correct - *a fortiori*, where, as here, the promisee does not have an unlimited option. The maximum of the rate of interest is fixed by the law and, in any event, the discretion may have to be exercised reasonably in the sense that it must take into account the rate customarily levied by the bank at that particular time in respect of that class of customer…. In my view there is no reason why such provision should not be enforceable."[199]

In my opinion it would seem that the learned judge found the clause to be valid and enforceable because firstly it did not confer an unfettered discretion on the credit provider (and thus was not contrary to the law of contract) and secondly because certain limitations were already in place (for example the maximum interest rate in terms of the Usury Act[200]). Furthermore the learned judge held that the discretion would have to be exercised in a reasonable manner and which would include taking cognisance of the rate usually levied to the class of customer such as the defendant.

Similarly the court in *Boland Bank Bpk v Steele*[201] had to determine whether a credit provider to a mortgage agreement could amend the rate of interest and the conditions of repayment. Counsel for the consumer alleged that the provision allowing the amendment was invalid because it created uncertainty as to what was to be performed. Van Dijkhorst J was however of the opinion that such a provision did not confer an unlimited discretion on the credit provider and that same would have to be exercised reasonably. To this end, the court held that:

"Wat redelik is sal noodwendigerwys bepaal word met inagname van die koerse en gebruike wat in die ope mark van toepassing is op dié soort verbande in dié soort omstandighede. So uitgelê is daar 'n vasstaande norm waaraan die handelinge van die eiser getoets kan word en is

[198] 73 G – I.
[199] 75 B – D.
[200] See n 11 above.
[201] 1994 1 SA 259 (T).

> daar nie die mate van onsekerheid wat tot ongeldigheid aanleiding kan gee nie. Ek bevind gevolglik dat klousule 17 van aanhangsel TKS2 nie vaag en onbepaalbaar en gevolglik onafdwingbaar is nie."[202]

It would seem that the common thread in the above mentioned matters was that the credit provider does not have an unfettered discretion when increasing the interest rate and that same had to be done in a reasonable manner and with reference to the prevailing circumstances regarding agreements of the same or similar nature and class. Thus the credit provider's discretion is to a large extent limited and it cannot be said that such a clause entitles the credit provider to choose what prestation will be in future.[203]

4.3.2.2 The decisions of the Witwatersrand Local Division

Subsequent to the aforesaid cases and in stark contrast thereto, three decisions of the former Witwatersrand Local Division of the high court (hereinafter referred to as "the WLD") were made.

The first of these cases was *NBS Boland Bank Ltd v Badenhorst- Schnetler Bedryfsdienste BK*.[204] In this case the court was called upon to consider the following discretionary interest rate clause as contained in a mortgage bond:

> "Notwithstanding anything to the contrary herein contained the bank may at any time and from time to time increase or decrease the rate of interest per annum on all amounts owing to or claimable by the bank in terms of this bond to the rate determined by the bank as payable for the class of bonds into which this bond falls, provided that the rate as increased or decreased does not exceed any limit imposed by any law in force at the time of such increase or decrease…"[205]

The court considered the aforesaid clause and found it to be invalid and stated the following:

> "In my judgment (apart from the exceptional case of the contractual provisions governing the contract of banker and customer relating to the charging of interest on an overdrawn current

[202] 276 G – I.
[203] Otto "Unilateral determination of interest rates by creditors: the supreme court of appeal (almost) settles the matter" 2000 *SALJ* 1 2.
[204] 1998 3 SA 729 (W).
[205] 732 F – H.

