

SOUTH AFRICA / JUDGMENT

Hodes v Broadacres Investments Ltd. and Another (622/88) [1990] ZASCA 83 (6 September 1990)

[1990] ZASCA 83

COURT

Supreme Court of Appeal

BEFORE

Smalberger, Milne, Eksteen

CASE / FILE NUMBER

622/88

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622/88N v H

HERBERT BERTRAM HODES AppellantandBROADACRES INVESTMENTS LIMITED First
Respondent

DE PUNT PLASE DIAMANTMAATSKAPPY

(EDMS) BEPERK Second Respondent

SMALBERGER, JA -

IN THE SUPREME COURT OF SOUTH AFRICA (APPELLATE DIVISION)

In the matter between:HERBERT BERTRAM HODES AppellantandBROADACRES INVESTMENTS
LIMITED First RespondentDE PUNT PLASE DIAMANTMAATSKAPPY(EDMS) BEPERK Second RespondentCORAM: SMALBERGER, MILNE, et EKSTEEN, JJAHEARD: 16
AUGUST 1990DELIVERED: 6 SEPTEMBER 1990

J U D G M E N T SMALBERGER, JA :-

The first respondent ("Broadacres") is a duly incorporated company. It owns all the shares in the

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2 company Strykpunt Beleggings Limited ("Strykpunt"). Strykpunt in turn holds all the shares in a number of other companies including the second respondent ("De Punt") and Strandfontein Minerale (Eiendoms) Beperk ("Strandfontein"). The appellant ("Hodes") was previously the majority shareholder in Broadacres. On 11 July 1978 a written agreement ("the agreement") was entered into between Hodes, certain other shareholders in Broadacres ("the shareholders"), one Seymour as nominee for the purchaser ("the purchaser"), Broadacres and Turf Holdings Limited

("Turf"). The agreement provided for the sale by Hodes and the shareholders to the purchaser of all the shares in Broadacres held or beneficially owned by them. Prior to the conclusion of the agreement Hodes contracted with Broadacres for the purchase of the whole of Broadacre's shareholding in Turf; in addition Broadacres sold off all its

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3assets save its shareholding in Strykpunt and itsclaims against Strykpunt and its subsidiaries. Theeffect of the agreement was to vest control ofBroadacres, and through it, Strykpunt and itssubsidiaries, in the purchaser. In the agreementStrykpunt and its subsidiaries are referred tocollectively as "the Strykpunt Group".

The present appeal turns upon the proper .

interpretation of clause 11.2 of the agreement. Thatclause provides:

"11. INDEMNITY HODES hereby indemnifies the PURCHASER and BROADACRES and the Strykpunt Group as it will emerge after the implementation of this agreement - 11.1 11.2 against any claims for taxation or penalty thereon arising out of the activities of BROADACRES and the Strykpunt Group prior to the effective date and out of the sale of TURF shares.

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4 (The "effective date", in terms of the agreement, was 30 June 1978.)In the court a quo (subject to what is said later in this regard) Broadacres and De Punt successfully sued Hodes for R174 737-87 plus interest and costs arising from Hodes' failure to perform in terms of the indemnity furnished by him. It is against this judgment that Hodes appeals with leave of the court a quo. Before considering the true meaning of clause 11.2, and the liability of Hodes in terms thereof, it is necessary to have regard briefly to the circumstances which gave rise to the action against Hodes.It is common cause that Hodes obtained control of Broadacres, and thereby of Strykpunt and its subsidiaries, in 1969. De Punt was at all relevant times the cessionary of a mining lease with the State,

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5 in consequence of which it had the right to recover precious stones in a certain area. In August 1976 an agreement was entered into between De Punt and Strandfontein. It provided for Strandfontein to conduct, on behalf of De Punt, the recovery of precious stones under the mining lease. It further obliged Strandfontein to account and pay over to De Punt the net proceeds of any sale of precious stones so recovered. In the June 1977 financial statements and tax returns of De Punt and Strandfontein (which at the time were both under the effective control of Hodes), the proceeds of the sales of precious stones recovered from the mining lease area were reflected as the income, not of De Punt (as should have been the case), but of Strandfontein. This income was set off against the large assessed loss (in excess of one million rand) which Strandfontein had accumulated. De Punt's tax

