

**The Pactum De Non Cedendo: Through a  
Constitutional Lens**

**By**

**Ebrahim Abrahams**

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**Supervisor: Professor Dale Hutchison**

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## ABSTRACT

The aim of this paper was to determine whether the current South African law governing the doctrine of *pacta de non cedendo* complies with the constitutional mandates imposed by our Constitution.

In terms of the current law a *pactum de non cedendo* will only be accorded validity if the debtor is able to demonstrate a substantial interest in the prohibition against cession. However, the interest requirement is only applicable when a *pactum de non cedendo* is superimposed onto a pre-existing right, and is not required when a right is born *ab initio* with a prohibition on transfer.

In my opinion the current law falls short of the “spirit, purport and objects of the Bill of Rights”, as required by s 39(2) of the Constitution, and is therefore, in need of development. In this paper I propose the following development: Firstly, by requiring the debtor to prove an interest that is served by the *pactum de non cedendo*, in certain circumstances, the law undermines the value of equality held so dearly by our society. This is because no such requirement exists when other types of restrictive clauses are concluded. It is my contention that the ‘interest requirement’ be relegated from being a free-standing requirement to simply being another factor to be taken into account when conducting the public policy enquiry.

Secondly, *pacta de non cedendo* appearing in book debts and other similar monetary obligations should always be held contrary to public policy due to the importance of the free flow of claims in commerce, specifically, the factoring and securitisation industries. Factoring plays a crucial role in the world economy, the most advantageous aspect of factoring is that small to medium size businesses may obtain much needed finance by selling their claims to a factoring house.

Lastly, the current distinction drawn between a *pactum de non cedendo* that is superimposed onto a pre-existing right, and a right that is created with a *pactum de non cedendo* is artificial and illogical, the correct distinction that should be drawn is between a *pactum de non cedendo* that is concluded by the debtor and creditor on the one hand, and between a *pactum de non cedendo* concluded between the cedent and cessionary on the other.

## Contents

	Page
<b><u>Chapter 1: Introduction</u></b> .....	5
1.1) Constitutional Framework.....	7
1.2) Current law on <i>pacta de non cedendo</i> .....	10
1.3) My conceptual analysis.....	13
<b><u>Chapter 2: Historical Development &amp; Academic Commentaries</u></b> .....	32
2.1) Paiges v Van Ryn Gold Mines Estates Ltd 1920 (A).....	32
2.2) Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd 1968 (A).....	41
2.3) Italtrafo SpA v Electricity Supply Commission 1978 (W).....	46
2.4) Vawda v Vawda and others 1980 (T).....	49
2.5) MTK Saagmeule (Pty) Ltd v Killyman Estates (Pty) Ltd 1980 (A).....	52
2.6) Joubert's Solution (1985).....	58
2.7) Roussouw's Solution (1991).....	61
2.8) Scott's solution (1991).....	65
2.9) Smuts v Booyens; Markplaas (Edms) Bpk en 'n ander v Booyens (2001) (SCA).....	70
2.10) Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd (2008) (C).....	73
2.11) Scott's Solution (2008).....	78

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2.12) Sunkel's Solution (2009).....	80
2.13) Born Free Investments 364 (Pty) Limited v Firststrand Bank Limited (2014) (SCA).....	82
2.14) Hutchison's Solution (2016).....	85
<b><u>Chapter 3: Comparative analysis</u></b> .....	91
3.1 UNIDROIT Factoring Convention.....	91
3.2 UNCITRAL Assignment of Receivables Convention.....	92
3.3 UNIDROIT PICC.....	93
3.4 American Law.....	94
3.5 German Law.....	99
3.6 French Law.....	100
<b><u>Chapter 4: Criticism, Analysis and Conclusion</u></b> .....	101
4.1 Current Law.....	101
4.2 Major criticisms of the current law.....	102
4.3 My Solution.....	103
4.4 Conclusion.....	105
<b>Bibliography</b> .....	107

## Chapter 1: Introduction

In light of the developments in factoring/discounting and securitisation, claims have emerged as the most important class of assets in commerce.<sup>1</sup> Factoring and securitisation are undoubtedly two of the most important cogs in the commercial wheel and constitute multi-trillion dollar industries globally.<sup>2</sup> Agreements prohibiting the transferability of a right by cession (*pacta de non cedendo*)<sup>3</sup>, however, “throw a proverbial spanner in the works” of these cogs of the commercial wheel. *Pacta de non cedendo* have the potential to inhibit and stultify the growth of these powerhouse industries.<sup>4</sup>

Both factoring and the securitisation of claims originate in the United States.<sup>5</sup> In the U.S factoring was introduced as a method to solve the difficulties incurred in providing commercial credit.<sup>6</sup> Small to medium size businesses are the major clients of a factoring house, often the only asset of these businesses are book debts, consequently, book debt financing is the only form of finance available to these businesses.<sup>7</sup> To obtain credit facilities all that the business is required to do is to cede

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I would like to extend my sincere appreciation to my supervisor, Professor Dale Hutchison, for all his hours he has spent assisting me and for all his insightful comments.

<sup>1</sup> S Scott, *Once Again: Agreements Prohibiting Cession*, (2008) 19 *Stellenbosch Law Review* 483.

<sup>2</sup> *Ibid.*

<sup>3</sup> D Hutchison, *Agreements in Restraint of Cession: Time for a New Approach*, (2016) *Stell LR* 273.

<sup>4</sup> K Sunkel, *A Comprehensive Suggestion To Bring The Pactum De Non Cedendo Into The 21<sup>st</sup> Century*, (2010) 3 *Stellenbosch Law Review* 463 at 474.

<sup>5</sup> Scott op cit note 1 at 484.

<sup>6</sup> *Ibid.*

<sup>7</sup> R Noel *et al*, *Salinger on Factoring 4ed*, (London, Sweet & Maxwell Ltd, 2006) pp 35 – 36.

its book debts to the factoring house.<sup>8</sup> Once the business has ceded its book debts the factoring house thereafter owns the book debts, and is consequently entitled to legally enforce these debts.<sup>9</sup> In return for ceding its claims (rights) the factoring house pays the client the value of the book debts less certain fees.<sup>10</sup>

The institution of factoring provides two valuable services: firstly, the factoring house provides credit facilities to their clients; secondly, the factoring house also provides financial services.<sup>11</sup>

Securitisation is highly complex commercial institution that may be defined as follows: “[it] is the process of converting illiquid claims against one’s debtor into a security, that is, into a financial instrument that can be traded”.<sup>12</sup>

Securitisations are usually coupled with a collective security arrangement, in terms of which security is held for the common benefit of a number of creditors.<sup>13</sup> The securities that are pooled together may take various forms, and include the following: “suretyship, pledge, mortgage or security cession of the assets (property) of the borrower (debtor) or of a third party”.<sup>14</sup> Collective security arrangements have the following advantages: substantial credit is provided over a longer period of time;

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<sup>8</sup> Sunkel op cit note 4 at 473.

<sup>9</sup> Ibid.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Hutchison op cit note 3 at 274 footnote 7.

<sup>13</sup> S Scott, *An Introduction to the Securitisation of Claims Incorporating a Collective Security Arrangement*, (2006) SA Merc LJ 397.

<sup>14</sup> Ibid.

administrative costs and taxes are reduced; the arrangement is less risk averse, and efficiency is increased.<sup>15</sup>

Securitisation is a financial technique that has the following basic construction: similar claims (such as book debts, instalment sale agreements, lease agreements, mortgage bonds and consumer loans) are pooled together so that they may be sold to an entity created for the specific purpose of acquiring such claims.<sup>16</sup> The seller and holder of these assets is known as the 'originator', and the buyer to whom these assets are sold and transferred to is known as a Special Purpose Vehicle (SPV).<sup>17</sup> In order to fund the sale of the assets the Special Purpose Vehicle issues commercial paper to investors.<sup>18</sup>

## 1.1 Constitutional Framework

Cession straddles both the law of property and the law of obligations simultaneously, and consequently forms part of private law.<sup>19</sup> The law of property is involved because cession concerns the transfer of an asset.<sup>20</sup> Cession involves the law of obligations, as cession has the effect of substituting one creditor for another.<sup>21</sup>

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<sup>15</sup> Ibid.

<sup>16</sup> Ibid 403.

<sup>17</sup> Ibid.

<sup>18</sup> Ibid.

<sup>19</sup> S Scott, *Cession for Students 2ed*, (Juta & Co Ltd, 2013) pp 4 – 7.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

Due to the great emphasis placed on the bifurcation between private law and public law it may seem somewhat paradoxical to discuss the application of constitutional law to an area of private law.<sup>22</sup>

With the adoption of the interim Constitution<sup>23</sup> in 1994 and the final Constitution<sup>24</sup> in 1996 South Africa's constitutional revolution was initiated, by abolishing parliamentary sovereignty and replacing it with the notion of constitutional supremacy.<sup>25</sup> In *S v Makwanyane*<sup>26</sup> the Constitutional Court held that in the vertical sphere, that is, between the State and its citizens, the rights in the Bill of Rights could be directly relied on in challenging the constitutional validity of state action.<sup>27</sup> However, in the horizontal sphere, that is, cases involving private parties, it was uncertain whether and to what extent the Constitution, specifically, the Bill of Rights, could be directly invoked. In other words, it was uncertain to what extent the Constitution applied to Private Law.

In the seminal decision of *Carmichele*<sup>28</sup> the Constitutional Court held that South Africa's Constitution not only regulates public power, as the Constitution encompasses what was referred to as an 'objective value system'.<sup>29</sup> Therefore, the Constitution contains both defensive subjective rights for individuals, as well as an objective value

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<sup>22</sup> A Price, *The Influence of Human Rights on Private Common Law*, (2012) 129 SALJ 330.

<sup>23</sup> Constitution, Act 200 of 1993.

<sup>24</sup> Constitution, Act 108 of 1996.

<sup>25</sup> P De Vos, et al, *South African Constitutional Law in Context*, (Oxford University Press Southern Africa, 2014) pp 26-27.

<sup>26</sup> 1995 (6) BCLR 665.

<sup>27</sup> Ibid.

<sup>28</sup> *Carmichele v Minister of safety and Security and Another* 2001 (4) SA 938 (CC) para 54.

<sup>29</sup> Ibid.

system.<sup>30</sup> This objective value system is a fundamental constitutional value which is applicable to all areas of law, and provides guidance to all three branches of the State.<sup>31</sup> Furthermore, the court stated that “the influence of the fundamental constitutional values on the common law is mandated by s 39(2) of the Constitution.”<sup>32</sup> Section 39(2) states that: “when developing the common law... every court... must promote the spirit, purport and objects of the Bill of rights”.<sup>33</sup> The court held that development of the law in terms of s 39(2) should be conducted within the matrix of the objective normative value system.<sup>34</sup> It is therefore, clear that the Constitution contains both rights and values.

The Constitutional Court, therefore, made it abundantly clear that the Constitution, at least its objective normative value system, applies to all law, including the private common law. Therefore, the Constitution does apply in the horizontal sphere.

There are, however, a number of theories on the horizontal application of constitutional rights, and determining which theory to apply is of central importance to any legal system.<sup>35</sup> South African Law has adopted the indirect application model in Private Law. In *Barkhuizen*<sup>36</sup> the Constitutional Court stated that the Bill of Rights

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<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Constitution supra note 24.

<sup>34</sup> *Carmichele* supra note 28.

<sup>35</sup> A Barak, *Constitutional Human Rights and Private Law*, in D Friedmann & D Barak-Erez, *Human Rights in Private Law* (2001) 13.

<sup>36</sup> *Barkhuizen v Napier* 2007 (5) SA 323 (CC).

applies indirectly in the context of an agreement concluded between private parties.<sup>37</sup> In terms of this model constitutional rights are applicable in private law, although their application is indirect.<sup>38</sup> A constitutional inlet is provided by pre-existing doctrines or the creation of new doctrines.<sup>39</sup> The most advantageous aspect of this model is that it does not create a new parallel system of human rights, but instead works within the pre-existing private common law.<sup>40</sup> For example, the concept of public policy has always attempted to strike a balance between competing human rights, the fundamental difference is that these rights have now been endowed with constitutional status.<sup>41</sup> In other words, the constitutional status of these rights have increased their normative status, and consequently these rights are given an increased weight in private law.<sup>42</sup>

“[T]he obligation of the courts to develop the common law, in the context of section 39(2) objectives, is not purely discretionary. On the contrary, it is implicit in section 39(2) read with section 173 that where the common law as it stands is deficient in promoting the section 39(2) objectives, the courts are under a general obligation to develop it appropriately”.<sup>43</sup>

## **1.2 Current law on *pacta de non cedendo***

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<sup>37</sup> Ibid paras 29 -30.

<sup>38</sup> Barak op cite note 35 at pp 21 – 26.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> De Vos op cit note 25 at 342.

One of the requirements for a valid cession is that the right being ceded is capable of being transferred.<sup>44</sup> The general rule is that all personal rights are transferable.<sup>45</sup> There are, however, a number of exceptions to this general rule.<sup>46</sup> One of which is the *pactum de non cedendo*.<sup>47</sup> A *pactum de non cedendo* is a clause prohibiting the transferability of right by cession.<sup>48</sup>

A *pactum de non cedendo* has the potential to prevent both an 'out-and-out' cession as well as a security cession.<sup>49</sup> An out-and-out cession is defined as a bilateral juristic act whereby a right is transferred by mere agreement between the transferor, termed a cedent, and the transferee, termed a cessionary.<sup>50</sup> Cession *in securitatem debiti* is the conditional cession of a right for security purposes, usually as security for a debt.<sup>51</sup>

*Paiges v Van Ryn Gold Mine Estates Ltd*<sup>52</sup> is still considered the leading case on the validity and effect of a *pactum de non cedendo*.<sup>53</sup> The court in this case held that the validity of the *pactum de non cedendo* depended on whether the prohibition against

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<sup>44</sup> R Sharrock, *Business Transactions Law*, (2011, Juta, 8ed) pp 252-254.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid. Other exceptions are: where the transferability of a personal right is restricted by statute; rights that are intensely personal, such as a *delectus personae*; and, where cession would result in splitting of the debt.

<sup>47</sup> Ibid.

<sup>48</sup> Ibid.

<sup>49</sup> *Smuts v Booyens; Markplaas (Edms) Bpk en n Ander v Booyens* 2001 (4) 15 (SCA).

<sup>50</sup> *Hippo Quarries (Transvaal) (Pty) Ltd v Eardley* 1992 (1) SA 867 (A).

<sup>51</sup> D Hutchison *et al*, *The Law of Contract in South Africa*, 2ed (Oxford, University Press, South Africa, 2012) pg 368.

<sup>52</sup> 1920 AD 600. See also the prior decision in *South African Railways v The Universal Stores Ltd* 1914 TPD.

<sup>53</sup> Hutchison op cit note 3 at pg 276.

transfer served a legitimate interest or purpose of the debtor, if it did then it would be valid and binding between the debtor and creditor subject to the prohibition, and by virtue of the *nemo plus iuris* rule<sup>54</sup>, it would also be effective against third parties, that is, any purported transfer to a third party would be completely ineffectual.

The debate as to the correct legal principles and theoretical underpinnings of *pacta de non cedendo* has raged on for almost a hundred years.<sup>55</sup> This debate has been re-ignited by two landmark decisions: *Capespan*<sup>56</sup> and *Born Free Investments*<sup>57, 58</sup>. The topic, however, remains a conceptually taxing area of study, in which legal opinions continue to differ.<sup>59</sup> Both of the respective courts in the aforementioned cases appeared to accept the correctness of the law as enunciated by Scott in 1991, where she states the following:

“The correct approach should be the following: a clear distinction should be drawn between a *pactum de non cedendo* in relation to existing rights, and one in relation to a right which is created as a non-transferable right. In relation to existing rights, the views of Sande and Voet should be followed in regard to both the validity and the effect of a

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<sup>54</sup> *Nemo plus iuris ad alium transferre potest quam ipse haberet* (nobody can transfer any greater right than he himself has).

<sup>55</sup> S Scott, *The Law of Cession 2ed*, (Juta & Co Ltd, 1991) pp 205 ff; N Joubert, *Die Regsbetrekkinge by Krediefaktoring*, (LLD thesis, Randse Afrikaanse Universiteit, 1985); GF Lubbe *et al*, *Contract Cases Materials Commentary 3<sup>rd</sup> ed*, (Juta & Co Ltd, 1988) pp 654-656; N Joubert, *Boekskuldfinansiering en Pacta de non Cedendo*, (1986) *Modern Business Law* 109; S Scott, *Pacta de non Cedendo*, (1981) *THRHR* 148; S Scott, *Sessie en Factoring in Suid-Afrikaanse Reg*, (1987) *De Jure* 15; SR Roussouw, *Pacta de non Cedendo*, (1991) *Responsa Meridiana* 52; Van Huyssteen *et al*, *Contract General Principles 5<sup>th</sup> ed* (Juta, 2016) pp 451-453.

<sup>56</sup> *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C).

<sup>57</sup> *Born Free Investments 364 (Pty) Ltd v Firststrand Bank Limited* [2014] 2 All SA 127 (SCA).

<sup>58</sup> Scott op cit note 1; S Scott, *Sessieverbiedende Ooreenkomste en die Posisie van die Kurator of Likwidateur by Insolvensie*, (2008) *TSAR* 776; Sunkel op cit note 4; GF Lubbe, *Cession in LAWSA*, 3<sup>rd</sup> ed (2013) par 164; K Sunkel, *The Pactum de non Cedendo: A Re-evaluation*, (LLM thesis, University of the Western Cape, 2009); Hutchison op cit note 3.

<sup>59</sup> Hutchison op cit note 3 at 273.

*pactum de non cedendo*. In other words, as such an agreement is contrary to the basic principle of the law of property that a *res in commercio* should not be withdrawn from commercial dealings, a good reason is required, or, as the courts interpret it, the person in whose favour the restraint is operating should have an interest in the agreement. The effect of such an agreement is that it is binding only on the parties to the agreement and a breach thereof results in a claim for damages the right, however, passes to the cessionary.

In relation to a right which is created as a non-transferable right, a *pactum de non cedendo* is valid as the principle of freedom of contract is paramount here and therefore the requirement that the debtor should have an interest in the agreement is unnecessary. A cession contrary to such an agreement is of no force and effect even in the event of involuntary cessions, as the nature of the right is such that it is not transferable".<sup>60</sup>

In light of the fact that the *Born Free Investments* decision was decided by the Supreme Court of Appeal the law as stated in that case has become the precedent. In my opinion the law as stated in this case is completely unconvincing and entirely artificial. The distinction drawn between a pre-existing right, in terms of which a *pactum de non cedendo* is superimposed onto, and a right which is created *ab initio* as non-transferable, is illogical.

