

The impact of *pacta sunt servanda* in the law of contract

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SUMMARY

The research in this dissertation investigates the impact of *pacta sunt servanda* in the South African law of contract. The notion that agreements seriously entered into must be honoured is an age-old principle which has found recognition in South African law.

The common law foundational principles of contract law are explained and the impact of the Constitution on these principles is analysed. The Constitution is the highest law in the land and all law, including the common law, must conform to it. The cornerstones of the South African law of contract are good faith, freedom of contract, sanctity of contract and privity of contract. The competing common law foundational values are discussed with particular emphasis on the principles of sanctity of contract and freedom of contract. The notion of freedom of contract is a constitutionally recognised principle which is associated with party autonomy and denotes minimal state interference. *Pacta sunt servanda* states that obligations created in terms of an agreement must be honoured; therefore parties who enter into contractual agreements with the relevant intention are obliged to respect the agreement.

There are many dimensions to a contract which affect its meaning as a legal instrument, apart from the legal dimension there is also a structural dimension of contracts. With regards to the structural dimension, the interpretation and the drafting of contracts is relevant because this is the process by which the agreement between the parties is codified and interpreted. In order for the principle of *pacta sunt servanda* to operate successfully in contractual agreements, the written contract must clearly indicate the intention of the parties. In this research both interpretation and drafting of contracts will be examined to identify their impact on the principle of *pacta sunt servanda*. *Pacta sunt servanda* influences the interpretation and drafting of contracts and must therefore always be considered when executing contractual agreements. The case law in this research highlights the fact that courts are in favour of contractual validity and have accepted *pacta sunt servanda* as a cemented principle in the South African law of contract.

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1. Introduction

Contractual law principles in South Africa are derived from the common law. The common law co-exists with the constitutional democracy and the Constitution requires that all law, including the common law, must conform to it.¹ In terms of the common law consensus and reliance are fundamental concepts in the law of contract.² This is because all modern contracts are consensual in that they are based on agreement. Where true consensus is absent, the reliance theory can form the basis of liability if it can be shown that there was a reasonable belief of the existence of consensus. In the case of *Pieters & Co v Solomon*³ the learned judge explained the moment at which a contract comes into existence and the impact of reservations in the minds of the parties. The following remarks were made in the case of *Pieters & Co*;

“When a man makes an offer in plain unambiguous language, which is understood in its ordinary sense by the person to whom it is addressed, and accepted by him *bona fide* in that sense, then there is a concluded contract. Any unexpressed reservations hidden in the mind of the promisor are in such circumstances irrelevant. He cannot be heard to say that he meant his promise to be subject to a condition which he omitted to mention, and of which the other party was unaware.”⁴

Other fundamental ideas include the four cornerstones of the law of contract: these are values that inform the South African law of contract. The cornerstones are freedom of contract, sanctity of contract, good faith and privity of contract.⁵

Freedom of contract forms the foundation of the classical theory of contract, which still informs the South African law of contract regardless of the fact that

¹ Section 2 of The Constitution of the Republic of South Africa, Act 108 of 1996 (herein after referred to as “the Constitution”).

² Hutchison & Pretorius (eds) (2012) 21.

³ *Pieters & Co v Solomon* 1911 AD 121.

⁴ *Pieters supra* n3 at 130.

⁵ Hutchison & Pretorius (eds) (2012) 21.

social and political values and conditions have changed.⁶ The notion of freedom of contract dictates that the creation of a contract is through free choice and the state should therefore not interfere. The idea is that people are free to decide whether, with whom and on what terms to contract. This is also known as party autonomy.⁷ It was stated by the Constitutional Court in *Barkhuizen v Napier*⁸ that “freedom of contract has been said to lie at the heart of constitutionally prized values of dignity and autonomy”.⁹ The principle freedom of contract limits state interference and is in line with the notion of individualism. Thus the law of contract maximises the liberty of the individual.¹⁰ This implies that courts are not concerned with the substantive fairness of a contract but instead will enforce a contract provided the parties entered into the agreement voluntarily. The fact that contracts freely and fairly entered into will be enforced promotes legal certainty, and commercial certainty which is an essential requirement for a flourishing, free-market economy.¹¹

The second cornerstone, sanctity of contract, entails that obligations in terms of a contract must be honoured because the contract was entered into voluntarily.¹² Contracts freely and seriously entered into must be honoured and, if necessary, enforced by our courts.¹³ This principle is also known as *pacta sunt servanda*. In the case of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd*¹⁴ the court described *pacta sunt servanda* as “...the age-old contractual doctrine that agreements solemnly made should be honoured and enforced (*pacta sunt servanda*).”¹⁵ In *Barkhuizen*,¹⁶ the court explained that “[p]*acta sunt servanda* is a profoundly moral principle, on which the coherence of any society relies. It is also a universally recognised legal

⁶ Hawthorne (1995) 157.

⁷ Hutchison & Pretorius (eds) (2012) 21.

⁸ *Barkhuizen v Napier* 2007 (7) BCLR 691 (CC).

⁹ *Barkhuizen* supra n8 at par 150.

¹⁰ Hawthorne (1995) 165.

¹¹ Hutchison & Pretorius (eds) (2012) 22.

¹² Hawthorne (1995) 173.

¹³ Hutchison & Pretorius (eds) (2012) 21.

¹⁴ *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC).

¹⁵ *Everfresh* supra n14 at par 70.

¹⁶ *Barkhuizen* supra n8 at par 150.

principle.”¹⁷ It can be said that the primary aims of the principle of *pacta sunt servanda* are legal certainty and ensuring that contracting parties honour their obligations as a matter of morality. Hutchinson explains that:

“If commercial enterprise is to take off on any significant scale, the parties must know that should either of them fail to honour their promise, the other might invoke the assistance of the law to hold them to the agreement... The State should and will lend its muscle for the enforcement of private bargains only if it is satisfied that it is fair and reasonable to do so in the circumstances. It must regulate, to some extent, the conclusion and performance of agreements, to ensure that there is no over-reaching or coercion, and that parties conduct themselves in an appropriate manner.”¹⁸

The notion of sanctity of contract goes hand in hand with freedom of contract, and these two principles seem to be in conflict with the foundational principle of good faith and fairness.¹⁹ In the case of contracts perceived as incompatible with general social customs, the principle of freedom of contract and the rule that contracts seriously concluded should be enforced, are superseded by other policy considerations.²⁰ Taking into consideration the requirements of a valid contract, freedom of contract explains that parties are free to enter into contracts and decide on the terms of the contract. The following passage has been approved by South African Courts:

“If there is one thing which, more than another, public policy requires, it is that men of full age and competent understanding shall have the utmost liberty if contracting, and that their contracts, when entered into freely and voluntarily, shall be held sacred and enforced by the courts of justice.”²¹

¹⁷ *Barkhuizen supra* n8 at par 187.

¹⁸ Hutchinson & Pretorius (eds) (2012) 21-22.

¹⁹ Hutchinson & Pretorius (eds) (2012) 22.

²⁰ Van Der Merwe *et al* (2012) 140.

²¹ *Wells V South African Alumenite Company* 1927 AD 69 at 73.

The third principle is good faith which explains that all dealings in a contract must take place in an honest manner. Parties are required to behave honestly and fairly in their dealings with one another.²² The concept of good faith has acquired a meaning wider than mere honesty and it has an objective content which includes other abstract values such as justice, reasonableness, fairness and equity.²³ In *Everfresh*, the court affirmed that “[c]ontracting parties certainly need to relate to each other in good faith.”²⁴ Fairness and good faith in contractual relations imply a degree of social control over the private business of contracting and reflects a more communitarian approach to contract.²⁵ Collectivism is informed by a communitarian vision and is associated with the rise of consumer protection. Collectivism advocates that courts should be concerned with the substantive fairness of the contract and that parties may be relieved from liabilities if justice requires it. Despite the fact that freedom of contract allows parties to determine the terms of a contract, it should not be expected of a court of law to enforce a contract or contractual provisions which are in contravention of widely accepted morals or public policy.²⁶ Social factors play an important role in determining what is fair and what is reasonable. It is important to note that public policy is not static and what is acceptable today may not have been acceptable ten years ago, therefore courts will have to take various factors into account in determining whether a contract is unreasonable or not.²⁷ In order for reasonableness and fairness to be established the courts should be given some latitude to make a value judgment.²⁸ The strict application of the notion of freedom of contract may lead to absurd outcomes; and the same applies to the principle of sanctity of contract. These principles should neither be applied too strictly, nor in isolation and policy considerations should always be used to make a holistic value judgment.²⁹

²² Hutchison & Pretorius (eds) (2012) 21.

²³ Brand (2009) 73.

²⁴ *Everfresh supra* n14 at par 72.

²⁵ Hutchison & Pretorius (eds) (2012) 22.

²⁶ Brand (2009) 75.

²⁷ Christe (2011) 14.

²⁸ Christe (2011) 17.

²⁹ Christe (2011) 15.

