IN THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Reportable

Case No: 195/2000

In the matter between:

DANIëL ELARDUS DE BEER `	Appellant

and

JOHAN KEYSER	1st Respondent
JOHANNES CORNELIUS MOLL	2nd Respondent
JAN HENRY JACOBS	3rd Respondent
HENDRIK DE WET	4th Respondent
CHRISTO KRUGER	5th Respondent
CAREL PIETER CRONJE STADLER	6th Respondent
PHILLIPUS BERNARDUS VAN DER MERWE	7th Respondent
RUDOLPH JOHANNES MARTINUS HERTZOG STADLER	8th Respondent
JACOBUS ZIRK BODENSTEUN	9th Respondent
GERHARDUS LABUSCHAGNE	10th Respondent
JAN KRUGER	11th Respondent
BERT VAN DER ZEE	12th Respondent
JAN BISSCHOFF	13th Respondent
WILLIE BEKKER	14th Respondent
CASPER JOHANNES BUITENDAG	15th Respondent
LOUIS J HITCHCOCK & CO PROKUREURS	16th Respondent

Coram: Marais, Streicher, JJA Cloete, Brand and Nugent AJJA

Heard: 2 November 2001

Delivered: 23 November 2001

Summary: Franchise agreement – whether void for vagueness or contrary to public policy – reciprocity of obligations

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J U D G M E N T

Nugent AJA:

[1] It has become common, both in this country and abroad, for business to be conducted under franchise. Although the terms of particular franchising arrangements will vary the underlying concept has been described as follows:

> 'A franchise is a system in which one organisation ("franchisor") grants the right to produce, sell or use a developed product, service or brand to another organisation ("franchisee"). Royalties based on turnover are usually paid by the franchisee. The franchisee agrees to comply with the franchisor's policies in respect of buying, marketing, and management. The franchisor may offer advertising and back-up services' (*Butterworths Australian Legal Dictionary*).

[2] This appeal concerns a franchise agreement in the micro-lending industry. Micro-lending entails lending small amounts of money, most often to individuals, and usually to tide them over until the next pay-day, in return for interest. The amounts that are lent are small enough for the transactions to fall outside the terms of the Usury Act 73 of 1968, and the

interest rate is usually far above the ruling rate for conventional loans. Those who engage in this form of lending usually justify the high rate of interest on the grounds that there is a high risk that borrowers will default.

[3] The appellant has developed what is apparently a successful model for the conduct of such business. The model includes a registered trade mark and distinctive get-up for marketing purposes, expertise as to the location of outlets, standards for office design and furnishing, a standard form in which business is transacted, and a customised computer accounting programme. The appellant grants franchises to others to use that model in return for a royalty. The terms upon which he does so are recorded in a standard franchise agreement that entitles the franchisee to the exclusive use, within a demarcated geographical area, for a period of ten years, of what is described as 'the product', which is defined to mean:

> ''n metode ... vir die dryf van die besigheid vir die uitleen van geld oor 'n kort termyn bestaande uit handelsname, handelsmerke, logos en ander

identifiseerbare materiale, wyses van advertering en reklame, besondere styl en aard van toerusting ...'

[4] The franchisee conducts the business at his own expense and for his own account but subject to strict controls. For example, the franchisee is obliged to conduct business under such trademarks and logos as the appellant may determine from time to time, the external appearance and internal layout of the business premises must be approved by the appellant, the franchisee must observe standards set by the appellant, the franchisee must allow the appellant's representatives and auditors to have access to the business, the franchisee is obliged to develop and promote his business within the demarcated area, and he must purchase all his business requirements from the appellant or the appellant's nominee.

[5] In return for the rights accorded to him by the appellant the franchisee is obliged to pay a royalty in an amount equivalent to 5% of the amount of

every loan that he makes. The royalty is payable to the appellant on the date that the particular loan becomes repayable irrespective of whether the loan is repaid.

[6] Clause 9 of the agreement places the appellant under an obligation to provide assistance and support to the franchisee in the following terms:

> '9. Tydens die bestaan van hierdie ooreenkoms moet die vergunner
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> 9.1 die opleiding wat hy nodig ag vir die voorbereiding van die vergunde en sy werknemers voorsien wat hulle in staat sal stel om die besigheid op 'n behoorlike wyse to bedryf;
>
> 9.2 die tegnise hulp en administratiewe bystand verleen soos gereël met die vergunde.'

[**7**] The appellant has concluded about two hundred such agreements with franchisees throughout the country in eleven business regions. In each region the appellant has appointed a regional representative whose function is to market the business, to provide assistance to franchisees where it is

required, to recruit new franchisees, and to collect royalties on his behalf. In return the regional representative receives a portion of the royalties collected in his region.

