Republic of South Africa

IN THE HIGH COURT OF SOUTH AFRICA

(CAPE OF GOOD HOPE PROVINCIAL DIVISION)

CASE No: 9609/2002

In the matter of

MURCIA LANDS CC **Plaintiff**

versus

ERINVALE COUNTRY ESTATE

HOME OWNERS ASSOCIATION **Defendant**

JUDGMENT DELIVERED : 17 MARCH 2004

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BUDLENDER, AJ:

1. The plaintiff, a close corporation, became the registered owner of erven 10939 and 10940 at Erinvale Country Estate, which is an upmarket development in the area of Somerset West.

2. The defendant is a body corporate established by its members pursuant to the provisions of section 29 of the Land Use Planning Ordinance No 15 of 1985. The members are (amongst others) the owners of what are referred to as Unit Erven at the Estate, such as erven 10939 and 10940. The defendant is responsible for the formulation and enforcement of rules and regulations at Erinvale Country Estate. Its powers include the power to make levies on members for the purposes set out in its constitution.

3. In terms of the sale agreement under which the plaintiff became the owner, and also in terms of a title deed condition in respect of those erven, the plaintiff became a member of the defendant for so long as it remained the registered owner of the erven concerned. As a member of the defendant, the plaintiff was subject to all of the obligations of membership of the defendant in terms of its constitution.

4. One of those conditions was that the plaintiff was obliged to commence construction of a dwelling house on the erven concerned by May 1999, and to complete construction within 12 months of commencement.

5. A further condition was that if the plaintiff failed to commence construction by the agreed date, the defendant would have the right to impose a levy upon the plaintiff, equal to ten times the levy per erf then imposed by the defendant on owners of erven with completed dwellings.

6. In breach of the agreement, the plaintiff did not commence construction of a dwelling by May 1999. The trustee committee of the defendant imposed on the plaintiff a penalty

levy equal to ten times the ordinary levy which was then levied on an erf with completed dwellings, in respect of each of the erven which the plaintiff had bought - in other words a total penalty of twenty times the ordinary levy for a single erf. The total penalty levies and interest during the period April 2000 to 26 February 2002 amounted to a total of R283 242,72.

7. In the meantime, on 8 November 1999, the two erven in question had been consolidated into one erf, with the consent of the defendant. At the time when the penalties were imposed, the property was therefore one consolidated erf.

8. The plaintiff subsequently decided to sell the erven (or at that stage, strictly speaking, the single consolidated erf). It obtained the consent of the defendant to "*deconsolidation"* of the erf, which again became two separate erven. The plaintiff then sold those erven to other parties.

9. In order to obtain the consent of the defendant to these sales, the plaintiff was obliged to pay to the defendant all sums due by it to the date of transfer. This condition was lawfully imposed by the defendant.

10. The plaintiff duly made payment to the defendant of R283 242,72 on 27 February 2002, doing so under protest and asserting that the penalties fall to be reduced in accordance with the Conventional Penalties Act 15 of 1962 ("the Act").

11. The plaintiff now sues the defendant for recovery of that sum.

The Conventional Penalties Act

12. The parties are agreed that the penalty levies constitute a penalty in terms of the Act. That is plainly correct.

13. Section 3 of the Act provides as follows:

"***Reduction of excessive penalty***

If upon the hearing of a claim for a penalty, it appears to the court that such penalty is out of proportion to the prejudice suffered by the creditor by reason of the act or omission in respect of which the penalty was stipulated, the court may reduce the penalty to such extent as it may consider equitable in the circumstances: Provided that in determining the extent of such prejudice the court shall take into consideration not only the creditor's proprietary interest, but every other rightful

interest which may be affected by the act or omission in question."

14. It seems to me that this requires me to investigate and reach conclusions on three matters:

(a) Is the penalty out of proportion to the prejudice suffered by the defendant by reason of the plaintiff's breach of contract? If so,

(b) would it be equitable for the court to reduce the penalty? If so,

(c) to what extent?

