



**THE SUPREME COURT OF APPEAL
OF SOUTH AFRICA**

CASE NO: 457/08

EKURHULENI METROPOLITAN MUNICIPALITY Appellant

and

GERMISTON MUNICIPAL RETIREMENT FUND Respondent

**Neutral citation: Ekurhuleni Metropolitan Municipality v Germiston
Municipal Pension Fund (457/2008) ZASCA 154 [2009] (27 November 2009)**

**Coram: NAVSA, LEWIS, HEHER AND MLAMBO JJA AND GRIESEL
AJA**

Heard: 2 November 2009

Delivered: 27 November 2009

***Summary:* Interpretation of pension fund rule: interpretation to be done
having regard to context – nature of fund, purpose of rule, general practice
and effect – in order to give commercially sensible meaning to rule.**

ORDER

On appeal from: High Court, Johannesburg (C J Claassen J sitting as court of first instance).

The appeal is dismissed with costs including those of two counsel.

JUDGMENT

LEWIS JA (NAVSA, HEHER AND MLAMBO JJA AND GRIESEL AJA concurring)

[1] This appeal turns on the interpretation of a pension fund rule. The respondent is the Germiston Municipal Retirement Fund (the Fund). It was established as the Germiston Municipal Pension Fund on 1 July 1924. The appellant, the Ekurhuleni Metropolitan Municipality (the Municipality), the successor to the Germiston Municipality, is the principal employer participating in the Fund. When the Fund was established it was primarily a defined benefit fund (the nature of which I shall discuss later). The Fund was converted in 1994 to a fund with a primarily defined contribution nature. Both parties are bound by the rules in terms of s 13 of the Pensions Fund Act 24 of 1956.¹ The rule in issue was carried over from the old rules (where it was rule 43.1) to the new, where it is rule 10.8(1) (which I will refer to generally as the Rule).

[2] The Rule states:

'If the rate of interest earned on the total moneys (including any uninvested moneys) of the Fund during any financial year should be lower than five and one-half per cent (5.5%) the Council [Municipality] shall contribute to the Fund such a sum as would

¹ '[T]he rules of a registered fund shall be binding on the fund and the members, shareholders and officers thereof, and on any person who claims under the rules . . . '.

increase, on being added to the interest actually earned, the rate of interest to five and one-half per cent (5.5%) during such financial year.'

[3] The Fund and the Municipality agree that 'moneys' means more than cash, and that 'interest' means more than interest earned on cash. It is not contested that interest on moneys includes the return on investments. This common understanding is based upon an interpretation of all the rules and the context in which they are used. They differ, however, as to the meaning of the phrase 'actually earned': the Municipality contends that it excludes gains on all unrealized assets, while the Fund asserts that in effect the Municipality has guaranteed growth, at least to the level of a 5.5 per cent increase in the value of the assets in every financial year.

[4] According to the Fund, in the financial year 1 July 2002 to 30 June 2003 its assets diminished in value by -4.3 per cent. This was the first time in the Fund's history that it had not achieved at least 5.5 per cent growth in its investments. The Fund accordingly instituted action against the Municipality, claiming that it was liable to contribute to the Fund the difference between -4.3 per cent loss and 5.5 per cent return in that financial year. The amount claimed was R61 173 822. The calculation of this figure was not disputed by the Municipality. What was, and remains, in dispute is the meaning of the phrase 'interest actually earned'. The Fund asserts that it includes a return on all its investments, taking into account all realized and unrealized capital gains and losses based on the market value of the assets. The Municipality contends that it means a return only on the gains actually achieved, which would exclude unrealized capital gains or losses. The Municipality raised the issue of interpretation shortly before the trial commenced. It had relied previously on a number of defences which it no longer pursues on appeal. The meaning of the Rule is the only issue before us.

[5] The high court accepted the Fund's interpretation of the Rule and ordered the Municipality to pay to the Fund the sum of R61 173 822 plus interest. It is against this order that the Municipality appeals with the leave of the high court.