The final cornerstone is privity of contract. A contract creates rights and duties exclusively for the parties to that contract and does not include random third parties. Parties who are not privy to a contract cannot sue or be sued on it.³⁰

From the discussion above it is clear that there is competition between the underlying values of the law of contract and it is important that these values are balanced in order for equilibrium to be reached. The friction between these competing values produces tension throughout the whole body of contractual law.³¹ A balancing exercise must be executed in respect of the competing values. The exercise will constitute a value judgment taking into consideration all factual and substantive information of each and every case.

The focus of this dissertation is the principles of *pacta sunt servanda* and freedom of contract in South Africa's constitutional legal system. Firstly the impact of the Constitution on these two principles will be discussed where after the systemic implications of *pacta sunt servanda* in respect of the substantial and functional contexts of contractual law will be explained. Furthermore, the various implications of *pacta sunt servanda* on the interpretation of contracts as well as the drafting of contracts will be discussed.

2. The Constitution and *pacta sunt servanda*

The Constitution is the highest law in the land and all other laws and practices must be legally compatible with it.³² In *Barkhuizen*,³³ the Constitutional Court made the following remarks:

“Under our legal order, all law derives its force from the Constitution and is thus subject to constitutional control. Any law that is inconsistent with

³⁰ Christe (2011) 269.

³¹ Hutchison & Pretorius (eds) (2012) 21.

³² S2 of the Constitution.

³³ *Barkhuizen supra* n8.

the Constitution is invalid. No law is immune from constitutional control.”³⁴

The primary values of the South African Constitution are the principles of dignity, equality and justice, which will have a significant effect on the law of contract. In discussing the law of contract, we must take into account the potential influence of the Bill of Rights on all existing legal rules and practices. This is because the Bill of Rights is directly applicable to state action and indirectly applicable to private law rules and principles. The Constitution explains that the Bill of Rights applies to all law, and binds the legislature, the executive, the judiciary and all organs of state.³⁵ Furthermore, in order to give effect to a right contained in the Bill of Rights, a court must apply or, if necessary, develop the common law to the extent that legislation does not give effect to that right.³⁶ It was mentioned earlier that the principles of the South African law of contract are almost solely drawn from the common law. However, it should now be clear that contract law should be developed to give effect to the rights contained in the Constitution and the Bill of Rights. Bhana gives the following explanation:

“... the framework and methodology employed by the common law of contract has generally favoured contractual autonomy as against competing common law rights.... Accordingly, the common law methodology must be reviewed against the substantively progressive aims of our constitutional order and adjusted appropriately to reflect the weight that ought to be attached to the respective constitutional rights. Here, judges can draw from ss8(2) and 36(1) of the Constitution to guide the adjustment of the common law framework and methodology.”³⁷

It can thus be said that, in a constitutional democracy, the common law of contract has to become infused with the values contained in the Constitution and for the past decade several courts have set out to achieve this ideal.

³⁴ *Barkhuizen supra* n8 at par 35.

³⁵ S8(1) of the Constitution.

³⁶ 8(3)(a) of the Constitution.

³⁷ Bhana (2008) 24 *SAJHR* 300.

In *Brisley v Drotsky*,³⁸ Cameron JA used section 39(2) of the Constitution to connect the common law of contract with the constitutional values of freedom, equality and justice. He explained that freedom in the Constitution also referred and related to the common law principle of freedom of contract. This is also in line with the judgment in *Afrox Healthcare v Strydom* where freedom of contract was in itself held to be a constitutional value.³⁹ Furthermore freedom of contract and the constitutional value of human dignity are linked because, human dignity allows an individual to take control of their lives and make their own decisions. In *Barkhuizen*, Ncobo J made the following comments:

“Self autonomy, or the ability to regulate one’s own affairs, even to one’s own detriment, is the very essence of freedom and a vital part of dignity. The extent to which the contract was freely and voluntarily concluded is clearly a vital factor as it will determine the weight that should be afforded to the values of freedom and dignity.”⁴⁰

Freedom of contract allows an individual the freedom to contract with whoever they wish using whatever terms they wish. However, in the case of *Brisley*, Cameron JA warned that an “obscene excess” of autonomy must be rejected as counter-intuitive to individual dignity and self-respect.⁴¹ It can be asserted that a strict application of freedom of contract which results in unfair or unreasonable contracts or contractual terms is unlikely to be enforced by a court of law.⁴² The reason for this can be found in the constitutional value of human dignity and the fact that the Constitution has a mandate of ensuring justice in society. Under common law it was noted that the values underpinning the common law of contract are in fact in competition with one another, and effect cannot be given to the principle of freedom of contract without infringing on another underlying principle.⁴³

³⁸ *Brisley V Drotsky* 2002 (4) SA 1 (SCA) at par 88-95.

³⁹ *Afrox Healthcare v Strydom* 2002 (6) SA 21 (SCA) at par 17-24.

⁴⁰ *Barkhuizen supra* n8 at 57

⁴¹ *Brisley supra* n38 at par 94-95.

⁴² Christe (2011) 15.

⁴³ Christe (2011) 5.

The observation made in the two cases above on the principle freedom of contract must, however, be understood in light of the principle of *pacta sunt servanda*. Parties enter into contractual agreements in order for a certain result to materialise. The fact that parties enter into an agreement gives effect to their constitutional right of freedom to contract, however, the carrying out of the obligations in terms of that contractual agreement relates to the principle of *pacta sunt servanda*. The Supreme Court of Appeal has expressed the view that there has to be some sort of restraint of freedom of contract and unreasonable contracts cannot be enforced, therefore it can be said that the application of the principle of *pacta sunt servanda* should be modified in that only reasonable contracts entered into voluntarily by parties must be enforceable by our courts. Cameron JA did, however, stress in *Brisley* that judges must exercise “perceptive restraint” lest contract law becomes unacceptably uncertain.⁴⁴

Subsequent cases have also supported an indirect horizontal application of the Bill of Rights. In *Afrox*, the court accepted that the values underpinning the section 27(1)(a) constitutional right to health-care services had to be taken into account in determining legality of an exclusion clause that excluded a hospital’s liability for the negligence of its nursing staff.⁴⁵ The court used the public policy scale and the “all or nothing” methodology to analyse whether the clause was valid or not.⁴⁶ It was found that the public interest in freedom of contract and *pacta sunt servanda* remained paramount.⁴⁷ The exemption clause was held to be valid and enforceable. It is important to note that courts are more willing to enforce a contractual agreement rather than setting it aside. The reason for this includes the fact that individuals have the right to freedom of contract as well as the right to have their agreements fulfilled and enforced as indicated in the principle of *pacta sunt servanda*.

⁴⁴ *Brisley supra* n38 at par 93-94.

⁴⁵ *Afrox Healthcare supra* n39 at par 17.

⁴⁶ Bhana (2008) 24 SAJHR 300.

⁴⁷ *Afrox Healthcare supra* n39 at par 23-24.

In the case of *Johannesburg Country Club v Stott*,⁴⁸ which dealt with the constitutional right to life embodied in section 11 of the Bill of Rights, there was an exemption clause located in a contract which excluded liability for negligently causing another person's death. The court held this clause to be invalid because it was contrary to public policy and the common law's high regard for sanctity of life as well as section 11 of the Constitution.⁴⁹ In this case, using a value judgment and policy considerations, the court did not enforce the exemption clause in spite of the principle of *pacta sunt servanda*.

The *Barkhuizen*⁵⁰ case is significant because it was the Constitutional Court's first direct engagement with the common law of contract. This case was an appeal against the Supreme Court of Appeal judgment. The appellant argued that the 90 day time bar clause in a short term insurance contract amounted to an unreasonable and unjustified limitation of the constitutional right of access to court enshrined in section 43 and was therefore contrary to public policy and unenforceable.⁵¹ In the majority judgment Ngcobo J endorsed Cameron JA's broader conception of the law of contract as reflected in *Brisley* and affirmed that the Constitution requires parties to honour contractual obligations that were freely and voluntarily undertaken.⁵² The constitutional court therefore affirmed that the principle of *pacta sunt servanda*, which is linked to the principle of freedom of contract, is in fact a concrete contractual principle and furthermore, is recognised in the Constitution. The principle of *pacta sunt servanda* is supported by the Constitution but is also under constitutional review to prevent injustices occurring wherever there is an abuse of contractual autonomy.⁵³ Therefore as explained by the court:

“While it is necessary to recognise the doctrine of *pacta sunt servanda*, courts should be able to decline the enforcement of ... a clause if it would result in unfairness or would be unreasonable.”⁵⁴

⁴⁸ *Johannesburg Country Club v Stott* 2004 (5) SA 511 (SCA).

⁴⁹ *Johannesburg Country Club supra* n33 at par 12.

⁵⁰ *Barkhuizen supra* n8.

⁵¹ *Barkhuizen supra* n8 at par 11.

⁵² *Barkhuizen supra* n8 at par 57.

⁵³ *Barkhuizen supra* n8 at par 15.

⁵⁴ *Barkhuizen supra* n8 at par 70.

