THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 637/2018

In the matter between:

ROBERTO CARLOS DE FREITOS DE VASCONCELOS	**FIRST APPELLANT**
PRIMOLITOS CC	**SECOND APPELLANT**
PRIMOPLAS CC	**THIRD APPELLANT**
PORTION CONTROL PACKERS CC	**FOURTH APPELLANT**

and

BUSINESS PARTNERS LTD	**RESPONDENT**

Neutral citation: *De Vasconcelos & others v Business Partners Ltd* (637/2018) [2019] ZASCA 80 (31 May 2019)

Coram: Cachalia, Mbha and Dambuza JJA and Davis and Plasket AJJA
Heard: 24 May 2019
Delivered: 31 May 2019

Summary: Loan and royalty agreements arising from loan; whether interest disguised as royalty; whether royalty agreement *contra bonos mores*; whether *in duplum rule* applies.

ORDER

On appeal from: Gauteng Division of the High Court, Pretoria (De Vos J sitting as court of first instance):

The appeal is dismissed with costs, including the costs of two counsel.

JUDGMENT

Cachalia JA (Mbha and Dambuza JJA and Davis and Plasket AJJA concurring)

[1] During 2009, Mr Roberto Carlos De Freitos De Vasconcelos (the first appellant), representing Eastprop Property Trust (the Trust), sought to raise a loan to finance working capital for one of three close corporations of which he was the alter ego. The businesses operated from a property the Trust owned in Wadeville, Johannesburg. The property was initially bonded to Absa Bank in an amount of R25 million. Absa later reduced their facility over the property to R18 million, which precipitated the Trust's need for further capital. The first appellant then approached Business Partners Limited (the respondent) on behalf of the Trust for assistance. The respondent finances small and medium enterprises where banks are not willing to undertake the risk. Its business model is to secure a higher rate of return for its investment.

[2] The Trust applied to the respondent for a loan of R10 million initially but, after protracted negotiations over a period of two years, the latter agreed to lend it an amount of R8 million. To this end the respondent entered into two written agreements with the Trust on 8 December 2011. In terms of the first, a loan agreement, the respondent lent and advanced the R8 million to the Trust, as principal debtor. The loan

would attract interest at one percentage point above the prime lending rate, and would be repayable in 84 instalments of R132 810, over a period of seven years. The loan was secured by the first appellant, and the three close corporations (the second to fourth appellants) signing suretyships, in terms of which they bound themselves to the respondent as sureties and co-principal debtors *in solidum* for an unlimited amount in respect of the Trust's indebtedness.

[3] The second agreement, styled a 'royalty agreement', required the Trust to pay a 'royalty' to the respondent. The value of the royalty was calculated at the higher of R12 896 964 or 24 per cent of the future market value of the Wadeville property. The royalty payment would become due and payable on 1 August 2019, at the end of the seven year period for repayment of the loan, but was subject to an acceleration clause in the loan agreement if the Trust failed to meet its repayment obligations. The royalty was payable in addition to repayment of the loan plus interest thereon.

[4] The Trust breached its obligations under the loan agreement by falling into arrears with its monthly instalments. The respondent then issued summons for payment of the amount of R6 985 926.44 for the outstanding balance due in terms of the loan agreement and the further amount of R12 896 964 provided for in the royalty agreement. It also claimed interest on these amounts at the rate of 10 per cent per annum as from 25 July 2014.

[5] During September 2015 the Trust settled the outstanding balance under the loan agreement, which was then R5 239 115.94. The trial proceeded only against the first to fourth appellants, as sureties, for payment of the amount then due under the royalty agreement. They resisted liability on several grounds. Invoking the common law rule against usurious agreements, their principal defence was that the royalty agreement purported to levy an excessive interest payment for the loan in an addition to the interest that was payable under the loan agreement, which was extortionate, oppressive or akin to fraud and therefore, *contra bonos mores* and unenforceable.

[6] The North Gauteng Division of the High Court (De Vos J) upheld the respondent's claim and dismissed all of the appellants' defences. The appellants now appeal against this order, with leave of the high court.