Conversion from a defined benefit to a defined contribution retirement fund

[6] Before turning to the different interpretations placed by the parties on the Rule I shall deal briefly with the differences between the nature of the Fund when it was established in 1924 and the nature after it was converted in 1994. It had previously been a defined benefit fund – one where every member is promised a pension benefit that is calculated as a percentage of the member's salary on retirement. The contribution of the Municipality as employer was thus calculated to meet the promise of a particular benefit. Where the Fund's investments in a particular year were good, the contribution by the Municipality might thus have been reduced: it had only to meet its promise as to the benefit payable. And conversely, in a bad financial year, the Municipality may have had to increase its contributions. (See *Tek Corporation Provident Fund v Lorentz*² and *Financial Services Board v De Wet NO*³ on the nature of a defined benefit fund and the employer's liability to make good its promise.) The Municipality thus carried the risk of bad investment performance.

[7] A defined contribution fund, on the other hand, is one where the rules define the contributions to be paid by both members and the employer. There is no guarantee of any particular benefit. And equally where a surplus or a loss is experienced by the fund the employer does not get the benefit of a contribution 'holiday', nor does it have to pay in where there is a loss.⁴ The member, on retirement, is entitled to the contributions made by him or her and by the employer, and any return on the amount in the member's account that has been invested.

² 1999 (4) SA 884 (SCA) paras 5 and 16.

³ 2002 (3) SA 525 (C) para 9.

⁴ *Financial Services Board* para 10.

[8] The parties were agreed, however, that the Fund, prior to 1994, was not purely a defined benefit fund, and that post 1994 it was not purely a defined contribution fund. It was hybrid in nature before and after conversion, with a primarily defined contribution complexion after the rules were amended.

[9] When conversion to a defined contribution fund was considered by the parties towards the end of 1993, the Fund started discussions with the members. The proposed rule amendments not only had to be approved by the Municipality and the Registrar of Pension Funds, but also by members. The amendments were presented to members in various circulars and at consultative meetings. There is not much information available about the entire consultative process. It is clear, however, that the package of rules was accepted by the necessary majority of members. Active members were treated differently from pensioners. The latter were governed by the old rules (in terms of Annexure C to the new rules). Pensioners and their spouses would be treated on the same basis as they had been prior to the conversion.

[10] On conversion in March 1994 the Fund changed its name to the Germiston Municipal Retirement Fund, whereas previously it had been called a Pension Fund. Nothing turns on this, and it remains the same legal entity.

[11] The Fund is now a hybrid that has both defined benefit and defined contribution features. These include the fact that the pensioners, as at the date of conversion, are entitled to defined benefits whereas the benefits of the active members are determined on a defined contribution basis. In addition, provision is made for safeguards that protect members' shares, such as the establishment of a reserve fund into which investment earnings, inter alia, are paid. The Rule must be interpreted in this light.

The meaning of the words in the Rule

[12] Interpretation of what is meant by ‘interest actually earned’ should be approached with ‘common sense and perspective’ (*Bekker NO v Total South Africa (Pty) Ltd*⁵) argues the Fund. And in determining the meaning of the words used in the Rule regard must be had to the entire set of rules – the contract between the members, the Fund and the Municipality. Both parties accept this canon of interpretation, invoking *Sassoon Confirming and Acceptance Co (Pty) Ltd v Barclays National Bank Ltd*.⁶

Principles of interpretation

[13] The principle that a provision in a contract must be interpreted not only in the context of the contract as a whole, but also to give it a commercially sensible meaning, is now clear. It is the principle upon which *Bekker NO* was decided,⁷ and, more recently, *Masstores (Pty) Ltd v Murray & Roberts (Pty) Ltd*⁸ was based on the same logic. The principle requires a court to construe a contract in context – within the factual matrix in which the parties operated. In this regard see *KPMG Chartered Accountants v Securefin*.⁹

Context and commercial sense

[14] What, then, is a commercially sensible construction of the Rule? The high court, relying on what it regarded as the ‘grammatical and ordinary meaning’ of the phrase ‘interest actually earned’, held that the Rule established a guarantee which would be invoked where the growth of the Fund’s investments was less than 5.5 per cent in the financial year in question. The Municipality’s principal attack on this construction is based on another purely linguistic – grammatical – canon: where different words are used in a document they must mean different things.