### **1.3 My conceptual analysis**

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<sup>60</sup> Scott (1991) op cit note 55 at 212 – 213; Scott 'Pacta' op cit note 55 at 160; Scott op cit note 1 at 782.

In my opinion much of the confusion surrounding the validity and effect of *pacta de non cedendo* may be alleviated by following a two-step approach.<sup>61</sup> Firstly, the validity of the *pactum de non cedendo inter partes* should be determined. If the *pactum de non cedendo* is valid *inter partes* a second enquiry should be undertaken to determine the effectiveness of the *pactum de non cedendo* against third parties, that is, it should be determined whether the *pactum de non cedendo* has the effect of preventing transfer to a potential cessionary.

**(i) Validity *inter partes***

There are at least two potential bases upon which a *pactum de non cedendo* could be rendered invalid *inter partes*<sup>62</sup>:

**(a) The interest requirement**

Firstly, if the *pactum de non cedendo* does not serve a real and/or legitimate interest of the debtor it will be held to be invalid.<sup>63</sup> Since the judgment in *Paiges* the practical utility of the interest requirement has been questioned.<sup>64</sup> Furthermore, others have argued, most notably, JC De Wet, that the debtor will always have an interest in knowing the identity of his creditor thus rendering the requirement superfluous.<sup>65</sup> While it must be acknowledged that the debtor will have an interest in knowing who his creditor is so as, *inter alia*, to avoid the risk of double payment, watering down the

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<sup>61</sup> This two stage analysis has been borrowed from Hutchison op cit note 3 at 273-274.

<sup>62</sup> *Paiges* supra note 52.

<sup>63</sup> Ibid 615.

<sup>64</sup> RS Welsh, General Principles of Contract, (1950) *Annual Survey of South African Law* 75 at 83.

<sup>65</sup> JC De Wet and AH Van Wyk, *Kontraktereg* 4ed (1993) 254.

interest requirement in this manner is certainly not what was envisaged by the court in *Paiges*.<sup>66</sup> It is not simply any interest that will suffice, what is required is a “substantial interest”.<sup>67</sup> Let us look at two examples to amplify what is meant by “substantial interest”.

Example 1: a company issues a special class of shares to satisfy its Black Economic Empowerment (BEE) requirements.<sup>68</sup> The company restricts the transfer of these shares to anyone outside of the designated class. It is clearly uncontentious that the debtor (the company) has a substantial interest in restricting the transferability of these rights.

Example 2: Dr. X is a general medical practitioner. Her clients all pay her using their respective medical aid schemes. Dr. X sells all her claims against the various medical aids to Y. Y later discovers that all the claims concerned are subject to a *pactum de non cedendo*. Do the medical aids (debtors) have a substantial interest in restricting the transferability of their respective claims? Surely not. Provided of course that all the medical aids received notice of the change in creditor, does it really make a difference whether the medical aid pays Dr. X or Y? In my opinion the interest of the debtor in this example is certainly not “substantial”.

## **(b) Public Policy**

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<sup>66</sup> Hutchison op cit note 3 at 283.

<sup>67</sup> Ibid.

<sup>68</sup> Ibid 284.

Secondly, because the *pactum de non cedendo* is a contract in its own right it must comply with the requirements for a valid contract. The most important requirement in this regard, for our purposes, is legality.

It is often stated by the courts that contracts are illegal because they are *contra bonos mores* or because they are contrary to public policy.<sup>69</sup> There is no value in distinguishing between these two concepts, as there is often overlap between the underlying principles of both concepts.<sup>70</sup>

In the law of contract the underlying principle is that all agreements seriously entered into must be enforced. This principle is encapsulated in the *maxim pacta sunt servanda*.<sup>71</sup> Furthermore, in terms of the notion of freedom of contract parties “are free to decide on whether, with whom and on what terms to contract”.<sup>72</sup> However, freedom of contract has always been limited by public policy.<sup>73</sup> Public policy has become firmly entrenched as a mechanism for judicial control over the enforcement of contractual obligations.<sup>74</sup> A court may refuse to enforce contractual provisions or even an entire contract, if it considers the impugned provision or contract to be contrary to public

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<sup>69</sup> Hutchison op cit note 51 at 176.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid 175.

<sup>72</sup> Ibid 21.

<sup>73</sup> Ibid 175.

<sup>74</sup> M Kruger, *The Role of Public Policy in the Law of Contract Revisited*, (2011) SALJ 712.

policy, despite the fact that the contractual terms have been freely and voluntarily concluded.<sup>75</sup>

The doctrine of public policy places great power in the hands of the judiciary, and with great power comes great responsibility, as Kruger notes:

“...the power provided by the doctrine is often criticised because it entails the application of value-laden and seemingly subjective policy considerations, including those of fairness, justice and equity, and therefore has the potential, when applied indiscriminately, to result in commercial uncertainty”.<sup>76</sup>

It is important to take cognisance of the fact that because public policy represents public opinion at a particular point in time, public opinion may change over time.<sup>77</sup> In other words, public policy is an open-ended standard.<sup>78</sup> However, since the inception of South Africa’s constitutional revolution in 1994 public policy has been rooted in the Constitution and the rights and values enshrined in the Bill of Rights, although it is not the only source of public policy.<sup>79</sup>

Public policy is a broad concept, which takes cognisance not only of the interest of the debtor, but also the interests of all parties affected by the transaction, as well as the social and economic impact of the clause or agreement in issue.<sup>80</sup> In this regard

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<sup>75</sup> Ibid.

<sup>76</sup> Ibid.

<sup>77</sup> F Du Bois *et al*, *Wille’s Principles of South African Law*, (2010, Juta, 9<sup>th</sup> ed) pg 763.

<sup>78</sup> Ibid.

<sup>79</sup> Ibid.

<sup>80</sup> Hutchison *op cit* note 3 at 283.

public policy has been held to include fairness, justice and reasonableness.<sup>81</sup> In *Sasfin v Beukes*<sup>82</sup> Smalberger JA held that “agreements which are clearly inimical to the interests of the community, whether they are contrary to law or morality, or run counter to social or economic expedience, will on grounds of public policy not be enforced”.<sup>83</sup>

Even though numerous cases have laid down general statements in relation to when public policy is applicable, and are replete with warnings against the overzealous application of this doctrine, very little guidance is provided by the courts on how exactly this doctrine is to be applied.<sup>84</sup> This has increased the legal uncertainty created in the application of the doctrine of public policy.<sup>85</sup> However, the lack of clarity on how to apply the doctrine is not fatal.<sup>86</sup> In fact it is commensurate with the nature of public policy as a standard-orientated concept that is context-dependent.<sup>87</sup> The flexibility inherent in the concept of public policy and its adaptability to changing times is in fact one of its best qualities.<sup>88</sup> “As such, there is no defined process to be constructed, no check-list to be marked-off by judges, or bright-line to mark in advance what will be contrary to public policy”.<sup>89</sup>

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<sup>81</sup> Ibid 30.

<sup>82</sup> 1989 (1) SA 1 (A) at 8D.

<sup>83</sup> Hutchison op cit note 3 at 283.

<sup>84</sup> Kruger op cit note 74 at 713.

<sup>85</sup> Ibid.

<sup>86</sup> Ibid.

<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid 714.

The absence of a clear methodology in the application of the public policy enquiry may be said to introduce an intolerable amount of uncertainty into the law, and that the concept of public policy is simply being used as a veil to cover the subjective unsubstantiated views of the presiding officer.<sup>90</sup> This view, however, fails to take cognisance of the fact that uncertainty may arise in any interpretation and application of the law, irrespective of whether we are applying rules of law, as opposed to open-ended standards and norms.<sup>91</sup> Value judgments are made in other areas of law, and in order to reduce the inherent uncertainty entailed in the application of these value judgments judicial and extra-judicial steps are undertaken.<sup>92</sup> There is no reason why these steps should not be applied in the public policy enquiry as well.<sup>93</sup>

Public policy is a difficult concept to define, however, at a rudimentary level public policy is a mechanism in terms of which the views of society are given expression to by the courts, and thereby ensures that society has a certain measure of control over private contractual relations.<sup>94</sup>

Devoid of context public policy has little or no substantive meaning.<sup>95</sup> As Sutherland has pointed out, it operates as “a collection of general principles and more

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<sup>90</sup> Ibid.

<sup>91</sup> Ibid.

<sup>92</sup> Ibid.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid 715.

<sup>95</sup> Ibid.

specific rules of contract law”.<sup>96</sup> Public policy refers to the examination of these principles and rules, which enables the courts to give content and meaning to the concept of public policy.<sup>97</sup>

The inherently flexible nature of the public policy enquiry, coupled with the fact that courts are always open to consider new factors, means that there is no *numerus clausus* of considerations a judge may take into account when engaging in the enquiry.<sup>98</sup> This conceptual understanding of the public policy enquiry means that a judge undertaking this enquiry is equipped with a “basket” of existing, and may even add new, public policy considerations.<sup>99</sup> “From this “basket” she is required, in a given case, to choose those considerations which are relevant to the facts of the case, and then to balance those considerations against each other so as to determine whether the particular contractual terms should be enforced. The outcome of this identification and balancing process is what courts’ term public policy”.<sup>100</sup>

Prior to South Africa’s constitutional revolution public policy was determined on a purely objective basis.<sup>101</sup> In other words an agreement or clause was said to be illegal if it was contrary to the interests of the community as a whole.<sup>102</sup> However, in the ground

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<sup>96</sup> PJ Sutherland, *Ensuring contractual fairness in consumer contracts after Barkhuizen v Napier 2007 5 SA 323 (CC) – Part 1*, (2008) 19 *Stell LR* 390 at 408.

<sup>97</sup> Kruger op cit note 74 at 715.

<sup>98</sup> Ibid 716.

<sup>99</sup> Ibid.

<sup>100</sup> Ibid.

<sup>101</sup> Hutchison op cit note 51 at 30.

<sup>102</sup> Ibid.

breaking decision of the Constitutional Court in *Barkhuizen*<sup>103</sup> the court set out a two stage approach to determine whether the clause at issue, a time-bar clause, was contrary to public policy, based on the general rubric of fairness.<sup>104</sup> This two stage test has both an objective and subjective aspect.<sup>105</sup> The Constitutional Court stated that the enquiry involves asking the following two questions:

“The first is whether the clause itself is unreasonable. Secondly, if the clause is reasonable, whether it should be enforced in the light of the circumstances which prevented compliance with the ...clause”<sup>106</sup>

The first leg of this test has two parts.<sup>107</sup> The first component implores a court to determine whether the clause at issue is manifestly unreasonable in that no further evidence is required to conclude that it is contrary to public policy<sup>108</sup>. This involves an objective assessment of the terms of the contract, which entails a balancing of two considerations: *pacta sunt servanda* and the right to seek judicial redress.<sup>109</sup> The second component of the first leg of the test involves the objective assessment of the terms of the contract with reference to the circumstances of the parties.<sup>110</sup> Ngcobo JA in this regard placed significant emphasis on the relative bargaining power of the parties to

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<sup>103</sup> *Barkhuizen* supra note 36.

<sup>104</sup> M Wallis, *Commercial Certainty and Constitutionalism: Are They Compatible?* (2016) *SALJ* 545 at 553.

<sup>105</sup> *Ibid.*

<sup>106</sup> *Barkhuizen* supra note 36 at para 56.

<sup>107</sup> Kruger op cit note 74 at 717.

<sup>108</sup> *Ibid.*

<sup>109</sup> *Ibid.*

<sup>110</sup> *Ibid.*

the agreement, and held that significant disparities in the relative bargaining power of the parties may render the terms contrary to public policy.<sup>111</sup>

The second leg of the test is not so much concerned with the terms of the contract, but rather focuses on the reasonableness of enforcing the terms in the prevailing circumstances of the parties at the time of enforcement.<sup>112</sup> This subjective leg of the test allows a party who failed to comply with a term of the contract to provide cogent reasons for non-compliance or to show that compliance would be unreasonable in the circumstances.<sup>113</sup>

In *Bredenkamp v Standard Bank of South Africa Ltd*<sup>114</sup> the Supreme Court of Appeal held that fairness is not an over-arching requirement in the law of contract.<sup>115</sup> Furthermore, the court narrowed down the scope of *Barkhuizen* by distinguishing *Barkhuizen* from *Bredenkamp* on the basis that the decision in *Barkhuizen* directly implicated a constitutional right.<sup>116</sup> In the *Everfresh* case the Constitutional Court affirmed the central importance of good faith in the law of contract.<sup>117</sup> Furthermore, the Court emphasised the desirability of infusing the law of contract with constitutional

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<sup>111</sup> Ibid.

<sup>112</sup> Ibid 718.

<sup>113</sup> Ibid.

<sup>114</sup> 2010 (4) SA 468 (SCA).

<sup>115</sup> Ibid.

<sup>116</sup> Ibid.

<sup>117</sup> *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC).

values.<sup>118</sup> Recently, the Constitutional Court has extended the reasoning in *Barkhuizen* in the context of exercising a right of cancellation.<sup>119</sup>

These three decisions of the Constitutional Court have been subjected to serious criticisms by numerous academics<sup>120</sup>, and even the judiciary.<sup>121</sup> The primary criticism is that the infusion of constitutional values, particularly fairness, has injected an intolerable amount of uncertainty into the South African Law of contract, and that this uncertainty will have dire consequences for the South African economy.<sup>122</sup> However, in terms of the principle of *stare decisis* and the doctrine of precedence the current approach is that contractual terms have to pass the two-stage test as set out in *Barkhuizen*.

As the foregoing has endeavoured to illustrate public policy is a broad and flexible concept, with no closed list of considerations that may be taken into account in determining whether a contractual clause is contrary to public policy. However, over the years the courts, both prior and after South Africa's constitutional revolution, have compiled a list of factors that may, depending on the context, be taken into account, referred to as the "basket" of considerations.<sup>123</sup>

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<sup>118</sup> Ibid.

<sup>119</sup> *Botha and Another v Rich NO and Others* 2014 (4) SA 124 (CC) para 24; Wallis op cit note 104 at pp 544-545.

<sup>120</sup> For example: G Glover, *Lazarus in the Constitutional Court: An Exhumation of the Exceptio Doli Generalis?* (2007) 124 SALJ 449.

<sup>121</sup> C Lewis, *The Uneven Journey to Uncertainty in Contract*, 2013 THRHR 80; LTC Harms, *The Puisne Judge, The Chaos Theory and The Common Law*, (2014) SALJ 3; FDJ Brand, *The Role of Good Faith, Equity and Fairness in the South African Law of Contract: The Influence of The Common Law and The Constitution*, (2009) 126 SALJ 71.

<sup>122</sup> Ibid.

<sup>123</sup> Kruger op cit note 74 at 719.

The traditional principal consideration in the public policy analysis is *pacta sunt servanda*, which is said to be “the cornerstone of our law of contract”.<sup>124</sup> In other words, the principle that agreements seriously and voluntarily entered into will be enforced is the starting point of any public policy inquiry. The importance of this sacred principle has been given recognition to in numerous cases. In *Shifren* the court stated that it is a fundamental principle in the law of contract that contracts be enforced.<sup>125</sup> The importance of this principle was also underscored by Smalberger JA in *Sasfin* when he held that power to declare contracts contrary to public policy should only be exercised sparingly, and only in the clearest of cases.<sup>126</sup> In *Basson* it was stated that without this principle “all trade would be impossible”.<sup>127</sup> In *Brisley* the Supreme Court of Appeal reaffirmed these principles in the new constitutional era by emphasising the central importance of commercial certainty to the economy.<sup>128</sup> In *Barkhuizen* the Constitutional Court held that the principle of *pacta sunt servanda* is crucial to the conception of “self-autonomy, or the ability to regulate one’s own affairs, even to one’s own detriment”<sup>129</sup>, and held that this “is the very essence of freedom and a vital part of dignity”.<sup>130</sup>

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<sup>124</sup> Ibid.

<sup>125</sup> *Sentrale Ko-op Graanmaatskappy Beperk v Shifren* 1964 (4) SA 760 (A) at 767.

<sup>126</sup> *Sasfin* supra note 82 at 9.

<sup>127</sup> *Basson v Chilwan* 1993 (3) SA 742 (A) at 762.

<sup>128</sup> *Brisley v Drotzky* 2002 (4) SA 1 (SCA) at para 90.

<sup>129</sup> *Barkhuizen* supra note 36 at para 57.

<sup>130</sup> Ibid.

Since the commencement of South Africa's new constitutional dispensation the Constitutional Court has given explicit recognition to the importance of principles such as: fairness, justice and equity, and reasonableness, in the public policy inquiry.<sup>131</sup>

The courts have also identified a plethora of principles and values that fall within the "basket" of considerations in the public policy inquiry.

"These include morality; the administration of justice; the interests of the community and social and economic expedience; the necessity for doing simple justice between contracting parties; the interests of the state, or of justice, or of the public; the free exercise by persons of their common law rights; and the concept of Ubuntu".<sup>132</sup>

The relative bargaining power of the parties has also been considered in the public policy analysis.<sup>133</sup> Furthermore, in the post-constitutional era the courts have given express recognition to the relevance of constitutional rights such as, the right to healthcare and the right to seek judicial redress, in the public policy analysis.<sup>134</sup>

The current jurisprudence therefore, provides two potential bases for invalidating a *pactum de non cedendo inter partes*: Firstly, if the debtor does not have a substantial interest that is served by the *pactum de non cedendo* the clause will be invalid; secondly, the *pactum de non cedendo* may be contrary to public policy and therefore invalid. In this paper I will argue that the interest requirement is actually part of the

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<sup>131</sup> Kruger op cit note 74 at 720.

<sup>132</sup> Ibid at 721.

<sup>133</sup> Barkhuizen supra note 36 at para 59.

<sup>134</sup> Kruger op cit note 74 at 721.

public policy requirement, because it is in the public interest that assets be transferable; hence the debtor must have a valid reason for prohibiting transfer.

