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ARE ACCELERATION CLAUSES CONTRARY TO PUBLIC POLICY?

A court ruling by Cape Town Judge Dennis Davis in the case of *Combined Developers v Arun Holdings & Others (*6105/2013) [2013] ZAWCHC 132 has raised concern for financial lenders across the country as to the validity of acceleration clauses in loan agreements.

Acceleration clauses provide comfort to lenders, affording them the right to call for repayment of an entire outstanding loan amount if a borrower defaults in paying his instalments. Traditionally, courts do not lightly interfere with contracts and ordinarily give effect to the intentions of the parties when contracting.

LETTER OF DEMAND

In the *Combined Developers* case, the debtor borrowed money from the lender and failed to pay an instalment on the due date. The lender sent an email to the debtor, which when translated into English, read along the following lines:

"*See below and attached, we have not yet received payment. Can you please make payment, or if payment has already been made, forward to us the proof of payment. Thank you, Renier Kerk."*

This email formed part of a string of emails and was preceded by an email sent internally from an employee of the lender to Renier Kerk confirming that payment had not been made by the debtor and asking Mr Kerk how much time they should give the debtor to make the payment. Although separate emails, Judge Davis found that the second email formed part of the totality which was presented to the debtor.

The clause in the loan agreement dealing with "events of default" specifically provided that the borrower would commit an event of default if it failed to pay the amount outstanding together with interest within three business days after receipt of written demand from the lender requiring the borrower to pay the amount to the lender.

The debtor paid the overdue instalment but made no payment in respect of penalty interest.

The lender, despite having received the overdue instalment, demanded that the borrower pay the full outstanding loan because it had failed to pay the penalty interest.

It must be pointed out that the penalty interest was an amount of R86,57 and the entire loan amount which was called up by the lender was in the region of R7.5 million.

The lender's email, according to the debtor, constituted an enquiry or a request that, if payment had not been made, it should be made, as opposed to a written demand as contemplated by the provisions of the loan agreement. The lender, on the other hand, relied on the email as being the written demand for payment which, when not complied with, constituted an event of default and triggered the acceleration clause.

The email failed to set out the exact amount owing and in particular, failed to set out the precise amount of interest which was due and payable. Judge Davis held that the email did not constitute proper demand as contemplated in the loan agreement. He came to this finding by examining the wording of the loan agreement which made a distinction between a written demand and a written notice and found that some form of communication to pay a "*measly sum of R86,57 immediately following payment of the large principal sum should surely have been required."*

The judgment goes on to state that "*it cannot be in line with public policy that a demand, in an ambiguous form as that which was included in the email by the lender, can first be met with silence because R86,57 has not been paid and then a week later, the full weight of the acceleration clause is applied by the lender to gain massive commercial advantage to the significant disadvantage of the debtor*."

Because the acceleration clause has draconian implications, Judge Davis found that at the very least, the debtor could have expected a proper demand to be made which would inform the debtor of the entire amount, as was the case in *Chatrooghoon v Desai and Others* 1951 (4) SA 122 (N) which had been heavily relied on by the lender. In the *Chatrooghoon* case, both the principal and interest amounts were set out in the letter of demand.

CONCLUSION

Some commentators have suggested that Judge Davis has ruled against acceleration clauses in totality. We feel that the effect of this judgment is more focused on the manner in which lenders implement an acceleration clause.

Lenders must consider the clauses of their loan agreements in detail and comply with each and every provision and time period of the agreement when demanding payment from a debtor. Judge Davis has made it clear that if written demand is required before an acceleration clause is triggered; the lender must then strictly comply with the provisions of the loan agreement.

FURTHER ADVICE

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