account in accordance with banking practice established by long usage) moneylending contracts, no less than contracts of lease and other contracts in general, must be established by means of provisions relating to the essentials of the contract which are certain in themselves, or which can be ascertained from an outside source not involving any further exercise of will on the part of any party to the contract. In a moneylending contract the rate of interest payable by the borrower from time to time is undoubtedly one of the essentials which must be rendered certain by the parties' agreement. If it is not, the contract would, on common-law principles, be void for vagueness. Their agreement may, of course, expressly or tacitly provide that the applicable interest rate is to be determined by law or by custom, or by reference to any objectively determinable market rate or other rate that is not dependent on the will of either party…There is no reason why the parties should not agree that the interest rate can be varied during the existence of the contract of loan and without the need for further agreement between them. Indeed, the Usury Act 73 of 1968 recognises that moneylending transactions often involve agreements for what is defined in s 1 of the Act as a 'variable finance charge rate'. However, there does not appear to be anything in the Act to suggest that agreement on a 'variable finance charge rate', as part of a moneylending transaction, implies that the parties are free to give to the moneylender the exclusive discretionary power to make unilateral decisions about the finance charge rate from time to time. Such a provision would tend to lead to oppressive practices which it could never have been the intention of the Legislature to sanction. On the contrary, it seems to me that the provisions made by the Legislature have been drawn in such a way as to harmonise with the general common-law rules of the law of contract. These lead to the conclusion that when the parties to a moneylending transaction wish to agree that the interest rate or finance charge rate is to be variable from time to time during the term of their contract, the contract will not be valid to the extent that it purports to empower one of the parties alone to vary the finance charge rate from time to time, arbitrarily or in his own discretion. To be valid and enforceable an agreement that the interest rate or finance charge rate is to be variable from time to time must define objectively ascertainable criteria according to which the time when, and the amount by which, the interest rate is to be varied can be ascertained without reference to the will of either the moneylender or the borrower." [206]

When considering the aforesaid it would appear that the learned judge did not take into account the variable interest rate clause as provided for in the mortgage bond. This is so because the relevant clause did in fact stipulate "objectively ascertainable criteria" namely that the interest rate may be increased or decreased "….to the rate determined by the bank as payable for the class of bonds into which this bond falls, provided that the rate as increased or

[206] 736 B – 737 A.

decreased does not exceed any limit imposed by any law…". Thus it is quite evident that the relevant clause placed two limitations on the credit provider when exercising its discretion, to wit, that the increase or decrease had to be consistent with that charged for the class of bonds into which the relevant bond fell and that such increase or decrease does not exceed any limit imposed by law. As such the clause did not confer upon the credit provider an absolute discretion when increasing or decreasing the interest rate. Furthermore in our law of contract and as explained previously[207] it is an accepted principle that in order for a contract (or the terms thereof) to be valid and enforceable, the obligations of the respective parties' need to be certain, failing which it will be considered invalid and unenforceable. That being said, and whilst our courts generally attempt to interpret contracts (or the terms thereof) so as to render it valid, a court will not find a contract enforceable which permits one of the contracting parties to determine, in its sole and unfettered discretion, whether to perform or not.[208]As stated above this is not the case here.

The aforesaid decision was followed in the unreported case of *Absa Bank Ltd (United Bank Division) v Henning*[209] and in *NBS Boland Bank Ltd v One Berg River Drive CC*[210]. In the latter case Southwood J was satisfied that the discretionary interest rate clause conferred an unfettered discretion on the credit provider to vary the interest rate and as such was invalid and unenforceable. To this end, Southwood J stated that:

> "It is a general principal of the law of contract that contractual obligations must be defined or ascertainable, not vague and uncertain - see *Westinghouse Brake & Equipment (Pty) Ltd v Bilger Engineering (Pty) Ltd* (*supra* at 574D--E). It is also a general principle of our law of contract that when it depends entirely on the will of a party to an alleged contract to determine the extent of prestation of either party the purported contract is void for vagueness - see *Murray & Roberts Construction Ltd v Finat Properties (Pty) Ltd (supra* at 514G--H). It has been held, however, that this rule applies only where it is left to the unfettered discretion of the other party - see *Benlou Properties (Pty) Ltd v Vector Graphics (Pty) Ltd (supra* at 186C--J)."[211]

[207] See par 4.3.1 above.
[208] Otto (n 190) 606.
[209] case no 32954/97 (W).
[210] 1998 3 SA 765 (W).
[211] 773 H – J.

