CASES / VONNISSE

RELATIVE BARGAINING STRENGTH AND ILLEGALITY

Uniting Reformed Church, De Doorns v President of the Republic of South Africa 2013 (5) SA 205 (WCC)

1 Introduction

The South African courts have recognized that the relative situation of contracting parties when concluding the contract – the strength of their bargaining positions relative to each other – is a relevant factor when determining whether a particular provision in the contract (or the contract as a whole) is contrary to public policy (see, eg, *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA) par 12; *Napier v Barkhuizen* 2006 (4) SA 1 (SCA) par 8; *Barkhuizen v Napier* 2007 (5) SA 323 (CC) par 59; *Jordan v Faber* [2010] JOL 24810 (NCB) par 15; *Swinburne v Newbee Investments (Pty) Ltd* 2010 (5) SA 296 (KZD) par 37; *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC) par 74; and *Maphango v Aengus Lifestyle Properties (Pty) Ltd* 2012 (3) SA 531 (CC) par 124). However, there are relatively few cases in which the court has actually relied upon inequality of bargaining power as a ground for holding that a contractual provision is illegal. In *Uniting Reformed Church, De Doorns v President of the Republic of South Africa* (2013 (5) SA 205 (WCC) (the "*URC* case")), Zondi J held that one of the reasons why a clause common to certain notarial leases was contrary to public policy was because the contractants had not occupied equal bargaining positions when entering into the leases. Whether or not one fully agrees with the judge's reasoning, the decision underscores the importance of understanding what is meant by relative bargaining strength and how and when it affects the lawfulness of a contract.

2 Background

The applicant church (the "church") owned three farm properties, each of which had a school on it. The church had acquired these properties at a time when, due to *apartheid* policies, there was a dire lack of adequate educational facilities in the farming communities which it served. As "part of its social and spiritual obligations", the church had felt compelled to undertake the responsibility of providing "decent educational facilities" to

these communities. It had assumed control of the schools and, using its own financial resources and loans, it had made improvements to the school buildings, which at the time were "very basic and largely neglected" (par 13). Some thirty years later, the House of Representatives (the "department") took over the responsibility of running the schools in terms of the then Coloured Education Act (47 of 1963). At that stage, the school buildings were badly in need of maintenance, which the church could not provide due to lack of funds. The department assisted the church in improving the school buildings by "facilitating" (par 15) the granting of loans totalling R1 671 290 by a life-insurance company ("Sanlam") in favour of the church against the registration of building-mortgage bonds over the immovable properties. The "facilitation" was achieved by the registration against the properties of three 20-year notarial leases. These required the department to pay amounts of rent that included the monthly bond instalments payable by the church to Sanlam (the department was required to pay the mortgage portions of the rent directly to Sanlam). The church was to remain liable for maintenance of the buildings, insurance of the properties, and rates, taxes and other levies. Clause 16 in each lease required the church, on expiry of the 20-year period, to transfer the leased property to the State free of charge. The leases were concluded at the instance of the department and the church agreed to the terms proffered with a view to achieving its objective of improving the school facilities.

After expiry of the 20-year period, the third respondent (the "respondent"), which had taken over all the department's functions and was responsible for the administration and control of schools in the Western Cape, sought to obtain transfer of the properties in terms of clause 16 of the leases. The church demurred. It applied for an order declaring, *inter alia*, that it was the lawful owner of the immovable properties, that it was under no obligation to transfer the properties to the State free of charge, that clause 16 was void *ab initio*; and that the State was obliged to pay the agreed, alternatively a fair, rental to the church in respect of its (the State's) continued occupation of the properties from the date of expiry of the leases.

Zondi J considered that the central issue to be decided was whether the provisions of clause 16 were contrary to public policy and, for that reason, void and unenforceable (par 11).