In the case of *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited*⁵⁵ the court explained that “[t]here is a countervailing policy consideration, also founded on constitutional values, which comes into play here. That is the respect for freedom of contract which, as this court has noted, “gives effect to the central constitutional values of freedom and dignity”.⁵⁶ The court in *Paulsen* aptly explained the effect of the judgment in *Barkhuizen* on the principles of freedom of contract and *pacta sunt servanda*:

“In *Barkhuizen* itself this Court made it clear that freedom of contract is by no means absolute under our constitutional dispensation. It endorsed an “approach that leaves space for the doctrine of *pacta sunt servanda* to operate, but at the same time allows courts to decline to enforce contractual terms that are in conflict with the constitutional values even though the parties may have consented to them”.⁵⁷

Contracts contrary to public policy are illegal. The values underlying the Bill of Rights are policy factors that when taken into consideration helps to determine what public policy is. Therefore private law, including contract law, must be interpreted in accordance with these values.⁵⁸

From the above, it can be explained that the common law contractual law principles are to be understood in light of our constitutional dispensation. It can thus be concluded that the principle of *pacta sunt servanda* is in fact concrete contractual law principle which is recognised within the constitutional dispensation.⁵⁹ It should also be noted that courts will give effect to a contract based on *pacta sunt servanda* unless it would be unreasonable or unfair to do so in the circumstances. Therefore the common law principles of contract law do not exist in isolation in South Africa but must instead be read with the values underlying our Constitution. The Bill of Rights has emphasised the fact that courts are required to develop the common law where necessary so that there is compliance with the rights and values in the Constitution. The

⁵⁵ *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited* 2015 (3) SA 479 (CC).

⁵⁶ *Paulsen supra* n55 at par 70.

⁵⁷ *Paulsen supra* n55 at par 71.

⁵⁸ Van Aswegen (1995) SAJHR 50

⁵⁹ *Barkhuizen supra* n8 at par 187.

principle of *pacta sunt servanda* is a rule of contractual law that applies in conjunction with the Constitution and the Bill of Rights. *Pacta sunt servanda* and freedom of contract are important principles which have become sealed in contract law as a whole. *Pacta sunt servanda* has presence throughout the body of contract law and finds significance in the structural dimension of interpretation and drafting of contracts.

3. Interpretation of contracts and the principle of *pacta sunt servanda*

3.1. General

Today, almost all contracts are drafted and recorded to facilitate proof of the agreement as well as stipulating the obligations, rights and time of performance of the parties to the agreement.⁶⁰ A court cannot establish what is in the mind of the parties to a contractual agreement, therefore, they seek clarity from the written agreement. In order to ascertain the terms of the contract a court will use principles of interpretation. With interpretation of contracts, a court's usual point of departure is the presumption of validity and, as has been shown above, courts are more likely to enforce agreements than not in terms of the principle of *pacta sunt servanda*.⁶¹ Interpretation in a court of law will generally only arise in instances of dispute: sometimes parties may have had different intentions or their intentions are not adequately reflected in their agreement. The main focus of interpretation of contracts is to ascertain the intention of the parties from the written instrument and give effect to the parties' collective intention.⁶² The focus of interpretation of contracts is in line with the common law contractual principle of *pacta sunt servanda*.

In as much as consensus or a reliance on consensus is the basis of contractual liability,⁶³ it is necessary to ascertain the intention of the parties in order to determine the eventual legal consequences of the contract.⁶⁴ In this

⁶⁰ Hutchison & Pretorius (eds) (2012) 400.

⁶¹ Cornelius (2007) 117-118.

⁶² Christe (2011) 159.

⁶³ Floyd T & Pretorius (1992) 668.

⁶⁴ Van Der Merwe *et al* (2012) 262.

part of the study, different theories on the interpretation of contracts will be discussed. The written agreement is a tool of interpretation which is used to ascertain the parties' intention, obligations and rights in terms of the contract. The intention of the parties is important as it shows a seriousness to be bound in terms of the agreement,⁶⁵ therefore the principle of *pacta sunt servanda* will apply and the agreement must be honoured. The contract is a reflection of the parties using their right to freedom of contract, and by virtue of *pacta sunt servanda* the agreement is solidified in writing to facilitate proof of the obligations to be fulfilled. Below it will be shown that the rules of interpretation enforce the foundational principles of *pacta sunt servanda* and freedom of contract.

3.2. The technique of interpretation

In the case of *Coopers & Lybrand v Bryant*⁶⁶ the court explained the technique of interpretation as follows;

“According the ‘golden rule’ of interpretation the language in the document is to be given it’s grammatical and ordinary meaning, unless this would result in some absurdity or some repugnancy or inconsistency with the rest of the instrument... The mode of construction should never be to interpret the particular word or phrase in isolation (*in vacuo*) by itself. The correct approach to the application of the ‘golden rule’ of interpretation after having ascertained the literal meaning of the word or phrase in question, is broadly speaking, to have regard:

- a) to the context within which the word or phrase is used with it’s interrelation to the contract as a whole, including the nature and purpose of the contract
- b) to the background circumstances which explains the genesis and purpose of the contract as well as matters present to the minds of the parties when they contracted⁶⁷
- c) to apply extrinsic evidence regarding the surrounding circumstances when the language of the document is on the face of it ambiguous, by

⁶⁵ Hawthorne (1995) 173.

⁶⁶ *Coopers & Lybrand v Bryant* 1995 (3) SA 761.

⁶⁷ Christie (2011) 213.

considering previous negotiations and correspondence between the parties, subsequent conduct of the parties showing the sense in which they acted on the document, save, direct evidence of their own.”⁶⁸

The purpose of interpretation of contracts is to ascertain the intention of the parties.⁶⁹ In the case of *Engelbrecht v Senwes Ltd*⁷⁰ the court explained it is as follows:

“The intention of the parties is ascertained from the language used in its contextual setting and in the light of admissible evidence. There are three classes of admissible evidence. Evidence of background fact is always admissible. Those facts, matters probably present in the minds of the parties when they contracted, are part of the context and explain the ‘genesis of the transaction’ or its ‘factual matrix’. Its aim is to put the court ‘in the armchair of the author(s) of the document. Evidence of ‘surrounding circumstances’ is admissible only if a contextual interpretation fails to clear up any ambiguity or uncertainty. Evidence of what passed between the parties during negotiations that preceded the conclusion of the contract is admissible only in the case where evidence of the surrounding circumstances does not provide ‘sufficient certainty’.”⁷¹

The above illustrates the methods a court will use to ascertain information of the agreement between parties. The courts have applied a set of rules to arriving at an accurate reflection of intention. There is a link between interpretation of contracts and *pacta sunt servanda*. The discussion above provides insight into the ways in which a court will go about ascertaining the intention of the parties; the courts conduct this exercise so they can give effect to the contractual agreement between the parties. It goes without saying that when parties enter into contractual agreements, they are in fact exercising their freedom of contract, and in turn are bound to honour their

⁶⁸ *Coopers supra* n66 at 767E-768E.

⁶⁹ *Christe* (2011) 213.

⁷⁰ *Engelbrecht v Senwes Ltd* (2007) 3 SA 29 SCA .

⁷¹ *Engelbrecht supra* n70 at 7.

obligations by virtue of *pacta sunt servanda*.⁷² In order to ascertain the intention of the parties, the courts apply the subjective theory of interpretation.

3.2.1. Subjective theory of interpretation

The subjective theory of interpretation has traditionally been applied in South Africa and in many other common law countries. This theory requires that the intention of the parties should be ascertained from the contract as a whole and from all surrounding circumstances.⁷³ Therefore the meaning of a contract is limited to what the parties had in mind when the contract was concluded.

The subjective theory explains that the intention expressed in the contract may not always be the same as the original intention of the parties. The problem here is that the subjective theory seems to equate the written text with the contract itself and loses sight of the fact that the written text is only a record of the underlying contract between the parties.⁷⁴

Another shortfall of the subjective theory lies in instances of duress and undue influence. In cases where consensus has been improperly obtained, in terms of the subjective theory of interpretation the ascertained intention must be given effect.⁷⁵ Therefore this theory does not concern itself with the way in which consensus was obtained but in fact will give effect to the ascertained intention. Strict application of the subjective theory of interpretation is bound to have unjust consequences on a party who entered into a contract because of duress.⁷⁶ Duress also falls outside the scope of the principle of freedom of contract which relates to contractual agreements voluntarily entered into. It can therefore be concluded that the pure subjective theory is not fully compatible with the general principles of the law of contract such as free will

⁷² Hawthorne (1995) 173.

⁷³ Cornelius (2007) 30.

⁷⁴ Kerr (2002) 152.

⁷⁵ Cornelius (2007) 30.

⁷⁶ Cornelius (2007) 30.

and reasonableness as well as the principle of freedom of contract and *pacta sunt servanda*.⁷⁷

The premise of the subjective literal approach is the sovereignty of the written word. According to Côté.⁷⁸ any literal approach is based on the following five assumptions:⁷⁹

- a) The written contract is a means of communication between the parties.
- b) Communication by language is possible.
- c) The parties wish to communicate certain ideas by means of their contract.
- d) They are familiar with the ordinary rules of language and.
- e) They use language competently.⁸⁰

The written words in a contractual document are the main and primary source of information from which the intention of the parties should be ascertained, and an interpreter may not venture beyond the words of the text to determine the meaning thereof.⁸¹ One of the golden rules of contractual interpretation is that if the words of the contract are unambiguous and clear, effect must be given to it.⁸² Therefore only in cases where the contractual terms are unclear will external aids be used to determine the meaning of the contract/contractual terms. There can also be cases where there are inconsistencies between different terms of the contract.