[8] The first to fifteenth respondents (to whom I will refer for convenience as the respondents) are all franchisees in the Kwa Zulu - Natal region. The first respondent was also the appellant's representative in that region until he resigned from that position with effect from 31 December 1998. The sixteenth respondent is the respondents' attorney.

[**9**] Towards the end of 1998 a rebellion, led by the first respondent, occurred in the Kwa Zulu-Natal region of the appellant's business empire. The allegations and counter-allegations relating to its cause are not now relevant: it is sufficient to say that the first respondent has made plain his wish to secede and to set up business on his own account and he expects that at least some of the other respondents will join him if he does so.

[10] The rebellion first manifested itself during October 1998 when the first respondent resigned from his appointment as regional representative. He nevertheless continued to collect royalties that fell due from the second to fifteenth respondents but failed to pay the moneys to the appellant. During January 1999, when the appellant became aware that the moneys had not been paid, he confronted the first respondent who then paid these (after deducting his commission) into the trust account of his attorney. The first respondent told the appellant that the second to fifteenth respondents had instructed him not to pay the moneys to the appellant and that was subsequently confirmed by the sixteenth respondent (who was then representing all the respondents). The only explanation that the respondents offered at the time was reflected in a letter written by their attorney on 3 February 1999 in which he confirmed that a sum of R110 389 had been paid into his trust account and he went on to say:

> '[T]he basis upon which the royalties are being retained by [the respondents] is that they have been advised that the Franchise Agreement may very well be unenforceable. In addition the Franchisees are of the opinion that due to the Franchisor's breach of Contract they have suffered damages.'

[11] Discussions ensued between the parties in an attempt to resolve their differences, but to no avail, and the appellant commenced urgent proceedings on notice of motion in the Natal Provincial Division for orders, *inter alia*, compelling the respondents to account to the appellant for the royalties that had fallen due and to pay them over to the appellant's attorney. An interim order was made by consent and ultimately the matter came before Hugo J. The application was opposed by all but the eighth and fourteenth respondents. The essential question that the court *a quo* was called upon to decide was whether the respondents were obliged to pay royalties to the appellant. Those of the respondents who opposed the application alleged on various grounds that they were not obliged to do so. One of their defences, that the franchise agreements were void for

vagueness, was upheld by the court *a quo*. As a result it dismissed the application and directed that the moneys that were then being held in trust by the sixteenth respondent be returned to the respective respondents but it granted the appellant leave to appeal to this Court.

[12] It has often been said that a court should not be astute to destroy an agreement that the parties have seriously entered into in the belief that it was capable of implementation. In *Soteriou v Retco Poyntons (Pty) Ltd* 1985 (2) SA 922 (A) at 931 G-I this Court said the following:

> 'The Courts are "reluctant to hold void for uncertainty any provision that was intended to have legal effect". (*Brown v Gould* 1972 Ch 53 at 56-58.) Lord Tomlin said in *Hillas & Co Ltd v Arcos Ltd* 1932 All E Rep 494 (HL) at 499H-I that:
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> > " ... the problem for a Court of construction must always be so to balance matters that, without the violation of essential principles, the dealings of men may as far as possible be treated as effective, and that the law may not incur the reproach of being a destroyer of bargains."'

[13] An agreement that is expressed in words that are capable of various meanings when they are viewed in isolation is not for that reason alone too

vague to be enforced. The proper meaning of words that might at first sight appear to be ambiguous, or ill-defined, or otherwise vague, might often emerge when the words are seen in their context, or against the background to the transaction, or when they are linked by admissible evidence to the circumstances in which they were intended to apply. As observed by Broome J in *Gandhi v SMP Properties (Pty) Ltd* 1983 (1) SA 1154 (D) at 1156E-F:

> 'It is notorious that the confusion experienced by, or the host of possible alternatives foreseen by, a party seeking to resile from an agreement can at times be exaggerated and unreal.'

[14] The considerations to be taken into account when deciding whether an agreement is too vague to be enforced were summarised in *Namibian Minerals Corporation Ltd v Benguela Concessions Ltd* 1997 (2) SA 548 (A) at 561G-J as follows:

> 'Once a Court is called upon to determine whether an agreement is fatally vague or not, it must have regard to a number of factual and policy considerations. These include the parties' initial desire to have entered into

> a binding legal relationship; that many contracts (such as sale, lease or partnership) are governed by legally implied terms and do not require much by way of agreement to be binding (cf *Pezzutto v Dreyer and Others* 1992 (3) SA 379 (A); that many agreements contain tacit terms (such as those relating to reasonableness); that language is inherently flexible and should be approached sensibly and fairly; that contracts are not concluded on the supposition that there will be litigation; and that the Court should strive to uphold – and not destroy – bargains.'

