

SOUTH AFRICA / JUDGMENT

East London Own Haven t/a own Haven Housing Association v Coface South Africa Insurance Company Limited (09/12141) [2011] ZAGPJHC 18 (22 March 2011)

[2011] ZAGPJHC 18

COURT

South Gauteng High Court, Johannesburg

BEFORE

Satchwell

CASE / FILE NUMBER

09/12141

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IN THE

SOUTH GAUTENG HIGH COURT, JOHANNESBURG

REPUBLIC

OF SOUTH AFRICA

CASE NO 09/12141

DATE:22/03/2011

In the

matter between:

EAST

LONDON OWN HAVEN t/a OWN HAVEN

HOUSING

ASSOCIATIONPlaintiff

And

COFACE

SOUTH AFRICA INSURANCE COMPANY LIMITED.....Defendant

JUDGMENT

SATCHWELL J:

INTRODUCTION

This exception requires interpretation of a guarantee issued by defendant ('the insurer') which, when called upon to meet its obligations in terms of such guarantee, seeks to rely upon the merits of an underlying agreement between plaintiff ('the employer') and a third party ('the contractor'). In addition, the exception deals with an estoppel pleading alleged verbal representations or terms giving rise to the written guarantee.

Plaintiff's claim against defendant is founded upon a construction guarantee in terms whereof defendant undertook to pay a guaranteed sum to plaintiff upon notice of cancellation of a principal building agreement. In its amended plea

defendant disputes the lawfulness of the termination of the principal building agreement. Plaintiff excepts to defendant's

amended plea. 1 Defendant has also pleaded that certain oral representations made by the contractor caused to the defendant to issue the

guarantee.

It is common cause that plaintiff entered into a principal construction agreement with Construct Construction (Pty) Ltd ('the

contractor') in respect of construction to be undertaken at Kenwick Close, East London. Pursuant thereto, defendant executed a construction guarantee² in favour of plaintiff in terms whereof defendant guaranteed payment by it to plaintiff of a guaranteed sum or the balance

thereof on certain terms.

Clause 5.1 of the construction guarantee provides that the defendant undertakes to make payment upon receipt of a first written demand from plaintiff "calling up this construction guarantee" stating that:

"The agreement has been cancelled due to the Contractor's default and that the Construction Guarantee is called up in terms of 5.0 The demand shall enclose a copy of the notice of cancellation;"

On 22nd September 2008 the contractor was informed that the construction agreement was cancelled with immediate effect.³ That letter states "due to the slow progress of building works on site, we are obliged to place on record that you again have failed to comply with clause 15.3 of the contract between yourselves and East London Own Haven in that you have failed to proceed with the works with due skill, diligence, regular expediency to bring the works to practical completion as per the dates in"

On 29 January 2009 plaintiff delivered to defendants nominated domicilium a letter giving notice that “the contract was cancelled due to the contractor’s default” and that “the construction guarantee is hereby called up in terms of clause 5.0 thereof and payment of the guaranteed sum of R 1,172,583.80 is hereby called for...”⁵

Defendant has not made such payment. In the mess of papers it appears that there have been more than one plea and amendment

thereto. At issue in this exception is the undated plea in the bundle indexed for the opposed roll of 1 February 2011.⁶

EXCEPTION TO PARAGRAPH 5 OF AMENDED PLEA

It is to paragraph 5 of the amended plea that plaintiff takes exception. That paragraph sets out:

. “ 5.1 The works to be performed included inter alia a design for the use of concrete and shuttering instead of conventioinal brick and mortar.

5.2 The principal building agreement concluded between the plaintiff and the contractor provided for plaintiff to accept all responsibility for the design of the works.

5.3 The termination of the agreement between the plaintiff and the contractor, Construct Construction (Pty) Ltd was as a result of the failure of the concrete and shuttering construction method.

5.4 By virtue of the foregoing and the provisions of the principal building agreement concluded between the plaintiff and Construct Construction (Pty) Ltd, the plaintiff remained responsible for the consequences of such failure and such failure does not constitute any breach on the part of the contractor.

5.5 As a result, the alleged termination of the agreement between plaintiff and Construct Construction (Pty) Ltd (if established) was not as a result of default on the part of Construct Construction (Pty)Limited.

5.6 Accordingly, defendant is not liable in terms of the construction guarantee, annexure ‘A’ to the particulars of plaintiff’s claim.

5.7 Defendant in any event pleads that what is stated in Annexure B are not grounds for lawful termination of the principal building

agreement and accordingly that plaintiff is non-suited in seeking any relief pursuant to such purported termination”.

Plaintiff has excepted to this defence, reliant upon the terms of the principal building agreement, as being one which is pertinently

precluded by reason of the terms of the construction guarantee⁷ and accordingly bad in law and irrelevant to the issues between the parties in respect of the obligations arising out of the terms of the construction guarantee.