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6 return reflected no income from mining operations during that year. The financial statements and tax returns of De Punt and Strandfontein for the 1978 tax year (a period during which Hodes was still in control) followed substantially the same pattern. Strandfontein was again (incorrectly) reflected as the recipient of the proceeds of the sales of precious stones mined in the area concerned, and the income so received set off against its assessed loss. In the latter half of 1978 the purchaser, after acquiring control of Broadacres (and hence Strykpunt and its subsidiaries), appointed new auditors who carried out certain financial investigations. These revealed that De Punt's and Strandfontein's financial statements and tax returns for the 1977 and 1978 tax years had been incorrect - as the net income from the proceeds of the sale of precious stones

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7 should have been attributed to De Punt and not to Strandfontein. In consequence, adjusted financial statements for De Punt and Strandfontein for the tax years in question were submitted to the Commissioner for Inland Revenue. This caused the Commissioner to issue (as he was entitled to) revised assessments for the tax years 1977 and 1978. In terms of the revised assessments De Punt was required to pay an additional amount of R174 737-87 by way of tax (including the State's share of profits). At the same time Strandfontein's assessed loss was re-instated by an amount equal to the net income wrongly attributed to it. An appeal by De Punt against the revised assessments to the Transvaal Income Tax Special Court was unsuccessful.

In due course Broadacres and De Punt instituted the action already referred to against

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Hodes for payment of R174 737-87, being De Punt's additional tax liability. Ultimately the matter came before GORDON, AJ, in the Witwatersrand Local Division. Prior to the hearing the parties agreed upon a stated case for adjudication by the court in terms of Rule 33 of the Uniform Rules of Court. After reciting certain introductory facts, the stated case records that De Punt's revised tax assessments were upheld by the Transvaal Income Tax Special Court. A copy of the judgment of that court was annexed to the stated case, and it was recorded "that the facts as set out therein are correct and, further, that there are no further facts which are relevant to the interpretation of clause 11(b)". (The reference to clause 11(b) should be to clause 11.2.) The stated case then proceeds

(at times somewhat inelegantly):

"5. The second plaintiff (De Punt) duly paid the amount of the additional

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assessment raised upon it.

6. The assessed loss re-instated by the revised assessments was set off against taxable income earned by Strandfontein in years after the effective date, thus reducing the amount of tax which Strandfontein was obliged to pay in subsequent years. Strandfontein is and was not a diamond mining company and its rate of tax was lower than that of second plaintiff which was a diamond mining company.

7.

- (a) The plaintiffs (Broadacres and

De Punt) contend that on a proper construction of clause 11(b) (11.2) of the agreement, the defendant (Hodes) is obliged to pay to the plaintiffs the amount which the second plaintiff was obliged to and did pay consequent upon the revised assessment on it.

- (b) The defendant contends that on a proper construction of clause 11(b) (11.2) of the agreement he is obliged to pay to the plaintiffs the amount of any loss which the Strykpunt Group (and/or the first plaintiff) may have suffered as a result

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of the revised assessments

raised against Strandfontein and against the second plaintiff, such loss being the difference in the financial position of the Strykpunt Group (and/or the first plaintiff) had the revised assessments on both Strandfontein and the second plaintiff been raised when the respective original assessments were raised, on the one hand, and the financial position of the Strykpunt Group (and/or the first plaintiff) as a result of the original assessment being followed by the revised assessments on the other.

- (c) It is agreed that the amount of the loss on the assumptions in (b) above is R62 742.

8. The parties request a ruling from the court as to which of the above interpretations is correct, and an order that the defendant pay to the plaintiff (sic) the amount consequently owing, with costs."