The subjective theory of interpretation also does not complement the will theory which is considered to be the basis of the law of contract in South Africa. According to the will theory, the existence of a contract is determined by considering the actual subjective intentions of the parties. The subjective theory of interpretation instead conforms to the declaration theory which

⁷⁷ Cornelius (2007) 30.

⁷⁸ Côté. 193.

⁷⁹ Côté. 193.

⁸⁰ Cornelius (2007) 30.

⁸¹ Cornelius (2007) 31.

⁸² Cornelius (2007) 31.

explains that the existence of the contract is determined by the outward manifestations of the parties' intention; for example signing a contract, saying "yes" or nodding their heads. The literal approach and strict application thereof denies the consensual nature of contracts. An intention-based theory of interpretation cannot provide for the application of the reliance theory of contractual liability.⁸³

In order to rectify the severe consequences that may arise in instances where the subjective literal approach is applied harshly, a more holistic approach to interpretation should be considered.

3.2.2. Holistic approach to interpretation

In the past a subjective literal approach to interpretation was followed. This approach was, however, unsatisfactory since language is indeterminate, very few words bear a single "ordinary" meaning, and the parties may have used a term, not in one of its popular everyday senses but in a somewhat restricted or technical sense.⁸⁴

In a constitutional dispensation the courts tend to take an open approach when it comes to the interpretation of a contract. The court first attempts to determine the ordinary and grammatical meaning of the words use by the parties.⁸⁵ The court proceeds on the assumption that this meaning accurately reflects the common intention of the parties.⁸⁶ The courts do not consider the words in isolation, divorced from their contextual setting. Language is indeterminate and we can therefore never be absolutely sure that we understand each other. Because of this the courts currently do not only follow a literal approach.

⁸³ Cornelius (2007) 33.

⁸⁴ Sharrock (2007) 170.

⁸⁵ Sharrock (2007) 170.

⁸⁶ Sharrock (2007) 170.

In the case of *Cinema City (Pty) Ltd v Morgenstern Family Estates (Pty) Ltd*,⁸⁷ the court explained that the first step in interpreting a contract is the reading thereof in order to establish the literal meaning. The judge further added that the literal meaning should then be qualified with a contextual approach. Jansen JA further explained the process of interpretation as follows;

“[T]he first step in interpreting a written contract is to read it. This entails attaching to each word that ordinary meaning (of the several which the word undoubtedly will bear) which the contract seems to require and applying the common rules of grammar (including syntax). Thus we may arrive *prima facie* meaning of each word, phrase and sentence. The document must, however, be read and considered as a whole and in doing so it may be found necessary to modify certain of the *prima facie* meanings so as to harmonize the parts with each other and with that whole. Moreover, it may be necessary to modify the meanings thus arrived at so as to conform to the apparent intention of the parties’.”⁸⁸

The court further explained as follows: “it would be consistent with modern thinking to allow evidence of surrounding circumstances in all cases as an aid to interpretation, without requiring the “open sesame” of uncertainty.”⁸⁹ From the above, it can be concluded that the court emphasised the fact that the context of the agreement can be taken into account in conjunction the literal meaning of the of the contract as well as the objective of interpretation is to arrive at the common intention of the parties. When qualifying a literal approach with a contextual approach, the principle of *pacta sunt servanda* is honoured, because the intention of the parties will be carried out.

Hereafter, courts started approaching the task of interpretation in a different manner – more liberally and also more in line with principle of freedom of contract and *pacta sunt servanda*. The courts have adopted a much more liberal approach in line with the principle of freedom of contract and *pacta sunt servanda* when interpreting a contractual agreement. There are various terms

⁸⁷ *Cinema City (Pty) Ltd v Morgenstern Family Estates (Pty) Ltd* 1980 (1) SA 796 (A).

⁸⁸ *Cinema City (Pty) Ltd supra* n87 at 803.

⁸⁹ *Cinema City (Pty) Ltd supra* n87 at 803G-806A.

in contracts which provide further information relating to the intention of the parties. As explained above, intention and *pacta sunt servanda* are related therefore these terms will have an impact on the honouring of contractual agreements.

3.3. Terms of a contract

The terms of the contract are the promises agreed upon by the parties which altogether make up the contract.⁹⁰ When there is doubt or dispute about what statements, oral or written, or conduct should be included in the contract as terms the court may have to carry out a two-stage enquiry to decide first, what was said, written or done and second, whether it must be included among the terms of the contract.⁹¹

Contractual agreements consist of various terms which ascribe meaning to the intention of the parties. These contractual terms are important as they shed light on what the parties' collective intention to a contract is. There are four kinds of terms in a contract: express terms which describe the promises made by the parties and are clearly set out in the contract; incorporated terms which refer to another instrument separate from the contract agreement; consensual tacit terms which are based on the actual consensus of the parties (fact), but are not expressed in the contract; and imputed tacit terms (fiction) which relates to the assumed intention of the parties to the contract and also does not expressly form part of the contract. In *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration*⁹² the court described tacit terms as follows:

“... an unexpressed provision of the contract which derives from the common intention of the parties, as inferred by the Court from the express terms of the contract and surrounding circumstances. In

⁹⁰ Hutchison & Pretorius (eds) (2012) 399.

⁹¹ Christe (2011) 159.

⁹² *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974(3) SA 506.

supplying such an implied term the Court, in truth, declares the whole contract entered into by the parties.”⁹³

There is no difference between express terms and tacit terms as far as their nature and effect is concerned, but there is a difference in which these terms are to be proved.⁹⁴ Express terms are proved by direct evidence and tacit terms are proved by circumstantial evidence.⁹⁵

Since express terms and incorporated terms do not pose a challenge to the application of the principle of *pacta sunt servanda*, only consensual tacit terms and imputed tacit terms will now be discussed in more detail. Express terms are clearly set out in the contract, therefore, the intention of the parties relating to those terms can easily be ascertained.⁹⁶ The express terms of a contract are to be found in the statements, expressions and words that the parties made or adopted in the process of reaching agreement.⁹⁷ It is difficult to establish the intention of the parties when it is not expressed in the agreement and tacit terms are unexpressed provisions which are derived from the common intention of the parties.⁹⁸

This discussion of the different contractual terms includes the extent to which a court will interfere with a contract in order to fill a contractual gap as a matter of strict necessity. The two types of tacit terms, namely consensual tacit terms and imputed tacit terms, are the main focus of this discussion and the question which needs to be answered here is when a court will find it necessary to complement terms of a contractual agreement.

3.3.1. Consensual Tacit Terms

Consensual tacit terms are based on the actual intention of the parties. It is normally something that the parties actually agreed upon or they hold a

⁹³ *Alfred McAlpine supra* n92 at 531-532.

⁹⁴ Van Der Merwe *et al* (2012) 174.

⁹⁵ Van Der Merwe *et al* (2012) 174.

⁹⁶ Van Der Merwe *et al* (2012) 174.

⁹⁷ Sharrock (2007) 155.

⁹⁸ Christe (2011) 174.

common expectation but they have not expressed it to each other. In the case of *Wilkins NO v Voges*⁹⁹ the court explained as follows:

“Moreover a tacit term will not be inferred merely because it is one that ‘would have been reasonable, or convenient, for the parties to have included in their agreement...but [it] is rather a term which, by necessary application, the parties must have intended would form part of their agreement or would have so intended if they had turned their minds to the particular issue.”¹⁰⁰

It is determined subjectively by looking at what the parties had in mind during conclusion of the contract. Express terms may deliberately exclude the possibility of importing tacit terms and this can be done by inserting an “entire agreement clause.”¹⁰¹

It can be concluded that consensual tacit terms illustrates the collective intention of the parties to a contract on a specific issue or the contract as a whole. These terms add value to the principle of *pacta sunt servanda* because if intention to be bound is found, then it goes without saying that the agreement must be honoured.

3.3.2. Imputed tacit terms

These terms relate to the assumed intention of the parties, and are applied by using the “officious bystander test”. This test is used to discover what was in the mind of the parties.¹⁰² The question to ask would be, “what would the parties have agreed to if they had thought about the matter?”

A tacit term that conflicts with an express term cannot be included. The necessity of imputed tacit terms is determined by whether the contract will fail without it or not, this is how a court will establish whether a tacit term should

⁹⁹ *Wilkins NO v Voges* 1994 (3) SA 130 (A)

¹⁰⁰ *Wilkins supra* n99 at 143D-F

¹⁰¹ *Van Der Merwe et al* (2012) 174.

¹⁰² *Barnbas Plein & Co v Sol Jacobson & Son* 1928 AD 25 at 31

be read into the contract or not.¹⁰³ The reading in of tacit terms into a contract is in line with the principle of *pacta sunt servanda* as it promotes validity of the agreement. Another noteworthy point is that only fairly simple clauses may be read into the contract.