Prejudice

15. In its plea, the defendant alleged that it suffered prejudice as a result of the plaintiff's breach of the agreement as follows:

(a) Nuisance resulting from building activity which should have been completed;

(b) Damage resulting from building activity which should have been completed;

(c) Security risks due to building activity not being completed;

(d) Employment of additional day security patrols due to building activity not being completed;

(e) Negative effect on property prices in Erinvale Country Estate due to building activity not being completed.

16. The evidence demonstrated that for the most part, only very limited prejudice was caused by the late building operations which were undertaken by the successors to the plaintiff. During the building period, trucks carrying building materials and workers would have been travelling up and down the road which runs through the estate, inevitably causing some noise and traffic inconvenience to the members generally. Building operations on the two sites would have caused some inconvenience to owners in the neighbourhood as a result of noise and dust. No evidence was led that this actually happened, but one can accept that it must have done. More speculative is the suggestion that the late building activities may have led to the need for neighbours to repaint their homes and to replace their curtains as a result of the dust created by building activities (Erinvale is in a very windy area). Neighbours may have had to pay increased insurance premiums because of the higher risk associated with living at a place where building activity is taking place in the neighbourhood. The suggestions to this effect are entirely speculative, and there is no evidence to suggest that it actually transpired.

17. The evidence suggested that the building activities of the plaintiff's successors may have caused damage to roads and the grassy verges. There was no evidence that this actually happened. The security risk may have increased as a result of having additional building activity on the site at a time when little other building activity was taking place. There is no evidence to show that there was an increased amount of crime, or any crime at all, during the period in question. The evidence suggests the contrary, if anything. In 2001, the defendant had instituted a high-tech security system which provided very sophisticated access control. There is no evidence to suggest that it was not effective at the time when the building took place on the two erven in question.

18. The allegation that additional day security patrols had to be employed as a result of building activity not completed, was not supported by any evidence. The evidence showed that the people working on the previous security patrols were re-deployed, and there was no evidence that additional security patrols were undertaken during the period when the houses in question were being built.

19. There was similarly no evidence that the building activities of the plaintiff's successors had any impact at all on property prices on the estate.

20. In sum, there is virtually no evidence to show that the plaintiff's failure to comply with the contract, which led to the buildings being erected late on the two sites in question, caused any material damage to the defendant, except that there must have been some additional noise and dust generated by the activities. If there was any prejudice caused by any requirement of painting or inconvenience to the neighbours, this prejudice was suffered by the individual owners of the erven in question, and not by the defendant as an institution. It is particularly noteworthy that the while defendant collected substantial penalty levies, it did not use any of this to compensate the owners of the neighbouring erven. In truth, the defendant profited materially from the late building activities, in that it received a penalty fee of some R283 000, while not having any additional expenses which were proved.

21. However, that is not the end of the matter. The prejudice to which the Act refers includes "*not only the creditor's proprietary interest, but every other rightful interest which may be affected by the act or omission in question"*.

22. If every owner had acted as the plaintiff did, or if a majority had done so, the defendant would have suffered very material prejudice. The security problem caused by extensive ongoing building activities (which the chairman of the defendant described as the main problem) would probably have been significant. This would have led to the inconvenience attached to being at risk of theft or burglary, and possibly to increased insurance premiums. The nuisance inevitably caused by building activities would have continued for a longer period than was actually the case, at a

substantial level. The damage caused by building activities might well have increased, as it would have been incurred repeatedly over an extended period, instead of occurring over a limited period and then being remedied. And it may well be that property prices in the estate would have been negatively effected. Mrs McLoughlin, the estate agent who was responsible for selling the properties, stated that it was a positive selling feature that the inconvenience caused by building would be over within a specified and limited time, because this provided an advantage from the security, aesthetic and nuisance points of view.

23. This potential prejudice did not materialise, for the reason that most of the homeowners complied with the obligations imposed by the contract.

24. It appears to me that the defendant had a "*rightful interest"* in ensuring and obtaining compliance with the terms of the contract. It was entitled to impose a penalty clause to compel the homeowners to carry out their obligations under the contract by providing "*harsh consequences"* should they default: **Western Bank Ltd v Meyer, De Waal, Swart & Another**, 1973 (4) SA 695 (T) at 699H.