The learned judge a quo upheld the plaintiffs'

contention and, as previously indicated, gave judgment

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against Hodes for the sum of R174 737,87, plus interest and costs. It is against this judgment that the present appeal is directed.

The main contentions advanced on behalf of

Hodes were succinctly set out thus in the heads of argument:

"Whether on a proper construction of the indemnity contained in clause 11.2, the appellant (Hodes) had undertaken to hold harmless against taxation the Strykpunt Group and the companies therein as an entity and whether, accordingly, the position of the Strykpunt Group as a whole might be examined to establish what financial consequences followed the claim for taxation which grounded the action; and Whether the doctrine of subrogation is applicable on the facts of this case." With regard to the first contention, the line

of argument advanced was the following. The purpose of the agreement was to transfer the control of Broadacres, and through Broadacres, Strykpunt and its

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subsidiaries, to the purchaser. What was envisaged was the acquisition by the purchaser of a restructured group of companies. The true intention of the parties in stipulating clause 11.2 of the agreement was to indemnify the purchaser against any diminution in the value of such group as a whole in order to ensure that the purchaser would receive the agreed value of his purchase. As contended in the appellant's (Hodes') heads of argument, "(a) although it was necessary to frame the indemnity in favour of each legal persona,

it does not follow that the indemnities are to be viewed in isolation. On the contrary, the intention of the parties, as expressed in clause 11.2, was to indemnify the purchaser against claims for taxation which reduced the value of the group of companies he had bought". It was therefore necessary, so it was argued, to lift the veil of corporate personality, and

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to treat the companies forming the group, not as individual personae, but as a notional legal entity, as the parties had intended them throughout to be regarded; on a proper construction of clause 11.2 it was accordingly permissible to have regard to the overall financial position of such entity in order to determine to what extent its value as a whole had been diminished consequent upon De Punt's liability for additional taxation. It was conceded that Hodes was obliged in terms of clause 11.2 to pay the amount of such additional taxation. It was argued, however, that he was entitled (in accordance with the doctrine of subrogation) to the benefit of the value to the group or entity of the corresponding increase in Strandfontein's assessed loss (once such value was capable of determination and expression in monetary terms), and to deduct such value from the amount owing

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by him. It was conceded that this argument only held good if the indemnity in clause 11.2 was construed as one given, not to each of the individual companies, but to such companies as an entity. Such concession was properly made because if, on a proper construction of clause 11.2, the indemnity is found to have been given to each company individually, the doctrine of subrogation would have no application on the facts of the present matter. The fundamental flaw in Hodes' main contention is that it overlooks the clear meaning of clause 11.2. The principal rule in the interpretation of contracts is to ascertain the true intention of the parties to a contract from the language used. In this respect the court endeavours as far as possible to give to the language used by the parties its ordinary grammatical meaning within the context of the agreement

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15 as a whole. It is only where such meaning is not clear that regard may be had to other, considerations (cf. *Jonnes v Anglo-African Shipping Co. (1936) Ltd* 1972(2) SA 827(A) at 834 D - G). Clause 11.2 of the agreement has already been quoted. It is convenient to recall that it provides an indemnity to "the PURCHASER and BROADACRES and the Strykpunt Group" against "any claims for taxation arising out of the activities of BROADACRES and the Strykpunt Group prior to the effective date". Clause 4.2.1 of the agreement refers to Strykpunt and all its subsidiaries (including De Punt and Strandfontein) by name, whereafter it is provided that "STRYKPUNT BELEGGINGS BEPERK and its abovementioned subsidiaries are hereinafter referred to as 'the Strykpunt Group'". It is significant that "the Strykpunt Group" is not defined to mean that group of

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16 companies, but that the agreement refers to each company individually and then states that they are thereafter to be referred to as "the Strykpunt Group". This is no more than a convenient way of referring collectively to Strykpunt and its subsidiary companies. The reference to "the Strykpunt Group" in clause 11.2 is not therefore one to a notional legal entity, but is a shorthand reference to each of the individual companies listed in clause 4.2.1. Similarly, the reference in the introductory part of clause 11 is to each individual company, and in particular to any one of the companies whose activities have given rise to an additional tax claim. This is in keeping with what appears to be the consistent use of the phrase "the Strykpunt Group" throughout the agreement to refer to the individual companies listed in clause 4.2.1.