It is my contention that the interest requirement should be subsumed into the public policy enquiry. In other words, the interest requirement should be relegated to being simply another factor to be taken into account when determining whether the *pactum de non cedendo* is contrary to public policy, and should not be a free-standing requirement. The interest of the debtor in enforcing the *pactum de non cedendo* must be added to the “basket” of considerations in the public policy inquiry. As Van Huyssteen has indicated:

“...underlying the approach of the courts to *pacta de non cedendo* is an assumption that a contractual restriction of a creditor’s capacity to dispose of a right is contrary to public policy unless justified by some legitimate interest of the person in whose favour the restriction is imposed”.<sup>135</sup>

This approach will allow the interests of all parties affected by the transaction to be considered when dealing with *pacta de non cedendo*.<sup>136</sup> These interests include<sup>137</sup>, *inter alia*:

“the interest of the debtor in maintaining the relationship with the original creditor; the interest of the creditor/cedent in using the claim as a financial asset; the interests of the actual and potential cessionaries (particularly factors and banks) in using the claim as an

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<sup>135</sup> Van Huyssteen op cit note 55 at 451.

<sup>136</sup> Hutchison op cit note 3 at 282 -283.

<sup>137</sup> B Lurger, *Assignment*, in Smits (ed) *Elgar Encyclopaedia of Comparative Law* (2006) 91 at 98-101.

asset in the course of their business; and the interests of the creditors of the cedent and cessionary, who rely on the effectiveness of the cession”.<sup>138</sup>

Lurger contends that the interests of the debtor are relatively weak in comparison when contrasted with the interests of these other parties.<sup>139</sup> Joubert shares a similar view, in terms of which the interest requirement should be retained, however, it should merely be an aspect of the broader enquiry into the lawfulness of *pactum de non cedendo*, and this enquiry would of course be dependent on considerations of public policy.<sup>140</sup>

If this approach is followed it will allow courts to declare any *pactum de non cedendo* that prohibits the transferability of book debts to be declared contrary to public policy in light of the numerous economic benefits to society that will be gained from the free transferability of these rights.<sup>141</sup> This conclusion gives effect to numerous rights in the Bill of Rights, and is also aligned to the values that the new Companies Act<sup>142</sup> seeks to promote, most notably the promotion of small to medium sized businesses’ economic growth.<sup>143</sup> Furthermore, this approach will allow *pacta de non cedendo* to be given effect to when they do serve interests that outweigh the interests of the other parties affected and the broader interests of society. Example 1 above provides the

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<sup>138</sup> Hutchison op cit note 3 at 284.

<sup>139</sup> Lurger op cit note 137 at 99.

<sup>140</sup> Joubert *Regsbetrekkinge* op cit note 55 at 459-463.

<sup>141</sup> Ibid 467.

<sup>142</sup> 71 of 2008.

<sup>143</sup> *South African Company for the 21<sup>st</sup> Century Guidelines for Corporate Law Reform*, (May 2004) GN 1183 of 2004, Govt Gazette 26493 (23 June 2004).

quintessential example of a case where the interests protected by the *pactum de non cedendo* outweigh the interests infringed by it.

As the case history will show in the next chapter, the courts have since *Paiges* to date failed to seriously consider the public policy implications of *pacta de non cedendo*.<sup>144</sup> As noted earlier, public policy is not a static concept, the case history should, therefore, not pose any hurdle in attempting to develop the law regarding the validity of *pacta de non cedendo inter partes* in the manner described above.

(ii) **Effectiveness against third parties**

This second leg of the two step approach only arises if the *pactum de non cedendo* is valid *inter partes*, because if it is invalid *inter partes* it can have no legal effect whatsoever.<sup>145</sup> If the *pactum de non cedendo* is valid *inter partes* any purported cession would constitute a breach of contract, in terms of which the breaching party could potentially be liable to pay damages.<sup>146</sup> Whether or not the breach does indeed result in loss will usually be dependent on whether the cession was effective.<sup>147</sup> That raises the most fundamental question to this stage of the enquiry: does the *pactum de non cedendo* merely operate *inter partes* or does it also prevent transfer to a third party, who in good faith, takes cession of a right unaware of the *pactum de non cedendo*?<sup>148</sup>

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<sup>144</sup> Hutchison op cit note 3 at 286-287.

<sup>145</sup> Ibid 287.

<sup>146</sup> Ibid.

<sup>147</sup> Ibid.

<sup>148</sup> Ibid.

It is crucial to recognise that the principles applicable to the transfer of corporeal property cannot be applied in relation to the transfer of incorporeal property.<sup>149</sup> In respect of corporeal property only a limited real right will subtract from the owner's dominium, such as a servitude or mortgage bond.<sup>150</sup> In other words, a third party who takes transfer of corporeal property in good faith, that is, in ignorance of another party's personal rights, will not be bound to give effect to that party's personal rights.<sup>151</sup>

However, the *pactum de non cedendo* constitutes a restraint on the transferability of a *res incorporalis*, and in this context, if not in others, one cannot treat incorporeals on the same footing as corporeal property.<sup>152</sup> In relation to an incorporeal personal right the ambit and content of the right being transferred will be determined by the actual terms of the contract.<sup>153</sup>

“Every term of the contract that limits the right serves to diminish the right and constitutes in a sense a subtraction from the holder's ‘*dominium*’ of the right. In accordance with the *nemo plus iuris* principle, the holder of the right cannot confer upon a third party any greater right than he himself has”.<sup>154</sup>

Hence the oft-quoted statement by De Villiers JA in *Paiges*:

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<sup>149</sup> Ibid.

<sup>150</sup> Ibid.

<sup>151</sup> Ibid.

<sup>152</sup> Ibid 288.

<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

“...the cessionary only steps into the shoes of the cedent, and can have no greater rights than the cedent himself has. When the cedent therefore has parted with the right to cede the debt, no other party can obtain any rights to it”.<sup>155</sup>

Therefore, provided the *pactum de non cedendo* does indeed limit the right concerned it will prevent a voluntary transfer to a third party, irrespective of the third party’s knowledge or ignorance of the presence of the *pactum de non cedendo*.

Lubbe’s theoretical explanation of the pledge construction of a cession in *securitatem debiti* is instructive in this regard.<sup>156</sup> Lubbe states that a right of action may be split into various components, for example, the right to enforce may be ceded without ceding the beneficial interest in the right.<sup>157</sup> Similarly, a right of action is split when a valid *pactum de non cedendo* has been inserted into the contract by the debtor and creditor. In other words, once the debtor and creditor have concluded a *pactum de non cedendo* one of the components of the personal right, namely, its transferability, will have been removed from the personal right concerned. The creditor, therefore, will not have the right or capacity to transfer the right concerned, he will, however, be able to enforce the right personally against the debtor. Furthermore, no other party may take transfer of the right concerned.

It is, therefore, clear that provided the *pactum de non cedendo* is valid *inter partes*, it will prevent transfer to a third party.<sup>158</sup> This will be the case irrespective of

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<sup>155</sup> Paiges supra note 52 at 616.

<sup>156</sup> GF Lubbe, *Sessie in Securitatem Debiti en die Komponente van die Skuldeiser’s Belang*, (1989) THR-HR 485.

<sup>157</sup> Ibid.

<sup>158</sup> Hutchison op cit note 3 at 288.

whether the *pactum de non cedendo* is superimposed onto a pre-existing right or is contained in the original agreement giving rise to the right or even if it is contained in a separate agreement, provided of course that the *pactum de non cedendo* is concluded by the original parties to the agreement, that is, the debtor and creditor.<sup>159</sup>

In my opinion the current law on the validity and effect of *pacta de non cedendo* is theoretically unsound and in need of development. I am of the opinion that my analysis sketched out above will bring much needed clarity to this highly complex area of law, and that any development, in line with this analysis, will give effect to South Africa's constitutional imperatives. I believe that reform in this area of law may be accomplished through judicial development of the law. In my opinion judicial reform is mandated by section 39(2) of the Constitution; the law of cession cannot remain insulated from the normative effect of the objective value system encompassed in the Bill of Rights. One of the fundamental objectives of any development in this area of law must be the promotion of commerce, particularly book debt financing, which is at the heart of the factoring and securitisation industries.<sup>160</sup>

In the next chapter I will trace the historical development of the legal principles applied to *pacta de non cedendo* in terms of both the case law and academic writings on the subject, chronologically. In the third chapter I will investigate and contrast the approach of other countries and institutions on the subject. And finally in the last chapter I will conclude with my final thoughts on the subject in light of all the preceding analysis and research I have conducted.

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<sup>159</sup> Ibid.

<sup>160</sup> Ibid 275.

## **Chapter 2: Historical Development & Academic Commentaries**

In this chapter I will trace the historical development of the legal principles applicable to *pacta de non cedendo* in terms of the case law, as well as the views of academic commentators on the matter, in chronological order. I will also offer my own views and critiques on this development, in order to promote my own analysis on the topic.

### **2.1 Paiges v Van Ryn Gold Mines Estates Ltd 1920<sup>161</sup>**

The *locus classicus* and fundamental starting point to any discussion on the validity and effect of *pacta de non cedendo* must be the seminal decision of the Appellate Division in *Paiges*.

In this case, Paiges, a general dealer, sued Van Ryn Gold Mines Ltd for wages due to one of its employees, one Klein, on the basis that Klein had ceded his right to wages to Paiges. In order to obtain groceries on credit from Paiges, Klein ceded his wages as security for repayment of the loan. Klein later defaulted on the loan agreement. Paiges then notified the company of the cession, however, the company refused to recognise the cession on the basis that their contract with their employee contained an undertaking by the employee that he would not cede his right to wages without the consent of the employer, as well as a provision, that any wages due would only be paid personally to the employee.

#### **i. Magistrate's Court**

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<sup>161</sup> *Paiges* supra note 52.

In the magistrates court judgement was given in favour of Paiges, on the basis that all rights of action may be ceded, and that a trader who provided credit to another on the strength of a security cession of the latter's wages could not be prejudiced by agreement concluded between an employee and employer which prohibited such a cession.<sup>162</sup>

The magistrate in this case simply applied the legal principles applicable to corporeal property to incorporeal property. As articulated in Chapter 1, this reasoning fails to take cognisance of the nature of an incorporeal asset, in terms of which the ambit and content of the right transferred is determined by the terms of the agreement creating the right.

ii. **Transvaal Provincial Division**

On appeal the decision of the magistrate's court was overturned by a majority of the full bench of the Transvaal Provincial Division. The court held that the *pactum de non cedendo* was valid *inter partes*, and that in light of the fact that a cessionary cannot be in a better position than the cedent from whom he obtained the rights concerned, the *pactum de non cedendo* was also effective in preventing transfer to Paiges.

(a) **Public policy argument**

In relation to the argument that the *pactum de non cedendo* was contrary to public policy, the court stated the following:

"It can hardly be seriously argued that it is illegal or immoral or against public policy for a workman to renounce the right to cede his wages. Employers of large numbers of

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<sup>162</sup> Ibid 601.

workmen find it a serious burden to be encumbered with cessions of wages and to be liable to claims put forward by persons with whom they have not contracted, and probably would never have contracted. All sorts of shady characters procure cessions and excite trouble where otherwise harmony would prevail and ought to prevail. Then if the employer is of a humanitarian frame of mind, he might desire to protect his workmen against improvidence, against moneylenders and such like who are only too ready to strike hard bargains and to appropriate the hard earned wages of the workman by obtaining cessions".<sup>163</sup>

The above reasoning is completely one-sided and paternalistic, and in my opinion, an affront to the dignity of the employee. By primarily focusing on the inconvenience encountered by the debtor in assessing the lawfulness of the *pactum de non cedendo*, the court fails to take cognisance of other factors relevant to the public policy enquiry. Employees, such as Klein, often have no other means of securing credit, other than by ceding their claims to wages or salary as security for their indebtedness. If Klein was unable to cede his right to wages how else could he obtain groceries on credit, and sustain his and his family's livelihood? The rights to life and dignity have been said to be the two most important rights in the constitutional era.<sup>164</sup>

In my view the impugned provisions are contrary to public policy. On the purely objective first leg of the *Barkhuizen* test the impugned provisions fail for at least three reasons. Firstly, the payment of wages is completely analogous to a book debt, does it really make a difference who the employer pays an employee's wages to? In my view it

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<sup>163</sup> Ibid 603.

<sup>164</sup> *Makwanyane* supra note 26.

certainly does not. In light of technological advancements, namely, Electronic Funds Transfers, all that the debtor would be required to do is to substitute the employee's bank information with that of the cessionary.

Secondly, even though it may be said that the employer is seeking to protect his employee from unscrupulous moneylenders this paternalistic argument loses sight of the fact that part of a person's right to dignity is the ability to regulate one's own affairs, even to one's own detriment.

Thirdly, the employer certainly has superior bargaining power to that of the employee in negotiating an employment contract, in fact it is highly likely that no negotiation took place and that the employer simply gave the employee his standard form contract to sign.

**(b) The interest requirement**

Furthermore, the court held that the debtor (employer) in this case certainly had a substantial interest in concluding the *pactum de non cedendo*, and that it was difficult to see why this should not be applicable to all contracts.<sup>165</sup> In other words, all employers would, in the courts view, have an interest in concluding a *pactum de non cedendo*.

**(c) Minority Judgment**

However, Wessels J, in his minority judgment, took an almost completely antithetical view, to that of the majority, to the situation.<sup>166</sup> In his view, an incorporeal right formed an asset in the estate of the person to whom it is owed, that is, the creditor, and that

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<sup>165</sup> *Paiges* supra note 52 at 604.

<sup>166</sup> *Ibid* 606.

such creditor may freely transfer any such right.<sup>167</sup> Furthermore, any restraint on the transferability of such a right would be invalid *inter partes*, unless it was in favour of some person or persons.<sup>168</sup> However, even if the *pactum de non cedendo* was valid between the debtor and creditor, public policy might dictate that in the circumstances transfer to the cessionary from the cedent should nevertheless be effective.<sup>169</sup> Wessels J stated that:

“It seems to me that if there is a term in a contract between A and B that A will not cede what is due to him by B, and A in breach of this agreement cedes his right to C, C will acquire A’s right against B and can enforce his claim. The arrangement that the creditor A must claim personally from the debtor B is not regarded as a part of the debt itself but as a subsidiary right. If enforceable it is at most a right for which damages may be claimed”.<sup>170</sup>

It appears that Wessels J was of the view that a *pactum de non cedendo* could be valid *inter partes* and ineffective against a third party/cessionary, simultaneously.<sup>171</sup> If the *pactum de non cedendo* was held to be effective against third parties it would deprive an employee of the capacity to obtain credit facilities on the strength of a security cession of his wages, and oblige such an employee to obtain credit from his employer, often at an exorbitant rate.<sup>172</sup> Whether the employer paid the employee

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<sup>167</sup> Ibid 607-608.

<sup>168</sup> Ibid 606-608.

<sup>169</sup> Ibid 607.

<sup>170</sup> Ibid.

<sup>171</sup> Hutchison op cit note 3 at 277.

<sup>172</sup> Paiges supra note 52 at 609.

personally, or his agent, or even a cessionary, would not make any substantial difference to the employer.<sup>173</sup>

Wessels J, therefore, applied the public policy enquiry in order to determine both the validity of the *pactum de non cedendo inter partes*, and its effect on transfer.

### iii. Appellate Division

In the Appellate Division Paiges appeal against the decision of the court *a quo* was dismissed with costs. The court in this case had to determine two fundamental issues: first, the court had to determine whether or not the *pactum de non cedendo* was valid *inter partes*; and secondly, if the agreement was valid *inter partes*, whether it had the effect of preventing transfer of the rights concerned to a purported cessionary.

De Villiers JA, who wrote the unanimous judgement of the court, stated that the general principle in our law was that all personal rights could be freely ceded, irrespective of the will of the debtor, and that this principle was equally applicable to an employee who ceded his right to wages against his employer to a third party.<sup>174</sup> However, one of the contentious issues in this case was whether the parties could render such rights incapable of cession by agreement.<sup>175</sup> In other words, the court had to ascertain whether there was any principle in law that could limit the principle of freedom of contract in this case.<sup>176</sup>

#### i. The interest requirement

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<sup>173</sup> Ibid 606.

<sup>174</sup> Ibid 614.

<sup>175</sup> Ibid.

<sup>176</sup> Ibid.

In this regard, De Villiers JA placed strong reliance on the writings of Sande<sup>177</sup> and Voet<sup>178</sup>, in terms of which agreements restricting an owner's right to freely dispose of his property were held to be invalid and of no force and effect, where the person imposing the restriction had no interest in the stipulation.<sup>179</sup> However, this principle was only applicable where the debtor did not have an interest in the restriction, therefore "if the stipulation can be shown to serve a useful purpose to the debtor, it is valid and binding upon the parties to the contract".<sup>180</sup> In the Court's view it was axiomatic that an employer of a large number of employees had a "very real interest" that was served by the restriction.<sup>181</sup> In light of the fact that an employer could be called upon to pay an employee's wages to a myriad of people, which could cause numerous complications, such an employer had a very real interest in seeking to avoid such situations by means of a *pactum de non cedendo*.<sup>182</sup>

## ii. **Public policy**

In response to the argument that the impugned provision was contrary to public policy in light of the fact that it placed an employee seeking an advance at the mercy of his employer, De Villiers JA acknowledged that there was merit in this argument, but

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<sup>177</sup> Sande, *De Prohibita Rerum Alienatione* 4 1 1, 4 2 1.

<sup>178</sup> Voet, *Commentarius ad Pandectas* 2 14 20.

<sup>179</sup> Paiges supra note 52 at 615.

<sup>180</sup> Ibid.

<sup>181</sup> Ibid.

<sup>182</sup> Ibid.

also pointed out that the clause in issue might in fact work to the advantage of the employee, as stated by Curlewis JA in *South African Railways*<sup>183</sup>.<sup>184</sup> The conclusive answer to the public policy argument, in De Villiers JA's view, was that the possible detriment to the employee was insufficient for the court to declare the impugned provision *contra bonos mores*, and deferred to the Legislature to decide whether the impugned provision was contrary to public policy.<sup>185</sup>

De Villiers JA's application of the public policy enquiry was essentially synonymous with that of the majority in the court *a quo*.<sup>186</sup> The criticisms levelled against the reasoning of the majority in the court *a quo*, therefore, apply with equal force to this aspect of De Villiers JA's judgment.

### iii. **Effectiveness against third parties**

The final argument that the court had to deal with was that a trader who extended credit to another, on the strength of the common law principle that rights are freely transferable, should not be prejudiced by an agreement to which he was not privy, and of which he had no knowledge. De Villiers JA stated that this argument overlooked the fact that the cessionary merely steps into the shoes of the cedent and could have no greater rights than the cedent himself had.<sup>187</sup>

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<sup>183</sup> *South African Railways* supra note 52 at 286.

<sup>184</sup> *Paiges* supra note 52 at 615.