⁵ 1990 (3) SA 159 (T) at 170G-H.

⁶ 1974 (1) SA 641 (A).

⁷ The decision was reversed on appeal, but the approach of Kriegler J in the court a quo was not disapproved.

⁸ 2008 (6) SA 453 (SCA).

⁹ [2009] ZASCA 7 (13 March 2009); 2009 (4) SA 399 (SCA) para 39.

The significance, if any, of different words

[15] As the Municipality points out, the words 'investment yield' and 'market value' are used elsewhere in the rules but not in the Rule. So, for example, the definition in the rules of 'accumulated contributions' has as a component the contributions paid by a member together with interest at a rate to be decided having regard to the 'investment yield achieved by the Fund'. Members' shares include 'investment earnings' transferred from the reserve account (to which I shall revert): the earnings are based on 'the investment yield achieved by the Fund during the period for which the investment earnings are credited to the member's account' (rule 2.2(1)(v)). And rule 10.5 requires the actuary to estimate what portion of the investment earnings is attributable to various accounts to ensure that any gain from investment assets is credited to the correct accounts.

[16] In rule 2.2(3)(c)(i) there is a reference to fluctuations in the 'market value of the Fund's investments'. Why not use the same phrase – rather than interest actually earned – if that was what was intended in the Rule, asks the Municipality? The Fund's response is that the rules have been drafted over a long period by different people, and that accordingly one cannot expect consistency in language. That may be so. But I think there is a more principled objection to the use of this guide to interpretation in this case: it is a guide resorted to in order to ascertain the linguistic meaning of words, not the real intention of the parties. It must thus be invoked only where that intention cannot otherwise be ascertained.¹⁰ If the Rule cannot be given a commercially sensible meaning by looking at it in context – in its general factual matrix¹¹ - then the use of different terms in different places may assist in interpretation. But if the parties' intention is ascertainable having regard to the context, we should not resort to purely linguistic, and invariably contrived, constructions.

¹⁰ See R H Christie *The Law of Contract in South Africa* (5 ed) 2006 p 219.

¹¹ *KPMG Chartered Accountants v Securefin* above para 39.

[17] The Municipality contends further that the high court did not have sufficient regard to the phrase 'actually earned' in the Rule. It concedes that 'actually' does not add to the meaning. The word simply means 'in fact' and adds emphasis. But the Municipality argues that 'earned' means gained: a gain is one which has in fact been made. Thus appreciation in the value of an asset that is not in fact realized is not a gain: nothing has been earned. One does not 'earn' simply because assets appreciate in value. And similarly, depreciation in value does not mean that a loss has been incurred. Thus fluctuations in the value of the Fund's investments in a particular period have no significance in themselves. Only where an asset is realized would there be a gain, and thus anything earned.

[18] This argument too is based on purely linguistic grounds: the Municipality seeks to give the words in the Rule their ordinary or usual meanings. It does not take account of the context: the purpose of the Rule, general practices in the pension fund industry and the effect of its interpretation. As the Fund contends, the investment performance of a pension fund is determined by having regard to the market value of its investments. Its financial stability is dependent on the value of the assets. If, in determining investment performance, one disregards all assets that have not been realized during the course of the financial year, one would not have a proper picture of the performance at all. In order to assess the market value of the Fund one must take into account the value of all the assets held by the Fund. Depreciation will mean that there has been an actual loss. Appreciation will result in a gain – an earning.

The context or factual matrix

The purpose of the Rule

[19] Both parties contend that the purpose of the Rule is to provide a safety net for members. They differ, however, on what that is. The Municipality argues that it is to guarantee that the employer will pay in to the Fund the amount necessary

to achieve a 5.5 per cent earning on investments realized, or interest earned. The Fund argues, on the other hand, that the net is safer than that. The Municipality, it contends, is required to make good the difference between the value of all assets in the Fund, as at the end of the financial year, and the total value with at least a 5.5 per cent appreciation. That difference in July 2003 is the amount claimed – R61 989 551. The high court adopted the Fund's interpretation, finding that the Municipality's view would exclude the biggest single indicator of the Fund's performance in the financial year – the market value of its investments.

