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news

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Newsletter

1 PREJUDICE AND THE CONVENTIONAL PENALTIES ACT

There is a real likelihood, and perhaps it may be heard more than once in a day, that either you or someone you know, claims to have suffered damages.

In South African law, "prejudice" means **patrimonial damages** caused by the breach of a contract. A court looks at all the interests which have been adversely impacted by the breach of a party that has suffered (the innocent party), this may include the impairment of a person's reputation or personal dignity or even, in certain circumstances, substantial inconvenience.

It is a subjective test and a court may take into account factors such:

as the previous conduct of the parties; the relationship between the parties; the

relative bargaining positions of the parties at the time the contract was concluded; the nature of the creditor's business; the reason for the debtor's breach; any apology for amending the effect of a reduction upon the creditor; the sanctity of the contract and the maintenance of business and professional standards.

In assessing what would constitute prejudice claimed by an innocent party as being "out of proportion", a court is unlikely to reduce a penalty unless it is "clear or plain" that it is out of proportion to the prejudice suffered. To this end, the amount of the penalty does not need to be offensively excessive in relation to the prejudice suffered but it must be "markedly in excess" of it. A court is unlikely to reduce the penalty if the penalty slightly exceeds the prejudice.

In the case of *Van Staden v Central South African Lands and Mines 1969 (4) SA 349 (W)*, the Court, in determining the interpretation of section 3 of the Conventional Penalties Act, 15 of 1963, observed that: *"Everything that can reasonably be considered to harm or hurt, or be calculated to harm or hurt a creditor in his property, his person, his reputation, his work, his activities, his convenience, his mind, or in any way whatever interferes with his rightful interests as a result of the Act or omission of the debtor, must, if brought to the notice of the Court, be taken into account by the Court in deciding whether the penalty is, in terms of Section 3 of the Conventional Penalties Act, 15 of 1962, out of proportion to the prejudice suffered by the creditor".*

In determining whether a contractual provision could constitute a penalty, it must:

1. **It must provide for a payment or for the delivery or performance of something, over and above what the debtor already owes in terms of the contract** (*Parekh v Shah Jehan Cinemas (Pty) Ltd 1982 3 ALL SA 697 (D*). A stipulation which adds nothing to the debtor's obligations and simply provides for payment of what is owed is not a penalty. The Court has similarly held that a pure acceleration clause is not a penalty clause because it merely governs the time of payment in the event of the breach of contract and does not place a significant additional burden on the guilty party: *Premier Finance Corporation (Pty) Ltd v Rotainers (Pty) Ltd 1975 1All SA 200 (W)*

2. **It must come into operation on breach of the contract** (*Da Mata v Otto 1972 4 All SA 33 (A)/Sun Packaging (Pty) Ltd v Vreulink 1996 17 ILJ 637 (SCA)* and must constitute "an act or omission in conflict with a contractual obligation". There is case authority that a clause may qualify as a penalty if the "event" which triggers the operation of the clause is sufficiently wide to include breach of contract, but is not limited to it.

3. *It* must have been intended to operate either **in terrorem or as a genuine pre-estimate of loss.** *(Tamarillo (Pty) Ltd v BN Aitken (Pty) Ltd 1982 1 ALL SA 191 (A).*.

An innocent party is not entitled to recover damages in lieu of the penalty, unless the contract expressly provides therefor. The Courts, however, have recognised that ***if*** **the contract stipulates that the creditor may recover both the**

penalty and damages, this gives the creditor power to choose between the two remedies, even though the contract did not state specifically that the claim for damages may take the place of the penalty: (*De Lange v Deeb 1970 1 All SA 234 (O).* If the contract only contains a penalty stipulation and no clause reserving the rights to claim damages then a party's claim would be limited to the amount of the penalty even if the possible damages claim exceeds the penalty.

In the case, *Plumbango Financial Services (Pty) Ltd v Janap Joseph,* the High Court had to consider whether the amounts claimed by a lessor in terms of an acceleration clause, could be reduced in terms of the court's powers under the Conventional Penalties Act (CPA), and further, that where parties had agreed that in the event of a breach of contract, the party in breach would have to pay the innocent party a "penalty", whether section 3 of the CPA would apply.

The Court had to consider whether an acceleration clause before it, constituted a "penalty". The Court reasoned that if it could not be considered as constituting a "penalty", then they would have no power to reduce it. If the clause did impose a penalty, then the Court had to further consider whether it was "equitable" to reduce it.

The Court in this particular case held that the accelerated rental, which fell due immediately on breach, represented a "windfall gain" for the lessor, which was a disproportionate to his actual loss. The Court then awarded judgment in the favour of the lessor but for a lesser sum of monies than the amount provided in the acceleration clause before it.

In another case, *Murcia Lands CC v Erinvale Country Estate Home Owners Association 2004 4 All SA 656,* the Court held that section 3 of the CPA requires a court to decide on three issues:

(a) Is the penalty out of proportion to the prejudice suffered by the defendant as a result of the plaintiff's breach of contract?

(b) Would it be equitable for the court to reduce the penalty?

(c) If so, to what extent?

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