<sup>185</sup> *Ibid* 616.

<sup>186</sup> *Ibid*.

<sup>187</sup> *Ibid* 616.

“When the cedent therefore has parted with the right to cede the debt, no other party can obtain any rights to it. The right which the creditor obtains, being circumscribed by the terms of his agreement with the debtor, becomes by agreement between the parties a strictly personal right, and cannot be ceded.”<sup>188</sup>

In relation to corporeal property a contractual restriction on alienation cannot prevent transfer of the property. Even though a personal right is an incorporeal asset, the analogous reasoning cannot be extended to incorporeal property due to the nature of the right being transferred.<sup>189</sup> As stated by Windscheid<sup>190</sup> “The stipulation against cession is part and parcel of the agreement creating the right, and the right is limited by the stipulation”.<sup>191</sup>

Over the next 48 years the law as stated in *Paiges* was essentially applied indiscriminately by the courts.<sup>192</sup> However, in 1968 the judgment of the Appellate Division in *Trust Bank*<sup>193</sup> elicited fierce debate when the court appeared to suggest that the interest requirement had only limited application.<sup>194</sup>

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<sup>188</sup> Ibid 617.

<sup>189</sup> Ibid.

<sup>190</sup> *Pandektenrechts* (8ed) 358, note 5.

<sup>191</sup> *Paiges* supra note 52 at 617.

<sup>192</sup> Hutchison op cit note 3 at 278. This view appears to be supported by the following decisions: *Northern Assurance Company Ltd v Methuen* 1937 SR 103; *Estate Fitzpatrick v Estate Frankel and others*; *Denoan and another v Estate Frankel and others* 1943 AD 207; *Friedlander v De Aar Municipality* 1944 AD 79; *Richter N.O v Riversides Estates (Pty) Ltd* 1946 OPD 209; *Du Plessis v Scott* 1950 (2) SA 462 (W).

<sup>193</sup> *Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd* 1968 (3) SA 166 (A).

<sup>194</sup> Hutchison op cit note 3 at 279.

## **2.2 Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd**

This case concerned certain deposit vouchers that were issued by Trust Bank to one of its customer's, Mrs. Davidoff. On eight occasions Mrs. Davidoff made deposits with Trust Bank and on each occasion she was issued with a deposit voucher. All of these deposit vouchers contained a clause stating that the deposit voucher was issued subject to the conditions endorsed overleaf.<sup>195</sup> Condition one stated that the deposit voucher was "neither transferable nor negotiable".<sup>196</sup>

Mrs. Davidoff subsequently became indebted to Trust Bank and agreed to repay her debt in monthly instalments. In order to secure her indebtedness she pledged and delivered all eight deposit vouchers, in terms of a security cession, to Trust Bank.

Sometime later all eight deposit vouchers were released back to Mrs. Davidoff unendorsed.

Subsequently, Mrs Davidoff approached Standard Bank, in her capacity as director of Chermedine Clothing Corporation (Pty) Ltd, in order to obtain certain credit facilities. Standard Bank agreed to extend credit to the company, and in order to secure repayment Mrs. Davidoff once again pledged the same eight deposit vouchers to Standard Bank in terms of a security cession. Standard Bank was unaware, at all material times that the eight deposit vouchers were previously pledged to Trust Bank, in terms of a prior security cession.

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<sup>195</sup> Trust Bank supra note 193 at 177.

<sup>196</sup> Ibid.

Standard Bank successfully sued Trust Bank in the Transvaal Provincial Division for a declaration that it was entitled, on presentation of the eight deposit vouchers, to receive payment of various amounts aggregating R3 400 in total. It is important to note that Hill J did not even consider Trust Bank's argument that condition one constituted a *pactum de non cedendo*.<sup>197</sup>

**(a) Minority Judgment**

The minority judgment, delivered by Ogilvie Thompson JA, considered the possibility that condition one constituted a *pactum de non cedendo*. He stated that generally all rights of action may be ceded, unless cession is restricted by the parties to the contract<sup>198</sup>, and on the authority of *Paiges* stated that a *pactum de non cedendo* may be enforced in certain circumstances. However, due to the restrictive nature of such a clause it would only be appropriate to enforce such a clause if it was expressed in "clear and unequivocal terms".<sup>199</sup>

Ogilvie Thompson JA concluded that condition one did not amount to a *pactum de non cedendo* as it was not phrased in clear and unequivocal language, and that, therefore, it did not invalidate the security cession of the deposit vouchers to Standard Bank.<sup>200</sup> This conclusion was premised on the following two reasons: firstly, if Trust Bank genuinely intended condition one to amount to a *pactum de non cedendo* it should

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<sup>197</sup> Ibid 188H.

<sup>198</sup> Ibid 181F-G.

<sup>199</sup> Ibid 181G-H.

<sup>200</sup> Ibid 181G-H and 182E.

have expressed its intention in more explicit language so that this intention could be conveyed.<sup>201</sup>

Secondly, the fact that condition one only referred to the 'deposit voucher' meant that the document itself was 'neither transferable nor negotiable', but did not entail that the rights recorded therein were 'neither transferable nor negotiable', and therefore, it could not be concluded that condition one prevented conferral of title of these rights to Standard Bank. Although Ogilvie Thompson JA was not explicit on this point, the clear implication was that the rights contained in the deposit voucher could be ceded, and that therefore, title was conferred onto Standard Bank to enforce these rights against Trust Bank.<sup>202</sup>

#### **(b) Majority Judgment**

However, the majority judgment, written by Botha JA, upheld Trust Bank's appeal on the basis that condition one did in fact amount to a *pactum de non cedendo*, which provided Trust Bank with a complete defence against Standard Bank's claim.<sup>203</sup>

Botha JA reached this conclusion by establishing from the outset that Mrs. Davidoff ceded the deposit vouchers to Standard Bank in terms of a cession in *securitatem debiti*, and that the only question that remained was the validity of these security cessions in light of the fact that the deposit vouchers were issued on condition that they were 'neither transferable nor negotiable'.<sup>204</sup>

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<sup>201</sup> Ibid 182A.

<sup>202</sup> Sunkel LLM thesis op cit note 58 at 95-139.

<sup>203</sup> Trust Bank supra note 193 at 189A.

<sup>204</sup> Ibid 189C.

On the authority of *Paiges*, Botha JA stated the law in this regard to be the following:

“The rule of our law is that all rights in *personam*, subject to certain exceptions based primarily upon the personal nature of the rights, not here relevant, can be freely ceded, but an owner’s rights of free disposal of his property may be restricted by a *pactum de non cedendo*. The effect of such a *pactum* depends upon the circumstances. Voet 2.14.20 and Sande, *Restraints*, 4.1.1 and 4.2.1, point out that an agreement whereby an owner deprives himself of the free right to deal with his own property, is without effect unless the other contracting party has an interest in the restriction, and Windscheid, *Pandektenrechts*, 8<sup>th</sup> ed, p 358, note 5, refers to the fact relied upon by *Seuffert* that also in the case of corporeals a contractual prohibition against alienation does not render the alienation void. *These principles do not, however, apply where the right is created with a restriction against alienation, and the restriction is contained in the very agreement recording the right, for in such a case the right itself is limited by the stipulation against alienation and can be relied upon by the debtor for whose benefit the stipulation was made*”.<sup>205</sup> [My emphasis]

In application of the law to the present matter Botha JA held that condition one did indeed amount to a valid *pactum de non cedendo*, as Trust Bank, for whose benefit the stipulation had been inserted, had a clear interest that was served by the prohibition.<sup>206</sup> Therefore, Trust bank was entitled to rely on condition one as a complete

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<sup>205</sup> Ibid 189D-F.

<sup>206</sup> Ibid 189H.

defence against any cause of action brought by a purported cessionary, such as Standard Bank.<sup>207</sup>

The above quoted passage appears to create the impression that when a right is born with a restriction on transfer, that is, the agreement creating the right also contains a *pactum de non cedendo*, the *pactum de non cedendo* would be valid irrespective of whether the debtor is able to prove an interest in the prohibition.<sup>208</sup> In other words, there is no interest requirement, which must be proven by the debtor in these circumstances.

In my view this apparent impression is untenable for two reasons. Firstly, Botha JA cites *Paiges* as authority for his above exposition of the law.<sup>209</sup> The ratio in *Paiges* is that a debtor must always prove an interest that is served by the restriction in order for the *pactum de non cedendo* to be valid.<sup>210</sup>

Secondly, in concluding that condition one did constitute a *pactum de non cedendo*, Botha JA stated that Trust Bank in any event had a clear interest in the prohibition.<sup>211</sup> Therefore, Botha JA's view that the debtor is not required to prove an interest in the *pactum de non cedendo* when the right is created with a restriction on transfer, was merely *obiter dictum*, and did not form part of the *ratio decidendi* of the decision, as Sunkel<sup>212</sup> contends.<sup>213</sup>

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<sup>207</sup> Ibid.

<sup>208</sup> Hutchison op cit note 3 at 279.

<sup>209</sup> *Trust Bank* supra note 193 at 189D-F.

<sup>210</sup> *Paiges* supra note 52.

<sup>211</sup> *Trust Bank* supra note 193 at 189H.

<sup>212</sup> Sunkel LLM thesis op cit note 58 at 143-144.

In relation to the argument that condition one only related to the document itself and not the rights contained therein, as Ogilvie Thompson concluded, Botha JA respectfully disagreed. Botha JA held that condition one not only prevented transfer of the document itself but also the rights contained therein.<sup>214</sup> In his view, to conclude that condition one only prevented transfer of the document itself would undermine and frustrate the very rationale of including condition one in the first place, which was to prevent transfer of the rights contained in the deposit vouchers.<sup>215</sup> The only mechanism in law in terms of which these rights could be transferred was by way of cession, and the reason Trust Bank included condition one was to prevent such transfer, therefore, in terms of the ordinary and literal meaning of condition one Mrs. Davidoff was precluded from ceding the deposit vouchers in *securitatem debiti* to Standard Bank.<sup>216</sup>

### **2.3 Italtrafo SpA v Electricity Supply Commission**<sup>217</sup>

In this case Escom successfully applied for an attachment *ad fundandam jurisdictionem* of a personal right which Italtrafo had against Escom. Subsequently, Italtrafo sought to set aside the attachment order on the basis that at the time of attachment the personal right concerned did not form part of their estate, as it had

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<sup>213</sup> Hutchison op cit note 3 at 279.

<sup>214</sup> *Trust Bank* supra note 193 at 189H and 190A.

<sup>215</sup> *Ibid* 190C.

<sup>216</sup> *Ibid* 191B-C.

<sup>217</sup> 1978 (2) SA 705 (W).

previously ceded the personal right concerned to Bank of Naples, in terms of a cession in *securitatem debiti*.

Escom, however, contended that the cession in *securitatem debiti* to Bank of Naples was ineffective and of no force and effect, due to presence of a *pactum de non cedendo* in the contract between Escom and Italtrafo in terms of which:

“... [Italtrafo] shall not assign or make over the contract or any part thereof or any share or interest therein to any other person without the written consent of Escom which may be refused without any reason being given”.<sup>218</sup>

Escom categorically denied that it had consented to the security cession of the personal rights from Italtrafo to Bank of Naples, and that therefore, the security cession was invalid.

King AJ presided over the matter, and summarised the *ratio* in *Paiges* in the following terms:

“...[S]uch a restraint will be enforced against a party claiming to be a cessionary if the debtor had a material and reasonable interest in making the stipulation”.<sup>219</sup>

In application to the facts of the case King AJ pointed out that because Escom employed the services of skilled manufacturers in the production of large pieces of equipment that it required in order to produce its own goods and services, it would

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<sup>218</sup> Ibid 708D.

<sup>219</sup> Ibid 710G.

cause Escom great loss if these pieces of equipment were defective.<sup>220</sup> This led King AJ to conclude that Escom did have a material and reasonable interest in the stipulation.<sup>221</sup>

Relying on the decision in *Trust Bank*, King AJ stated the following:

“...[W]here the restriction against the transfer of the rights formed part of the contract in question, the person claiming to be the cessionary could not acquire the cedent’s rights without the debtor’s consent. Any rights obtained by the person claiming to be the cessionary would be subject to such a restraint”.<sup>222</sup>

It is interesting to note that in King AJ’s view “[t]he Appellate Division seems to have departed from the test of material and reasonable interest laid down in *Paiges’* case”, in its decision in *Trust Bank*.<sup>223</sup> In reaching this conclusion King AJ relied, *inter alia*, on the following sentence from the judgment of Botha JA in *Trust Bank*:

“These principles do not, however, apply where the right is created with a restriction against alienation, and the restriction is contained in the very agreement recording the right, for in such a case the right itself is limited by the stipulation against alienation and can be relied upon by the debtor for whose benefit the stipulation was made”.<sup>224</sup>

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<sup>220</sup> Ibid 710H.

<sup>221</sup> Ibid.

<sup>222</sup> Ibid 710H-711A.

<sup>223</sup> Ibid 711A.

<sup>224</sup> Ibid.

In my view, King's AJ interpretation of the *Trust Bank* case is unwarranted, for the reasons stated above.<sup>225</sup> Relying on his own interpretation of the decision in *Trust Bank* King AJ came to the following conclusion:

“As I have already found as a matter of probability that the restraint against cession formed part of the contract in respect of the transformer...the cession is not a valid one”.<sup>226</sup>

Approximately two years after the decision in *Italtrafo* a full bench of Transvaal Provincial Division had an opportunity to express its views on the doctrine of *pacta de non cedendo* in *Vawda*.<sup>227</sup>

## **2.4 Vawda v Vawda and others**

This case concerned the sale of immovable property, which was sold by the Community Development Board to Mr. Vawda. The parties agreed that the purchase price was to be paid off in monthly instalments. In terms of clause 11 of their agreement the purchaser was obliged to obtain the consent of the seller prior to ceding his rights under the agreement.<sup>228</sup>

After conclusion of the sale both Mr. and Mrs. Vawda took occupation of the property. Furthermore, Mrs. Vawda paid some of the monthly instalments on the property. Subsequently, Mr and Mrs. Vawda experienced matrimonial difficulties, and

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<sup>225</sup> Refer to pg 45.

<sup>226</sup> Ibid 711A-B.

<sup>227</sup> *Vawda v Vawda and others* 1980 (2) SA 341 (T).

<sup>228</sup> Ibid 483.

Mrs. Vawda became aware that her husband was attempting to sell the property in order to finance his emigration.

In order to prevent the sale of the property Mrs Vawda paid Mr. Vawda R 2000 in exchange for him agreeing to cede all his rights and interests in the property to her. Despite ceding all his rights and interests in the property to Mrs. Vawda, Mr. Vawda nevertheless sold the property to a third party.

The present matter arose when Mrs. Vawda attempted to interdict the transfer of the property to the third party upon becoming aware of the sale agreement.

In the court *a quo* Mrs. Vawda's application was dismissed by Nicholas J on the basis that the cession to Mrs. Vawda was invalid.<sup>229</sup> Mrs Vawda's subsequent appeal to a full bench of the Transvaal Provincial Division was dismissed by the unanimous judgment of Boshoff AJP.

Mrs Vawda contended, *inter alia*, that clause 11 constituted an invalid *pactum de non cedendo* and was therefore ineffective.<sup>230</sup> This was because, so the argument ran, the validity of the *pactum de non cedendo* depended upon whether the restriction could be shown to serve a 'useful purpose' to the debtor.<sup>231</sup>

Furthermore, Mrs. Vawda contended that the onus of proving the existence of such an interest rested on the person seeking to enforce the restraint.<sup>232</sup> Relying on the

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<sup>229</sup> Ibid 344F-G.

<sup>230</sup> Ibid 345B-C.

<sup>231</sup> Ibid 345C-D.

<sup>232</sup> Ibid.

decision in *Du Plessis*<sup>233</sup>, so the argument ran, the court was entitled to look at the contract itself in order to determine whether or not such an interest existed.<sup>234</sup> In Mrs. Vawda's view, a careful examination of the contract clearly demonstrated that no such interest could be shown to exist by the Community Development Board.<sup>235</sup>

The final leg of this argument was that the party required to demonstrate an interest in the stipulation in this case was the Community Development Board, and because the Community Development Board had made no attempt to demonstrate an interest in the restriction, there was no interest present as required. Therefore, the *pactum de non cedendo* was invalid and ineffective.<sup>236</sup>

Boshoff AJP's point of departure to Mrs Vawda's arguments was that in terms of decision in *Paiges* the entire sale agreement had to be considered in order to ascertain the extent of Mr. Vawda's rights thereunder.<sup>237</sup>

Although Boshoff AJP accepted the correctness of Mrs. Vawda's arguments in relation to the interest requirement, he pointed out that the defect contained therein was that she considered the *pactum de non cedendo* to be a separate agreement from that of the sale agreement, when in fact, the *pactum de non cedendo* was "part and parcel of the agreement creating the right, and the right is limited by the stipulation"<sup>238</sup> <sup>239</sup>.

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<sup>233</sup> *Du Plessis* supra note 192.

<sup>234</sup> *Vawda* supra note 227 at 345E-F.

<sup>235</sup> *Ibid.*

<sup>236</sup> *Ibid* 345F-G.

<sup>237</sup> *Ibid* 346A.

<sup>238</sup> *Paiges* supra note 52 at 617.

Furthermore, Boshoff AJP stated that apart from the interest requirement, one should also take cognisance of the contents of 4 1 1, 4 1 6 and 4 1 7 in Sande's *De Prohibita*.<sup>240</sup> Boshoff AJP subsequently stated that Botha JA in *Trust Bank*:

“[r]ecognised this difference and did not depart from the test of material and reasonable interest laid down in *Paiges*' case as suggested by King AJ in *Italtrafo*”.<sup>241</sup>

In light of the above Boshoff AJP concluded that clause 11 did in fact constitute a valid *pactum de non cedendo* which prevented cession of Mr. Vawda's rights to Mrs. Vawda. Therefore, the purported cession to Mrs. Vawda was invalid and unenforceable. Most notably Boshoff AJP explicitly rejected King AJ's suggestion that the decision in *Trust Bank* amounted to a departure from the *ratio* in *Paiges*. This view appeared to be confirmed by the Appellate Division in the case of *MTK Saagmeule (Pty) Ltd v Killyman Estates (Pty) Ltd*<sup>242</sup> when it re-stated the interest requirement.<sup>243</sup>

## **2.5 MTK Saagmeule (Pty) Ltd v Killyman Estates (Pty) Ltd**

The plaintiff in this case, Killyman Estates, was awarded a tender by the Department of Forestry, and in 1973 the parties concluded an agreement in terms of which Killyman Estates would harvest and remove certain standing timber located on

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<sup>239</sup> *Vawda* supra note 227 at 346A.