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17 The "Strykpunt Group" is not a legal persona and could not have sued *eo nomine* for any loss in respect of which the indemnity in clause 11.2 was given. Nor could it ever have been intended that any one of the companies listed in clause 4.2.1 might sue in respect of any loss suffered by any other company arising from claims for taxation. It was clearly intended that only the company that actually suffered loss (or the purchaser or Broadacres) would be entitled to sue for, and recover, such loss. This is what the words in clause 11.2 mean when given their literal

interpretation. The wording of clause 11.2 neither expressly nor by necessary implication supports the main contention advanced by Hodes. If the parties had intended that the extent of the indemnity was to be determined with reference to the diminution in value of

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all the companies comprising the group as a whole, one would have expected the agreement to have been couched in more appropriate language. Apart from the language of clause 11.2 indicating the contrary, it is unlikely that the parties would have contemplated an overall value indemnity bearing in mind associated problems with regard to causality and proof. The simple formulation of clause 11.2, which provides for the company actually suffering loss to be indemnified, obviates any conceptual problems in this regard. The fallacy of Hodes' main contention may also be illustrated by the following example. Let it be assumed that after the agreement had been concluded, but before De Punt's liability for additional taxation had been discovered, the shares in De Punt were sold to a third party. Upon determination of De Punt's additional tax liability Hodes could have been sued by

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De Punt in terms of the indemnity furnished under clause 11.2 of the agreement. De Punt no longer being part of the Strykpunt Group, any conceivable benefit to such group arising from the increased assessed loss of Strandfontein could clearly not be relied upon by Hodes to reduce De Punt's claim. Nor is there any basis on which Hodes could have claimed the value of such benefit from "the Strykpunt Group" or from Strykpunt or any of its subsidiaries. This serves to underline the fact that the parties could not have intended clause 11.2, contrary to its clear meaning, to provide an indemnity in respect only of the diminution of the value of the group as a whole. In view of the conclusion to which I have come it is not necessary to consider the applicability of the doctrine of subrogation. On a proper interpretation of clause 11.2 Hodes was obliged to pay

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De Punt the full amount of its additional tax liability. There was no basis on which Hodes became entitled to a reduction in such liability. For the reasons stated, Hodes' liability to indemnify is not limited to a diminution of the value of the companies involved as an entity. It is common cause that if this is so then, as De Punt received no benefit from Strandfontein's increased assessed loss, there is no right that Hodes could have been subrogated to in order to reduce the extent of his liability. It follows that the appeal must fail. In the court a quo there were two plaintiffs. The learned judge a quo simply granted judgment "for the plaintiff" without indicating whether such judgment was in favour of the first or the second plaintiff, or both. The right of both plaintiffs to sue was never in issue. It is common cause, however, that judgment

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21 should have been in favour of the second plaintiff (De Punt) as the additional tax liability was paid by it. The first and second plaintiffs (Broadacres and De Punt) were both represented by the same attorneys and counsel, and in view of their relationship to each other it is assumed that the costs of the one were also the costs of the other. It was not suggested otherwise. It is therefore not necessary to make any specific order in regard to the costs of the first plaintiff (Broadacres). The appeal is dismissed, with costs. The order of the court a quo is amended to reflect that the judgment granted is in favour of the second plaintiff.

J W SMALBERGER JUDGE OF APPEAL

MILNE, JA)

) CONCUREKSTEEN, JA)

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Prepared on 10 October 2026 · Esheria