REPUBLIC OF SOUTH AFRICA

THE SUPREME COURT OF APPEAL
OF SOUTH AFRICA

REPORTABLE
Case number: **683/05**

In the matter between:

MUTUAL AND FEDERAL INSURANCE COMPANY — Appellant

and

CHEMALUM (PTY) LTD — Respondent

CORAM: **MPATI DP, STREICHER, NUGENT, HEHER and MAYA JJA**

HEARD: **13 NOVEMBER 2006**

DELIVERED: **29 NOVEMBER 2006**

Summary: Insurance – Business Interruption section of insurance policy – providing for indemnity for loss of gross profit due to reduction in turnover – insured business affected by damaging fire for period in excess of 12 months – effect of average clause on indemnity for loss of gross profit.

Neutral citation: This judgment may be cited as *Mutual and Federal v Chemalum* 2006 SCA 147 (RSA)

JUDGMENT

MPATI DP:

[1] This appeal concerns the proper computation of an amount to be paid by the appellant to the respondent as indemnity under a policy of insurance. The appellant insured the respondent in terms of a Multimark III policy of insurance against, *inter alia*, loss following interruption of, or interference with, the respondent's business in consequence of damage occurring at the latter's factory at 15 Duralumin Duct, Alton, Richards Bay (the insured premises), during the period of insurance. The period of insurance was 1 August 1999 to 31 July 2000, covering a maximum indemnity period of 12 months.

[2] It is common cause that as a result of damage to the insured premises, caused by a fire on 18 March 2000, the respondent's business was brought to a standstill for two months. It suffered from the impact of the damage for a period in excess of 12 months from the date of the fire, with a consequent loss of profits due to a reduction in turnover. The respondent instituted action in the Durban High Court against the appellant for payment of the sum of R3 000 000, being the maximum sum insured, although the total financial loss it allegedly suffered was calculated at R4 141 052. Interest was also claimed at the rate of 15,5% per annum 'according to law'.

[3] The relevant provisions of the policy read as follows:

'**Item 1 Gross profit (difference basis)**

The insurance under this item is limited to loss of gross profit due to

(a) **reduction in turnover** . . .

(b) . . .

and the amount payable as indemnity hereunder shall be

(a) **in respect of reduction in turnover** the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period shall, in consequence of the Damage,

fall short of the standard turnover

(b) . . .

. . . provided that the amount payable shall be proportionately reduced if the sum insured in respect of gross profit is less than the sum produced by applying the rate of gross profit to the annual turnover where the maximum indemnity period is 12 months or less . . . .'

[4] The terms 'standard turnover', 'annual turnover' and 'rate of gross profit' are defined in the policy as follows:

'**Standard turnover**
Standard Revenue
Standard gross rentals The turnover (revenue) (gross rentals) during that period in the twelve months immediately before the date of the Damage which corresponds with the indemnity period

Annual turnover
Annual revenue
Annual gross rentals The turnover (revenue) (gross rentals) during the twelve months immediately before the date of the Damage

Rate of gross profit The rate of gross profit earned on the turnover during the financial year immediately before the date of the Damage

to which such adjustments shall be made as may be necessary to provide for the trend of the business and for variations or other circumstances affecting the business either before or after the Damage or which would have affected the business had the Damage not occurred, so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which, but for the Damage, would have been obtained during the relative period after the Damage.

Note If the Damage occurs before the completion of the first year's trading of the business at the premises, the value of bracket terms shall be calculated by using values proportionate to the results obtained during the period between the commencement of the business and the date of Damage.

I shall refer to the words to the right of the bracket as 'the bracketed provisions'. It is not in dispute that they are part of the definition of the terms inside the bracket.

[5] No evidence was led at the trial, but at its commencement, and in addition to the common cause facts mentioned above, the parties proposed to argue the matter on the

following agreed facts, as set out in a supplementary minute in terms of Rule 37:

‘1

The parties have agreed that:-

1.1 the standard turnover contemplated by the insurance policy, adjusted in accordance with the terms of the policy, and for the twelve month indemnity period from the 19th March 2000 to the 18th March 2001 is R9,058,770.00, excluding VAT;

1.2 the actual turnover of the Plaintiff in the indemnity period was R4,406,855.00, excluding VAT;

1.3 accordingly, the Plaintiff’s reduction of turnover for the purpose of calculating its loss of gross profit, in terms of the policy, was R4,651,909.00, excluding VAT;

1.4 the Plaintiff’s rate of gross profit, adjusted as aforesaid, for the purposes of the policy, was 57%;

1.5 in the result, the measure of the Plaintiff’s claim for loss of profit in terms of the policy is 57% of R4,651,909.00, namely, R2,651,588.00, excluding VAT.