3 Arguments

With reference to *Sasfin (Pty) Ltd v Beukes* (1989 (1) SA1 (A) 7), *Barkhuizen v Napier* (*supra* par 59), and *Magna Alloys and Research SA (Pty) Ltd v Ellis* (1984 (4) SA 874 (A) 891), the church contended that clause 16 was contrary to public policy for two reasons: first, because the parties had not had equal bargaining power when the leases were concluded; secondly, because the clause violated section 25 of the Constitution which proscribes arbitrary deprivation of property and expropriation of property without compensation. The respondent's case was that there was no evidence to support the contention that the church was in a weaker bargaining position than the department at the time of conclusion of the leases, or that clause 16

was harmful to the public interest. In support of its contention, the respondent relied on *Barkhuizen v Napier* (*supra* par 30), *Breedenkamp v Standard Bank of South Africa Ltd* (2009 (5) SA 304 (GSJ)), *Sasfin (Pty) Ltd v Beukes* (*supra* 9), *Botha (now Griessel) v Finanscredit (Pty) Ltd* (1989 (3) SA 773 (A) 782–783), and *Afrox Healthcare Bpk v Strydom* (*supra*).

4 Decision

Zondi J agreed with the church's contention. He reaffirmed that our common law does not recognize agreements that are contrary to public policy (par 25) and that the determination whether a contractual term is contrary to public policy must be made by reference to constitutional values as given expression by the provisions of the Bill of Rights (par 28). The constitutional values of human dignity, equality and freedom require the courts to approach their task of striking down contractual provisions with "perceptive restraint" (*Brisley v Drotsky* 2002 (4) SA 1 (SCA) par 94), but in determining the weight to be attached to these values the extent to which the contract was freely and voluntarily concluded is a "vital factor" (pars 32–33). Public policy requires the courts, not merely to enforce contracts, but also "to ensure that a minimum degree of fairness is observed, and this includes consideration of the relative positions of the contracting parties" (par 34). This "principle" was approved by the Constitutional Court in *Barkhuizen v Napier* (*supra* par 59), where the court said:

> "If it is found that the objective terms are not inconsistent with public policy on their face, the further question will then arise which is whether the terms are contrary to public policy in the light of the relative situation of the contracting parties. In [*Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA)] the Supreme Court of Appeal recognised that unequal bargaining power is indeed a factor that together with other factors plays a role in the consideration of public policy. This is recognition of the potential injustice that may be caused by inequality of bargaining power. Although the court found ultimately that on the facts there was no evidence of an inequality of bargaining power, this does not detract from the principle enunciated in that case, namely that the relative situation of the contracting parties is a relevant consideration in determining whether a contractual term is contrary to public policy. I endorse this principle. This is an important principle in a society as unequal as ours" (par 34).

Zondi J was satisfied from the church's papers that it had established facts which demonstrated that at the time of the conclusion of the lease agreements it was in a weaker bargaining position than the department and that "the effect of inequality in bargaining position was harmful to public interest" (*sic*) (par 35). This, in the judge's view, was evident from allegations in the church's founding affidavit that the department "dictated the terms of the agreement", which the church "had little option but to accept" and that clause 16 "was inserted at the instance of the state and the applicant [church] was left with no choice in the matter. It simply had to comply in order to fulfil the demands of the state for assuming responsibility of the schools" (par 35). The respondent, in reply, had averred simply that the notarial leases were "necessitated by the realities" facing the church and the department, "namely limited financial resources". Zondi J refused to

entertain this notion because, in his opinion, it disregarded the fact that it was the responsibility of the department, not the church, to see to it that the educational needs of the farm workers' children were adequately addressed. The church and the department had not been partners or in a partnership relationship (par 36).

