PUNITIVE CONTRACTUAL CLAUSES IN SOUTH AFRICAN LAW UNLAWFUL BY DESIGN & CONSTITUTIONALLY CONSTRAINED

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INTRODUCTION

Private law in South Africa is anchored in the principle known as *pacta sunt servanda*. This means contracts freely concluded should be respected and enforced. However, many standard-form commercial and consumer contracts are concluded in circumstances of unequal bargaining power, where one party dictates the terms and the other party is either forced to take them or leave. One such instance is the inclusion of punitive costs clauses, which entitle one party upon breach of the other party to recover the majority of their legal costs following enforcement proceedings.

When dealing with punitive costs clauses, courts are required to interpret and enforce contracts in a manner consistent with constitutional values, statutory protections and public policy, especially where contractual terms operate harshly or disproportionately against the weaker party.

In *FFS Finance South Africa (RF) (Pty) Ltd t/a Ford Credit v Lamola,*[1] the Gauteng division of the High Court was confronted with whether such clauses should be enforced against defaulting consumers. The judgment identified three significant flaws associated with punitive costs clauses, namely: (1) their conflict with the court's discretion in relation to costs orders; (2) their inconsistency with statutory provisions; and (3) their contravention of public policy. The court accordingly held that a more cautious judicial approach should be adopted when considering the enforcement of punitive costs clauses.

COURTS AWARDING COST ORDERS

Prior to dealing with punitive cost orders, it is important to understand what costs orders awarded by courts are and the different types of costs orders that exist. When a party ("the initiating party") calls another party ("the defaulting party") to court to either seek specific performance under a contract or claim damages for a breach of a contract, legal costs are incurred in bringing legal proceedings. Upon the initiating party being successful, a court can order the defaulting party not only to perform as per the contract or pay damages, but can also order the defaulting party to pay the legal costs incurred by the initiating party who brought the proceedings. The same principle applies to the defaulting party should they be successful in defending the case brought by the initiating party. This is premised on the rule that not only did the initiating party waste the court's and the defaulting party's time but the defaulting party also had to incur legal costs to defend themselves in court.

The court can grant either ordinary party-and-party costs, or costs on attorney-and-client scale (also known as punitive costs), or order that each party pay their own costs. Party-and-party costs are limited to those costs strictly necessary to conduct the litigation such as court appearances. Attorney-and-client costs permit recovery of a broader range of legal expenses incurred between an attorney and their client, including costs not ordinarily recoverable from the opposing party, such as consultation fees with attorneys. It is important to note that courts have the sole discretion to determine what type of costs are appropriate for a particular case.

In the past there has been an untested practice of parties agreeing what type of costs the other party can recover should any of the parties default on the contract. Recently, this position though not fully resolved, has come under judicial consideration by a High Court in Gauteng in *Lamola*.

THE LAMOLA DECISION ON PUNITIVE COSTS CLAUSES

In *Lamola*, the Gauteng division considered two default judgment applications brought by credit providers seeking to enforce instalment sale agreements against defaulting consumers. Crucially, the agreements contained clauses permitting the plaintiffs to recover punitive costs upon the institution of legal proceedings following default.

The central legal questions were whether the court could, or should, be bound by the parties' punitive costs clauses particularly where the consumer did not oppose the proceedings, or whether the court was required to exercise its own discretion in awarding costs.

A) Court's assessment of costs discretion

Acting Judge Marumoagae emphasised that the power to award costs is inherently vested in the discretion of the court and cannot be ousted by agreement between the parties. Citing Molemela AJA (as she then was) in *Khumalo & Another v Twin City Developers*[2], Marumoagae AJ noted that:

"It bears emphasising that ... all courts have an unfettered discretion in relation to the award of costs."

Further reliance was placed on *Mulder v Kuhn*,[3] where the court noted that:

"It is known to the parties that in awarding costs this court has a discretion which should be exercised judicially upon the consideration of the facts in the matter and that in essence, a decision be made where fairness to both sides should be considered."