With regards to this case it should be noted that the provision in question was identical to that in *Boland Bank Ltd v Badenhorst- Schnetler Bedryfsdienste BK*[212] and as such I am of the opinion, once again, that there were factors which the credit provider had to consider when increasing the interest rate and that as such it did not enjoy an unfettered discretion. In respect of the decision made by Southwood J it was argued by Mofokeng that there were three objective standards against which the exercise of the discretion in varying the interest rate could have been tested by the court and which may have led the court to a different conclusion.[213] These standards were firstly that a mortgagee should exercise its discretion *arbitrio boni viri* (this was ultimately found to be correct by the supreme court of appeal) secondly that a proven trade usage about the treatment of interest rates in mortgage bonds could have formed part of the contract and thirdly that the clause in question provided an objective standard in itself in that any variation could not exceed the limit imposed by law.[214]

As described by Otto in an article titled "Unilateral determination of interest rates by creditors: the supreme court of appeal (almost) settles the matter"[215] the consequences of the decisions of the WLD meant that credit providers would only be able to charge the consumer the interest rate initially agreed upon regardless of the changing circumstances within the economic and financial environment. This, from the consumer's perspective, is seemingly ideal but one has to bear in mind the converse of such decision which would entail that a credit provider would (due to the fact that it was not permitted at a later stage to increase the interest rate) from the outset impose high interest rates and which the consumer would have to pay for the duration of the agreement and regardless of the changing economic and financial environment and which may be to their detriment especially when interest rates are low.[216] To this end, Otto criticised the decisions of the WLD and sufficiently set the position as follows:

> "Daar is nie 'n manier dat alle banke op 'n langtermyn deurgaans met vaste koerse kan werk nie. Die mark gedoog nie so 'n situasie nie. Banke se geld val nie uit die lug nie. Hulle moet dit iewers in die hande kry en hulle moet daarvoor betaal. Banke neem meestal geld op korttermyn op, maar leen dit op langtermyn uit…. Vaste koerse deug nie in sulke omstandighede nie. Ekonomiese faktore, markkragte en monetêre beleid hier te lande en selfs in verre wêrelddele,

[212] See n 204 above.
[213] Mofokeng "At any rate... the discretion of banks to vary interest rates in mortgage bonds challenged" 1998 *Juta's Business Law* 55 56.
[214] Mofokeng (n 213) 56 – 57.
[215] Otto (n 203) 2.
[216] Otto (n 203) 3.

het 'n deurlopende invloed op rentekoerspatrone waaroor banke en ander gelduitleners nie altyd beheer het nie. Die koste van geld wissel voortdurend en daar is 'n groot mate van inter-afhanklikheid."[217]

4.3.2.3 Investec Bank (Pty) Ltd v GVN Properties CC[218]

In the case of *Investec Bank (Pty) Ltd v GVN Properties CC*[219] Wunsh J considered the early case law as well as the decisions of the WLD. He also took into account the cases of *Absa Bank Ltd v Deeb*[220] and *Standard Bank of South Africa Ltd v Friedman*[221], both of which went on appeal to the supreme court of appeal. Wunsh J was of the opinion that the three decisions in the WLD as discussed above[222] were incorrect and decided that in such case the plaintiff did not "have an unqualified right to capriciously or unreasonably increase the rate of interest."[223] In this case the loan agreement provided that the credit provider may amend the variable interest rate provided that where the Usury Act[224] applied the amended interest rate would not exceed the maximum rate in terms of such act and that where the Usury Act[225] did not apply the credit provider must take into consideration any changes to the cost to it in making the loan or any other market considerations. [226]

4.3.2.4 NBS Boland Bank Ltd v One Berg River Drive CC; Deeb v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd[227]

Due to the conflicting decisions of the high court, the supreme court of appeal was called upon to finally decide the issue with regards to the varying of interest rates by a credit provider.