25. The fact that the contractual provision is intended as a penalty which creates a deterrent, rather than as a provision which provides compensation for default, does not mean that the defendant suffered no "*prejudice"* as a result of the breach of contract. The prejudice was prejudice to its right to enforce concerted action for the common good, and to its interest in obtaining concerted action.

26. Section 3 of the Act requires me to determine whether the penalty was "*out of proportion"* to the prejudice suffered by the defendant.

27. In circumstances such as these, where one is not dealing with monetary prejudice, this requires the court to make a value judgment in order to decide whether the penalty is "*unduly severe to an extent that it offends against one's sense of justice and equity"*: **Western Bank (supra)** at 700A.

28. In **Maiden v David Jones (Pty) Ltd** 1969 (1) SA 59 (N), the court held that the following was the proper approach in the dealing with this question:

"*If in this matter we are left in doubt as to whether or not the penalty is markedly or unfairly out of proportion to the prejudice, then the penalty falls to be enforced as agreed. If, therefore, in this case, we are left with no data enabling us to establish that there was a disproportion or the extent of such disproportion, then the Magistrate correctly awarded the creditor the full amount of the*

agreed penalty. We think, however, that there is information on which one can, in a very general manner, appraise the fairness of the penalty in relation to the prejudice which we have found that the defendant suffered." (At 64E-G.)

29. In this matter, the evidence provided certain comparative data as to the penalties imposed at other estates.

30. At Bell'Aire, another estate in the Somerset West area, the penalties imposed were three times the monthly levy. Bell'Aire did not impose a "*double"* penalty in respect of erven which had been consolidated; it imposed one penalty per erf existing at the time of the default. The evidence shows that Bell'Aire is also an upmarket estate. The prices of properties there are not as high as those at Erinvale, apparently partly because it does not have a golf course. The price range for properties at Bell'Aire is currently R1,8 million to R4 million. At Erinvale, the range is currently R2,5 million to R10 million. But I accept that Bell'Aire is a development of a similar sort, in the same area, and the evidence shows that purchasers sometimes looked at both estates before making a purchase.

31. At Bell'Aire the imposition of a penalty which was three times the standard levy per site was largely successful in inducing compliance. Approximately 75% of the buyers complied with the time limit for commencing and completing building operations.

32. By contrast, at Erinvale the penalty was ten times the standard levy, and a double penalty in respect of erven which had been consolidated, in other words, twenty times the standard levy in the case of the plaintiff. The penalty system was largely successful in inducing compliance. Approximately 80% of the owners complied with the commencement and completion rate. That is not a markedly different outcome from that achieved at Bell'Aire.

33. Steenberg Estate is an upmarket housing and golf estate similar to Erinvale, situated in Tokai in Cape Town. The penalties imposed on members who do not commence or complete construction within the stipulated time period is as follows: three times the monthly levy for the first six months, and thereafter five times the monthly levy. The monthly levies are substantially higher than at Erinvale: whereas at Erinvale at the relevant time it was R650 per month, at Steenberg it varied from R1 300,20 to R1 557,00 per month. There has never been a consolidation of erven at Steenberg, and the question of penalties for consolidated erven has therefore not arisen.

34. A further relevant set of data related to the size of the total penalty imposed on the plaintiff, and the income which has been received by the defendant as a result of the penalty levies in general.

35. During the critical 18 months ended on 31 August 2001, the total operating costs of the defendant were R4,538 million. The penalties imposed upon the plaintiff constituted about 5% of the entire operating costs of the defendant during that period. The defendant had some 412 members at the time.

36. During those 18 months, the total levy income of the defendant was R5,379 million. Penalties constituted R1,1 million of this – in other words, more than 20%. Put differently, the penalty levies were approximately 25% of the total operating expenditure (R4,538 million) during that period. The defendant had a nett surplus before taxation of R1,457 million for that period, and R1,352 million after taxation. By June 2002 the total penalties invoiced amounted to R2,588 million, of which R1,735 million had been collected.