The Abandoned Defences

[7] The appellants raised as a defence that the trustees of the Trust, one of whom was the first appellant, who was instrumental in negotiating these agreements, were not authorised to sign the royalty agreement on behalf of the Trust as the resolution from which their authority emanated was passed only after the agreement was signed. The second to fourth appellants pleaded a similar defence in respect of the resolutions authorising the conclusion of the suretyships. These spurious defences were abandoned at the commencement of the trial.

[8] The Trust also disputed that the royalty agreement annexed to the particulars of claim was the true agreement signed. This required the respondent to lead evidence to prove the agreement, which it did. The evidence was uncontested and, during argument, this defence too was abandoned.

[9] However, another defence was persisted with in the trial court: this was that the royalty agreement, which imposed an obligation on the Trust to pay a royalty, was disguised to conceal its true purpose, which was to extort additional and exorbitant interest from the Trust in order to circumvent the provisions of National Credit Act 34 of 2005 (the NCA). It was, so it was pleaded, therefore a simulated transaction and not a genuine one. This defence was doomed to failure for two reasons: first, the NCA does not apply to large agreements where the principal debt exceeds R250 000 and the borrower is a juristic person,[1] which this agreement does; and secondly, the evidence did not establish any fraudulent misrepresentation or dishonesty on the part of the respondent in concluding this agreement.[2] The trial court correctly dismissed this defence. The appellants do not contest this finding.

The *Contra Bonos Mores* (Public Policy) Defence

[10] The appellants persist with their common law defence, which, as I understand the pleading, is that the royalty agreement is *contra bonos mores* and unenforceable on the grounds that:

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[1] Section 4(1) read with s 9(4) and s 7(1)*(b)* of the NCA. The higher threshold was determined as R250 000 in terms of GN 713, *GG* 28893, 1 June 2006.

[2] *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC & others* [2014] ZASCA 40; 2014 (4) SA 319 SCA para 30.

(a) The loan of R8 million was adequately secured by the loan agreement and interest in an amount of R2.6 million was paid over the period in the present instance. Had the loan agreement run its course over the full period of seven years the capital would have attracted interest of R3.2 million;
(b) The royalty of R12.896 964 million, which was calculated with reference to the value of the Wadeville property, conferred no benefit on or quid pro quo for the Trust;
(c) The royalty was no more than additional interest to the R3.2 million interest on the loan agreement, which was not commensurate with the risk undertaken by the respondent;
(d) The respondent did not fully disclose the extent, impact and implications of the royalty to the first appellant before concluding the loan and royalty agreements;
(e) Had the Trust realised that the royalty agreement required the payment of additional interest it would not have concluded the loan agreement;
(f) The respondent failed to disclose the real interest rate payable by disguising it as a royalty;
(g) The additional interest is therefore usurious in the circumstances.

[11] There was some debate in the high court and in this court as to whether the two agreements are inseparable parts of a single contract or two separate contracts, one to secure the loan and the other to levy additional interest, disguised as a royalty. But nothing turns on this. The loan agreement refers repeatedly to the royalty agreement and must be read together with it. The two agreements form part of a single transaction. It matters not whether the payment claimed under the royalty agreement is properly described as a royalty or interest payment. It remains a payment obligation incurred for the loan. The only issue is whether this obligation offends public policy.

[12] There is no statutory limitation on the amount of interest that may be charged for repayment of the loan at issue in this appeal. So, the mere fixing of a high amount of interest for repayment of a loan between contracting parties is not unlawful. The appellants understand this and therefore rely, as I have mentioned, on the common law rule against usurious contracts. Its effect is to render an agreement or transaction usurious and invalid if shown to be tainted by oppression, or extortion or something

akin to fraud.[3] The appellants, upon whom the onus lies, must establish the facts in this regard, as it would for any public policy challenge to the terms of a contract.[4] There is no suggestion that the rule is inimical to any constitutional principle or value.[5]

[13] But this defence is built primarily on two sets of contradictory allegations. It is apparent from the plea that the pivotal allegation is that the respondent 'disguised' the interest payment as a royalty payment to induce the Trust to conclude the contract. This means – and can only mean – that the respondent dishonestly described the interest payment as a royalty to conceal the true nature and extent of the obligation from the Trust.