This research highlights the fact that:

“The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make the instrument or contract fairer or more reasonable. It is concerned only with discovering what the instrument means.”¹⁰⁴

Courts are not willing to introduce new terms into an agreement or further develop an agreement because this kind of practice would be contrary to the foundational contract law principles of freedom of contract and *pacta sunt servanda*. The courts are exclusively concerned with ascertaining what the intention of the parties to the agreement constitutes. The courts are reluctant to surmise the intention of the parties but would rather use the exercise of interpretation to ascertain meaning of the agreement. If the court were to interfere in the intention of the parties, the principles of sanctity of contract and freedom of contract may be compromised.

The courts will look at the terms of the written instrument in order to ascertain meaning of the contractual agreement and the true intention of the parties to a contract. Where interpretation of the written agreement does not clearly define the intention of the parties, the courts may introduce imputed tacit terms to ascertain this intention.

¹⁰³ Christe (2011) 174.

¹⁰⁴ Cornelius (2013) 1093 *De Jure* 1088.

3.4. Parol evidence rule

When a dispute arises about an agreement reduced to writing (whether writing is a constitutive requirement or whether it is used for purposes of proof), a party will often experience a need to bring evidence from outside the document (“extrinsic evidence”) to prove his version of the content and meaning of the contract.¹⁰⁵ In such circumstances the parol evidence rule generally comes into play to restrict the nature and extent of the evidence that may be brought.¹⁰⁶

In the case of *Union Government v Vianini Pipes (Pty) Ltd*¹⁰⁷ the parol evidence rule has been expressed as follows;

“[W]hen a contract has been reduced to writing, the writing is, in general, regarded as the exclusive memorial of the transaction and in a suit between the parties no evidence to prove its terms may be given save the document or secondary evidence of its contents nor may the contents of such a document be contradicted, altered, added to or varied by parol evidence...”¹⁰⁸

In the *KPMG Chartered Accountants v Securefin*¹⁰⁹ case, the SCA reiterated the principle that interpretation is a matter of law and not of fact and that therefore it is for a court and not witnesses to interpret terms of a contract.¹¹⁰ The court also expressed its disapproval of the growing “undesirable practice” of allowing expert witness to testify as to the meaning of contracts.

In terms of the parol evidence rule, once a contract is reduced to writing the document is exclusive proof of the terms of the contracts. Anything outside of the contract that the parties have signed is inadmissible if it detracts, varies or contradicts the terms of the contract. Therefore evidence determining the

¹⁰⁵ Van Der Merwe *et al* (2012) 148.

¹⁰⁶ Van Der Merwe *et al* (2012) 148.

¹⁰⁷ *Union Government v Vianini Pipes (Pty) Ltd* 1941 AD.

¹⁰⁸ *Union Government supra* n107 43-47.

¹⁰⁹ *KPMG Chartered Accountants v Securefin Ltd and another* 2009 (2) All 523 SCA.

¹¹⁰ *KPMG supra* n109 at 39.

contents of a contract is inadmissible. It must be noted that this rule only applies to written contracts.¹¹¹ The parol evidence rule has the effect that when a contract is reduced to writing that writing is generally regarded as the exclusive record of the transaction and no evidence to prove the terms of the contract is admissible.¹¹² Therefore if parties reduce a contract to writing, courts only look at the writing as a tool of interpretation. The parol evidence rule prevents parties from altering their initial intention in terms of the agreement, if parties were allowed to do this it could lead to absurd results and will be contrary to the principle of *pacta sunt servanda*.

Attention must be drawn to the fact that there are exceptions to the parol evidence rule. Strict application of the parol evidence rule can lead to injustice. The application of the rule is limited by certain principles or exceptions, which render extrinsic evidence admissible in certain instances.¹¹³ Strict application of this rule may also inhibit the principle of *pacta sunt servanda* as the intention of the parties may not be adequately ascertained. The parol evidence rule applies only if the whole document has been integrated in the written record; therefore if the writing is only a partial integration of the transaction then the parol evidence rule will not apply, and extrinsic evidence to prove unwritten terms and assist with the interpretation of the writing may be inadmissible.¹¹⁴

In terms of the parol evidence rule, evidence can always be presented to identify parties to the contract or goods in the contract.¹¹⁵ In the case of *Tsantsabane Municipality v Thabula Trade & Investment (Pty) Ltd and Another*,¹¹⁶ the court explained that the alienation of land is only permissible if certain requirements are met. The court held that the contract contains an “entire agreement” clause which makes the application of the parol evidence rule explicit. If the “entire agreement” clause was not inserted, there would be

¹¹¹ *Johnston v Leal* 1980 (3) SA 927 A.

¹¹² *Cornelius* (2007) 96.

¹¹³ *Cornelius* (2007) 96.

¹¹⁴ *Cornelius* (2007) 98.

¹¹⁵ *KPMG supra* n109 at 40.

¹¹⁶ *Tsantsabane Municipality v Thabula Trade & Investment (Pty) Ltd and Another* (2012) 4 All SA 219

room for tacit agreement. Therefore, in this case, parol evidence was not admissible to modify the terms or change the names of the parties in the contract.

In the *Delmas Milling Co Ltd v Du Plessis* case, the court explained the clear meaning rule of interpretation of a contract.¹¹⁷ This case laid down the three successive principles regulating the admissibility of extrinsic evidence to contradict the plain meaning of the words.¹¹⁸ The rules are as follows:

- a) On the face of it, if the meaning of a contract is clear, then that is the meaning that must be applied. However, the problem with this rule is that words cannot be examined in isolation without the context.
- b) If the meaning of the contract is not clear, the background circumstances may be taken into account to establish the meaning.
- c) In cases of ambiguity, the statements of the parties must be examined.

In the English case of *Pacific Gas and Electrical Company v GW Thomas Drayage & Rigging Company*,¹¹⁹ the court made the following comments:

“The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous language on its face, but whether the evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible... A rule that would limit the determination of the meaning of a written agreement to its four corners merely because it seems to the court to be clear and unambiguous, would wither deny the relevance of the intention of the parties or presuppose a degree of verbal precision and stability our language has not attained.”¹²⁰

¹¹⁷ *Delmas Milling Co Ltd v Du Plessis* 1955 (3) SA 447 A

¹¹⁸ Cornelius (2007) 99.

¹¹⁹ *Pacific Gas and Electrical Company v GW Thomas Drayage & Rigging Company Inc* 40 ALR 3d 1373.

¹²⁰ *Pacific Gas and Electrical Company v GW Thomas Drayage & Rigging Company Inc* 40 ALR 3d 1373.

The court held that evidence is permissible to prove reasonable meaning within a contract. The English law is still conservative as can be seen in the *Investors Compensation Scheme Ltd v West Bromwich Building Society*¹²¹ case which explains that the contract is interpreted against the factual background that was reasonably available to the parties. The court made the following remarks: “Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.”¹²² In the South African case of *Telkom*,¹²³ the court applied the *Pacific Gas* case thereby allowing relevant evidence.

There has been a relaxation of the Delmas principles in subsequent case law. There, however, seemed to be some confusion in respect of the type of evidence which was admissible to establish the meaning of words in a contract. In *Haviland Estates v McMaster*¹²⁴, the court held that evidence concerning background circumstances is in fact admissible. However, in the case of *Coopers & Lybrand and others v Bryant*,¹²⁵ the court read each word in context and was of the opinion that the surrounding circumstances should only be considered when the contract is ambiguous. A court should only look at the surrounding circumstances in the interpretation of a contract when the contract is ambiguous. This case also alluded to the question relating to the difference between surrounding and background circumstances. The court found that evidence of surrounding circumstances refers to what passed between the parties during the negotiations that preceded the conclusion of the agreement and this would include;

¹²¹ *Investors Compensation Scheme Ltd v West Bromwich Building Society* 1998 (1) WLR 896.

¹²² *Investors Compensation Scheme supra* n121 at 912.

¹²³ *Telkom Suid Afrika Bpk v Richardson* 1995 (4) SA 183 A.

¹²⁴ *Haviland Estates v McMaster* 1969 (2) SA 312 A.

¹²⁵ *Coopers & Lybrand and others v Bryant* 1995 (3) SA 751 A.

”previous negotiations and correspondence between the parties, subsequent conduct of the parties showing the sense in which they acted on the document, save direct evidence of their own intentions”.¹²⁶

The *KPMG Chartered Accountants* case, heard by the SCA, carried an important judgment in South Africa. Harms DP stated that the terms ‘background circumstances’ and ‘surrounding circumstances’ are vague and confusing. The court held that there is no merit in distinguishing between background circumstances and surrounding circumstances. The distinction between background circumstances and surrounding circumstances has proved itself to be more of a hindrance than a help as it was never clear precisely which contextual circumstances were regarded as ‘background’ and which as ‘surrounding’ circumstances.¹²⁷ In this case the court also expressed its disapproval of the growing ‘undesirable practice’ of allowing expert witnesses to testify as to the meaning of contracts.¹²⁸

In the case of *Bothma-Batho Transport (Edms) Bpk*,¹²⁹ the court held that all relevant contexts must be considered and the process is now unitary. “Relevant” relates to the consensus of the parties; for example, did the parties actually agree or did one party create a reasonable impression that he/she is agreeing? However, the parties’ respective thoughts on the matter would not be relevant.