A court will be even more reluctant to hold that a clause in an agreement is void for uncertainty where the agreement is no longer executory but has been partly performed (Lewison: *The Interpretation of Contracts* par 7.12; *Sudbrook Trading Estate Ltd v Eggleton* [1983] 1 AC 444 (HL) at 484E – 485A).

[15] The only contentious portion of the agreements in the present case is clause 9.2 which obliges the appellant to furnish to the franchisees "die tegniese hulp en administratiewe bystand … soos gereël met die vergunde". The court *a quo* held that the phrases "tegniese hulp" and "administratiewe bystand" were not capable of being given a sufficiently definite meaning;

that the clause was not severable from the remaining terms; and that the agreements were accordingly void *ab initio*.

[**16**] Where the subject of a franchise agreement which is to endure for many years is a method of doing business, as it is in the present case, the parties will often intend that its content might vary from time to time to account for changed circumstances, for business methods must necessarily be adapted and altered if the business is to remain competitive. The parties to such an agreement will be constrained in those circumstances to express their respective obligations, and particularly those of the franchisor, in relatively broad and flexible terms if they wish to achieve the result that both of them intend. In such circumstances one cannot expect the specific content of those obligations to be spelt out in advance but that does not mean that such an agreement is too vague to be enforced: the validity of an agreement does not depend upon whether the obligations have been

described with such linguistic precision that their ambit is ascertainable solely by reference to the language in which they are couched - it suffices that their ambit is capable of being identified by recourse to admissible extrinsic evidence.

[17] In my view the phrases 'tegniese hulp' and 'administratiewe bystand', which at first sight appear to be imprecise, are indeed capable of being given definite content once they are seen in their context and measured against what is required for the conduct of a business of the kind to which they relate. It is clear from the agreement when it is read as a whole that the parties intended the agreement to relate to a business that belonged to the franchisee: it would be for the franchisee to secure premises from which to conduct the business, to equip the premises, to employ the requisite staff, to transact business, and generally to do what is required of a person who conducts his own business. In my view what the parties intended the

appellant to furnish was expertise and guidance that would enable the franchisee to go about doing so. Precisely what expertise and guidance is required to be furnished by the appellant (whether it relates to the technical aspects of the business or to its administration) will necessarily depend upon what is required from time to time for the establishment and conduct of a business of that nature: that is capable of being determined by extrinsic evidence.

[18] What was submitted before us by the respondents, however, was not that those phrases are incapable of a determinate meaning, but rather that the clause allows the appellant unilaterally to determine the nature and extent of his obligations, inasmuch as it obliges him to furnish assistance and support 'soos gereël met die vergunde'. Accepting, correctly in my view, that those words refer to arrangements to be made in the future, it was submitted by the respondents that the appellant is obliged to furnish only such assistance and

support as he arranges to provide with the result that he has an unfettered discretion to determine its nature and extent.

[**19**] 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.

[20] The court *a quo* did not find it necessary to consider the remaining defences relied upon by the respondents. In view of the conclusion reached above it is now necessary to do so.

[**21**] It was submitted before us that the agreements are also unenforceable because they are contrary to public policy. In support of that submission the respondents relied, not on the terms of the agreements by themselves, but rather on the purpose for which they were concluded.

[22] There might well be circumstances in which an agreement, unobjectionable in itself, will not be enforced because the object it seeks to achieve is contrary to public policy. Nevertheless a court should be cautious when it performs its role as arbiter of public policy. In *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A) at 9 B-E Smalberger JA said:

> 'No court should therefore shrink from the duty of declaring a contract contrary to public policy when the occasion so demands. The power to declare contracts contrary to public policy should, however, be exercised sparingly and only in the clearest of cases, lest uncertainty as to the validity of contracts result from an arbitrary and indiscriminate use of the power. One must be careful not to conclude that a contract is contrary to public policy merely because its terms (or some of them) offend one's individual sense of propriety and fairness. In the words of Lord Atkin in *Fender v St John-Mildmay* 1938 AC 1 (HL) at 12 ([1937] 3 All ER 402 at 407B-C),
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> "the doctrine should only be invoked in clear cases in which the harm to the public is substantially incontestable, and does not depend upon the idiosyncratic inferences of a few judicial minds."
>
> (see also *Olsen v Standaloft* 1983 (2) SA 668 (ZS) at 673G). Williston on *Contracts* 3rd ed para 1630 expresses the position thus:
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> "Although the power of courts to invalidate bargains of parties on grounds of public policy is unquestioned and is clearly necessary, the impropriety of the transaction should be convincingly established in order to justify the exercise of the power."'