As far as the "harmful effect" of clause 16 was concerned, Zondi J found that it was "inimical to the values enshrined in the Constitution". The particular section "implicated" was s 25, which prohibits "arbitrary deprivation of property" (s 25(1)) and the expropriation of property not "for a public purpose or in the public interest" and not "subject to compensation" (s 25(2)(a) and (b)) (par 37–38). Zondi J considered that enforcement of clause 16 would leave the church with "no alternative but to transfer its properties to the [respondent] without receiving any compensation". The transfer would constitute a "deprivation" as envisaged by section 25(1) and one which did not comply with the requirements of section 25(2)(a) and (b) (par 39). The deprivation would also be "arbitrary" according to the principles laid down in *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service* (2002 (4) SA 768 (CC) par 100). The judge elaborated:

> "There is no sufficient reason for the deprivation from the perspective of either the relationship between the means employed and ends sought to be achieved or the relationship between the purpose for the deprivation and the applicant. The fact that the 3rd respondent's predecessor assumed control and management of the three schools located on the applicant's properties can never, in my view, be a sufficient reason to justify the deprivation of the applicant's properties. Neither can the fact that the 3rd respondent's predecessor facilitated a loan on behalf of the applicant be a justifiable reason for depriving the applicant of its properties. The applicant's properties were used to secure the loan and the mortgage loan repayments were made from the rental which the applicant received from the 3rd respondent. Financially, the 3rd respondent's contribution to the funds for the development of the schools was zero. That being the case there is no sufficient reason to warrant the deprivation of the applicant's properties. To the extent that clause 16 of the lease seeks to deprive the applicant of its properties without creating an obligation on the 3rd respondent to pay compensation, it is, in my view, unfair and therefore contrary to public policy" (par 40).

In Zondi J's view, there were "less intrusive means" which the department could have employed to ensure that it did not lose the right to use the school buildings and other facilities on the church's properties on expiry of the leases. It could, for instance, have negotiated for itself an option to purchase the properties (par 41).

Zondi J concluded:

> "In these circumstances there is no rational relationship between the means employed and the ends sought to be achieved; in my view the provisions of clause 16 in seeking to deprive the applicant of its properties are unnecessarily overbroad. The enforcement of clause 16 will completely extinguish the applicant's ownership in the relevant properties for which the applicant receives no compensation. It is clear that the provisions of clause 16 are a disguised form of expropriation and cannot be allowed to stand" (par 41).

5 Comment

5 1 Arbitrary deprivation?

It is not proposed to comment in detail on the correctness of Zondi J's view that clause 16 provided for arbitrary deprivation or expropriation of property in violation of constitutional values. However, it may be observed *en passant* that the judge's reasoning on this issue appears to ignore or gloss over important facts. These were that the church had agreed to give up its properties for no charge on expiry of the 20-year period in return for receiving the funds it needed to bring about improved school facilities for the communities that it served. At the relevant time, the school properties were badly in need of maintenance, which the church could not provide, and the church obviously made a conscious decision to relinquish its right of ownership of the properties in return for achieving its goal of improved educational facilities for the relevant farming communities. Whatever improvements to the school buildings that resulted were clearly directly attributable to the intervention of department. Far from making no ("zero") contribution to the funds for the development of the schools, the department effectively paid for their development by making payments of rent which included the building-bond instalments. The judgment does not mention what the department's policy was in regard the ownership of school properties under its administration and control, but there does not seem to be anything particularly unusual or disproportionate about its insisting on eventually being given ownership of the school properties, seeing that it had assumed responsibility for the running of the schools as well as liability for the cost of upgrading the school buildings. Zondi J's emphatic assertion that this could "never … be sufficient reason" to justify depriving the church of its properties fails to take account of the economic realities, as the respondent endeavoured to point out. The idea that the deprivation would be without compensation is also misconceived because it ignores the fact that the department effectively repaid the loan needed to upgrade the school buildings, even though the amounts paid were treated as forming part of the rental. Zondi J's closing remark that clause 16 provided for a "disguised form of expropriation" overlooks the obvious point that the clause was agreed to by both parties, even if the church had no alternative but to agree if it was to achieve its purpose.