In his judgment, Van Heerden DCJ discussed firstly the principles of the law of contract and held that "the views of our writers that a sale or lease containing a power to fix the price or

[217] Otto (n 190) 615 - 616.
[218] 1999 3 SA 490 (W).
[219] See n 218 above.
[220] 1999 2 SA 565 (N).
[221] 1999 2 SA 456 (C).
[222] See par 4.3.2.2 above.
[223] 499 G – H.
[224] See n 11 above.
[225] See n 11 above.
[226] 492 A – C.
[227] See n 192 above.

rental is invalid is not only illogical but also sadly out of step with modern legal systems."[228] Van Heerden DCJ went on to state that if this rule were to be applied it would only find application when dealing with an agreement of sale or lease and that in any event a clause dealing with the levying of interest was not an essential term of a loan agreement as a perfectly valid loan agreement could be concluded if same was silent on the issue of interest.[229] Taking these factors into consideration Van Heerden DCJ held that the discretionary interest rate clause is perfectly valid but that the exercise of same by a credit provider may be objectionable.[230] To this end, he stated that:

> "In sum I am of the view that, save, perhaps, where a party is given the power to fix his own prestation, or to fix a purchase price or rental, a stipulation conferring upon a contractual party the right to determine a prestation is unobjectionable. Second, as has been said above, there is an additional reason for holding that the clause under discussion is valid. Of course, in some cases providing for discretional determinations there may be no enforceable contract until the determination is made. But when made an unconditional contract comes into being. All this does not mean that an exercise of such a contractual discretion is necessarily unassailable. It may be voidable at the instance of the other party. It is, I think, a rule of our common law that unless a contractual discretionary power was clearly intended to be completely unfettered, an exercise of such a discretion must be made *arbitrio bono viri*."[231]

The learned judge went further on to say:

> "The discretionary powers vested in the mortgagees by the relevant deeds must therefore be subject to this inherent limitation. The attack made on behalf of the mortgagors concerned effectively assumes that there is no such limitation. It is an erroneous assumption. So far I have confined myself to our common law and comparable legal systems. An analogous conclusion may well be reached if one applies the modern concept of the role of public policy, *bona fides* and contractual equity to the question in issue (see, for example, *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 (4) SA 302 (SCA) at 318 - 31, *per* Olivier JA)."[232]

Accordingly, when dealing with a variable interest rate clause the inherent limitation is that same must be exercised in a reasonable manner by the credit provider. It is also interesting to

[228] 935 A – C.
[229] 935 D – F.
[230] 937 H – I.
[231] 936 I – 937 B.
[232] 937 E – G.

note that Van Heerden DCJ pointed out that the mortgagors did not attempt to dispute the increased interest rate but merely relied on the clause being invalid and unenforceable.[233] It is for this reason that I will discuss the defence of usury as this may have been an alternative defence which the mortgagers could have relied upon.[234]

4.4 *Academic commentary*

As reiterated by Lubbe[235] it is trite law that in a contract the obligations (or prestation) of each party should be determined or easily determinable, failing which the contract (or a specific term thereof) may be deemed invalid and unenforceable. This principle of our law is what the decisions in the cases discussed above have turned on. In this regard, however, Lubbe offers up many instances where a clause conferring on a party a discretion is valid and enforceable. Such clauses are for instance where a party to a contract has the discretion to determine whether the other party to a contract is in breach of such contract or the instance where a party can determine in its discretion whether a contractual condition has been fulfilled.[236] These clauses Lubbe states are valid and enforceable because:

> "Die diskresie in bogenoemde gevalle nie verband hou met die inhoud van die verbintenis nie. Dit gaan nie oor die vraag wat presteer moet word nie- dit is in al hierdie gevalle seker- maar oor periferale kwessies soos die werking en uitvoering van die verbintenis. 'n Diskresie van so 'n beperkte omvang bring nie die bepaaldheidsvereiste in die gedrang nie, veral ook nie omdat die diskresie meesal nie 'n volslae ongebonde besluit behels nie. Die willekeurige element word telkens ingeperk met verwysing na 'n objektiewe gebeurlikheid (soos die dood van die skuldenaar in die geval van 'n voile diskresie omtrent die tyd van prestasie), of behels andersins dat, soos hierbo aangetoon, die oordeel wat gevel word aan objektiewe criteria getoets kan word."[237]