[23] I have already drawn attention to the fact that in the business of micro-lending there is apparently a high risk that loans will not be repaid. To reduce that risk the appellant's business model provides for loans to be made only to persons who are in fixed employment and whose earnings are paid into a bank account which is capable of being drawn against at an automatic teller machine by using a cash-card linked to a personal identification

number (‘PIN’). The technique for ensuring the repayment of the loan is to require the borrower to surrender his cash-card and disclose his PIN to the lender, and to require him to authorise the lender to use the card to draw against the account in recovery of the debt. On the date that the loan becomes due for repayment, which usually coincides with the date upon which the borrower’s earnings are paid into his account, the lender will use the cash-card and the PIN to recover the debt from an automatic teller machine.

[24] The respondents submitted that that technique (which is apparently almost indispensable to the successful conduct of such a business) is contrary to public policy and for that reason the franchise agreements are unenforceable. It strikes me as rather cynical that the respondents, who have already recovered their loans and earned their interest in reliance on that technique, should now seek to avoid their obligations to the appellant on the

grounds that what they have done is contrary to public policy. Whether the respondents would indeed be entitled to withhold the royalties on those grounds is not necessary to decide because in my view the use of that technique is in any event not contrary to public policy.

[25] The disquiet that the use of this technique evokes does not arise, in my view, from the nature of the technique itself but rather from the fact that it is necessary to use it. It suggests that borrowers in this industry are as anxious to avoid repayment of their loans as they were to secure them in the first place. No doubt that is because they will often be no more solvent when the debt falls due for repayment than they were at the time that the loan was made. When the burden of substantial interest is added the potential exists for the borrower to spiral into ever-increasing debt, but that potential is inherent in this form of business.

[26] It is not the business of this form of money-lending itself, however, that was said to be contrary to public policy, but only the means that is used for recovery. The respondents submitted that it is contrary to public policy for a lender to have access to the borrower's account, principally because it allows for what was said to be a form of *parate executie.* In my view that analogy is misplaced. *Parate executie* occurs where a creditor has the right to sell the property of a debtor in satisfaction of a debt. The principal objection to the practice is that without judicial control the property might be sold by the creditor on terms that are unduly prejudicial to the debtor. Until recently the practice has nevertheless been considered to be unobjectionable where it relates to movable property (*Osry v Hirsch, Loubser & Co., Ltd* 1922 CPD 531 at 541-8; *Iscor Housing Utility Co. and Another v Chief Registrar of Deeds and Another* 1971 (1) SA 613 (T) at 616 B-D) but various statutory forms of *parate executie* have since been held to be

constitutionally invalid (*Chief Lesapo v North West Agricultural Bank and Another* 2000 (1) SA 409 (CC); *First National Bank of South Africa Ltd v Land and Agricultural Bank of South Africa and Another* 2000 (3) SA 626 (CC)) and so too where it occurs by agreement (*Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd* 2001 (1) SA 251 (E)).

[**27**] The practice of drawing upon the debtor's bank account in collection of the debt does not constitute *parate executie* nor does it share its objectionable features. Moreover, it is implicit in the authority that is granted by borrowers in the present case that the card may be used only to withdraw what is lawfully due. In the event that the indebtedness is disputed it is open to the borrower to countermand the authority or to seek the intervention of a court and there is no question of the judicial process being circumvented. It is commonplace for debtors to authorise their creditors to satisfy their debts by withdrawing money directly from the

debtor's bank account, as, for example, in the case of a debit order. The distinction in the present case is only that the authority is capable of being abused. Fraud is capable of occurring in many circumstances and in my view the practice that is now in issue is not contrary to public policy only because it creates the opportunity for it to occur. Once it is accepted that the borrower is obliged to repay the debt, in my view it is not objectionable for the borrower to furnish a ready means for its collection.

[28] It was also submitted that if the franchise agreements were to be enforced we would be assisting the appellant to conduct the business of a bank in contravention of s 11 of the Banks Act 94 of 1990. In support of that submission the respondents alleged that it is the appellant's practice to secure moneys from outside sources which he in turn lends to franchisees for the conduct of their business. The evidence does not establish that the appellant secures moneys in contravention of the Act, nor, for that matter, do

the franchise agreements oblige the appellant to do so or the franchisees to borrow from the appellant.