5 2 Meaning of relative bargaining strength

Zondi J agreed with the church's argument that when the leases were concluded it was in a weaker bargaining position than the department. This raises the question of what exactly is meant by "bargaining power" and when parties can be said to have unequal bargaining power relative to each other.

It is suggested that the term "bargaining power" in this context refers to a party's leverage in relation to a particular contract – his or her ability (capacity) to influence the terms of the contract and conserve his or her interests in concluding it (or declining to do so). The factor that probably most diminishes this ability in a party is his or her need to make the contract in question when there are no realistic bargaining alternatives available (*cf*

Gerolomou Constructions (Pty) Ltd v Van Wyk 2011 (4) SA 500 (GNP) par 20–21). However, bargaining power is also frequently impaired by a lack of bargaining skill or inability to bargaining generally. In South Africa, this kind of bargaining disadvantage is typically attributable to lack of education, lack of knowledge of the subject matter of the contract, inexperience in commercial or legal matters, or inability to read or understand the language of the contract (*cf Standard Bank of South Africa Ltd v Dlamini* 2013 (1) SA 219 (KZD) par 23 and 53). It may also be caused by physical or mental illness, impaired faculties (eg, due to old age) and mental disability (*cf Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 (4) SA 302 (SCA) 330–331). Other disadvantages that undermine bargaining power are a lack of access to independent advice or material information concerning the transaction (especially advice or information regarding the advisability of concluding it or adopting particular terms) and emotional dependence on the other contracting party (*cf Jordan v Faber supra* par 16).

It seems clear that to determine whether parties have unequal bargaining power relative to each other, it is necessary to evaluate each party's bargaining position separately. One party's potential bargaining strength is not necessarily the other party's bargaining weakness. It does not follow, for example, that A is in a strong bargaining position relative to B because A is under no pressure to make the contract in question with B and is able to offer B pre-formulated (standard) terms and tell him to "take it or leave it". B may not need to make the contract with A and may be quite content to "leave it" and go elsewhere or do without. It is only if B needs to make the contract and does not have the option of going elsewhere (because there is not a reasonably competitive range of alternative parties available with whom he or she may make the contract) that A's bargaining position is superior to B's and, accordingly, there is bargaining inequality. For further discussion (see Trebilcock "The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords" 1976 26 *U Toronto LJ* 359 364; Beale "Inequality of Bargaining Power" 1986 6 *OJLS* 123 125; and Thal "The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness" 1988 8 *OJLS* 17 27.

The question whether contractants had unequal bargaining positions when concluding the contract is one of fact. Superior bargaining power must, therefore, be proved by the party who relies on it (*cf Breedenkamp v Standard Bank of South Africa Ltd* 2009 (6) SA 277 (GSJ) pars 23–27, overruling the contrary view adopted in *Breedenkamp v Standard Bank of South Africa Ltd* 2009 (5) SA 304 (GSJ) pars 60–62; and see also Nortje "Unfair Contractual Terms – Effect of the Constitution: Breedenkamp v Standard Bank of South Africa Ltd 2009 5 SA 304 (GSJ) and 2009 6 SA 277 (GSJ)" 2010 73 *THRHR* 517 520).

It will be observed that in the *URC* case, Zondi J did not interrogate the issue of the parties' relative bargaining power. He did not consider, for example, whether the department was bound by law or by its own policy, or was perhaps under pressure from the government, to spend money on upgrading the schools. The fact that the department was prepared to hire the properties from the church and delay their transfer for 20 years arguably demonstrates that the department's bargaining stance was not entirely

inflexible. Zondi J also accepted at face value the church's allegation that it had no option but to accept the terms proffered. There is no indication in the report whether the church had attempted to negotiate different terms with the department or tried to raise the required finance from other sources. This is not to suggest that Zondi J's conclusion on the issue of bargaining equality was necessarily wrong, merely that the matter may well have required closer scrutiny and probably called for more background facts. It stands to reason that without all the relevant information needed to evaluate the bargaining positions of contractants, it cannot safely be concluded that the ingredients of an unequal bargaining relationship are present.