The above cases illustrate the approach the courts now use with regards to admissibility and further demonstrate that the courts have in fact relaxed the parol evidence rule and will allow relevant evidence in appropriate circumstances.¹³⁰ The relaxation of the parol evidence rule to ascertain the parties’ intention is in line with the principle of *pact sunt servanda* because by ascertaining the intention of the parties, the obligations in terms of the contractual agreement become clearer and must be honoured. The principle

¹²⁶ *Coopers supra* n125 at 768E.

¹²⁷ Hutchison & Pretorius (eds) (2012) 260.

¹²⁸ *KPMG supra* n109 at 40.

¹²⁹ *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk* 2014 (2) SA 494 (SCA).

¹³⁰ Cornelius (2007) 96.

of *pacta sunt servanda* explains that agreements, seriously and voluntarily entered into, must be honoured;¹³¹ therefore once the agreement has been interpreted to give effect to the intention of the parties, the parties are bound by the obligations contained in the contract. Should either party not honour their obligations in terms of the contract, the complying party will be able to effect legal action on the defaulting party.

3.5. Problems that arise in the interpretation of contracts

Word usage and ascribed meaning can vary from person to person therefore determining the meaning of a contract is not always an easy exercise. “Parties to a contract express themselves in language calculated to embody the agreement they have arrived at, and they determine the intended shape which the contract must assume.”¹³² This statement emphasises the fact that the intention of the parties to a contract is contained in the contract itself. In order to give effect to their intention, the contract must be interpreted with the objective that the execution of the contract must be in accordance with the intention of the parties to the contract. This is also in line with the contractual principle of *pacta sunt servanda* because if the contract is interpreted effectively, by giving effect to the parties’ intention, the obligations contained in the agreement will be carried out the way it was intended to.

Although the language used to construct a contract is important, as it is the key to determining the meaning of the contents of the agreement, the language usage is not bound by the rules of grammar.

It is generally accepted that most words have more than one meaning; therefore it is not possible to determine precisely what message the emitter may have meant to convey with the words he/she used.¹³³ The starting point in discussing the problems of interpretation with regards to the language used in contracts is that language does not provide exact clarification of meaning or

¹³¹ Hutchison & Pretorius (eds) (2012) 21.

¹³² *Zandberg v Van Zyl* 1910 AD 302 at 309

¹³³ Cornelius (2007) 25.

intention.¹³⁴ There can be no doubt that indeterminacy and even ambiguity are ever-present in any verbal expression. Even language which is ostensibly self-evident is open to differing interpretations.¹³⁵ Furthermore, words are symbols of meaning, but unlike mathematical symbols, words can never attain quantitative precision since they are intrinsically qualitative and palpably inexact.¹³⁶ Each party to a contract may have different interpretations of the meaning contained in the terms of a contract. This is associated with semantics.

Semantics is further affected by social change which is inevitable in societies. For example, the introduction of a democracy in South Africa has generated social change; a change that has been spearheaded by the Country's new and highly regarded Constitution¹³⁷. Not only has the Constitution altered legal interpretation, but it now includes the Bill of Rights (Chapter 2) which has an indirect horizontal application.¹³⁸ The Constitution goes even further and explains that international law can also be used as an interpretation tool wherever necessary.

From the above it is clear that communication (both verbal and written) is often open to misinterpretation. Interpretation is an important task, because if done correctly, can result in legal certainty, which is the desirable outcome of legal proceedings.¹³⁹ Legal certainty embodies the values of fairness and justice. If there is legal certainty, the outcome in legal proceedings is somewhat predictable. However, the possibility remains that parties will reach different interpretations in respect of the same text. This is because parties have a tendency to read and interpret contracts based on their own (often flawed) memories of the negotiations and events leading up to the conclusion of the contract, or in order to confirm their own preconceived views of the transaction.¹⁴⁰

¹³⁴ Cornelius (2007) 25.

¹³⁵ Carpenter G (1999) 627 *THRHR* 627.

¹³⁶ Carpenter G (1999) 627 *THRHR* 627.

¹³⁷ Hawthorne (2004) 294.

¹³⁸ Brand (2009) 84.

¹³⁹ Carpenter G (1999) 627 *THRHR* 627.

¹⁴⁰ Cornelius (2007) 27.

3.6. Final remarks on interpretation of contracts

South African courts have become more liberal in their approach to the interpretation of contracts by considering all the circumstances of each case in order to effectively give effect to the intention of the parties. This is the approach that will yield more equitable results than the application of a purely literal approach which may yield unfair, harsh results which would be contrary to the principle of freedom of contract. The courts have relaxed the parol evidence rule which can be seen throughout case law. The approach the courts are using now is more in line with a constitutional dispensation and the contractual principle of *pacta sunt servanda*, as well as freedom of contract. Furthermore, interpretation of a contractual agreement is successful if the interpretation gives effect to the parties' collective intention and the parties honour their obligations, as initially intended, in terms of their agreement. The drafting of the contractual agreement is an important function that can assist in the interpretation exercise.

4. Principles of drafting contracts that affect the common law contractual principle of *pacta sunt servanda*

4.1. General

A contract as an agreement is intended to create legally enforceable obligations.¹⁴¹ The definition of a contract is an agreement entered into by two or more people with the intention of creating legally binding obligations.¹⁴² This agreement should be one that the law recognises as binding between the parties. Therefore the difference between a contract and a gentleman's agreement *per se* would be the presence of *animus contrahendi* which is the serious intention to create legally enforceable obligations.¹⁴³

¹⁴¹ Hutchison & Pretorius (eds) (2012) 7.

¹⁴² Hutchison & Pretorius (eds) (2012) 6.

¹⁴³ Christe (2011) 31.

There are many dimensions to a contract; there is the legal/substantive dimension, the physical dimension of the contract as well as the interpretation and drafting dimension. All these factors affect a contract as a whole and as a legal instrument; therefore drafting a contract should be done with the utmost care and accuracy in order to prevent any uncertainty from occurring. Drafting should aim to identify the parties to a contract, set out the obligations and rights of each party accurately, contain all the necessary clauses in terms of the agreement such as time frames and method of payments and clearly state all possible avenues that can be utilised should a breach occur. All material information relating to the agreement must be stated clearly and with sufficient certainty.

The obligations in terms of a contractual agreement are extremely important as they relate to the principle of *pacta sunt servanda*. The principle emphasises the fact that contracts seriously and voluntarily entered into must be honoured.¹⁴⁴ All contracts are entered into to achieve some purpose; we can therefore call this purpose the obligations as set out in the agreement. If the obligations are not drafted clearly, and are not ascertainable with sufficient certainty the execution of *pacta sunt servanda* will be inhibited. Parties cannot carry out the purpose of their contractual agreement effectively, if the purpose cannot be detected from the written instrument. Furthermore a court will not be able to ascertain the true intention of the parties if the contract is drafted poorly, and perhaps not be able to locate the obligations of the agreement or where the responsibility of the obligations lie.

In terms of drafting, the contractual obligations must be stated accurately and wherever necessary the correct time frames, details pertaining to when or where the obligation must be carried out and the party to whom the obligation is given must be made clear.¹⁴⁵

¹⁴⁴ Hawthorne (1995) 173

¹⁴⁵ Hutchison & Pretorius (eds) (2012) 404.

4.2. Consensus as basis of a contract

Subjective agreement is the actual meeting of the minds in respect of all the material terms of contracting.¹⁴⁶ Therefore the perfect scenario would be where both parties have the exact same thing in mind. In South Africa the will theory is the primary basis of contract law.¹⁴⁷ This theory explains that there must be consensus before a contract comes into existence.¹⁴⁸ This theory constitutes a subjective approach whereby true consensus is the sole basis for liability and there is no contract if there is no genuine concurrence of wills.

This theory was also confirmed as the true basis of contractual liability in our law in *Saambou-Nasionale Bouvereniging v Friedman* as well as in *Steyn v LSA Motors Ltd*.¹⁴⁹ The initial basis of contractual liability in South African is consensus and the secondary basis is reasonable reliance which is used by a party that wants to assert the contract. The reliance theory postulates that enforceability depends on the concurrence of the declared intention of the parties.¹⁵⁰

4.2.1. Establishing consensus in a contract

There is a strong link between drafting of contracts and consensus. A court will look at the physical contract to establish the consensus of the parties. Drafting needs to reflect this consensus in a logical and systematic manner so there is no confusion as to whether there is consensus and what the consensus actually is. To avoid situations of conflict, a contract must be drafted with the purpose of expressing the intention of the parties. Consensus is a requirement of a valid contract and, should a court not be satisfied that consensus between the parties was established, a contract may in fact be

¹⁴⁶ Christe (2011) 24.

¹⁴⁷ Louis F. van Huyssteen (2010) 155.

¹⁴⁸ Van Der Merwe *et al* (2012) 19.