37. It seems to me that the question of whether the penalty was "*out of proportion*" to the prejudice can be assessed in three ways: by looking at comparable situations where the desired result was achieved; by looking at the size of this penalty and the penalties in general in relation to the income and expenditure of the defendant; and by exercising one's sense of fairness and justice.

38. As to the first, there was a great deal of argument as to whether the penalties at Steenberg were equivalent to those at Erinvale. Adv **Grobbelaar** for the defendant submitted that in order to assess the penalty, one has to look at the actual cash amount, and that as the monthly levies at Steenberg were higher than the monthly levies at Erinvale, the nett result was that a higher multiple at Erinvale led to more or less the same cash outcome as the lower multiple at Steenberg. I doubt whether this is the correct approach. If the focus of the penalty was an amount of a particular size, it would have been more likely to stipulate a cash amount for the penalty. Instead, it provided for a multiple of the levy, which is variable from time to time by the defendant. The contract therefore provided for a variable amount, which was to bear a particular relation to the levy. That being so, it seems to me that it is the multiple rather than the total amount of the levy which is most relevant. That this is the more appropriate approach is supported by the fact that at Bell'Aire, the multiple was similar to that at Steenberg, even though the amounts of the respective levies varied greatly. (At Bell'Aire the levy was R385,00 per month whereas the Steenberg levy was initially R1 300,20 and became R1 557,00 per month.) What is in any event not in dispute is that a penalty of twenty times the levy on an erf is far in excess of any of the penalties placed before the court, whether one uses the multiple or the actual cash amount as the determinant.

39. In this regard, it has to be borne in mind that at the time that the penalty was levied (from month to month), the erf in question was a single erf, having already been consolidated. Mr Ibertson, the chairman of the defendant sought to justify the "double penalty" on a consolidated erf. He gave two reasons. First, he said, that it was the amount determined initially by the developers, which the homeowners subsequently wished to keep in place. This of course does not justify the penalty – it is an explanation rather than a justification. Secondly, he said that owners would tend

to build larger homes on double erven, and would therefore cause increased prejudice through late building activities. While there is some substance to this argument, it cannot carry much weight, particularly having regard to the fact that in the case of single erven, the size of the house built is disregarded in determining the penalty. His evidence showed that the sizes of the houses on single erven do vary tremendously.

40. It seems to me that the comparative material therefore suggests that the penalty was out of proportion to the prejudice suffered.

41. The second test I have suggested is the size of this penalty and the penalties in general in relation to the income and expenditure of the defendant.

42. I have already referred to the evidence in this regard. Over an 18-month period, the penalties imposed upon the plaintiff, who was one of 412 owners, amounted to some 5% of the total operating costs of the defendant. That strikes me as quite extraordinary. When one throws into the pot the fact that the penalties in general constituted some 20% of the income of the defendant, and some 25% of its operating costs, one is left with the strong impression that the defaulters in general were required to contribute an amount which was out of proportion to the operating costs of the estate, and the prejudice suffered by the defendant.

43. The reality is that the defendant received a benefit of almost R2,6 million as a result of the default of some of the owners. That strikes me as being out of proportion to the goal which it was legitimately seeking to achieve, namely to compel compliance with the term of the contract.

44. These factors, taken together with my sense of justice and equity, lead me to conclude that the penalty imposed upon the plaintiff was out of proportion to the prejudice suffered by the defendant.

An equitable penalty

45. That requires me to consider whether the penalty should be reduced, and if so, to what extent.

46. I have already referred to the evidence which was placed before the court. This constitutes the basic material which I should use for determining what is an equitable penalty under the circumstances.

47. Mr Zaptia of the plaintiff said that he would be quite satisfied to pay a penalty of double the monthly levy to be charged for a single erf. However, I do not think that this would be equitable, for two reasons.

48. First, the evidence shows that comparable estates impose a penalty of three to five times the monthly levy. I cannot think of any reason why it is equitable for the levy at Erinvale to be lower than that range.