Moreover our courts have on various occasions maintained that where it is tasked with deciding whether a clause is vague or not that it should, where possible, make a finding that prefers the validity and enforceability thereof.[238] In order to do so courts have often read

[233] 937 H – I.
[234] See par 2.3 above and 4.6 below.
[235] Lubbe "Kontraktuele diskresies, potestatiewe voorwaardes en die bepaalheidsvereiste" 1989 *TSAR* 159.
[236] Lubbe (n 235) 161.
[237] Lubbe (n 235) 162.
[238] Otto (n 190) 603.

implied contractual terms into agreements, applied trade usages known within the industry concerned and considered the standards of reasonableness.[239]

In the writings of Otto[240] and as relied upon by counsel in the case of *NBS Boland Bank Ltd v One Berg River Drive CC; Deeb v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd*[241] Otto discusses the English case of *Lombard Tricity Finance v Paton*[242] and wherein the English court of appeal had to determine whether a discretionary clause conferring upon a credit provider the right to unilaterally vary the interest rate was valid and enforceable. The court in this instance found that such a clause was valid and enforceable.[243]

With this in mind Otto critically evaluated the decisions of the WLD as well as the practical consequences thereof. To this end he made the following comment:

> "Die effek van die Witwatersrandse beslissings hierbo is dat banke deur kliënte wat nie tot wysigings wil toestem nie vir die volgende tien of twintig jaar verplig kan word om teen 'n vaste koers rente te hef op grond van hulle bestaande kontrakte, tensy daar 'n uitkomkans is waaraan ek nie nou kan dink nie. (Oproep van die verband in gepaste omstandighede mag 'n moontlikheid wees maar dit veronderstel gewoonlik kontrakbreuk). Sulke banke sal uiteraard ook onwillig wees om rente afwaarts aan te pas wanneer ekonomiese faktore dit andersins wel sou regverdig, soos wat natuurlik van tyd tot tyd gebeur. Hulle sal eenvoudig moet "opmaak" vir dié tye wanneer hulle economies gesproke veronderstel is om koerse te verhoog, maar vanweë die bepalings in ou kontrakte en in verbandaktes en die howe se seining daarvan, dit nie mag doen nie. Dit kan eweneens duisende kliënte benadeel wat vir 'n verlaging in koerse in aanmerking sou kon kom. Dit moet onthou word dat twee verskillende banke se verbandaktes in die drie Witwatersrandse beslissings ongeldig verklaar is. Daar is geen rede om selfs te vermoed dat die betrokke verbandaktes nie standaarddokumente is nie waarvan daar duisende soortgelykes geregistreer is wat nog vir baie jare die verhouding tussen die partye moet reël. Dit is 'n pynlik ongesonde situasie."[244]

In this regard Otto has also expressed his views as follows:

[239] Otto (n 190) 604.
[240] See n 190 above.
[241] See n 192 above.
[242] 1989 1 All ER 918 (CA).
[243] Otto (n 190) 607.
[244] Otto (n 190) 617.

> "Financial institutions worldwide make use of variable interest rates, particularly in long- term contracts. The simple laws of economics dictate that this should be done. It cannot be expected of moneylenders to use fixed rates in a fluctuating economic market influenced by local as well as international factors. Moreover, it is not necessarily in the interest of consumers to make use of non- variable rates that could be to their detriment during periods of declining rates."[245]

It is therefore obvious that variable interest rate clauses are essential in order to keep South Africa's economy stable and viable. Furthermore in order for South Africa's legal system to keep abreast of development in other countries our courts should recognise the validity of variable interest rate clauses in those instances where it is able to do so. Where the variation of an interest rate is left to the discretion of one of the parties to an agreement such discretion should be measured against objectively ascertainable criteria, if available, alternatively same should be exercised reasonably.