<sup>240</sup> *Ibid* 346D-H.

<sup>241</sup> *Ibid* 346H.

<sup>242</sup> 1980 (3) SA 1 (A).

<sup>243</sup> *Hutchison* op cit note 3 at 279.

two farms, against payment of the price to the Department. Clause 27 of their agreement contained a *pactum de non cedendo* and stated that: “The purchaser (Killyman Estates) shall not cede, transfer or assign his rights under the contract without the written consent of the seller (Department of Forestry)”.

However, in 1974 Killyman Estates entered into an agreement with the defendant, MTK Saagmeule, in terms of clause 3 of their agreement Killyman apparently agreed, *inter alia*, to assign all rights, obligations and liabilities under its contract with the Department, to MTK Saagmeule. It was common cause that the Department had not consented to the purported cession. Clause 5 of their agreement, however, stated that Killyman Estates:

“undertakes to make the payments to the Department of Forestry as the timber is sawn and in terms of the contract. The said Saagmeule undertake hereby to saw and remove the timber strictly in terms of the contract which is known to them and of which they have a copy”.

Furthermore, in terms of clause 7 of their agreement MTK Saagmeule declared that they “had properly read through” the agreement concluded between Killyman Estates and the Department of Forestry, and that they “fully understood their responsibility”.

Subsequently, MTK Saagmeule fell behind schedule in harvesting and removing the wood. The plaintiff thereafter instituted action against the defendant for breach of contract and claimed R 29 500 with interest.

In the court *a quo* the following issues arose for determination:<sup>244</sup> Firstly, whether on a proper interpretation of the agreement concluded between the plaintiff and the defendant, the plaintiff was obliged to substitute the defendant for the plaintiff in terms of their agreement concluded with the Department? Secondly, whether or not the agreement concluded between the plaintiff and defendant was valid and enforceable in law in light of the fact that the Department had not consented thereto? Thirdly, whether the defendant was obliged to pay the purchase price to the plaintiff prior to the plaintiff performing in terms of the agreement? The final issue was whether or not the defendant was entitled to cancel their agreement with the plaintiff on the ground that the plaintiff had failed to perform?

In the court *a quo* judgment on all four issues was given in favour of the plaintiff.<sup>245</sup> The court held that the agreement concluded between Killyman and MTK Saagmeule was valid and enforceable as the parties did not intend a full substitution.<sup>246</sup>

On appeal in the Appellate Division MTK Saagmeule contended that the intention of the parties was to effect a cession of the rights concerned, and in light of the fact that the Department did not consent to the transfer, the agreement concluded between Killyman and MTK Saagmeule was void.<sup>247</sup>

MTK Saagmeule argued further that in the present matter clause 27 of the agreement concluded between Killyman and the Department constituted a *pactum de*

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<sup>244</sup> *MTK Saagmeule* supra note 242 at pg 3.

<sup>245</sup> *Ibid.*

<sup>246</sup> *Ibid.*

<sup>247</sup> *Ibid* 9H.

*non cedendo* that had the effect of rendering any cession concluded without the written consent of the debtor invalid.<sup>248</sup>

Rumpff CJ, who wrote the unanimous judgment of the court, rejected MTK Saagmeule's *pactum de non cedendo* argument.<sup>249</sup> Rumpff CJ stated that in the present matter the doctrine of *pacta de non cedendo* was inapplicable, and that MTK Saagmeule's reliance thereon was misplaced.<sup>250</sup>

Rumpff CJ held that there was no common intention by the parties (that is, the plaintiff and the defendant) to effect a substitution or a cession, in spite of clause 3 of their agreement.<sup>251</sup> In other words, it was not the intention of the parties that MTK Saagmeule would substitute Killyman in the contract between Killyman and the Department. Furthermore, the parties did not intend that Killyman's rights under their agreement with the Department would be ceded to MTK Saagmeule. The Court held that when a provision in a contract is ambiguous a court may take cognisance of other provisions in the agreement, and that the court may draw inferences from the proven facts in order to ascertain how the parties interpreted their agreement.<sup>252</sup>

Rumpff CJ acknowledged that in general a court is not entitled to interpret a document by taking account of the conduct of the parties.<sup>253</sup> However, he held that

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<sup>248</sup> Ibid 9H – 10A.

<sup>249</sup> Ibid 10D.

<sup>250</sup> Ibid.

<sup>251</sup> Ibid 2.

<sup>252</sup> Ibid.

<sup>253</sup> Ibid.

when there is ambiguity a court may attempt to ascertain the real intention of the parties by taking cognisance of other provisions in the contract as well as evidence indicating how the parties to the contract understood their agreement.<sup>254</sup>

Rumpff CJ held that in the present matter the parties did not intend to effect a cession or substitution for the following reasons:<sup>255</sup> Firstly, clause 7 of their agreement indicated that the defendant was well aware that the Department would only recognise a transfer if it had consented to such transfer. Secondly, the defendant had never insisted upon such consent, this together with the contents of clause 5 of their agreement, must lead one to infer that the defendant did not intend to replace the plaintiff. Thirdly, subsequent to the agreement concluded between the plaintiff and the defendant, the plaintiff continued to conduct itself as though it was still a party to the contract with the Department, and that this was in conflict with an intention that the defendant would substitute the plaintiff in their agreement with the Department.

Finally, Rumpff CJ held that:

“having regard to the other provisions of the contract and to how the parties themselves had interpreted the contract, that it had to be found that the parties had not intended what had apparently been provided in clause 3, namely that a transfer should take place and that defendant should take the place of plaintiff; the parties had only intended to give the defendant the opportunity of exercising the rights of the plaintiff, against payment of a specified amount, and these rights would be exercised strictly according to the terms of the contract between plaintiff and the Department.”

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<sup>254</sup> Ibid.

<sup>255</sup> Ibid 3-4.

Rumpff CJ held that the agreement concluded between the plaintiff and the defendant was, therefore, valid in law, and that the plaintiff was entitled to rely thereon.<sup>256</sup> Furthermore, he held that the plaintiff had not failed to perform, and that the defendant had breached their contract.<sup>257</sup> The appeal was, therefore, dismissed.<sup>258</sup>

The cumulative effect of Rumpff CJ's judgment was that Killyman would remain party to the contract with the Department and would then have a back to back agreement with MTK Saagmeule. Therefore, their agreement with the defendant would not fall foul of the *pactum de non cedendo* contained in clause 27 of their contract with the Department.

Interestingly, even though Rumpff CJ ruled out the application of the doctrine of *pacta de non cedendo* he did offer valuable *obiter dictum* when he re-stated the interest requirement. In this regard Rumpff CJ stated the following: in discussing *Paiges* case he held that, "Legally it was clear that when the original debtor had 'an interest' in the prohibition on transfer, the prohibition is valid in respect of the debtor concerned."<sup>259</sup> Furthermore, he stated that, "Because such a *pactum* infringes the owner's right of control over his property, it is regarded as valid only if it is to the advantage or in the interest of the other contracting party."<sup>260</sup>

These statements are clearly commensurate with the view of Boshoff AJP in *Vawda*. In other words, even if a right is born *ab initio* with a restriction on transfer the

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<sup>256</sup> Ibid 4.

<sup>257</sup> Ibid.

<sup>258</sup> Ibid.

<sup>259</sup> Ibid 10F-H.

<sup>260</sup> Ibid 11.

*pactum de non cedendo* will only be accorded validity if the debtor is able to demonstrate an interest.

## **2.6 Joubert's Solution**

In 1985 Joubert proposed his own solution to the controversial interest requirement in his doctoral thesis. In his view the inquiry into validity of *pacta de non cedendo inter partes* does not involve, contrary to Scott's assertion<sup>261</sup>, a choice between freedom of contract on the one hand, and freedom of trade on the other.<sup>262</sup> Joubert argues that these values may be reconciled.<sup>263</sup> He proposed the following approach:

“Daar word aan die hand gedoen dat dit nie nodig is om met besondere reëls te werk waarmee die geldigheid van *pacta de non cedendo* beoordeel moet word nie. Al wat nodig is, is om aan die hand van die normale geldigheidsvereistes vir 'n kontrak vas te stel of 'n *pactum de non cedendo* geldig is. Veral die geoorloofheidsvereiste kom in hierdie verband ter sprake. In die Suid-Afrikaanse reg is 'n kontrak onder andere ongeoorloofd indien dit in stryd met die openbare belang is”.<sup>264</sup>

In his view it is not necessary to adopt either a law of obligations or law of property approach, to determine the validity of *pacta de non cedendo*, since he contends that *pacta de non cedendo* should not be assessed in terms of the interest requirement. Instead, he argues that the validity of *pacta de non cedendo* should be

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<sup>261</sup> Scott 'Pacta' op cite note 55 at 149.

<sup>262</sup> Joubert LLD thesis op cit note 55 at 464 footnote 144; Joubert 'Boekskuldfinansiering' op cit note 55.

<sup>263</sup> Ibid.

<sup>264</sup> Joubert LLD thesis op cit note 55 at 463.

determined by the general requirements for contractual validity.<sup>265</sup> One such requirement is that a contract should be lawful, whether or not a contract is unlawful is ascertained by conducting a public policy inquiry.<sup>266</sup> In other words, Joubert's contention is that the freedoms of contract and trade may be reconciled in the public policy inquiry.

In order to illustrate his approach Joubert relies on the decision in *Magna Alloys and Research SA (Pty) Ltd v Ellis*.<sup>267</sup> This case concerned a restraint of trade agreement, in contrast to a *pactum de non cedendo*. The court in this case held that a restraint of trade clause is *prima facie* valid, unless it could be shown that the clause was contrary to public policy, and that an unreasonable restraint of trade clause would be contrary to public policy.<sup>268</sup> In other words, if the restraint of trade clause could be shown to be unreasonable it would be contrary to public policy, and as such invalid and unenforceable. Furthermore, Joubert states that an indication of the unreasonableness of such a clause would be where the person in whose favour the restraint had been inserted had no interest that was served by the clause.<sup>269</sup>

In Joubert's view the decision in *Magna Alloys* mandates an approach, analogous to that of restraint of trade clauses, to determine the validity of *pacta de non cedendo*. In other words, if the person in whose favour the *pactum de non cedendo* has been inserted is able to demonstrate an interest in the prohibition the *pactum de non*

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<sup>265</sup> Ibid; Joubert 'Boekskuldfinansiering' op cit note 55.

<sup>266</sup> Ibid.

<sup>267</sup> 1984 (4) SA 874 (A).

<sup>268</sup> Ibid 886I-887; 891A-B.

<sup>269</sup> Joubert LLD thesis op cit note 55 at 466; Joubert 'Boekskuldfinansiering' op cit note 55.

*cedendo* would be reasonable, this factor would, therefore, favour upholding the lawfulness and enforceability of the *pactum de non cedendo*.<sup>270</sup>

I, however, share Lubbe and Murrays' scepticism that restraint of trade clauses are not sufficiently akin to *pacta de non cedendo* to warrant an analogous approach.<sup>271</sup>

Sunkel, however, endorses Joubert's approach and states that:

"I believe that the two constructions are sufficiently similar to justify a comparison and as Joubert has pointed out, a restraint of a trade clause and a *pactum de non cedendo* are both restraints voluntarily agreed to by parties in the commercial arena".<sup>272</sup>

Sunkel, however, concedes that Joubert's association of the reasonableness criterion in the determination of the validity of *pacta de non cedendo* is problematic since this factor has not been used by the courts.<sup>273</sup> I too agree, as Sunkel<sup>274</sup> does, with Roussouw's criticism that the fundamental problem with Joubert's approach is that he attempts to encompass the assessment of *pacta de non cedendo* under the umbrella of the decision in *Magna Alloys*.<sup>275</sup>

In my view Joubert's general proposition that the interest requirement should be subsumed into the public policy enquiry in order to determine the lawfulness and validity *pacta de non cedendo* is sound. Reasonableness is certainly a factor that may be taken

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<sup>270</sup> Joubert LLD thesis op cit note 55 at 465; Joubert 'Boekskuldfinansiering' op cit note 55.

<sup>271</sup> Lubbe op cit note 55 at 655. See also Scott (1991) op cit note 55 at 212.

<sup>272</sup> Sunkel LLM thesis op cit note 58 at 149 – 153.

<sup>273</sup> Ibid.

<sup>274</sup> Ibid.

<sup>275</sup> Roussouw op cit note 55 at 61.

into account in the public policy enquiry. However, in my opinion one should not apply the specific test to determine the reasonableness of a restraint of trade when determining the overall lawfulness of a *pactum de non cedendo*. I, therefore, reject Joubert's assertion that an analogous approach to that taken in determining the lawfulness of a restraint of trade clause is warranted in relation to determining the lawfulness of a *pactum de non cedendo*.

## **2.7 Roussouw's Solution**

Roussouw argues, as Lubbe and Murray do, that the interest requirement unduly fetters freedom of contract, which is undeniably the cornerstone of the South African law of contract.<sup>276</sup> Roussouw contrasts the approach to *pacta de non cedendo* to the approach taken to limitations on the alienation of rights in the law of things. He points out that in the context of the law of things both real rights and personal rights may limit an owner's right to alienate his property.<sup>277</sup> To fortify this proposition Roussouw lists the following examples: an option, a right of pre-emption, a restraint on alienation and, a *fideicommissum*.<sup>278</sup>

Roussouw argues that these types of restrictive personal rights are completely valid and binding, and that some may even be perceived of as an encumbrance on

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<sup>276</sup> Ibid 54-55; Lubbe op cit note 55 at 655.

<sup>277</sup> Roussouw op cit note 55 at 54.

<sup>278</sup> Ibid.

immoveable property, and may be registered as real rights.<sup>279</sup> In my opinion, even though personal rights may be registered in terms of the Deeds Registries Act<sup>280</sup>, registration does not transform the personal right into a real right.<sup>281</sup>

I am, however, in complete agreement with Roussouw's contention that in light of the fact that these types of restrictive personal rights are automatically valid, without a need to prove an interest in the restriction, there is no reason why *pacta de non cedendo* should not also be valid without the need to prove an interest.<sup>282</sup>

Roussouw makes an excellent point. Contractants who conclude these other types of restrictive agreements are not required to prove an interest in the prohibition in order for the prohibition to be valid and binding, why then are debtors' required to prove an interest in the *pactum de non cedendo*, even though both parties have agreed to insert the term, in order for such an agreement to be valid?<sup>283</sup>

Provided the contract is valid in every other respect a *pactum non cedendo* should be valid, irrespective of whether or not the debtor is able to prove an interest in the prohibition.<sup>284</sup> However, whether there is such an interest is not irrelevant; it is one aspect of the public policy enquiry. In my opinion, such an approach to the validity of *pacta de non cedendo* is mandated by s 39(2) of the Constitution. In my view, the rule

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<sup>279</sup> Ibid 54-55.

<sup>280</sup> 47 of 1937.

<sup>281</sup> H Mostert *et al*, *The Principles of the Law of Property in South Africa*, (Oxford University Press, 2012) pg 51.

<sup>282</sup> Roussouw op cit note 55 at 55.

<sup>283</sup> Sunkel LLM thesis op cit note 58 at 144-147.

<sup>284</sup> Ibid.

that a debtor must prove an interest in a *pactum de non cedendo* in order for such an agreement to be valid, falls short of the spirit, purport and objects of the Bill of Rights. Equality is one of the most important values encompassed in the Constitution, this value will be promoted by demoting the interest requirement to simply being another factor to be taken into account in the public policy analysis, and not a free-standing requirement.

However, the proposition that the interest requirement unduly fetters freedom of contract is not supported by all academics. Welsh, for one, points out that in certain circumstances an interest may be gleaned from the contract itself, obviating the need for the debtor to prove an interest, as occurred in *Du Plessis*<sup>285</sup>.<sup>286</sup> Welsh states that such a conclusion leads one to question whether freedom of contract is actually fettered, given the limited practical utility of the interest requirement in these circumstances.<sup>287</sup>

De Wet and Van Wyk argue that in light of the broad and vague meaning ascribed to the interest requirement in *Paiges*, and the fact that it is surely in the debtor's interest to know the identity of his creditor, any intrusion, if any, on the principle of freedom of contract is negligible.<sup>288</sup> In fact De Wet and Van Wyk argue that the

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<sup>285</sup> *Du Plessis* supra note 192 at 618.

<sup>286</sup> Welsh op cit note 64 at 82.

<sup>287</sup> *Ibid.*

<sup>288</sup> De Wet op cit note 65 at 254 footnote 16. See too S Scott, *Italtrafo SpA v Electricity Supply Commission 1978 (2) SA 705 (W)*, (1978) *Tydskrif vir Hendendaagse Romeins-Hollandse Reg* 334 and Scott (1991) op cit note 58 at 206.

interest requirement is superfluous given the ease with which a debtor may be prove an interest in the stipulation.<sup>289</sup>

Roussouw's solution to this dilemma is to jettison the interest requirement altogether, and to assess the validity of *pacta de non cedendo* in terms of the general public policy approach.<sup>290</sup> In terms of this approach the central question to be answered is whether freedom of contract or freedom of trade should be favoured in any given case. It is clear that Roussouw's approach was influenced by Joubert's approach, but unlike Joubert, Roussouw does not confine the public policy enquiry to the approach adopted in *Magna Alloys*, he instead prefers to assess the validity of *pacta de non cedendo* against the approach adopted in general when conducting the public policy enquiry.<sup>291</sup> Furthermore, Roussouw asserts that by only judging *pacta de non cedendo* against a single element may increase certainty.<sup>292</sup>

In my view, it would be unwise to jettison the interest requirement altogether, instead the interest requirement should be subsumed and relegated to being simply another factor to be taken into account when conducting the public policy analysis. In my opinion the futility of the interest requirement has been exaggerated by many of the academics.

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<sup>289</sup> Ibid.

<sup>290</sup> Roussouw op cit note 55 at 61.

<sup>291</sup> Ibid 63.

<sup>292</sup> Ibid 64.