[20] The Municipality argues that the high court did not take into account the anomaly that results from this interpretation: it can be called upon to pay in to the Fund simply because the financial year end coincides with a temporary fall in the stock market. If the market improves soon afterwards the Fund will have a gratuitous windfall, unrelated to earnings generated on the Fund's investments. Moreover, such an anomalous windfall would not be consonant with a defined contribution Fund. (As indicated, the Municipality does acknowledge that the Fund is a hybrid one.)

[21] The Fund responds that all deadlines give rise to anomalies and that there must be a cut-off point when the Fund's investment performance can be analysed. Moreover, it argues, the Municipality could have protected itself by providing 'claw backs' in subsequent periods when performance is better. It would be equally anomalous if the guarantee would be triggered only upon the realisation of losses, through the sale of investment assets, but not by the performance of investments generally.

[22] The arguments for the Fund's interpretation are based also on the need for the safety net provided by the Rule, the purpose for which it was agreed being to meet that need. The purpose is to provide a guarantee by the Municipality to its employees, or former employees, of investment performance to ensure the financial well-being of the Fund. The rules of any fund must be based on sound

financial principles and the board of a fund has the obligation to ensure that members' interests are protected (see ss 7C and 7D of the Act on the objects and duties of pension fund boards). An administrator of a fund must maintain adequate financial resources to meet its commitments and manage the risks to which a fund is exposed (s 13B(5)(f)). The guarantee must be seen in the light of these provisions and makes sense given the duties to protect members' interests.

Practices in pension funds generally

[23] The Fund contends further that in ascertaining the meaning of the Rule the court must have regard to general practices in the pension fund industry. Usually performance of funds is determined with reference to changes in the market value of their assets, and the ability to meet their obligations to their members. The Municipality's interpretation, the Fund argues, is unrelated to the market value of the fund's assets. It introduces the notion of realizing profits and losses which, the Fund contends, is foreign to the usual operations of a pension fund. Moreover, the assets of the Fund have readily ascertainable market values. The realization of the assets does not change the actual financial position of the Fund. The only effect that realization would have is to convert the assets into cash. Further, on the Municipality's interpretation, the guarantee would be triggered only where, in addition to the fall in value of the assets, the Fund had converted the assets to cash. This is an arbitrary consequence.

The effect of the Rule according to the different interpretations

[24] The investment risk that the Rule guards against is the depreciation of the Fund's investments. On the Municipality's interpretation, where the value of the Fund's assets falls, the members may find their benefits reduced in consequence, and the Municipality would not have to contribute to alleviate the situation for so long as the Fund did not realize those assets that perform poorly. Such a result, the Fund contends, could not have been intended by the members

when they agreed to the amendments to the rules and the change in nature of the fund.

[25] The Fund argues that the Rule had the same meaning and effect prior to the amendments. Where a defined benefit was payable to a pensioner the Rule would have ensured that the Fund was able to meet its commitments to pensioners. But the same safety net is needed for members after 1994 and there is nothing to suggest that members agreed to give up the protection they had had. If there is a depreciation in value of the Fund's assets then the members will be prejudiced on the Municipality's interpretation. In my view, that cannot have been intended. It is not a commercially sensible outcome.

[26] It is not one that the Municipality appeared to accept either. For even in its amended plea,¹² it set out the 'average annual rate of interest' for the years ending June 2000 (14 per cent), June 2001 (14.7 per cent) and June 2002 (12.5 per cent) based on the market value of the Fund's assets. (It states also that for the year ending June 2004, the average annual return on the total moneys invested exceeded 5.5 per cent.) The figures reflect a gain on the value of all assets, and not those actually realized.

[27] A further difficulty arising from the Municipality's approach is that the obligation to pay would be triggered only when assets are realized and losses are incurred. This consequence runs counter to the general practice that the health of a pension fund is measured by the value of its investments and their performance.