This emphasises that although contractual freedom is important, courts retain the discretion to determine appropriate costs orders irrespective of contractual terms.

In *Ferreira v Levin NO and Others; Vryenhoek and Others v Powell NO and Others*[4] although dealing with costs in constitutional litigation, Ackermann J observed that courts have developed two fundamental principles governing the award of costs. The first is that the award of costs, unless expressly provided otherwise by statute, lies within the discretion of the presiding judicial officer. The second is that the successful party should, as a general rule, be awarded costs (also referred to as "costs follow the cause").

Importantly, the second principle is subject to the first. It is important to note that costs which follow the cause are ordinarily awarded on a party-and-party scale. This general rule is further subject to exceptions rendering it inapplicable taking into account factors such as: (a) the conduct of the parties; (b) the conduct of their legal representatives; (c) whether a party has achieved only technical success; (d) the nature of the litigants; and (e) the nature of the proceedings.

When courts simply rubber-stamp an attorney-and-client costs order per the punitive costs clauses without properly exercising their discretion, they unfairly prejudice parties. It also undermines the powers of the courts. Similarly, legal practitioners should refrain from inserting punitive costs clauses that show no regard to the discretion of the courts in dealing with costs orders.

The court in *Lamola* observed that punitive costs provisions in standardised instalment sale agreements operate within a context of unequal bargaining power, as ordinary consumers rarely negotiate such terms or fully understand their implications. Marumoagae AJ noted: "Contracts that insert as a term, a clause that binds a consumer without any prior discussion or explanation of the implications of such clauses, present the clearest case that warrants judicial intervention".

The approach adopted in *Lamola* accords with one of the factors in dealing with costs supported by the Constitutional Court's reasoning in *Ferreira*[5] that: "the principles which have developed in relation to the awards of courts are by nature sufficiently flexible and adaptable to new needs".

B) Punitive costs clauses and statutes

The court in *Lamola* further noted that the statutory objectives of the National Credit Act 34 of 2005 (the NCA) and the Consumer Protection Act 68 of 2008 (the CPA) protect creditors from unequal bargaining powers. The CPA provides, inter alia, that its purpose is "to improve standards of consumer information" and "to prohibit certain unfair marketing and business practices". Similarly, the NCA aims to "provide for general regulation of consumer credit and improved standards of consumer information".

The court in *Lamola* held that punitive costs clauses in commercial agreements offend against the spirit of both the NCA and the CPA because they create an additional mechanism for perpetuating over-indebtedness among consumers whose

default indicates an inability to meet their financial obligations.

The CPA directly addresses issues of contractual fairness. Section 48(2)(a) and (b) provides that a contract is unfair, unreasonable or unjust if it is excessively one-sided in favour of any person other than the consumer and is so adverse to the consumer as to be inequitable. Although *Lamola* did not formally invalidate the punitive costs clauses under section 48, the court noted that taking into account the above statutory objectives, punitive costs clauses are excessively one-sided and unlawful.

C) Public policy and constitutional values

The court in *Lamola* invoked the constitutional values of human dignity, equality, and freedom when interpreting contracts in a manner consistent with public policy when it held that the automatic enforcement of punitive costs clauses against unrepresented, defaulting consumers without the exercise of judicial discretion may be contrary to public policy and therefore potentially unlawful.

Although the court did not formally declare such clauses generally unlawful, it stated that punitive costs clauses "are against public policy, potentially unlawful and should not be granted". These considerations are particularly important where such provisions impose disproportionate burdens on consumers who neither negotiated nor fully understood the implications of the clauses.

Even outside the consumer protection framework, the common law and constitutional doctrine permit courts to refuse enforcement of contractual terms that offend public policy or constitutional values. In *Barkhuizen v Napier*, the Constitutional Court held that public policy must be determined with reference to the values embodied in the Constitution. A contractual term may therefore be unenforceable if it infringes constitutional rights or is contrary to public policy, particularly where there is inequality of bargaining power or where enforcement results in unfair outcomes. The court adopted a two-stage inquiry into fairness and reasonableness: first, whether the clause itself is unreasonable; and second, if not, whether enforcement in the particular circumstances would nevertheless be contrary to public policy.