[14] The appellants also plead that the respondent was required to disclose that the royalty was in truth an obligation to pay interest. This is a different defence and rests on a duty of a contracting party – the respondent in this case – to disclose information within his or her exclusive knowledge that is not reasonably ascertainable by the other party from a source other than with whom he or she is contracting. Put simply, a party cannot take advantage of another's ignorance of facts that he or she is not reasonably expected to ascertain for himself or herself.[6] The courts have said that the duty to disclose the information and the correlative right to have this information communicated to him or her is mutually recognised by honest contracting parties in the circumstances.[7]

[15] The factual bases of the two defences differ fundamentally, but are conflated in the appellants' plea. Apart from this problem, the appellants also face an intractable obstacle with this part of their pleaded case. The first defence – the allegation that the respondents 'disguised' interest as royalty – is simply a case of a fraudulent misrepresentation, which, as I have pointed out, the appellants now expressly disavow. The second defence – the duty to disclose – rests on the allegation that the

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[3] *African Dawn Property Finance 2 (Pty) Ltd v Dreams Travel and Tours CC & others* [2011] ZASCA 45; 2011 (3) SA 511 (SCA) para 20.
[4] *AB & another v Pridwin Preparatory School & others* [2018] ZASCA 150; 2019 (1) SA 327 (SCA) para 27.
[5] In *African Dawn* fn 3 above para 29 this Court said that the rule is not inconsistent with constitutional norms.
[6] R H Christie *The Law of Contract in South Africa* 6 ed (2011) at 291.
[7] *ABSA Bank Ltd v Fouche* 2003 (1) SA 176 (SCA) at 180J-181D; R H Christie *Law of Contract in South Africa* 6 ed (2011) at 289-291.

respondent had a duty to disclose the true nature of the obligation that the Trust had undertaken, which was an obligation to pay interest and not a royalty. But in the face of the high court's compelling finding that the first appellant was fully aware of the obligation he was undertaking in concluding the royalty agreement, the appellants could hardly have persisted with either ground, separately or rolled up together, to support this defence. Unbowed, they did.

[16] In response to questions from the court as to whether the appellants had shown any deception or fraud on the part of the respondents to establish its public policy defence, it was contended that it is not necessary to go that far. All they needed, the argument went, was to establish that the respondent's conduct was akin to fraud, or otherwise extortionate or oppressive. Apart from the fact that there were no facts pleaded to support this contention, the evidence did not even begin to show conduct of this nature on the part of the respondent. In fact it showed quite the opposite.

[17] Mr Roger Hicksley, the respondent's area manager, testified that their business is to finance mainly small to medium enterprises where traditional banking institutions may not. Its commercial model is take a risk with a client for a commensurate return.

[18] The first appellant had approached the respondent to fund the working capital required for the business in Wadeville on several occasions and was personally involved in the negotiations with him regarding the proposed loan. They discussed various other funding options, most of which were not viable. Importantly, all aspects of the structure of the transaction, including the royalty payment, with which the first appellant was satisfied, were deliberated upon on several occasions. The application was for a loan of R10 million initially but only R8 million was eventually approved, almost two years later, after a due diligence was done.

[19] Mr Hicksley also testified that the respondent structures transactions relating to royalties in various ways. This includes, for example, taking equity in a company or determining an amount based on turn-over, profit-sharing, the volume of fuel pumped at a filling station, or a percentage of the value of the property, as in the present case. The royalty is therefore compensation for the additional risk the respondent undertakes for its investment in lieu of a shareholding. It is not, he maintained, an

additional interest charge. In this regard he maintained that it was explained to the first appellant that the respondent would not only charge interest on the loan but determine a royalty payment based on the future value of the property calculated over the period of the two agreements, which was set out in both agreements. The total return on the investment, taking the transaction risk into account, was 23.56 per cent, including interest on the loan. The royalty portion was calculated as a return for the unsecured portion of the loan.

[20] The first appellant, who holds a doctorate in business administration, admitted that the principle of the royalty was explained to him. And that other possibilities, including the respondent taking equity in the business or a share in the property, were also considered. He was also aware that the respondent worked on a business model that differs from banking institutions. Importantly, he was happy to accept an earlier proposal in terms of which the royalty payable would have exceeded R16 million, for a higher loan amount. And he was also fully aware of the extent of the obligation when the agreements were signed.