[28] It is important to bear in mind also that people who were already pensioners in 1994 continue to be governed by the former rules of the Fund, including one identical to the Rule (former rule 43.1). It would be most odd if the Municipality were obliged to make good the guarantee in respect of them, but not

¹² Para 9. The figures were originally set out in a letter from the principal officer of the Fund to the chief financial officer of the Municipality dated 11 December 2003.

in respect of other pensioners or active members of the Fund. And how would this be achieved? Would the guarantee be triggered for pensioners when the overall assets of the Fund are determined at financial-year end, but not for active members? Again, the interpretation of the municipality makes no commercial sense.

[29] The Fund argues too that in order to determine what risk it is that the Rule guards against (what purpose the 'safety net' serves), the court must have regard to the benefits to which members are entitled. Rule 4 provides that on retirement the member's share will be transferred to an account (a pensions account or an insurer's account, say) to secure the pension. Thus the benefit to which a member is entitled depends on what is in his or her account – what the share is. The sources of the credits in the member's account are determined by rule 2.2(1)(a), and in particular (a)(v). This provides that investment earnings must be transferred from a Reserve Account: and such investment earnings 'shall be based on the investment yield achieved by the Fund during the period for which the . . . earnings are credited to the Member's Share Account; . . .'. Thus it is not profits realized that are placed in the member's account, but the investment yield (rule 2.2(1)(b)(i)). Equally, 'valuation losses' must be debited to the member's share (rule 10(5)). The corresponding provision is to be found in rule 2.2(3) which establishes a Reserve Account, which comprises a record of all moneys of the Fund that have not been allocated to the Share Account or the Pensions Account. Valuation losses debited to the Share Account must be credited to the Reserve Account (rules 2.2(3)(a)(iii) and 2.2(1)(b)(i)). And rule 10.5(4) provides that if the financial position of the Fund requires it, on the recommendation of the actuary, 'the Committee may increase or decrease the contribution rate and/or the benefits under the Fund in any manner including the granting of bonuses; provided that if the valuation reveals a surplus and the Actuary so agrees, such surplus shall be allocated to the various accounts . . . to increase the benefits supported by such accounts'.

[30] Thus, argues the Fund, it is clear that the financial position of the Fund has a direct effect on the benefits received by members. It matters not that depreciation in value in a financial year may be made up in following years. In each year the financial health of the Fund may impact directly on the benefits or bonuses payable to members. The better the performance in a year the more likely it is that a member's share would be increased. And of course, the poorer the performance the more likely it is that the benefits will be reduced. Thus the Municipality's guarantee of a rate of 'interest' of 5.5 per cent in a financial year amounts to a guarantee that benefits will not be reduced beyond a particular level when the Fund's performance is poor. The rules reflect the truly hybrid nature of the Fund: the pension of a member is related not only to contributions that are defined, but also to good financial performance that may result in increased benefits and possibly bonuses too.

[31] The Municipality's interpretation, on the other hand, provides no 'safety net' for members. It entails the consequence that the benefits received on retirement are related only to realization of assets and not the overall performance of investments. It does not protect members against the risk of poor investment performance.

[32] It is true that the rules provide for other 'safety nets'. The creation of the Reserve Account into which, inter alia, investment earnings are paid ensures some level of risk aversion. So too does the requirement of actuarial valuations on a regular basis. But that is no reason to assume that another measure of protection is not desirable. Given that both parties regard the Rule as providing a risk aversion measure, one must ask what the risk is and how members are to be adequately protected. In my view, the Fund's argument that the real risk is the fall in the value of investments overall is compelling. There is no need to protect against random losses incurred in the realization of only some assets.

[33] Having regard to the context of the rules – the nature of the Fund, the general practice of pension funds, and, most importantly, the purpose and effect of the Rule – the only sensible commercial meaning to be given to it is that argued for by the Fund and accepted by the high court. The Municipality is accordingly obliged to pay to the Fund the amount claimed.

[34] The appeal is dismissed with costs including those of two counsel.

C H Lewis
Judge of Appeal

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