4.5 *Determination of reasonableness*

As pointed out by Otto the supreme court of appeal failed to provide instances in which factors which would render the credit provider's exercise of its/her/his discretion reasonable.[246] That being said, Otto is of the opinion that this does not pose a problem as our courts have on many occasions dealt with the concept of reasonableness and moreover clear guidelines exist with regards to interest rates.[247]

Otto sets out certain criteria which may be used by the courts to determine whether a credit provider has reasonably exercised its discretion when varying the interest rate applicable to a credit agreement. These criteria Otto derives from the principle that a court may reduce an interest rate which is found to be usurious to a rate which is deemed to be reasonable. Such criteria are:[248]

(i) As with many of the cases discussed above, the actual agreement between the credit provider and the consumer may set out criteria according to which the interest rate must be varied.

[245] Otto (n 203) 3.
[246] Otto (n 203) 5.
[247] Otto (n 203) 5.
[248] Otto (n 203) 6 – 7.

(ii) In the absence of any criteria in the agreement, the credit provider should take into account the rate of interest levied at that particular time in respect of the class of consumer.
(iii) The credit provider should consider changes in interest rates within the credit market.
(iv) The credit provider should consider changes in the economy in general.
(v) The credit provider should take into account the interest rates charged in respect of certain types of credit agreements.
(vi) The credit provider should also be mindful of the interest rates charged by other financial institutions.

4.6 *The defence of usury*

Thus far I have discussed the issue of variable interest rate clauses in terms of the provisions of the NCA as well as in terms of the common law with reference to the various decisions of the high courts of South Africa together with the final decision made by the supreme court of appeal.

In the cases decided in terms of the common-law position the increasing (and decreasing) of the interest rate contained in a credit agreement was considered in light of the question as to whether the clause concerned was valid and enforceable in terms of the principles of the law of contract. That being said it was pointed out by Van Heerden DCJ in *NBS Boland Bank Ltd v One Berg River Drive CC; Deeb v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd*[249] that none of the mortgagors attempted to dispute the actual increased interest rate.[250]

Thus if the mortgagors had in fact disputed the resultant interest rate by alleging that same amounted to usury they might have been successful on such ground. Of course the defence of usury will only come to the fore in those circumstances where the NCA is not applicable to a certain set of facts as the NCA contains very specific provisions relating to the maximum interest rate which may be levied upon a consumer in respect of a certain type of credit agreement. However, where the NCA is not applicable it would be prudent for a consumer to consider the defence of usury as discussed in chapter two as this may provide an alternative

[249] See n 192 above.
[250] 937 H – I.

basis for avoiding the interest rates levied by a credit provider in terms of a variable interest rate clause.

CHAPTER 5

CONCLUDING REMARKS

5.1 *Conclusion*

In chapter one of this dissertation I postulated two different scenarios regarding variable interest rate clauses and posed the question whether same would be considered valid and enforceable either in terms of the NCA or in terms of the common-law position regarding variable interest rate clauses.

The first of these two scenarios was expressed in the following terms:

> "Showtime Flooring CC buys immovable property from Commercial Realtors (Pty) Ltd. Showtime Flooring CC intends conducting its business from such property and it obtains financing for such property from The Price is Right Bank Limited. In terms of the credit agreement between The Price is Right Bank Limited and Showtime Flooring CC, the initial interest rate applicable to the credit agreement is 15% per annum. The credit agreement however provides that The Price is Right Bank Limited may at any time during the currency of the credit agreement, in its discretion, reduce or increase the interest rate and adjust the instalments accordingly."