¹⁴⁹ *Steyn v LSA Motors Ltd* 1994 (1) SA 49 (AD)

¹⁵⁰ Christe (2011) 1.

declared invalid.¹⁵¹ Drafting is a task that must be taken seriously and must be carried out with the utmost care and precision.

In drafting a contract, the question is “how do we give effect to consensus in drafting this contract?” Consensus is the intention to create a legal relationship, which is the meeting of the minds of the parties involved in the agreement. The meeting of the minds of the parties involves the creation of obligations between them and it is therefore imperative that when drafting a contract the obligations are expressed clearly.¹⁵²

Pacta sunt servanda and consensus are inextricably linked because *pacta sunt servanda* is the carrying out of the obligations and consensus is the intention to create the obligations.¹⁵³ If the obligations are drafted vaguely, the courts will not be able to enforce them because it will not be clear whether the parties have reached consensus or not. This would be contrary to the principle of *pacta sunt servanda* because the court will not be able to enforce the obligations and in turn the contractual agreement will not be honoured.

An obligation is a coin with two sides, there is the duty to perform and the right to claim performance. Examples of obligations are as follows:

1. Delivering something
2. Rendering services
3. Refraining from certain conduct

The principle of *pacta sunt servanda* relates to the duty to perform or honouring the contractual agreement.¹⁵⁴ Should a party not perform as directed in terms of the contract, the other party will have recourse against this.¹⁵⁵ A contract is usually drafted from the point of view of the person who..., for instance a purchaser who has to pay the purchase price.

¹⁵¹ Christie (2011) 24.

¹⁵² Van Der Merwe *et al* (2012) 19.

¹⁵³ Van Der Merwe (2012) 19.

¹⁵⁴ Hutchison & Pretorius (eds) (2012) 21.

¹⁵⁵ Kerr (2002) 152.

In defining the obligations in a contract it is imperative to specify the date, time and place of performance. Not specifying this does not render the contract invalid but the common law rules relating to time, date and place of performance will apply. The problem associated with this is that default common law rules will be exacted on the contract and this may not be what the parties actually intended. Should this happen there would be variation of the foundational rights of freedom of contract and sanctity of contract.

4.2.2. Signature as an indication of consensus

In a contract a signature is a very strong indication of the expression of consensus and functions as proof that consensus has been reached.¹⁵⁶ Signature can be said to be an external manifestation of the principle of *pacta sunt servanda* because by signing an agreement a party is providing a clear intention to be bound by the terms of the agreement and should therefore be held liable to the obligations contained in the contractual agreement.¹⁵⁷ In the case of *South African Railways and Harbours v National Bank of South Africa Ltd*¹⁵⁸ the court made the following comments:

“The law does not concern itself with the working of the minds of the parties to a contract, but with the external manifestations of their minds. Even therefore if from a philosophical standpoint the minds of the parties did not meet, if by their acts their minds seem to have met, the law will, where fraud is not alleged, look to their acts and assume that their minds did meet and that they contracted in what the parties purport to accept as a record of their agreement.”¹⁵⁹

It is for the party seeking relief from an agreement that he has signed to convince the court that he was misled as to the purport of the words to which

¹⁵⁶ Louis F. van Huyssteen (2010) 172.

¹⁵⁷ Louis F. van Huyssteen (2010) 172.

¹⁵⁸ *South African Railways and Harbours v National Bank of South Africa Ltd* 1924 AD 704.

¹⁵⁹ *South African Railways supra* n158 at 715-716.

he was thus signifying his assent.¹⁶⁰ Therefore, if a person has signed an agreement and does not want to be bound by that agreement, then that person has to convince the court that he was misled in terms of the agreement.¹⁶¹

Caveat subscriptor means “let the signatory beware”. This principle premises itself on the fact that if a party attests a signature to an agreement, then they will be bound by the terms of such an agreement. In the case of *Burger v Central South African Railways*,¹⁶² the court provided an explanation for the meaning of *caveat subscriptor*. The court stated the following:

“It is a sound principle of law that a man, when he signs a contract, he is taken to be bound by the ordinary meaning and effect of the words which appear over his signature.”¹⁶³

In the case of *Roberts and Another v Martin*, there was a written contract signed by one party and not the other. However both parties started to perform in terms of the agreement. The court held that signature was not needed to show consensus because the performance was a clear indication of the party’s willingness to be bound by the agreement.¹⁶⁴ It should be noted that case law has differing opinions regarding the importance of signature for the establishment of consensus.

In the *D&H Piping Systems (proprietary) Limited v Trans Hex Group Limited* case;¹⁶⁵ the court held that signing was irrelevant. The court explained that performance cannot be delivered first and only afterwards are the terms of the agreement explained. The terms of the agreement must be explained and accepted before performance can be delivered and accepted. The court explained as follows:

¹⁶⁰ *George v Fairmead (Pty) Ltd* 1958 (2) SA 465(A).

¹⁶¹ Louis F. van Huyssteen (2010) 172.

¹⁶² *Burger v Central South African Railways* 1903 TS 571.

¹⁶³ *Burger v Central South African Railways* 1903 TS 571.

¹⁶⁴ *Roberts and Another v Martin* 2005 (4) SA 163 (C).

¹⁶⁵ *D&H Piping Systems (proprietary) Limited v Trans Hex Group Limited* 2006 (3) 393 (SCA).

“Neither a delivery note nor an invoice is a contractual document i.e. the type of document in which the recipient would expect to find terms and conditions intended to form part of the contract between the sender of the document and the recipient. Both the delivery notes and the invoices received by the appellant’s employees reflected performance, or part performance, of a contract already concluded. Neither constituted an offer to do business. They would therefore not have required the attention of a person authorised by the appellant to negotiate and agree to the terms of any contract with the respondent.”¹⁶⁶

The case of *Walker v Redhouse*¹⁶⁷ involved a person falling off a horse after signing an exemption of liability clause and the court found that common law rule of *caveat subscripto* was applicable in this case. The court found the exemption of liability clause to be valid and that this clause was accepted by the individual riding the horse when she attested her signature to it. The court explained as follows:

“The indemnity provides that Walkerson’s stables shall not be liable for loss sustained ‘as a result of my injury . . . in the course of my horse riding . . .’. The language clearly covers all liability resulting from, or caused by, the activity of riding a horse, whether or not the injury is caused by a horse acting out of character. This interpretation is consistent with the second sentence of the indemnity in which Redhouse acknowledged that she was aware of the risks involved in horse riding and accepted them. The extent to which such a provision may be enforceable (for example where the person indemnified has contracted out of liability for the negligent performance of a contract⁸) does not arise here. There was certainly no evidence of negligence or any wrongdoing on the part of Walker or his staff.”¹⁶⁸

In the case of *Cecil Nurse (Pty) Ltd v Nkola*,¹⁶⁹ a dispute arose from a suretyship agreement which was duly executed and mistakenly sent to the other party by the CEO’s secretary. In deciding the outcome the court

¹⁶⁶ *D&H Piping Systems supra* n165 at para 15.

¹⁶⁷ *Walker v Redhouse* (2007) 4 All SA 1217 (SCA).

¹⁶⁸ *Walker supra* n167 at para 19.

¹⁶⁹ *Cecil Nurse (Pty) Ltd v Nkola* 2008 (2) SA 441 (SCA).

referred to the case of *Smith v Hughes*¹⁷⁰ where the judge made the following remarks:

“If, whatever a man’s real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party’s terms.”¹⁷¹

The court also referred the *Sonap Petroleum (South Africa) (Pty) Ltd v Pappadogianis* case,¹⁷² where it was held that the law concerns itself with the external manifestations and not the workings of the minds of the parties to a contract. The judge in *Sonap Petroleum* explained the following:

“In my view, therefore, the decisive question in a case like the present is this: did the party whose actual intention did not conform to the common intention expressed, lead the other party, as a reasonable man, to believe that his declared intention represented his actual intention? ... To answer this question, a three-fold enquiry is usually necessary, namely, firstly, was there a misrepresentation as to one party’s intention; secondly, who made that representation; and thirdly, was the other party misled thereby? ... The last question postulates two possibilities: Was he actually misled and would a reasonable man have been misled?”¹⁷³

This test laid down in *Sonap Petroleum* supports an objective approach. In applying the test of *Sonap* to the facts of *Cecil Nurse* the court concluded the following:

“There is no question on the facts of the present case that the answer to the first and third questions in the above enquiry is a resounding yes. As to the second, the misrepresentation was clearly made on behalf of the

¹⁷⁰ *Smith v Hughes* (1871) LR 6 QB 597.

¹⁷¹ *Smith supra* n170 at 607.

¹⁷² *Sonap Petroleum (South Africa) (Pty) Ltd v Pappadogianis* 1992 (3) SA 234 (AD).

¹⁷³ *Sonap Petroleum supra* n172 at 239I-240B.

respondent. Once the original suretyship, signed by him and two witnesses, was sent to and received by Lindsay, a contract of suretyship came into being. ¹⁷⁴

The court concluded that an impression to be bound in terms of the agreement was created and that the respondent was bound in terms of the agreement. In this case the respondent acted negligently but was still held liable in terms of the contract.