It must, however, be acknowledged that the Supreme Court of Appeal in *Smuts v Booyens; Markplaas (Edms) Bpk en 'n ander v Booyens*<sup>293</sup> appeared to accept De Wet and Van Wyk's assertion that the debtor will always have an interest in knowing the identity of its creditor.<sup>294</sup>

## **2.8 Scott's solution (1991)**

Scott, like King AJ in *Italtrafo*, interpreted the majority judgment of Botha JA in *Trust Bank* as an express departure from the law as previously stated in *Paiges*.<sup>295</sup> In her view, the interest requirement was not universally applicable, and only applied when a *pactum de non cedendo* was superimposed onto a pre-existing right, it was not, however, applicable when the right was born *ab initio* with a restriction on transfer.<sup>296</sup>

Scott expressed her view in the following terms:

“To my mind the present position in South African law at the moment in regard to *pacta de non cedendo* is as follows: an agreement restricting the cedability of existing rights is invalid unless the restriction is in the interest of the person in whose favour it has been made. If the restricting agreement is part and parcel of the agreement creating the right, such an agreement is also valid, even if the cedent has no interest in the restraint. In both cases, however, the effect of the *pactum de non cedendo* is that a cession contrary

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<sup>293</sup> 2001 (4) SA 15 (SCA).

<sup>294</sup> Hutchison op cit note 3 at 280.

<sup>295</sup> Scott (1991) op cit note 55 at 212-213; Scott 'Pacta' op cit note 55 at 160; Scott op cit note 1 at 782.

<sup>296</sup> Ibid.

to the restraint is of no force or effect and does not result [only]<sup>297</sup> in a claim for damages.

The correct approach should be the following: a clear distinction should be drawn between a *pactum de non cedendo* in relation to existing rights, and one in relation to a right which is created as a non-transferable right. In relation to existing rights, the views of Sande and Voet should be followed in regard to both the validity and the effect of a *pactum de non cedendo*. In other words, as such an agreement is contrary to the basic principle of the law of property that a *res in commercio* should not be withdrawn from commercial dealings, a good reason is required, or, as the courts interpret it, the person in whose favour the restraint is operating should have an interest in the agreement. The effect of such an agreement is that it is binding only on the parties to the agreement and a breach thereof results in a claim for damages the right, however, passes to the cessionary.

In relation to a right which is created as a non-transferable right, a *pactum de non cedendo* is valid as the principle of freedom of contract is paramount here and therefore the requirement that the debtor should have an interest in the agreement is unnecessary. A cession contrary to such an agreement is of no force and effect even in the event of involuntary cessions, as the nature of the right is such that it is not transferable.”<sup>298</sup>

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<sup>297</sup> Hutchison op cit note 3 at 280 footnote 36: “I believe the word “only” has been omitted by mistake in this sentence. See Scott 1986 *De Jure* 15 at 32, where the author, again summarising her view of the existing positive law, states: “In albei gevalle is die effek van ‘n geldige sessieverbiedende ooreenkoms dat die reg onoordraagbaar is en het verbreking daarvan nie slegs ‘n eis vir skadevergoeding op grond van kontrakbreuk tot gevolg nie”.”

<sup>298</sup> Scott (1991) op cit note 55 at 212-213; Scott ‘Pacta’ op cit note 55 at 160; Scott op cit note 1 at 782.

Scott's reliance on the decision in *Trust Bank*, as authority for her view, that there are two constructions of *pacta de non cedendo*, in terms of which different rules are applicable, is in my view, fundamentally flawed for the reasons stated above.<sup>299</sup> Van Huyssteen *et al* point out that the cumulative effect of Scott's proposed solution is that the interest requirement will almost completely disappear, as the vast majority of *pacta de non cedendo* are inserted at the time of conclusion of a contract.<sup>300</sup>

In my opinion Scott's proposed solution, is with all due respect, illogical, for the following reasons:

Scott states that in relation to pre-existing rights in terms of which a *pactum de non cedendo* is super-imposed onto the debtor must prove an interest in order for such an agreement to be valid *inter partes*, however, even if the debtor is able to prove an interest the *pactum de non cedendo* would not prevent transfer of the right to a third party due to the operation of the fundamental principle in property law that a *res in commercio* should not be withdrawn from commerce. The debtor will, however, be able to sue the cedent for breach of contract in these circumstances.

Scott states that an example of a *pactum de non cedendo* that is superimposed onto a pre-existing right is where the right concerned is created without a restriction on transfer but the cedent and cessionary agree that the cessionary will not transfer the ceded right further.<sup>301</sup> Although I agree with Scott's views as to the effect of such an agreement, I categorically deny the validity of her reasons for this conclusion. The

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<sup>299</sup> Refer to pg 45.

<sup>300</sup> Van Huyssteen op cit note 55 at 451 footnote 166.

<sup>301</sup> Scott (1991) op cit note 55 at 213 footnote 284.

reason why transfer will not be prevented in these circumstances is because only the debtor and creditor to the agreement creating the right may validly remove the element of transferability from the rights concerned, and not because, as Scott contends, of the operation of the principle that a *res in commercio* should not be removed from commerce.<sup>302</sup> In other words, only the debtor and creditor to the agreement may validly remove the element of transmissibility from the rights concerned in these circumstances.<sup>303</sup> Therefore, if the cedent and cessionary agree to insert a *pactum de non cedendo* such a prohibition is insufficient to prevent transfer of the right from the cessionary to a third party, as the cedent and cessionary are not able to remove the element of transmissibility, only the original debtor and creditor may do so.

A further reason to doubt the operation of the property principle is that if the underlying rationale of this principle is that a restraint would unduly impede the free flow of commerce in these circumstances, logically, as Lubbe points out, this principle should apply to both constructions of *pacta de non cedendo* identified by Scott.<sup>304</sup> Furthermore, Scott's proposal appears to encompass the following situation within the category of pre-existing rights onto which a *pactum de non cedendo* is superimposed: where the debtor and creditor create a right that is born without a restriction on transfer, but subsequently agree to insert a *pactum de non cedendo*. If this scenario is indeed what Scott had in mind as falling within her pre-existing right construction, then her

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<sup>302</sup> Hutchison op cit note 3 at 288.

<sup>303</sup> Ibid.

<sup>304</sup> Lubbe op cit note 55 at par 164.

conclusion that the cedent will not be prevented from effecting transfer to the cessionary in these circumstances is untenable.

Such a conclusion is incongruent with the nature of cession discussed earlier.<sup>305</sup> If the debtor and creditor agree to insert a *pactum de non cedendo* into their agreement, whether this occurs at the time of conclusion of the contract or subsequently, the element of transmissibility will be removed from the rights concerned, rendering any purported cession thereof ineffective.<sup>306</sup>

In relation to a right which is created as non-transferable nothing prevents the original parties to the agreement, that is, the debtor and creditor, from agreeing to remove the *pactum de non cedendo* by mutual consent, why can the parties not reinstate the transferability of the rights concerned?<sup>307</sup> The fact that a right is created as non-transferable, therefore, does not act as a complete bar to the transferability of the rights concerned, as the parties are still free to remove the *pactum de non cedendo* from their original agreement by mutual consent, why then does it matter that the right was created as non-transferable?<sup>308</sup>

In light of the foregoing it is clear that Scott's proposed analysis is unconvincing, and that the distinction drawn between a pre-existing right in terms of which a *pactum de non cedendo* is superimposed onto, and a right that is born ab initio with a restriction on transfer, is illogical.

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<sup>305</sup> Refer to pp 28-31 above.

<sup>306</sup> Hutchison op cit note 3 at 283.

<sup>307</sup> Ibid.

<sup>308</sup> Ibid.

“The better distinction is that drawn by Nienaber between (a) a *pactum* in the agreement between debtor and creditor, A and B, creating the right purportedly being ceded, and (b) a *pactum* between creditor/cedent B and cessionary C, in the obligatory agreement that preceded or accompanied the act of cession. The reason why the *nemo plus iuris* principle cannot apply in the latter situation – and thus why a *pactum* cannot prevent a transfer of the right to the third party C – is not because a restraint on alienation cannot be imposed on an existing right originally created as transferable (as Scott would have it). Rather, it is because the content of the right can be changed only by the parties to the obligation. Thus, A and B might agree to superimpose a *pactum* on a right which they originally created as a transferable right; so too if B were to cede the right to C, C and A might agree that the right is henceforth to be non-transferable; but B and C cannot by agreement between themselves change the content of the obligation between A and B (or for that matter between A and C).”<sup>309</sup>

Unfortunately, these criticisms were not grasped by the courts in *Capespan* and *Born Free Investments*, who unequivocally accepted Scott’s views as to the correct approach to be adopted in South African law.<sup>310</sup>

## **2.9 Smuts v Booyens; Markplaas (Edms) Bpk en ‘n ander v Booyens**

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<sup>309</sup> Ibid 288-289.

<sup>310</sup> *Capespan* supra note 56 at 11-13; *Born Free Investments* supra note 57 at 6.

This case concerned a private company, Markplaas (Edms) Bpk, which had two shareholders, Smuts and Roux, who each had a 50% share in the company, and were its only directors.

In 1993 Roux entered into a sale agreement with Booyens, in terms of which Roux agreed to sell his shares in the company to Booyens. Smuts was unaware of this transaction.

Later in January 1994 Roux concluded a second transaction in terms of which he agreed to cede the same shares as security for a loan he obtained. In September 1994 Roux was provisionally sequestered, and in October 1994 the provisional sequestration order was made final. Subsequently, Roux collected his share certificate from the auditors of Markplaas and delivered it to Booyens.

In the court *a quo* Smuts's application to set aside the sale agreement was dismissed. Smut argued that the sale agreement was invalid because Roux had failed to comply with a provision in the company's articles of association relating to the sale of shares. The court *a quo* rejected this argument and held that the conclusion of the sale agreement entitled Booyens to the shares, and, therefore, at least *prima facie*, entitled him to have his name inserted in the share register.

Smuts appealed the decision of the court *a quo*, persisting in the argument that, the company's articles of association contained an agreement not to transfer the rights in the company (that is, the shares) unless the correct procedure was followed, and that Roux's failure to follow the procedure set out in the articles of association precluded Booyens from becoming entitled to the shares.

The unanimous judgment of the court was delivered by Cameron JA.

Cameron JA explicated that s 20 of Companies Act<sup>311</sup> obliged a private company to restrict the transferability of its shares, and that this restriction was a vital characteristic of a private company.<sup>312</sup>

Cameron JA held that the word 'transfer' in the Companies Act should be given its 'full' and 'technical' meaning.<sup>313</sup> He held that transfer encompassed a number of steps: firstly, it entailed an agreement to transfer, secondly, it included the execution of a deed of transfer, and finally, the registration of the transfer.<sup>314</sup> Cameron JA held that if the restrictions imposed by the Act and the company's articles of association were not complied with the shares would be completely non-transferable.<sup>315</sup>

In terms of the company's articles of association any shareholder wishing to sell his shares must first offer the shares to the existing shareholders before offering them to any third party.<sup>316</sup> In other words, the shareholders of a private company have a right of pre-emption to the sale of any shares in their company.<sup>317</sup>

The court in this case equated the right of pre-emption contained in the company's Articles of Association, which is treated as a contract between the members

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<sup>311</sup> 61 of 1973.

<sup>312</sup> *Smuts* supra note 293 at 21A-D.

<sup>313</sup> *Ibid* 21G.

<sup>314</sup> *Ibid* 21H this assertion was based on the judgment of Rumpff JA in *Inland Property Development Corporation (Pty) Ltd v Cilliers* 1973 (3) SA 245 (A) 251C.

<sup>315</sup> *Smuts* supra note 293 at 22D.

<sup>316</sup> *Ibid*.

<sup>317</sup> *Ibid*.

*inter se*, to a *pactum de non cedendo*.<sup>318</sup> The court stated that the *pactum de non cedendo* was valid as the company had an interest in it.<sup>319</sup> In regard to the issue of transferability the court held that the restriction on transfer existed when the shares were created.<sup>320</sup> The shares therefore, lacked the characteristic of transferability.<sup>321</sup>

Therefore, both the purported cession to Booyens and the security cession to the third party did not transfer Roux's shares in the company as Roux had failed to first offer Smut's the option of purchasing his shares before he purported to sell them to Booyens.<sup>322</sup> The court, therefore, set aside both the purported cession and security cession, respectively.

## **2.10 Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd**<sup>323</sup>

This case concerned two companies, Chance Brothers (Pty) Ltd and Club Champion Investments (Pty) Ltd, who each concluded separate marketing agreements with Capespan. Both marketing agreements contained similar terms. In 2001 a dispute arose between Chance Brothers and Club Champion on the one hand, and Capespan on the other. Chance Brothers and Club Champion alleged that Capespan had breached certain clauses of their respective marketing agreements. Arbitration

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<sup>318</sup> *Ibid.*

<sup>319</sup> *Ibid.*

<sup>320</sup> *Ibid* 24G.

<sup>321</sup> *Ibid.*

<sup>322</sup> *Ibid.*

<sup>323</sup> *Capespan* supra note 56.

proceedings did initially commence but were never completed, and in December 2002 both Chance Brothers and Club Champion were placed under provisional liquidation, which were subsequently made final. Joint liquidators were appointed to wind-up the companies. In September 2005 the liquidators purported to cede the rights arising from the respective marketing agreements to Any Name 451.

Both marketing agreements contained a clause prohibiting the cession of any rights arising from the marketing agreement without the consent of Capespan.<sup>324</sup> It was common cause that Capespan had not consented to the cessions.<sup>325</sup> Therefore, the central issue in this case was the validity of the *pactum de non cedendo*.<sup>326</sup>

In the court a quo Any Name 451 brought an application that it be substituted for Club Champion Investments and Chance Brothers. Capespan objected to the substitution, *inter alia*, on the ground that such a substitution was prohibited by clause 16 of their respective agreements with each company.

Zondi AJ, on the authority of *Paiges*, held that the prohibition only contemplated a voluntary cession and did not encompass an involuntary cession.<sup>327</sup> On this basis Zondi AJ held that the liquidators were, therefore, not prevented by the *pactum de non cedendo* from ceding the rights of the liquidated companies to Any Name 451.

On the authority of *Lithins*<sup>328</sup>, Zondi AJ stated the following:

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<sup>324</sup> Ibid 511-513.

<sup>325</sup> Ibid.

<sup>326</sup> Ibid.

<sup>327</sup> *Any Name 451 (Pty) Ltd v Capespan (Pty) Ltd* 2007 JOL 19402 (C) at 26.

<sup>328</sup> *Lithins v Laeveldse Kooperasie Bpk and another* 1998 (3) SA 891.

“A *pactum de non cedendo* does not bind the liquidator who alienates and cedes the contractual right pursuant to his duties as liquidator in insolvency unless it appears in a lease, in which case section 37(5) of the Insolvency Act<sup>329</sup> applies, or unless it appears from the *pactum* that it would also be applicable in the case of insolvency”.

In Zondi AJ’s view clause 16 could not be interpreted as being binding on the liquidators on insolvency. Therefore, he held that the liquidators were free to cede the respective rights of the liquidated companies to Any Name 451.<sup>330</sup>

Capespan appealed to the Full Bench. The unanimous judgment of Thring J, however, took a very different view to that of the court *a quo* in this matter.<sup>331</sup>

Thring J agreed with Zondi AJ’s observations that a *pactum de non cedendo* will not always bind a liquidator in insolvency, unless the *pactum de non cedendo* is included in a lease agreement or where the *pactum de non cedendo* expressly stipulates that it will bind a liquidator or trustee on insolvency.<sup>332</sup> However, Thring J stated that there was a third instance in which a *pactum de non cedendo* could triumph against insolvency, which Zondi AJ overlooked.<sup>333</sup>

Thring J criticised Zondi AJ’s reliance on *Paiges* as authority for the view that an involuntary cession could not be precluded by a *pactum de non cedendo*. In his view, De Villiers JA in *Paiges*, was merely stating that a *pactum de non cedendo* cannot

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<sup>329</sup> 24 of 1936.

<sup>330</sup> *Ibid.*

<sup>331</sup> *Capespan supra note 56.*

<sup>332</sup> *Ibid* 513A-513C.

<sup>333</sup> *Ibid* 513C.

prevent the rights from vesting in a trustee or liquidator on insolvency, as this occurs by operation of law.<sup>334</sup> Thring J stated that De Villiers JA's judgment could not be interpreted as authority for the proposition that a *pactum de non cedendo* did not bind a liquidator or trustee in insolvency.<sup>335</sup>

In formulating the third instance in which a *pactum de non cedendo* would bind a trustee or liquidator in insolvency, Thring J began his exposition of the law by discussing whether the decision in *Trust Bank* constituted a departure from the *Paiges* judgement. Thring J stated that the court in *Trust Bank* held that where a right is created with a prohibition against cession the debtor would not be required to prove an interest because the right was limited by the stipulation.<sup>336</sup>

Thereafter, the court explicitly endorsed Scott's views on the validity and effect of a *pactum de non cedendo* in these circumstances, and quoted with approval the aforementioned passages in her textbook.<sup>337</sup> The court justified its adoption of Scott's view, *inter alia*, on the following grounds. First, the court explained that Scott's views were both congruent and positively supported by the case law.<sup>338</sup> Second, Scott's view was in line with the courts' approach to freedom of contract, that is, "the maxim *pacta*

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<sup>334</sup> Ibid 513H-514A. *Paiges* supra note 52 at 616.

<sup>335</sup> Ibid.

<sup>336</sup> Ibid 514C-F.

<sup>337</sup> Refer to pp 65-66 above.

<sup>338</sup> *Capespan* supra note 56 at 515B-J.

*sunt servanda* is still a cornerstone of our law of contract".<sup>339</sup> Third, Scott's view was supported by some decisions at local and provincial level, for example, *Italtrafo SpA*.<sup>340</sup>

In summation Thring J stated the following:

"first, that a distinction must be drawn between a *pactum de non cedendo* which prohibits the cession of an existing right, i.e. one which pre-existed the conclusion of the *pactum*, on the one hand, and a *pactum de non cedendo* of a right which, by means of the *pactum* itself, was created *ab initio* as a non-transferable right, on the other. In the case of the first *pactum*, that which relates to an existing right, It will not always be enforceable; in particular, it will not bind the trustee in insolvency or the liquidator of the creditor and prevent him from executing a valid "involuntary" cession of the right to a third party in the course of carrying out his duties as trustee or liquidator. However, in the case of the second type of *pactum*, that which relates to a right which was created *ab initio* as a non-transferable right, the *pactum* is valid and enforceable against the world because the right is simply inherently incapable of being transferred by anyone; and a cession of such a right contrary to the *pactum* will be putative, and of no force or effect, even if it is a so-called "involuntary" cession; in other words, it will bind even a trustee in insolvency or a liquidator of the creditor. I hasten to add that I do not use the term "involuntary cession" to include the vesting of an insolvent's assets in his trustee, which takes place, not by an act of cession, but automatically, by operation of law, as was mentioned in *Paiges'* case, *loc cit*: the term as I understand it refers now to an attempt

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<sup>339</sup> Ibid 518D-E.