49. Secondly, there is the question of the consolidation and subsequent deconsolidation of the erven in question. The nett result of those actions was that the two erven in question *were* in fact dealt with as two erven: two separate houses were constructed on them. Such harm as was caused by the late building, was the harm caused by the building of two houses on two erven, and not by the building of one house on a consolidated erf. In **Van Staden v Central South African Land and Mines** 1969 (4) SA 349 (W), **Snyman, J** held that "*the date of the infliction of the harm or hurt"* is not relevant: "*if when the matter is heard by the court the harm or hurt has been inflicted, or if it appears that it might reasonably be expected to occur at some future date, the court will have regard to it"*. (At 353A.)

50. It is true that **Snyman, J** was dealing there with the question of prejudice, rather than the question of the equitable award. However, in that case the two concepts were run together, and not separated as I have attempted to do here. It seems to me that the principle which he enunciates is applicable to the "*equitable"* stage of the inquiry. What is equitable is what is fair. We are dealing here with an equitable exception to the general rule that parties are bound to the terms of their contractual undertakings. It seems to me that it is fair to all concerned that in deciding this question the court should make use of the best information available to it at the time when it hears the matter, rather than restricting itself to the circumstances at the time of the breach.

51. If one approaches the matter in that manner, then in this case a double penalty is not unreasonable or unfair, having regard to the fact that the erven were again "*deconsolidated"*after the original consolidation. My view would have been different if we had still been dealing with a consolidated erf on which a single house had been built. But those are not the facts here.

52. What then is the multiple which would be fair? Again, on these facts – and having regard to the fact that I consider that a double penalty is fair under these particular circumstances - it seems to me that a point in the mid-range of Steenberg would be reasonable. That would produce a figure to 4%, which is slightly higher than Bell'Aire. This is not inappropriate given the different profiles of the estates concerned.

53. Under the circumstances, it appears to me that it would be equitable for the penalty to be reduced to 8% of the standard levy in respect of the consolidated erf, for the period in question (April 2000 to 26 February 2002). Interest in respect of unpaid penalties should obviously be added to this amount. The parties were agreed that I should make an order as to the appropriate multiple to be applied, and leave it to them to calculate the precise amount due including interest. I am happy to do this.

54. The question of interest on my award was not debated at the hearing. In its particulars of claim, the plaintiff asked for interest at the rate of 15,5% per annum from 27 February 2002 to date of payment. This approach could be justified on the premise that an overpayment was made on that date. It could however also be contended that this claim is akin to a claim for damages, in which event the interest runs only from the date when the damages have been determined by the court. It seems to me that the first approach is correct, if only for the reason that the defendant has had the use of the plaintiff's money during the two years which have passed – and according to the evidence, has set most of it aside in a notional reserve fund, where it has no doubt accumulated interest. It seems to me that it is not equitable that the plaintiff should be prejudiced, and the defendant should benefit, in that manner.

55. That leaves the question of costs. Adv **Smalberger** for the plaintiff suggested that the usual test should apply, namely that the plaintiff should be awarded the costs if it has had substantial success. Adv **Grobbelaar** suggested that the costs should be borne in some proportion to the award – for example, if I reduced the penalty by 50%, then each party should pay its own costs.

56. In my view, Adv **Smalberger** is correct in principle. The plaintiff has sued for a specified amount of money or for such amount as the court may award. The defendant has contested the claim in its entirety, and has not made any tender of any kind. Under the circumstances, the plaintiff has achieved substantial success if it achieves a substantial reduction of the penalty. In this instance, the reduction is of the order of 60%. This very substantial on any basis, both as a percentage and in terms of the amount of money involved, which I estimate must be between R160 000 and R170 00.

57. In the result, I make the following order:

(a) the penalty imposed by the defendant on the plaintiff is reduced to eight times the monthly levy payable in respect of a single erf at Erinvale;

(b) the defendant is to pay to the plaintiff the difference between the amount of R283 242,72, and the amount payable in terms of the penalty determined in paragraph (a) above (together with interest on the amount unpaid during the period April 2000 to 26 February 2002).

(c) the defendant is to pay interest on the sum referred to in paragraph (b) at the rate of 15.5%

per annum from 27 February 2002 to date of payment.

(d) the defendant is to pay the costs of the action.

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G M BUDLENDER