In the *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd*,¹⁷⁵ which subsequently went to the Supreme Court of Appeal, the issue of writing above a signature was analysed. The High Court examined a contractual exemption clause relating to defective products. Chicken Land had signed the contracts but they wrote above the signature. The court said that this meant they did not agree to the clause. The SCA did not agree with the High Court. The SCA did not consider the signature and the writing above the signature but said that Sudan Red was an illegal substance and the exemption clause therefore does not apply because performance was not lawful.

In the case of *Dole South Africa (Pty) Ltd v Pieter Beukes (Pty) Ltd*,¹⁷⁶ the defendant sought to avoid the written agreement signed by both parties. The court explained that in order to avoid *caveat subscriptor* there has to be *iustus* error. If there is a *iustus* error in terms of an essential element of a contract then there is no consensus, if there is *iustus* error pertaining to a non-essential element of the contract then the contract will be valid but voidable. The court held the following:

“In my view, in these circumstances, the Defendant must be held bound to what he signified with his signature.”¹⁷⁷

¹⁷⁴ *Cecil Nurse supra* n169 at para 15.

¹⁷⁵ *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd* (2011 (4) SA 276 (SCA)).

¹⁷⁶ *Dole South Africa (Pty) Ltd v Pieter Beukes (Pty) Ltd* (2006) SA WCHC 58.

¹⁷⁷ *Dole supra* n176 at 47.

The above case law supports the fact that, in contract law, signature is a very strong indication of consensus. The principle of *caveat subscriptor* is a binding contractual law principle and will be enforced by the courts. Signing a written agreement enforces the principle of *pacta sunt servanda* as it shows a serious intention to be bound by the terms of the contract and subsequently the agreement must be honoured. Courts are in favour of contract validity and will generally uphold signed written agreements unless there is *iustus* error. A drafter should also consider having a space where parties can initial each page of the written agreement to prevent non-compliance and invalidity.

4.3. Drafting guidelines

A contract does not have to be in writing in order to be valid; a verbal agreement is also a contract and in many cases the drafting of a contract is done for evidential purposes to show that a valid contract between the parties does exist.¹⁷⁸

The starting point of drafting will be the general principles of the law of contract. When considering the law of contract, the Bill of Rights must be taken into account because of its horizontal legal application.¹⁷⁹ A drafter must also always be aware of the context within which a contract will exist as context always affects the meaning of the instrument.

A physical contract needs to identify the parties involved in the agreement and reflect the intention of the parties to the contract. A contract is therefore a written instrument that shows the consensus of the parties involved¹⁸⁰. It defines all the rights and obligations the parties intended and reflects the purpose of the agreement. It further consists of time frames, clauses and important information that should be taken into account in executing the contract.

¹⁷⁸ Hutchison & Pretorius (eds) (2012) 4.

¹⁷⁹ Chapter 2 of the Constitution.

¹⁸⁰ Hutchison & Pretorius (eds) (2012) 7.

A contract in written form provides evidence of an agreement between parties. The actual agreement is the meeting of the minds of the parties, which is *animus contrahendi*,¹⁸¹ and therefore the consensus reached must be reflected in the physical contract as accurately as possible so that no disputes arise from the written agreement. Therefore a written contract is an account of an agreement between parties.

When drafting the terms of a contractual agreement, the drafter should use clear and simple language.¹⁸² For example, when setting out the contractual terms of an agreement, it would be prudent for the drafter to include a clause which emphasises the consensus of the parties such as “the parties agree as follows...”¹⁸³ A recital explains what the contract is about as well as the nature and purpose of the contract. It is important for the recital to be kept as short as possible, perhaps one or two lines.¹⁸⁴ By including a recital that emphasises the consensus between the parties the drafter can prevent disputes relating to consensus from arising at a later stage.¹⁸⁵ The recital will solidify the fact that the parties have reached consensus and in terms of *pacta sunt servanda* the agreement between the parties therefore must be honoured.

When drafting the obligations the drafter should keep the following points in mind to ensure that the written agreement is simple and easily understandable:

- a) The drafter should make a checklist which consists of all the obligations in terms of the contractual agreement and then split the obligations into two parts. For example: what are the obligations of the purchaser and what are the obligations of the seller?
- b) Each clause should deal with a different obligation.

¹⁸¹Christe (2011) 31.

¹⁸² Christe (2011) 159.

¹⁸³ Hutchison & Pretorius (eds) (2012) 400.

¹⁸⁴ Hutchison & Pretorius (eds) (2012) 399.

¹⁸⁵ Hutchison & Pretorius (eds) (2012) 400.

- c) A drafter should deal with each party's obligation in separate parts of the contract.
- d) Under each clause explain the obligation separately.

It is important that a drafter of a contract thinks about every single detail, no matter how small, that goes into a contract because there must be a good reason for every word used in a contract.¹⁸⁶ Some important questions that must be asked when drafting a contract are as follows:

- a) What are the legal issues in drafting?
- b) Why do I draft what I am drafting?
- c) What is the purpose of each and every clause added into the contract?

There are many disputes that arise as a result of poor drafting of contracts where the rights and obligations are not clearly defined,¹⁸⁷ the performance of the debtor is not sufficiently described or the time for performance is not allocated. In order to avoid these instances, which would cause delay and monetary loss, the drafter of a contract must include all-important information relating to the contract and convey the intention of the parties clearly.¹⁸⁸ The drafter should also take care in using simple language so that the agreement is easily understandable to the parties and so that a court will not have any trouble in interpreting the agreement.

Drafting of contracts plays an important role in contract law, more especially when a dispute arises. The contract needs to contain all the important information so that the principle of *pacta sunt servanda* can be carried out whereby the parties honour the contractual agreement.

A drafter of a contract must be knowledgeable of all the presumptions of interpretation and the presumptions substantive law which may have an effect on the contract; this knowledge will enhance the drafting of the contract so

¹⁸⁶ Hutchison & Pretorius (eds) (2012) 403.

¹⁸⁷ Christe (2011) 200.

¹⁸⁸ Hutchison & Pretorius (eds) (2012) 404.

that parties' intention is reflected clearly.¹⁸⁹ Should a contract be questionable, there are default common law contract law rules which a court will apply to ascertain the meaning of the agreement. There is a presumption that where a parties' signature appears on a contract it is presumed that the party has the required legal capacity to contract.¹⁹⁰ There is a presumption against agency therefore a party is presumed to act as the principle unless otherwise stated.¹⁹¹ There is a presumption that no person writes what he/she did not intend, therefore the intention of the parties coincides with what was written in the contract.¹⁹² When a party puts their signature on a document, they indicate that they are familiar with the contents of the document.¹⁹³

The above is an indication of some of the presumptions of substantive law that will affect the principle of *pacta sunt servanda*. These presumptions will apply unless the written agreement provides otherwise. The presumptions favour contractual validity rather than setting aside the contract. It can therefore be concluded that the presumptions of substantive law in the law of contract support the principle of *pacta sunt servanda*.

A drafter must take a holistic approach when writing contractual agreements. The sole purpose of drafting is making the intention of the parties clear. A contract is not one-dimensional and there are many factors that affect a written agreement. It is the duty of the drafter to make sure that there are no points of contention or gaps in the contract. The drafter must be aware of the presumptions of substantive law affecting agreements and the drafter must be write a contract which is logical, systematic and simple.

5. Conclusion

This discussion has focused on the common law principle of *pacta sunt servanda* and the effect it has on the various aspects of contract law. The

¹⁸⁹ Hutchison & Pretorius (eds) (2012) 413.

¹⁹⁰ Cornelius (2007) 122.

¹⁹¹ Cornelius (2007) 122.

¹⁹² Cornelius (2007) 122.

¹⁹³ Cornelius (2007) 122.

honouring of contractual agreements is a basic contract law principle in South Africa that has also found relevance and authority in our constitutional democracy. The reason contracts are entered into is so that a particular outcome can materialise, this is the objective of contracts- to achieve some purpose. It can therefore be said that to honour a contractual agreement is to act fairly and in line with the principles of sanctity of contract and freedom of contract.

Consensus and *pacta sunt servanda* are accordingly coupled. The maxim explains that contracts seriously entered into must be honoured and consensus is the serious intention to be bound by the terms of an agreement. The research has illustrated that if courts are satisfied that consensus between parties has been reached; then the agreement will be enforced.

The written agreement is a tool which a court will use for interpretation. There are various forms of interpretation that will be used in order to ascertain the intention of the parties. A court will use the rules of interpretation to determine whether consensus between the parties has been reached so that the obligations in terms of the agreement can be honoured.

A contract as a physical instrument needs to contain all-important information pertaining to the agreement and clearly indicate the consensus of the parties. A well-drafted agreement will prevent disputes from arising and will assist in the enforcement of *pacta sunt servanda*.

Pacta sunt servanda is an important principle in contract law that is recognised and favoured by the courts. As a foundational principle, *pacta sunt servanda* has relevance throughout the body of contract law and must always be accounted for when drafting and interpreting agreements. Furthermore freedom of contract and its counterpart sanctity of contract are values which find significance in the Constitutional values of freedom, equality and justice.

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