[21] The evidence thus established firmly that the first appellant approached the respondent without any inducement to enter into the transaction. He was aware of the interest rate that was payable on the loan and could not but have also been aware of the terms and rationale for repayment of the royalty.

[22] Whether one characterises this repayment obligation as a royalty[8] as it is described in the royalty agreement, or simply as additional interest that was payable for the loan, as the appellants insist it is, is a matter lawyers may quibble about. The real issue is not how one characterises the royalty agreement, but whether the Trust understood the nature and extent of the obligation it was undertaking.

[23] Of that there was simply no misapprehension in the first appellant's mind. Nor could there have been, as counsel for the appellants attempted to argue. It is abundantly clear from the terms of both the loan and royalty agreements, and the

[8] A royalty is usually described as a benefit granted by a rights-holder to a user of the right. A well-known example of a royalty would be the payment a publisher makes to an author of a book for its publication and dissemination.

evidence, that there could have been no doubt in the minds of the first appellant, or of the other appellants, of the nature and extent of the repayment obligations that were undertaken in both the loan and royalty agreements in return for the loan.

[24] Whether or not the total obligation under the two agreements was commensurate with the risk the respondent had undertaken is also immaterial. The respondent is not a money-lender. So it makes perfect commercial sense that it would seek an additional payment at the end of the term of a contract in lieu of a shareholding to compensate for its investment. The contention that the royalty obligation was not commensurate with the risk undertaken by the respondent for the loan is not a ground for invalidating an agreement, absent any taint of extortion, oppression or something akin to fraud. This is so even if one accepts, which I do not, that the repayment may have been excessive in the circumstances. The appellants' real complaint is that the Trust struck a bad bargain, not an illegal one. That unfortunately happens daily in commercial life. Having concluded two agreements deliberately and seriously with the intention to create two sets of lawful obligations under the loan and royalty agreements, the appellants must live with both of them and cannot escape their consequences by seeking refuge in a public policy defence that was neither properly pleaded, not established in the evidence.

[25] I should add that if there was anything opprobrious about anyone's conduct in this matter, it was that of the first appellant, not the respondent. He entered into these agreements with open eyes, but then dishonourably put up spurious defences in his attempt to avoid their consequences. These included taking issue with the authenticity of the royalty agreement and the resolutions pertaining to the conclusion of the surety agreements. He tried to make a case of fraud against the respondent initially only to abandon that during the trial when this defence became unsustainable. The high court was therefore fully justified in criticising his conduct, and rejecting his attempt to avoid liability.

Whether the *in Duplum rule* applies

[26] The appellants have a further string to their bow. They plead, relying on the *in duplum rule*, that the respondent is not entitled to claim interest on the capital amount

in excess of the equivalent of the outstanding capital amounts. The *in duplum rule* prevents arrear interest accumulating beyond the outstanding capital amount.

[27] The appellants' main contention is that the Trust settled the loan in full during September 2015 when the property was sold. And because the royalty payment is nothing but interest, no further payments of the outstanding capital could accrue. The alternative argument is that the capital amount of R4 947 608.45 was outstanding in September 2015 and as a consequence the respondent is not entitled to arrear interest in excess of double the capital amount owing.

[28] These contentions have no merit. It is apparent, from what I have said in the previous section, that the appellants undertook two separate obligations under the loan and royalty agreements, albeit that the *causa* for both was the loan. The agreements made a clear distinction between the loan, which attracted a specific rate of interest, and the royalty, which introduced an additional obligation for the risk the respondent undertook in providing credit to the Trust. That being so, the repayment obligation under the royalty agreement cannot be added to the interest payment that accumulated under the loan agreement. Payment of the royalty obligation, which becomes payable immediately upon default, does not therefore constitute arrear interest that brings the *in duplum rule* into play.

[29] For these reasons the appeal is dismissed with costs, including the costs of two counsel.

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A Cachalia

Judge of Appeal

Appearances

For the Appellant:	P F Louw SC (with him J Moorcroft)
Instructed by:	David Kotzen Attorney c/o Andrea Rae Attorney, Pretoria Honey Attorneys, Bloemfontein
For the Respondent:	J P Vorster SC (with him M T Shepherd)
Instructed by:	Strydom Britz Mahulatsi Inc, Pretoria Symington & De Kok, Bloemfontein