<sup>340</sup> Ibid 518C-H.

by a trustee or liquidator to transfer the right concerned, by means of cession, to a third party.”<sup>341</sup>

Thring J, therefore, recognised a third instance in which a *pactum de non cedendo* would bind a trustee or liquidator in insolvency: where the right was created *ab initio* as non-transferable, the *pactum de non cedendo* would prevent even an involuntary cession.<sup>342</sup>

In application to the facts of the case the court held that the rights were created *ab initio* as non-transferable, and were consequently binding on the liquidators.<sup>343</sup> The purported cessions were, therefore, invalid and ineffectual in transferring the rights.<sup>344</sup> The full bench in *Capespan*, therefore, failed to recognise the deficiencies in Scott’s proposed solution that were discussed earlier. The Supreme Court of Appeal had the opportunity to state its views on the law relating to *pacta de non cedendo* in the seminal decision of *Born Free Investments*.

## **2.11 Scott’s Solution (2008)**

The decision in *Capespan*, in which the court unequivocally accepted Scott’s initial solution to the problems in the doctrine of *pacta de non cedendo*, prompted Scott

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<sup>341</sup> Ibid 518-519.

<sup>342</sup> Ibid 518C-E.

<sup>343</sup> Ibid 521E-G and 521I-J.

<sup>344</sup> Ibid.

to re-evaluate her position as to the correct approach.<sup>345</sup> In an ironic twist of events, Scott has now for the first time unequivocally changed her view, and now proposes an approach that is essentially<sup>346</sup> antithetical to her prior position.<sup>347</sup>

After conducting a comparative analysis of the law as expressed in certain continental and international instruments, as well as the approaches in some of the leading foreign jurisdictions, Scott questioned the wisdom of allowing parties the freedom to create rights that are completely non-transferable.<sup>348</sup> She states that, “This kind of agreement prohibiting cession is the bone of contention since it inhibits the smooth operation of factoring and securitisation”.<sup>349</sup>

From the perspective of the law of obligations, the principle of freedom of contract entitles parties to determine the contents of their agreement, provided such an agreement falls “within the boundaries set by law”.<sup>350</sup> Although Scott acknowledges that *pacta de non cedendo* may be held invalid, *inter alia*, on the ground that such an agreement may be contrary to public policy, she states that in principle she can see no reason why such agreements should be contrary to public policy.<sup>351</sup> Once the validity of

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<sup>345</sup> Scott op cit note 1.

<sup>346</sup> I say ‘essentially’ because in relation to exiting rights Scott persists in the view that *pacta de non cedendo* should only operate *inter partes* in these circumstances, and should not prevent transfer to a third party. 486-487

<sup>347</sup> Scott op cit note 1 at 494.

<sup>348</sup> *Ibid.*

<sup>349</sup> *Ibid* 487.

<sup>350</sup> *Ibid.*

<sup>351</sup> *Ibid.*

the *pactum de non cedendo* has been established *inter partes*, the parties to the agreement are bound due to the operation of the principle of *pacta sunt servanda*.<sup>352</sup>

However, Scott argues that the contentious issue is whether it is contrary to public policy to allow the parties to the agreement “to re-instate the personal nature of their obligation in such a way that their agreement is effective against third parties”.<sup>353</sup> In light of the trend internationally, Scott proposes the following solution: *pacta de non cedendo* should be accorded validity *inter partes* due to the operation of the principle of freedom of contract.<sup>354</sup> Any cession concluded contrary to such an agreement will give the innocent party a claim for breach of contract against the guilty party, and where appropriate a right to claim damages.<sup>355</sup> However, such an agreement should not prevent transfer to a third party unless, “the debtor has an interest in re-instating the personal nature of the obligation”, which may be re-instated in the agreement creating the claim.<sup>356</sup>

## **2.12 Sunkel’s Solution**

Sunkel argues that the current state of the South African law on the validity and effect of *pacta de non cedendo* is out of sync with international developments in this area of law.<sup>357</sup> Sunkel proposes that South African law follow the U.S.’s lead in drawing

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<sup>352</sup> Ibid.

<sup>353</sup> Ibid.

<sup>354</sup> Ibid 494.

<sup>355</sup> Ibid.

<sup>356</sup> Ibid.

<sup>357</sup> Sunkel op cit note 4 at 465.

a distinction between general contracts and commercial contracts.<sup>358</sup> She argues that South African Law should adopt the view that *pacta de non cedendo* contained in commercial contracts should be considered invalid *inter partes*, and should not prevent transfer to a third party.<sup>359</sup> In other words, a *pactum de non cedendo* contained in a commercial contract will have no legal effect whatsoever.<sup>360</sup>

In relation to general contracts Sunkel proposes that South African Law adopt the default position in U.S law.<sup>361</sup> That is, a *pactum de non cedendo* contained in a general contract should not prevent transfer to a third party.<sup>362</sup> However, it will result in a claim for breach of contract against the cedent by his debtor.<sup>363</sup> Furthermore, damages may be claimed, if it can be proven.<sup>364</sup> Sunkel, however, argues, in contrast to the approach taken in American law, that the parties should not be able to depart from the default position that a *pactum de non cedendo* would not prevent transfer to a third party, by manifesting an intention that their agreement will prevent transfer to a third party. She argues that if South African law were to adopt such a position it would introduce uncertainty into our law.

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<sup>358</sup> Ibid.

<sup>359</sup> Ibid 475-477.

<sup>360</sup> Ibid.

<sup>361</sup> Ibid 471.

<sup>362</sup> Ibid.

<sup>363</sup> Ibid 475-478.

<sup>364</sup> Ibid.

Sunkel argues that if South African law adopts this position the interest requirement would be rendered redundant, and should therefore, be abandoned.<sup>365</sup>

Sunkel is of the view that this approach could be incorporated into South African Law through a judicial decision.<sup>366</sup> Sunkel however, fails to explain exactly how such wholesale changes to the South African law are to be achieved.

### **2.13 Born Free Investments 364 (Pty) Limited v Firstrand Bank Limited**<sup>367</sup>

The facts of this case were virtually identical to that in *Capespan*. The case concerned two companies in liquidation: Summer Season Trading 49 (Pty) Ltd and Central Lake Trading 256 (Pty) Ltd. These companies had borrowed money from Firstrand Bank, and at the time of liquidation owed R49, 2 million and R25, 1 million, respectively. Later the liquidators of these companies ceded their rights arising out of their respective loan agreements to Born Free Investments, who alleged that Firstrand Bank had repudiated both of the loan agreements causing the companies to suffer losses of R109, 2 million and R69, 1 million, respectively.

In pursuance of the cessions Born Free Investments instituted action against Firstrand Bank in the South Gauteng High Court. In the High Court Born Free Investments action was dismissed, *inter alia*, on the basis that each of the loan

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<sup>365</sup> Ibid.

<sup>366</sup> Ibid 471.

<sup>367</sup> *Born Free Investments* supra note 57.

agreements contained a *pactum de non cedendo*, which rendered the rights concerned non-transferable.<sup>368</sup> That is, the *pactum de non cedendo* was binding upon the liquidators of the insolvent estate.<sup>369</sup>

In the Supreme Court of Appeal *Born Free Investments* argued that a *pactum de non cedendo* cannot prevent a liquidator, who in the execution of his duties as a liquidator, cedes a contractual right to a third party.<sup>370</sup> Ponnann JA, delivering the unanimous judgment of the court, rejected this argument for exactly the same reasons as those expressed by the court in *Capespan*.<sup>371</sup> The court concluded that the rights in question were created *ab initio* as non-transferable rights, and the application of the *nemo plus iuris* principle meant that the liquidator as cessionary could have no greater rights than the cedent himself had, as he merely stepped into the cedent's shoes.

In order to justify his conclusion Ponnann JA cited the above-quoted passage<sup>372</sup> from the judgment of Thring J in *Capespan*, and in relation to the application of the *nemo plus iuris* principle he quoted passages from the judgments in *Paiges* and *Trust Bank*.<sup>373</sup>

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<sup>368</sup> Ibid 5.

<sup>369</sup> Ibid.

<sup>370</sup> Ibid.

<sup>371</sup> Ibid 6-7.

<sup>372</sup> Refer to pp 77-78 above.

<sup>373</sup> *Born Free Investments* supra note 57 at pp 6-7.

In application of the foregoing to the facts of the case the SCA concluded that the rights concerned were created *ab initio* as non-transferable rights.<sup>374</sup> Therefore, the purported cessions were invalid and of no force and effect.<sup>375</sup> Thus, the appeal was dismissed.<sup>376</sup>

Intriguingly, Ponnar JA quoted and referred to, but did not comment on, Scott's views as expressed by her subsequent to the decision in *Capespan*, in terms of which she advocates an approach *to pacta de non cedendo* fundamentally different from that proposed by her previously, as discussed above at 2.11.<sup>377</sup>

Furthermore, Ponnar JA did not himself explicitly express a view on the controversial interest requirement, even though he implicitly endorsed the view that when a right is created as a non-transferable right the interest requirement is inapplicable.<sup>378</sup> This leads Hutchison to surmise that perhaps the court in this case "preferred to leave the matter open for consideration in a subsequent case".<sup>379</sup>

The Supreme Court of Appeal, like the court in *Capespan*, once again failed to recognise the deficiencies in the Scott's reasoning. The resultant effect of this judgment is that Scott's views have now been elevated to being the national precedence, even

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<sup>374</sup> Ibid pp 8-9.

<sup>375</sup> Ibid.

<sup>376</sup> Ibid.

<sup>377</sup> Ibid 7-8.

<sup>378</sup> Hutchison op cit note 3 at 282.

<sup>379</sup> Ibid.

though her assertions, are in my view, unconvincing and illogical. The current position is, therefore, in my view, unsatisfactory and most distressing.

## **2.14 Hutchison's Solution**

The recent contribution by Hutchison is, in my opinion, the most erudite and elucidating proposed solution to address the deficiencies in the doctrine of *pacta de non cedendo* proffered thus far. Hutchison states that the central issues to be determined when dealing with *pacta de non cedendo* are the following: “should *pacta de non cedendo* always be accorded validity; and should they in any event be effective to preclude a transfer of the right to a third party?”<sup>380</sup>

Hutchison argues that in order for a *pactum de non cedendo* to be accorded validity *inter partes* the debtor must demonstrate a substantial interest that is served by the restriction.<sup>381</sup> Hutchison criticises the view, espoused by numerous commentators and even the courts, that the debtor will always have an interest in knowing the identity of his creditor, and states that such an interpretation is certainly not what De Villiers JA envisaged in *Paiges*, he argues that the debtor must prove a “substantial interest”.<sup>382</sup>

However, even if the debtor is able to prove a substantial interest in the stipulation, the modern public policy test should be utilised to take cognisance of the interests of other parties as well as the broader interests of society in general, these

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<sup>380</sup> Ibid.

<sup>381</sup> Ibid 283-284.

<sup>382</sup> Ibid.

interests should then be weighed against the interest of the debtor in order to determine whether the *pactum de non cedendo* is contrary to public policy.<sup>383</sup> Furthermore, the importance of trade credit, in the form of book debt financing, to the modern economy should be considered in determining whether the *pactum de non cedendo* is contrary to public policy.<sup>384</sup>

If a *pactum de non cedendo* is held to be valid *inter partes* the next issue is to determine whether the *pactum de non cedendo* is effective in preventing transfer to a third party.<sup>385</sup> In determining whether the *pactum de non cedendo* has such an effect Hutchison states that two legal devices should be employed: firstly the courts should adopt a restrictive interpretation to *pacta de non cedendo*; and secondly, the modern public policy approach should be employed.<sup>386</sup>

“In this regard, it is important to recognise that a restraint can be effective against a third party only if it limits the right by taking out the element of transferability. If it was intended to restrict merely the creditor’s right to effect a transfer, rather than his competence to do so, then it does not limit the right and the restraint can have effect only *inter partes*.

There will generally be little objection to the validity of such a provision. However, if or in so far as the restraint was intended to prevent a transfer of the right to a third party, such a provision might well be considered contrary to public policy, depending on the circumstances of the case. The interests of all the parties involved would have to be taken into account – not merely those of the party imposing the restraint – as well as

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<sup>383</sup> Ibid 285-287.

<sup>384</sup> Ibid.

<sup>385</sup> Ibid 287.

<sup>386</sup> Ibid 289-290.

broader considerations of commerce and public policy. In regard to debts sounding in money, the submission will be that the restraint should be held invalid to the extent that it purports to prevent a transfer of the right unless the debtor can demonstrate a very real and substantial interest in preserving the personal nature of the obligation".<sup>387</sup>

Hutchison is optimistic that his proposed solution can be incorporated into the South African law through judicial development of the law.<sup>388</sup>

As will be illustrated in Chapter 3, Hutchison's proposed solution is synonymous with the approach taken in the United States. However, the fundamental difference between the two approaches is that the American approach was incorporated into American Law through the promulgation of legislation, whereas Hutchison seeks to incorporate the same approach into South African law by employing the modern concept of public policy, and by taking a restrictive interpretation of *pacta de non cedendo*.

I am, however, pessimistic that the South African courts' would be inclined to take such far reaching reform of the law through judicial development, and in my opinion such a comprehensive reform of the South African law is best left to the legislature, as opined by Scott.<sup>389</sup> My pessimism stems from the current apathy of the courts in failing to properly utilise the modern concept of public policy, in determining the validity of *pacta de non cedendo inter partes*, let alone its application in determining the

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<sup>387</sup> Ibid 275-276.

<sup>388</sup> Ibid 275.

<sup>389</sup> Scott op cit note 1 at 494.

effectiveness of *pacta de non cedendo* in preventing transfer of the rights to a third party.

Furthermore, the courts' in the United States are not in conformity as to what constitutes a "manifest intention" to depart from the default position that *pacta de non cedendo* are only valid *inter partes* and cannot prevent transfer of the rights to a third party.<sup>390</sup> In order to determine whether the parties who concluded the *pactum de non cedendo* did indeed intend for the *pactum de non cedendo* to restrict the capacity of the creditor, and thereby prevent any transfer of the rights to a third party, three different approaches have been advocated by the courts.<sup>391</sup> This divergence of the United States courts' has certainly infused a degree of uncertainty into their law, and casts doubt on the utility of their approach being incorporated into South African law through judicial development. If the American courts' cannot agree on the correct approach to be taken in these circumstances, irrespective of the fact that their law is governed by legislation, what chance then does South African law have of establishing a uniform approach through judicial development?

As alluded to earlier, Hutchison argues that a restrictive interpretation should be adopted in determining whether the *pactum de non cedendo* has limited the creditor's capacity to cede the rights concerned, or whether it merely sought to restrict his right to do so. In my view recourse to a restrictive interpretation is indicative that one is dealing with a fiction, and that the courts are no longer interpreting the contract, rather they are making the contract.

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<sup>390</sup> Refer to 3.4 below.

<sup>391</sup> *Ibid.*

In light of the foregoing criticisms I am unable to agree with Hutchison that his approach may be incorporated into South African law through judicial development. The fundamental problem with such a development is that if a court unequivocally embraces Hutchison's approach such a decision would declare what the law has always been, and would have disastrous consequences for all debtors who have concluded *pacta de non cedendo* prior to such a decision. In other words, debtors who intended such *pacta de non cedendo* to prevent transfer of the right to a third party, but did not clearly express their intention in the wording of the stipulation, will be held to only have restricted the creditor's right to effect transfer and not his capacity to do so.

In almost all of the cases I have considered all of the *pacta de non cedendo* have been formulated in a manner that may be said to only restrict the creditor's right and not his capacity to effect transfer of the rights concerned, however, the courts in these cases have held that these creditors are unable to effect transfer due to the presence of the *pactum de non cedendo* concluded between the debtor and creditor. Therefore, if Hutchison's approach is adopted all debtors would be required to reformulate their respective *pacta de non cedendo* if they intended their respective *pacta de non cedendo* to restrict the capacity of their creditors to effect transfer in these circumstances. In order to accomplish this, these debtors would require the consent of their respective creditors', who may be unwilling to consent to such reformulation.

In light of the fact that such a distinction, as Hutchison points out<sup>392</sup>, has never been drawn by the courts this will result in inequity. Whereas, if Hutchison's approach is promulgated in legislation, this would allow *pacta de non cedendo* concluded prior to

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<sup>392</sup> Hutchison op cit note 3 at 286.

such promulgation to be uninhibited by the reform, as such legislation would not have any retrospective effect.

## **Chapter 3: Comparative analysis**

In this chapter I will briefly set out and analyse the approach taken to the validity and effect of *pacta de non cedendo* in certain international instruments, as well as the approach taken by some of the leading jurisdictions.

### **3.1 UNIDROIT Factoring Convention**

“The UNIDROIT Factoring Convention applies to the assignment of receivables pursuant to a factoring contract whenever the receivables arise from a contract of sale of goods between the assignor and one of her customers whose place of business are in different states”.<sup>393</sup>

Article 6(1) states that an assignment of a receivable by a supplier/creditor to a factor/cessionary effectively transfers the right, irrespective of the presence of a *pactum de non cedendo* that has been concluded between the debtor and creditor.<sup>394</sup> In other words the right is effectively transferred from the creditor to the factor. However, in terms of Article 6(3) the anti-assignment clause is nevertheless valid *inter partes*, therefore, any assignment of such rights constitutes a breach of contract by the creditor, which may entitle the debtor to hold the creditor liable for damages.<sup>395</sup> Such an assignment will not, however, be effective against a debtor if “the debtor has a place of business in

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<sup>393</sup> Scott op cit note 1 at 488.

<sup>394</sup> Ibid.

<sup>395</sup> Lurger op cit note 137 at 101

a Contracting State which has made a declaration under Article 18 of this Convention”.<sup>396</sup>

### **3.2 UNCITRAL Assignment of Receivables Convention**

This convention is applicable to both the assignment of international receivables and international assignments of receivables, where the parties to the agreement are located in different states.<sup>397</sup>

In terms of Article 6 the assignor, assignee and debtor may agree to derogate or vary from, the default position in the Convention, in relation to their respective rights and obligations.<sup>398</sup> However, such an agreement does not affect the rights and obligations of any person not privy to such an agreement.<sup>399</sup>

In terms of Article 9(1) any assignment of a receivable is effective irrespective of any agreement limiting the assignor’s ability to assign its rights.<sup>400</sup> Furthermore, Article 9(1) applies irrespective of whether the anti-assignment clause pertains to pre-existing right or rights created with a restriction on assignment.<sup>401</sup> Therefore, anti-assignment clauses only operate *inter partes*, and cannot prevent transfer of the right to a third party.<sup>402</sup>

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<sup>396</sup> Scott op cit note 1 at 488-489.