[29] Finally, it was submitted by the respondents that they are excused from paying the royalties because the appellant has failed to perform his own obligations in terms of the franchise agreements. The appellant was alleged to have breached the agreements in three respects. First, the respondents alleged that they had requested the appellant to arrange for the business to be expanded so as to include the issuing of funeral insurance policies which the appellant had failed to do in breach of his obligation to furnish "tegniese hulp" as provided for in clause 9.2. Clause 9.2 clearly does not oblige the appellant to embark upon what is in effect a new form of business and for that reason alone the submission is unsound. Secondly, it was alleged that during October 1998 the respondents requested the appellant to pursue negotiations for the installation of electronic banking equipment in the

premises of franchisees which the appellant failed to do. Thirdly, it was alleged that the appellant had permitted franchisees to be located within the demarcated business area of the first and the fifteenth respondents in breach of their exclusive rights.

[**30**] Whether the appellant was indeed obliged to pursue the negotiations, and not to permit the outlets to which I have referred is not necessary to decide. Assuming that he was, in my view his failure to do so did not entitle the franchisees to withhold payment of the royalties. The defence relied upon by the respondents (*exceptio non adimpleti contractus*) entitles a contracting party to withhold performance only where his obligation to perform is dependent upon the prior or simultaneous performance by the other contracting party of a reciprocal obligation (De Wet and Yeats *Kontraktereg en Handelsreg* 4th ed at 178; Christie *The Law of Contract* 4th ed 489-90; *Anastasopolous v Gelderblom* 1970 (2) SA 631 (N)). Whether

the obligation is so dependent is a matter for construction of the particular agreement. In the present case the obligations of the appellant are ongoing in their nature and might sometimes take a considerable time to be performed: the parties could not have intended that the obligation to pay royalties would be suspended in the meantime. Indeed, as has been noted, the agreement specifically stipulates when payment of the royalty falls due.

[31] In my view the respondents have not established any lawful grounds upon which to withhold payment and the appeal must succeed. The eighth and fourteenth respondents did not oppose the application or the appeal and the parties have agreed that the sixteenth respondent (whose interest was peripheral) ought not to be ordered to pay the costs in either court. The parties have also agreed upon the form that our order should take in the event that the appeal succeeds.

[**32**] Accordingly the appeal is upheld. The costs of the appeal are to be paid by the respondents (other than the eighth, fourteenth and sixteenth respondents) jointly and severally, the one paying the others to be absolved, which are to include the costs occasioned by the employment of two counsel. The order of the court *a quo* is set aside and the following order is substituted therefor:

> ‘1. Die eerste respondent word gelas om binne 10 (tien) dae vanaf datum van hierdie bevel verrekening teenoor die applikant te doen met betrekking tot die volgende:
>
> 1.1 Die presiese hoeveelheid tantieme wat die eerste respondent by elk van die tweede tot vyftiende respondente gevorder het vir die maande Desember 1998, Januarie 1999 en Februarie 1999;
>
> 1.2 Die bedrag wat die eerste respondent vir himself toegeëien het as synde kommissie vir die invordering van die tantieme in paragraaf 1.1 vermeld.

2. Die eerste respondent word gelas om kommissie wat deur hom gevorder is vir die maand Desember 1998, binne 10 (tien) dae vanaf datum van hierdie bevel, te betaal aan die applikant se prokureurs van rekord, mnre Cilliers-Reynders Ing, h/v Ronelstraat & Jeanlaan, Doornkloof, 0140, Centurion.

3. Die eerste tot vyftiende respondente word elk gelas om:

3.1 binne 10 (tien) dae vanaf datum van hierdie bevel, verrekening te doen teenoor die applikant met betrekking tot die bedrag tantieme wat aan die applikant verskuldig is vir die maande Desember 1998, Januarie 1999 en Februarie 1999.

3.2 aan die applikant ’n uiteensetting te verskaf van presies watter bedrag tantieme aan die eerste respondent oorbetaal is vir die maande Desember 1998, Januarie 1999 en Februarie 1999;

3.3 binne 10 (tien) dae na toestaan van hierdie bevel alle tantieme aldus verskuldig aan die applikant se prokureurs van rekord, mnre Cilliers-Reynders Ingelyf, h/v Ronelstraat & Jeanlaan, Doringkloof (0140), Centurion, te betaal.

4. Die respondente, met uitsluiting van die agste, veertiende en sestiende respondente, word gelas om die koste van die aansoek, insluitende die koste van twee advokate, gesamentlik

en afsonderlik te betaal, welke koste die koste wat voorbehou is ten opsigte van die verrigtinge van 22 Februarie 1999, insluit.'

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R W NUGENT
Acting Judge of Appeal

Marais JA)
Streicher JA)
Cloete AJA)
Brand AJA) concur