2

The Defendant proposed and the Plaintiff agreed the quantification of standard turnover, as recorded in paragraph 1.1 above, which is based upon what is recorded in the Plaintiff’s notice in terms of Rule 36(9)(b), relating to the witness, Mr OOSTHUIZEN, together with the contents of the schedule of turnover which is annexure “A” to the Defendant’s Rule 37(4) List, namely the average of the monthly turnover for the months of May and June 2002 projected over a twelve month period.

3

There is thus a dispute as to the date from which the Plaintiff is entitled to interest on its claim, taking account of the provisions of Sections 2A(2)(a) and 4 of the Prescribed Rate of Interest Act.

4

It also remains in dispute as to whether the Plaintiff’s claim falls to be reduced proportionally, as contemplated by the proviso to the description of the indemnity under item 1 on page 1/6 of the Business Interruption Section of the insurance policy.

5

The Court is therefore asked to adjudicate only upon the issues described in paragraphs 3 and 4 above and to give judgment accordingly, taking into account the Plaintiff’s agreed entitlement as recorded in paragraph 1.5 hereof.’

It will be noted that the annual turnover as defined was not agreed upon.

[6] The trial court (Skweyiya J) granted judgment in favour of the respondent in the sum of R2 652 585 and interest thereon as claimed ‘from the date of service of the summons to date of payment’. It subsequently granted the appellant leave to appeal to the Full Court against the order relating to the capital sum. The respondent cross-appealed against the order pertaining to the date from which the interest was to run.

The Full Court (Jappie J, Tshabalala JP and Kruger J concurring) dismissed both the appeal and cross-appeal and ordered the appellant to pay the respondent's costs of the appeal. The appellant is before us with the special leave of this court in respect of the appeal only.

[7] In arriving at their conclusion the trial court and the court *a quo* both found that it was unnecessary to apply any adjustments to the annual turnover, a figure of R1 477 007, which, it would seem to be common cause, represents the respondent's total sales for the period March 1999 to February 2000. The court *a quo* said the following in this regard:

> 'As respondent's annual turnover is easily calculable with reference to the sales figures for the year ante the 18th March 2000 there is no need to apply any adjustments to this figure. There is therefore, in the context of this case, no necessity for the respondent to have performed the exercise of overestimating its annual turnover and paying the premiums on an overestimated amount for an indemnity period which was to run for twelve months after the 364th day as set out in the policy. This is an exercise that may quite correctly be described, as the [trial court] did, as "crystal ball" gazing into the future.'

And further:

> 'Applying the agreed gross profit rate of 57% to this figure (R1 477 007), the product is the sum of R824 700,93. This amount is significantly less than the maximum indemnity provided in the policy of R3 m.'

The court *a quo* accordingly held that the trial court quite correctly declined to reduce the agreed loss of gross profit of R2 651 588.

[8] In this court counsel for the respondent disavowed any support for the approach adopted by the trial court and the court *a quo*. He submitted, instead, that the amount claimed by the respondent should not be reduced in terms of the average provision for two reasons. First, in order to establish whether the average provision applied and, if it did, the extent to which the amount payable should be reduced, the annual turnover should be determinable. Relying on *Eagle Star Insurance Company Ltd v Willey*[1] he argued that the onus was on the appellant to prove that the average provision applied, but that it failed to do so in that it failed to prove facts on the basis of which the annual turnover could be determined. Second, the policy made provision for the upward adjustment of the sum insured should it transpire that the insured was underinsured with

1 1956 (1) SA 330 (A)

the result that the average provision could never become operational.

[9] In respect of the first contention he disagreed with the submission of counsel for the appellant that because the period over which the standard turnover is calculated is the same as that over which the annual turnover is to be determined ('during the 12 months immediately before the date of the damage'), the annual turnover should accordingly be the same as the standard turnover (adjusted as agreed to R9 058 770). Counsel submitted that there is a myriad of factors and circumstances that might be relevant for the determination of the standard turnover but not so in respect of the annual turnover. It therefore does not follow that the figures for the two would necessarily be the same. He argued that merely because the parties agreed a figure for 'standard turnover' cannot relieve the appellant from its obligation to prove, by appropriate evidence, the correct value of 'annual turnover', in the absence of any further agreement. Without that evidence, no value can be ascribed to 'annual turnover' and it is then impossible to quantify any amount for the purpose of applying the 'average' clause.