<sup>397</sup> Ibid 489.

<sup>398</sup> Ibid.

<sup>399</sup> Ibid.

<sup>400</sup> Ibid.

<sup>401</sup> Ibid.

<sup>402</sup> Lurger op cit note 137 at 101.

### **3.3 UNIDROIT PICC**

The UNIDROIT PICC is a set of general rules that parties may rely on when concluding international commercial contracts.<sup>403</sup> These rules are applied when contractants agree that their contract will be governed by them.<sup>404</sup> Furthermore, these rules may be used as a model by national and international legislators, and may be used as an interpretive guide in interpreting international instruments and even domestic law.<sup>405</sup>

Chapter 9 of the UNIDROIT PICC deals extensively with nearly all aspects of assignment of receivables.<sup>406</sup> This chapter covers both the outright assignment of rights, on the one hand, and security assignments on the other.<sup>407</sup>

In terms of Article 9.1.9 an assignment of a right to receive a sum of money effectively transfers these rights to the assignee irrespective of an agreement concluded between the assignor and debtor limiting or prohibiting the assignment of the rights concerned.<sup>408</sup> The assignor may, however, be held liable by the debtor for breach of contract.<sup>409</sup> If, however, the rights being assigned do not pertain to the payment of a monetary sum, and the debtor and assignor have concluded an ant-assignment clause,

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<sup>403</sup> Scott op cit note 1 at 489.

<sup>404</sup> Ibid.

<sup>405</sup> Ibid.

<sup>406</sup> Luger op cit note 137 at 93-94.

<sup>407</sup> Scott op cit note 1 at 490.

<sup>408</sup> Ibid.

<sup>409</sup> Ibid.

any purported assignment from the assignor to the assignee is ineffective.<sup>410</sup> Such an assignment will, however, be effective if the assignee neither knew nor ought to have known of the presence of an anti-assignment clause at the time of assignment.<sup>411</sup> In these circumstances the assignor may be held liable for breach of contract by his debtor.<sup>412</sup>

### **3.4 American Law**

The American approach to the validity and effect of *pacta de non cedendo* is considered to be the leading system in the world. In the United States a distinction is drawn between “General” contracts and “Commercial” contracts.<sup>413</sup> The effect of this distinction is that the validity and effect of a *pacta de non cedendo* differs depending on which category of contracts the impugned provision falls into.<sup>414</sup>

General contracts refer to all contracts which are not factoring contracts.<sup>415</sup> *Pacta de non cedendo* contained in general contracts are all treated uniformly under the Second Restatement of Contracts.<sup>416</sup> Therefore, in the U.S all *pacta de non cedendo* contained in general contracts are treated uniformly, the only exception being commercial contracts.<sup>417</sup>

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<sup>410</sup> Ibid.

<sup>411</sup> Ibid.

<sup>412</sup> Ibid.

<sup>413</sup> Sunkel op cit note 4 at 465.

<sup>414</sup> Ibid 465-476.

<sup>415</sup> Ibid 465.

<sup>416</sup> Ibid 466.

The U.S approach to the validity of *pacta de non cedendo* contained in general contracts is governed by s 332(2)(b) of the Second Restatement of Contracts.<sup>418</sup> Section 332(2)(b) states that “if a contract prohibits the assignment of a right and a contracting party assigns the right regardless of the prohibition, then, unless a different intention is manifested, the debtor is entitled to damages for breach of the contract, but the breach does not render the assignment ineffective.”<sup>419</sup> Therefore, the default position in the U.S in relation to general contracts is that a *pactum de non cedendo* does not prevent the transfer of a right transferred in violation of the *pactum de non cedendo*.<sup>420</sup> It does, however, provide a claim for damages to the debtor who has suffered loss as a result of the breach of contract by his creditor.<sup>421</sup>

This so-called “modern approach” does, however, allow parties to deviate from the default position where the parties manifest a different intention.<sup>422</sup> Exactly what constitutes a “manifest intention” to depart from the default position has been heavily debated.<sup>423</sup> The American courts have proposed three different interpretative approaches in this regard:

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<sup>417</sup> Ibid.

<sup>418</sup> Ibid 468.

<sup>419</sup> Ibid.

<sup>420</sup> Ibid.

<sup>421</sup> Ibid.

<sup>422</sup> Ibid.

<sup>423</sup> Ibid.

Firstly, in terms of the “*Allhusen*<sup>424</sup> or *Rumbin v Utica*<sup>425</sup> minority approach” the parties to the agreement are merely required to use general terms to clearly and unambiguously convey their intention to render the right non-transferable, and consequently prevent any purported transfer of the right to a third party.<sup>426</sup> An example of an anti-assignment clause employing such general terms is the following: “[n]o payment under this annuity contract may be...assigned...in any manner by the [plaintiff]”.<sup>427</sup>

The second interpretative approach proposed by the American courts is the so-called “magic words approach”.<sup>428</sup> In terms of this approach parties who desire to render the rights created in their agreement non-transferable must employ specific words in formulating their anti-assignment clause.<sup>429</sup> For example, the anti-assignment clause may state that any purported assignment is “void” or “invalid” or “ineffective”.<sup>430</sup>

Thirdly, in terms of the so-called “Illinois approach” contractants are not required to employ general or specific words in order to render their rights non-transferable in formulating their anti-assignment clause.<sup>431</sup> Instead, the courts should adopt a more holistic approach and should take cognisance of all factors as well as the surrounding

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<sup>424</sup> *Allhusen v Caristo Construction Corp* 303 N Y 446 (1952) decided in the Court of Appeals in New York.

<sup>425</sup> *Rumbin v Utica Mutual Insurance Co* 757 A 2d 526 (2000) decided by the Supreme Court in Connecticut.

<sup>426</sup> Sunkel op cit note 4 at 469.

<sup>427</sup> *Rumbin* supra note 425 at 529.

<sup>428</sup> Sunkel op cit note 4 at 469.

<sup>429</sup> *Ibid.*

<sup>430</sup> *Pravin Banker Associates Ltd v Banco Popular Del Peru* 109 F 3d 856 (1997); *Rumbin* supra note 425 at 532-533.

<sup>431</sup> Sunkel op cit note 4 at 469.

circumstances of the case in order to determine whether the parties desired to render the personal rights concerned non-transferable.<sup>432</sup>

The apparent lack of consensus amongst the American courts has injected a considerable amount of uncertainty into their law in this respect.<sup>433</sup>

The validity and effect of a *pactum de non cedendo* contained in a commercial contract is governed by the Uniform Commercial Code (UCC).<sup>434</sup> The UCC “is a model piece of statutory law that governs certain types of contracts dealing with commercial transactions and payment with the purpose of unifying the laws of such commercial transactions across all the states of America.”<sup>435</sup> Assignments of a commercial nature are governed by Article 9 of the UCC, whereas Article 9-406(d)(1) deals with the validity and effect of an anti-assignment clause.<sup>436</sup> In *CGU Life Insurance Co of America v Metropolitan Mortgage and Securities Co* the court stated that the effect of Article 9-406(d)(1) is that:

“A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the consent of the account debtor to such assignment or security interest.”<sup>437</sup>

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<sup>432</sup> *Bank of America, NA v Moglia* 330 F 3d 942 (2003) decided by the Court of Appeals in Illinois.

<sup>433</sup> Sunkel op cit note 4 at 469.

<sup>434</sup> *Ibid* 472.

<sup>435</sup> *Ibid*.

<sup>436</sup> *Ibid*.

<sup>437</sup> 131 F Supp 2d 670 (2001).

The term “account” is defined as a “right to payment of a monetary obligation arising out of a closed list of obligations”.<sup>438</sup> This closed list includes, for example, monetary claims arising from a contract of sale or lease that is due or will become due.<sup>439</sup> Furthermore, certain claims are expressly excluded from the definition of “account”, for example, health care receivables.<sup>440</sup>

Article 9-406(d)(1) therefore, encompasses what in the U.S is referred to as “accounts receivable”, and in South Africa is referred to as “book debts”.<sup>441</sup> Book debts refer to monies owed by debtors to their creditors arising most commonly from hire-purchase agreements or services which have been rendered.<sup>442</sup>

In terms of the American approach to commercial contracts all anti-assignment clauses are invalid *inter partes* and therefore have no effect whatsoever.<sup>443</sup> The underlying rationale of this approach may be summarised in the following terms:

“Accounts and other simple written promises to pay are important collateral in modern commercial transactions, and their value as collateral is maximized by stripping them of encumbrances, such as antiassignment clauses unlikely to be noticed in the haste of transacting”.<sup>444</sup>

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<sup>438</sup> Sunkel op cit note 4 at 472.

<sup>439</sup> Ibid.

<sup>440</sup> Ibid.

<sup>441</sup> Ibid.

<sup>442</sup> Ibid.

<sup>443</sup> Ibid 475.

<sup>444</sup> *Bank of America* supra note 432 at 948 – 949.

### **3.5 German Law**

In German law the following three situations must be differentiated: firstly, in the domestic context, when a right is created as non-transferable, that is, the right is created with a prohibition on transfer, any purported cession thereof is ineffective in terms of paragraph 399 of the BGB.<sup>445</sup>

Secondly, in cases where both the assignor and debtor are merchants, or the debtor is a state institution, an agreement prohibiting cession is only valid *inter partes*, consequently any transfer made to a third party is effective.<sup>446</sup> There is, however, one exception, the debtor may validly discharge his obligation by making payment to the cedent in these circumstances.<sup>447</sup>

Thirdly, in light of the fact that Germany has ratified the UNIDROIT Factoring Convention all agreements prohibiting cession are only operative *inter partes* and consequently do not invalidate the transfer of the right to a third party.<sup>448</sup>

Due to its recognition of the importance of claims in the commercial world the German courts have a tendency to interpret paragraph 399 of the BGB restrictively.<sup>449</sup> In cases where a debtor has no interest in the prohibition the validity of the prohibition has been challenged on the basis that the term is unreasonable or on the basis of the doctrine of abuse of rights.<sup>450</sup>

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<sup>445</sup> Lurger op cit note 137 at 100.

<sup>446</sup> In these circumstances paragraph 399 of the BGB is superseded by paragraph 345a of the *Handelsgesetzbuch (HGB)*.

<sup>447</sup> Scott op cit note 1 at 492.

<sup>448</sup> Ibid.

<sup>449</sup> Ibid.

<sup>450</sup> Ibid.

### **3.6 French Law**

French law views the law of cession as an aspect of the law of property since it concerns the transfer of an incorporeal asset.<sup>451</sup> Consequently, agreements that prohibit cession are viewed with disfavour since such agreements ignore the fundamental property law principle that things should not be removed from commerce.<sup>452</sup>

Again, three situations must be distinguished: firstly, in terms of the *Civil Code* agreements prohibiting cession only operate *inter partes*, and therefore, do not preclude transfer to the cessionary.<sup>453</sup>

Secondly, if the debtor is a producer, merchant, industrialist or craftsman, then in terms of article L442-6 any agreement prohibiting cession has no effect whatsoever, that is, it is not valid even *inter partes*.<sup>454</sup>

Lastly, because France is a signatory of the UNIDROIT Factoring Convention it was entitled to make a declaration under Article 18, and has done so, therefore, an assignment is ineffective against a debtor who has its place of business in France.<sup>455</sup>

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<sup>451</sup> Ibid.

<sup>452</sup> Scott 'Pacta' op cit note 55 at 150-151.

<sup>453</sup> Scott op cit note 1 at 491.

<sup>454</sup> Ibid.

<sup>455</sup> Ibid.

## **Chapter 4: Criticism, Analysis and Conclusion**

The fundamental aim of this paper was to set out the current South African law on *pacta de non cedendo* with a view to elucidating the problems and deficiencies in our law, and then to provide a possible solution to address these issues. One of the most important objectives of my proposed solution was to address the needs of commerce by viewing the law of cession generally, and the doctrine of *pacta de non cedendo* specifically, through a constitutional lens, as mandated by our Constitution. Section 39(2) obliges a court to develop the common law when it fails to promote the objectives under s 39(2). In my opinion, the common law doctrine of *pacta de non cedendo* fails to promote these objectives and is, therefore, in need of development.

### **4.1 Current Law**

In terms of the current law a *pactum de non cedendo* will only be accorded validity if the debtor is able to demonstrate a substantial interest in the prohibition. However, the interest requirement is only applicable if the *pactum de non cedendo* is superimposed onto a pre-existing right. When a right is born *ab initio* with a prohibition on transfer the *pactum de non cedendo* is automatically valid without the need for the debtor to prove an interest in the stipulation. Once the *pactum de non cedendo* has been accorded validity *inter partes* the application of the *nemo plus iuris* principle renders any purported cession thereof ineffectual, irrespective of the distinction drawn between pre-existing rights and rights created with a prohibition on transfer.

## **4.2 Major criticisms of the current law**

Firstly, by requiring the debtor to prove an interest before the *pactum de non de non cedendo* may be accorded validity, our law unfairly discriminates between debtors in these circumstances and all other contracting parties, arbitrarily.

Why should debtors who seek to rely on *pacta de non cedendo* be required to jump over the additional hurdle of the “interest requirement” when no other contracting party is required to do so in any other circumstance? This requirement fails to promote the value of equality.

Secondly, the current law fails to facilitate economic development, as *pacta de non cedendo* that restrict or prohibit the transfer of book debts and other similar debts sounding in money, are currently valid and enforceable.

Thirdly, the distinction drawn, *inter alia*, by the Supreme Court of Appeal between a *pactum de non cedendo* that is superimposed onto a pre-existing right and a right that is created with a prohibition on transfer is completely illogical and should be excised from our law.

Lastly, the *obiter dicta* by, *inter alia*, the Supreme Court of Appeal that in relation to pre-existing rights, in terms of which a *pactum de non cedendo* has been superimposed onto, that even if the debtor is able to prove an interest in the prohibition transfer to the cessionary would not be prevented, is fundamentally flawed and incommensurate with the nature of cession. Once a valid *pactum de non cedendo* has been concluded between the debtor and creditor to the agreement it will prevent transfer of the right to the cessionary as the element of transferability has been removed.

### **4.3 My Solution**

In my opinion all *pacta de non cedendo* should be analysed in terms of the following two-step approach: first, the validity of the *pactum de non cedendo inter partes* should be determined. Secondly, if the *pactum de non cedendo* is valid *inter partes*, it should then be determined if the *pactum de non cedendo* is effective in preventing transfer to a third party.

#### **(a) Validity *inter partes***

Due to the fact that the interest requirement unfairly discriminates against parties who conclude *pacta de non cedendo*, in contradistinction to all other contracting parties, the interest requirement should be subsumed into the public policy enquiry. By subsuming the interest requirement into the public policy enquiry the court will be able to weigh up the interests of the debtor in enforcing the clause; against the interests of all other parties affected by the transaction as well as the broader interests of society, in not enforcing the clause, in determining whether the clause is unlawful. As Van Huyssteen has indicated:

“...underlying the approach of the courts to *pacta de non cedendo* is an assumption that a contractual restriction of a creditor’s capacity to dispose of a right is contrary to public policy unless justified by some legitimate interest of the person in whose favour the restriction is imposed”.<sup>456</sup>

In this regard I submit that all *pacta de non cedendo* that prohibit the transfer of debts sounding in money, such as book debts, should be held to be contrary to public

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<sup>456</sup> Van Huyssteen op cit note 55 at 451.

policy in light of the numerous benefits to society that will be obtained through the free flow of trade credit. This will allow the factoring and securitisation industries to flourish.

I am cognisant of the fact that Joubert and Roussouw have proposed similar solutions to overcome the problems inherent in the interest requirement, and that their views have not enjoyed the attention of the courts. However, I believe that this view, that the validity of a *pactum de non cedendo inter partes* should only be assessed against the contractual requirement of legality, has a renewed impetus, in light of South Africa's constitutional imperatives and the contemporary application of the public policy enquiry.

I do not however, accept Roussouw and Sunkels' views that the interest requirement should be completely jettisoned from our law. The interest "requirement" is not irrelevant and may be relied upon as a factor to illustrate that the stipulation is not contrary to public policy. I take solace in the fact that my approach is consistent with the general approach taken internationally.

(b) Effectiveness against third parties

Internationally, the trend has been to take the following approach :a *pactum de non cedendo* should only operate *inter partes* but should not prevent transfer to a third party unless the parties clearly manifest an intention to re-instate the personal nature of the claim in order to prevent transfer to a third party. Furthermore, this approach has been endorsed by two of our country's most eminent academic commentators, Hutchison and Scott.

Hutchison and Scott, however, differ on how exactly such whole scale reform may be incorporated into our law. Scott states that such a fundamental reform of the law

requires legislative intervention, whereas Hutchison believes that reform may be brought up through judicial development of the law. I am inclined to agree with Scott on this point. Unfortunately, the legislature has remained obstinate for decades, and as Hutchison opines legislative reform “is unlikely to be forthcoming in the foreseeable future”. Therefore, our law requires a solution to the problems in our law that may be incorporated through judicial development of the law.

In my view, the current approach taken in determining the effectiveness of a *pactum de non cedendo* should be retained: once it has been concluded that the *pactum de non cedendo* is valid *inter partes* the operation of the *nemo plus iuris* principle would render any purported cession thereof ineffective. However, if the debtor and creditor omit to include a *pactum de non cedendo* in their agreement but the cedent and cessionary conclude a *pactum de non cedendo* such a clause will only *operate inter partes* and will not prevent transfer to a third party as only the debtor and creditor may validly remove the element of transferability from the rights concerned.

#### **4.4 Conclusion**

It is my firm contention that my proposed analysis will resolve all of the problems and inconsistencies in our law, and that it may be easily assimilated into our law, for the following reasons:

Firstly, my approach is mandated by s 39(2) of the Constitution. Secondly, my approach merely requires the courts to apply the modern public policy enquiry to *pacta de non cedendo*. Thirdly, it will promote economic growth by invalidating all *pacta de non cedendo* appearing in claims sounding in money. Finally, commercial certainty in

this area of the law will be enhanced by only assessing the validity of *pacta de non cedendo inter partes* against the requirement of legality, and by retaining the effectiveness of such prohibitions in preventing transfer to a third party.

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