5 3 Relative bargaining strength and illegality

In deciding that clause 16 was contrary to public policy, Zondi J evidently regarded the parties' relative bargaining positions as important (*cf* par 33–34), but *how* important, we do not know. The judge did not indicate precisely what impact the disparity in bargaining power had on his decision and, in particular, he did not clarify whether he would have held clause 16 to be contrary to public policy if the parties had occupied equal bargaining positions or if the clause had not infringed a constitutional value. This lack of clarity is potentially problematic because it leaves unanswered the question whether in certain circumstances an imbalance in bargaining power, on its own, can be enough to render a contract illegal.

If one has regard to the case law, it is possible to advance several propositions regarding relative bargaining strength and its affect on the legality of terms.

> The fact that terms have been imposed by a party in a dominant bargaining position does not, in itself, make the terms illegal or offensive to public policy (see, eg, *Afrox Healthcare Bpk v Strydom supra* par 12). Whether a contractual provision offends against public policy – for example, whether it is so manifestly unfair as to be harmful to the public interest: see *Sasfin (Pty) Ltd v Beukes* (*supra* 7) – depends on its substantive content, not on how or why it came to be incorporated in the contract. The wielding of unequal bargaining power frequently produces terms that are unfair (*cf* the exclusion clause in *Afrox*), and may even result in terms that are so objectionable as to be contrary to public policy (*cf Sasfin*), but neither consequence follows as a matter of course.
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> Exact equality of bargaining power is rare and everyday contractual negotiations frequently involve one party taking advantage of some bargaining advantage to secure a "better deal" for him or herself. As Dillon LJ observed in *Alec Lobb (Garages) Ltd v Total Oil GB Ltd* ([1985] 1 All ER 303 (CA) 313):
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> > "It is seldom in any negotiation that the bargaining powers of the parties are absolutely equal. Any individual wanting to borrow money from a bank, building society or other financial institution in order to pay his liabilities or buy some property he urgently wants to acquire will have virtually no bargaining power; he will have to take or leave the terms offered to him. So [also], with house property in a seller's market, the purchaser will not have equal bargaining power with the vendor."

In run-of-the-mill negotiations in which one party enjoys a bargaining advantage, there is obviously no question of the imbalance in bargaining power affecting the legality of the resultant contract. To take this approach would place a question mark over the legality of a vast number of contracts. It is suggested that unequal bargaining power impacts on the element of legality only if there is a marked disparity in the parties' bargaining positions and the "stronger" party abuses his or her dominant position, as where he or she knowingly takes advantage of the other party's bargaining weakness to impose onerous terms on him or her. A number of legal systems consider conduct of this kind to be a sufficient reason for setting aside the contract (see, eg, Beale *Chitty on Contracts: General Principles* Vol 1 31ed (2012) par 7-130–7-140 and the cases cited there; Hardingham "The High Court of Australia and Unconscionable Dealing" 1984 4 *OJLS* 275; Enman "Doctrines of Unconscionability in Canadian, English and Commonwealth Contract Law" 1987 16 *Anglo–Am LR* 191; s 138(2) of the *Bürgerliches Gesetzbuch* (*BGB*); article 3(1)(1) of the UNIDROIT Principles of International Commercial Contracts (PICC); and article 4:109(1) of the Principles of European Contract Law (PECL)).

The fact that unfair terms have been imposed by a party in a dominant bargaining position obviously enhances the unfairness of enforcing those terms, but this unfairness, in itself, does not make the enforcement *unlawful*. The Supreme Court of Appeal has made it clear that whether enforcement of a *prima facie* valid contractual term is unlawful depends on whether the enforcement offends against a constitutional value or some other recognized societal norm. The mere fact that it will produce a result which is unreasonable or unfair is not enough (see, eg, *Brede-nkamp v Standard Bank of South Africa Ltd* 2010 (4) SA 468 (SCA) par 53; and *Maphango v Aengus Lifestyle Properties (Pty) Ltd* 2011 (5) SA 19 (SCA) 27 par 25). The principle is limited to enforcement of a "*prima facie* valid" term – if the term does violate a constitutional value or societal norm – for example, if it is so manifestly unfair as to be harmful to the public interest (as in *Sasfin (Pty) Ltd v Beukes supra* 7) – then, obviously, enforcement of the term will also be contrary to public policy.