[10] It is in my view not necessary to quibble about where the onus lies in this case. The purpose of applying adjustments, in terms of the bracketed provisions, to the total sales for the period March 1999 to February 2000 (the 12 months immediately before the date of the damage) in determining the standard turnover is to obtain a figure that will represent 'as nearly as may be reasonably practicable the result which, but for the Damage, would have been obtained during the relative period after the Damage'. This is so because account has to be taken of different circumstances that are likely to play a roll, either favourably or negatively, in the respondent's business during the indemnity period. The very same objective is sought to be achieved in respect of the annual turnover. The indemnity period, ie 'the relative period after the Damage', in the instant case is twelve months. The period in the twelve months immediately before the date of the damage 'which corresponds with the indemnity period' is thus exactly the same as that over which the annual turnover is to be determined. The same figure (total sales) is used as a basis for the determination of both turnovers. I can find no reason why the

factors and circumstances the parties agreed to considered in determining the standard turnover should differ in the case of the determination of the annual turnover. There may very well be a case for such difference, I consider, where, for example, the indemnity period was in excess of twelve months. Different factors might come into play for the period in excess of the first twelve months following the damage.

[11] The view just expressed finds support in the work *Riley on Business Interruption Insurance* 8ed (Sweet and Maxwell)[2], in which the author, David Cloughton, says the following:

'If the other circumstances clause (ie the bracketed provisions) is invoked by an insured in a claim settlement in order to obtain the benefit of an upward trend by increasing the figure of the standard turnover the same percentage increase is, in the absence of other special circumstances which would condition it in some way, automatically applied to the annual turnover. The effect of this latter adjustment is to increase the figure to be used for comparison with the sum insured in applying the average clause.'[3]

Thus by agreeing the amount of the standard turnover the parties in effect agreed the amount of the annual turnover.

[12] In respect of the contention that in terms of the policy the insured amount had to be adjusted upward in the event of the insured being under insured, counsel for the respondent relied on the provisions of the 'premium adjustment clause' in the policy. It reads:

'4 ADJUSTMENT OF PREMUIM

If the premium for any section of this policy has been calculated on any estimated figures, the insured shall, after the expiry of each period of insurance, furnish the company with such particulars and information as the company may require for the purpose of recalculation of the premium for such period. Any difference shall be paid by or to the insured as the case may be.'

Counsel submitted that upon a proper construction of this clause there must be a recalculation of the premium payable under the relevant section of the insurance policy at the end of the period of insurance and, if it turns out that there was under-insurance, the insured sum must be adjusted upwards, the premium adjusted upwards accordingly and the shortfall in premium paid by the insured. It was not open to the appellant, so

2 The relevant pages were made available by counsel for the appellant who drafted the heads of argument but did not argue the appeal.

3 At p 53 para 55

the argument continued, to apply any adjusted value of 'annual turnover', for the purpose of applying average, without taking into account a corresponding adjustment in the sum insured, occasioned by the application of the premium adjustment clause.

[13] The terms of the contract of insurance between the appellant and respondent are evidenced in the policy of insurance at issue. The premium adjustment clause is totally silent on a possible adjustment of the sum insured. A specific clause in the business interruption section of the policy, the 'deposit premium clause', that provides for a provisional premium calculated on 75 percent of the sum insured, the premium being subject to adjustment on expiry of the period of insurance, is also silent on a possible adjustment of the sum insured. What the two clauses make provision for is a refund of part of the premium paid where there has been over-insurance, or an additional payment where there was under-insurance (in each instance not exceeding $33^{1}/_{3}$ percent of the provisional premium paid – this in terms of the deposit premium clause). No provision is made for an adjustment of the sum insured. There is therefore no basis for the contention that an upward adjustment of the premium must follow upon an upward adjustment of the sum insured.

[14] To sum up: since the period over which the standard turnover was determined (12 months immediately before the damage) is the same as the period over which the annual turnover is to be calculated, and the same adjustments are required to be made to both amounts, the figure for both must necessarily be the same, viz R9 058 770 (the agreed standard turnover). When the agreed rate of gross profit (57%) is applied to the annual turnover (R9 058 770) the result produced is R5 163 495. The sum insured (R3 000 000) being less than this product, the amount payable as indemnity (R2 651 585) is to be reduced proportionately. It was not in dispute that the rate of under-insurance is 58%. Applying this last-mentioned rate to the amount payable as indemnity for loss of gross profit, the actual amount payable to the respondent is reduced to the sum of R1 537 920,00.

[15] In the result, the appeal succeeds with costs, such costs to include those of two counsel. The order of the court *a quo* is set aside and for it is substituted the following:

'(1) The appeal succeeds with costs and the cross-appeal is dismissed with costs, including the costs of two counsel to the extent that two counsel were employed.

(2) Paragraph 1 of the order of the trial court is set aside and replaced with the following:

"(1) Payment of the sum of R1 537 920,00 excluding VAT."'

L MPATI DP

CONCUR:

STREICHER JA
NUGENT JA
HEHER JA
MAYA JA