From this scenario it is clear that Showtime Flooring CC is a juristic person for purposes of the NCA. Furthermore the credit agreement concluded between Showtime Flooring CC and The Price is Right Bank Limited would, without getting into the technicalities of things, be a mortgage agreement which is considered to be a large agreement for purposes of the NCA. As discussed in paragraph 3.3 above in terms of section 4 of the NCA the provisions thereof will not apply to a credit agreement where the consumer is a juristic person with an asset value or annual turnover of more than R100 000 000 nor will it apply to a large credit agreement concluded with a juristic person. This latter instance is applicable to this scenario. Moreover the provisions of section 6 of the NCA provides that certain parts thereof will not apply to a credit agreement where the consumer is a juristic person. Of importance in this regard is the exclusion of those provisions dealing with interest rates and variable interest rate clauses.

From this it is evident that the variable interest rate clause contained in the mortgage agreement concluded between Showtime Flooring CC and The Price is Right Bank Limited would not be regulated by the NCA. As such the validity of the variable interest rate clause would fall to be decided in terms of the common law. In this regard the decision of the supreme court of appeal in *NBS Boland Bank Ltd v One Berg River Drive CC; Deeb v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd*[251] would have to be employed which would entail that the variable interest rate clause is valid and enforceable in principle but that The Price is Right Bank Limited would have to exercise its discretion in a reasonable manner.

The second scenario postulated in chapter one was the following:

> "John James buys a Mercedes Benz from Herman Nel Motors CC. The purchase price in respect of such vehicle is financed by The Price is Right Bank Limited and an instalment sale agreement is concluded. With regards to the charging of interest the instalment sale agreement provides that the interest rate applicable is 15% per annum but that The Price is Right Bank Limited may at any time during the currency of the instalment sale agreement increase or decrease the interest rate by the same margin as, and in accordance with, changes in the prime lending rate of The Price is Right Bank Limited."

In the aforesaid scenario John James is a natural person and as such enjoys full protection in terms of the NCA. As such in order for The Price is Right Bank Limited to validly vary the interest rate payable it needs to adhere to the provisions of section 103(4) of the NCA. The variable interest rate postulated above provides that any increase or decrease in the interest rate will be by the same margin and in accordance with changes in the prime lending rate of The Price is Right Bank Limited and as such it meets the requirements of the NCA and is therefore valid and enforceable.

5.2 *Recommendations*

As discussed in paragraph 3.3 above the NCA only has limited application in so far as juristic persons are concerned. This, as was pointed out, is not ideal. Furthermore, it is questionable whether the purposes of the NCA as set out in section three are really being achieved.

[251] See n 192 above.

The exceptions made in terms of the NCA with regards to juristic persons effectively means that a large portion of the credit industry is regulated by the common law and which we have seen is not always clear and unequivocal.

As such my recommendation in order to cure the situation at hand is for the minister to increase the threshold of R1 000 000 so as to ensure that relatively small juristic persons are afforded protection under the NCA. This amount limits the application of the NCA to juristic persons. An increase in this regard may ease the situation to a certain extent but would still not allow sufficient protection to juristic persons. This is so because in addition to this since all mortgage agreements are considered to be large agreements for purposes of the NCA a juristic person will never enjoy protection in terms of the NCA when it purchases immovable property. As such I would recommend that a mortgage agreement not be automatically considered a large agreement and that certain other requirements should be adopted in order to determine whether a mortgage agreement is to be considered a large agreement (for instance, whether the principal debt exceeds a certain amount).

In addition to the aforesaid I would recommend that the NCA be amended so as to, at the very least, allow those provisions regarding interest rates be made applicable to credit agreements concluded with a juristic person as a consumer.

Whilst the recommendations suggested above may negatively affect the profit margins of certain financial institutions same would still be entitled to levy the charges, fees and interest as determined by the NCA and thus they could for instance, where the consumer is a juristic person, levy a higher or the maximum interest rate permissible.

As an alternative to the aforesaid, the NCA could be amended so as to make provision for certain interest rates to be applicable only to natural persons whilst completely different interest rates are made applicable only to juristic persons.

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