The primary consequence of the taking unfair advantage of superior bargaining power appears to be that it diminishes the weight to be attached to the constitutional values of dignity, equality and freedom which underpin the principle of sanctity of contract (*pacta sunt servanda*) and which provide, in part, the rationale for enforcement of the terms in question (see *Barkhuizen v Napier supra* par 57; and *African Dawn Property Finance 2 (Pty) Ltd v Dreams Travel and Tours CC* 2011 (3) SA 511 (SCA) par 32). This, in turn, means that correspondingly greater weight must be accorded to any feature which weighs against the legality of the terms or their enforcement. The upshot is that a contractual provision, or the enforcement of a contractual provision, which, *on its own*, is not so objectionable as to be offensive to public policy, may be found to be contrary to public policy if the contract is the product of one party taking unfair advantage of his or her superior bargaining power. Obviously, no hard and fast rule can be formulated to determine when an abuse of bargaining power will tip the scales in favour of illegality. It is for

> the court to decide in each case how much significance should be accorded to any factor that impinges on the legality of the contract. In general, one may postulate that the more aggravated the abuse of bargaining power, the more it will support or justify a finding of illegality.
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> The fact that terms are the product of negotiation between contractants of more or less equal bargaining strengths does not necessarily validate the terms or their enforcement, but it tends to reinforce the constitutional values of dignity, equality and freedom that justify enforcement of the contract. This means that correspondingly less significance must be accorded to any substantive unfairness or other objectionable feature of the terms (cf *Breedenkamp v Standard Bank of South Africa Ltd* 2009 (6) SA 277 (GSJ) par 21; *Logbro Properties CC v Bedderson NO* 2003 (2) SA 460 (SCA) par 10 fn 11; *Structured Mezzanine Investments v Davids* 2010 (6) SA 622 (WCC) par 21; and *African Dawn Property Finance 2 (Pty) Ltd v Dreams Travel and Tours CC supra* par 31).

In the *URC case*, it will be noted, Zondi J did not deal specifically with the question of whether the department took *unfair* advantage of its superior bargaining position. He may possibly have had something like this in mind when he said that the "effect" of the "inequality in bargaining position" had been "harmful to [the] public interest" (par 35). Whatever the judge meant by this remark, he did not highlight any unfairness issue other than the fact that clause 16 required the church to transfer the properties without receiving any compensation (that is, compensation that it could appropriate to itself rather than spend on the school buildings). It is suggested that in the circumstances, this feature was not *per se* sufficient to make the department's exercise of bargaining power unfair.

6 Conclusion

The *URC* case may come to be regarded as something of a landmark judgment in the law relating to contract illegality, simply because of the prominence which the court accorded to the factor of inequality of bargaining power in reaching its decision. However, closer analysis of the judgment reveals possible weaknesses in the court's reasoning. The real value of the judgment may prove (ironically) to be the discussion that it subsequently inspires on unequal bargaining power, leading to clarification of the relevant principles. The concept of unequal bargaining power is not always fully understood and it has the potential to become an "unruly horse" – one which, if left unchecked, can significantly undermine the sanctity of contract. The courts need to clarify several issues, including the meaning of "bargaining power", when parties have unequal bargaining positions relative to each other, precisely when the wielding of superior bargaining power has implications for the legality of the contract, and whether the taking of unfair advantage of bargaining weaknesses can, in itself, ever render contractual terms or their enforcement illegal. This note suggested possible answers to these questions.

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