The automatic imposition of attorney-and-client costs, without judicial scrutiny, risks producing outcomes that are disproportionate, oppressive and inconsistent with constitutional values of fairness, equality and dignity. This as pointed out above creates over-indebtedness to consumers. On this basis, even if the clauses themselves are not inherently unreasonable, their enforcement in the circumstances before the court is contrary to public policy. It can be clearly depicted from statute in the CPA and NCA that public policy dictates that consumers who are already in financial difficulty cannot be expected to pay the costs of litigation on the highest scale.

This constitutional framework has been reaffirmed in subsequent jurisprudence. In *Beadica 231 CC and Others v Trustees for the Time Being of the Oregon Trust and Others.*[6] the Constitutional Court confirmed that public policy is informed by constitutional values and that enforcement of contractual terms contrary to those values is impermissible, particularly where enforcement would be unfair or unjust. Although *Beadica* did not concern punitive costs clauses, it provides the broader constitutional context within which courts may refuse to enforce contractual provisions that offend public policy.

More recently, in *Melki Propdev Initiatives (Pty) Ltd v Cunningham*,[7] the KwaZulu-Natal division of the High Court reinforced the principle that contractual terms inconsistent with constitutional values are unenforceable and may be severed from an agreement. The court emphasised that terms inimical to the constitutional foundations of fairness and equality offend public policy. This approach aligns closely with the reasoning in *Lamola*, which stressed the constitutional and statutory limits on the enforcement of punitive contractual provisions.

Public policy doctrine therefore embraces a measure of judicial regulation of unfair contract terms, requiring courts to decline enforcement where doing so would conflict with constitutional norms such as equality and fairness. At the same time, the constitutional approach does not permit courts to refuse enforcement on the basis of subjective unfairness alone. Rather, the party seeking enforcement of punitive costs clauses should be required to demonstrate that enforcement would not be so unfair, unreasonable or unjust as to be contrary to public policy.

Earlier authority, such as *Afrox Healthcare v Strydom*[8] although dealing with exclusionary or indemnity clauses, confirmed that clauses such as this may be unenforceable on public policy grounds where they are so one-sided that their enforcement would conflict with the public interest and constitutional values. This same principle should be applied when dealing with punitive costs clauses.

The above court decisions clearly show that the enforcement of punitive costs clauses that disproportionately burden consumers without meaningful negotiation or reciprocal benefit is contrary to public policy.

CONCLUSION

As shown above, the enforcement of punitive costs clauses requires careful judicial intervention.

Contractual agreements providing for attorney-and-client costs cannot displace the court's inherent discretion in awarding costs and must therefore be approached with caution to ensure that such discretion is not undermined or hijacked by private agreement.

When dealing with punitive costs, courts are required to exercise their discretion judicially and independently, rather than rubber-stamping such awards merely because the parties have agreed to them. In doing so, courts must take into account constitutional values, considerations of public policy, and relevant statutory objectives. *Lamola* represents a step in the right direction to reaffirming the need for meaningful judicial oversight in the enforcement of punitive costs clauses. A

Notes

1 *FFS Finance South Africa (RF) (Pty) Ltd t/a Ford Credit v Lamola 2024 (2) SA 427 (GP).*
2 *Khumalo & Another v Twin City Developers* [2017] ZASCA 143 (2 October 2017).
3 *Mulder v Kuhn* [2022] ZAGPPHC 336.
4 *Ferreira v Levin NO and Others; Vryenhoek and Others v Powell NO and Others* 1996 (1) SA 984 (CC).
5 *Ferreira v Levin* at par 3.
6 *Beadica 231 CC and Others v Trustees for the Time Being of the Oregon Trust and Others* [2020] ZACC 13.
7 *Melki Propdev Initiatives (Pty) Ltd v Cunningham* [2025] ZAKZPHC 40.
8 *Afrox Healthcare v Strydom* [2002] ZAENGTR 1 (31 May 2002).