Plaintiff argues that the only jurisdictional fact of relevance to the calling up of the guarantee is the fact of the cancellation

of the principal building agreement. The validity of such cancellation is of no relevance.

Defendant argues that one of the jurisdictional facts for invoking the construction guarantee is the cancellation of the principal

building agreement due to “the contractor’s default” and that there is therefore nothing to preclude defendant from alleging facts indicating that the contractor was not in default and accordingly that the construction guarantee may not be called up.

Reference to Principal Building Agreement

Both parties referred this court to a number of authorities dealing variously with construction guarantees or letters of credit

and whether or not they should be read in conjunction with the principal building contract or trading agreement.

In *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996(1) SA 812 AD, *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd and Others* 2010 (2) SA 86 (SCA) and *Dormell Properties* 282 CC v *Renasia Insurance Company Limited & others* 491/09 SCA the insurer or bank had issued construction guarantees or letters of credit on behalf of a contractor or buyer in favour of the employer or seller.⁸ In each case there were difficulties in execution of obligations by the contractor or buyer and cancellation was involved. A number of principles may be extracted from the relevant judgments⁹.

Firstly, the Supreme Court of Appeal has expressed itself clearly as to the purpose of the issue of such guarantees: In *Lombard supra* the court stated that the guarantee “..was to protect [the employer] in the event of default by [the contractor]. In *Dormell supra* the majority judgment repeatedly stated that “ the guarantee was intended to provide the employer with a ready cash fund for the completion of the development project in the event of the building contract having to be cancelled by the employer prior to its finalization.” and “ the issue of the guarantee was in order to enable the employer to finalise the building project if the contract between it and the contractor were to be cancelled before the work was completed” and the guarantee was “intended to secure the employers position” and “the guarantee is intended to enable the employer to complete the contract in case of default by the contractor.”

Secondly, the Supreme Court of Appeal has consistently emphasized the significance of the event which triggers the claim under the guarantee: In *Loomcraft supra*¹⁰ “The unique value of a documentary credit, therefore, by issuing and confirming the credit, the bank undertakes to pay the beneficiary provided only that the conditions specified in the credit are met” and “ The

liability... arises upon presentment of the documents specified in the credit.... Which on their face conform strictly to the requirements of the credit". In Lombard supra, the court found the guarantee issued by the insurer "creates an obligation to pay upon the happening of an event", "the bank undertakes to pay provided only that the conditions specified in the credit are met" and "The trigger event of which it granted the guarantee had occurred and demand was properly made.". Both judgments in Dormell supra cited Loomcraft supra and Lombard supra with approval and the majority judgment went on to say "In principle therefore, the guarantee must be honoured as soon as the employer makes a proper claim against it upon the happening of a specified event".

Thirdly, the Supreme Court of Appeal has been at pains to stress that obligations under the guarantee are not reliant upon nor concerned with any underlying disputes in contractor-employer or seller-buyer agreements: In Loomcraft supra the court commented on the "The unique value of a documentary credit, therefore, is that whatever disputes may subsequently arise between the issuing bank's customer (the buyer) and the beneficiary under the credit (the seller) in relation to the performance or, for that matter, even the existence of the underlying contract, by issuing and confirming the credit, the bank undertakes to pay the beneficiary provided only that the conditions specified in the credit are met". The court in Loomcraft supra approved the speech of Kerr J in R D Harbottle (Mercantile) Ltd and Another v National Westminster Bank Ltd and Others [1977]2 All ER 862 (QB) at 870b-d where was said "the machinery of irrevocable obligations assumed by banks.. ... are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in the clear cases of fraud... the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees". In Lombard supra, the court held that the guarantee "is not unlike irrevocable letters of credit issued by banks and used in international trade. This obligation is wholly independent of the underlying contract and assures the seller of payment of the purchase price before he or she parts with the good being sold. Whatever disputes may subsequently arise between buyer and seller is of no moment insofar as the banks obligation is concerned."

The Construction Guarantee and its terms

The upshot of these extracts from three fairly recent decisions of the Supreme Court of Appeal is that the plaintiff (as employer) is entitled to rely upon the guarantee of which it was the beneficiary to provide it with necessary funds upon the identified event taking place.

That event is set out in clauses 5.0 and 5.1 of this construction guarantee:

"The guarantor undertakes to pay the employer the guaranteed sum or the full outstanding balance upon receipt of a first written demand from the employer to the guarantor... calling up this construction guarantee stating that: the agreement has been cancelled due to the contractors default..." (my underlining)

It would seem that there are four jurisdictional requirements to this demand – (1) a statement (2) that there has been cancellation (3) due to the (4) default of the contractor.

Plaintiff has argued that the only question is whether or not there has been cancellation and then demand and submits that the wording of the guarantee requires no more than a statement as to cancellation by reason of default and does not require proof of such default.

I am far more persuaded by the logic of defendants argument that there would be no reason for clause 5.1 of the guarantee to have identified the reason for cancellation if that reason were irrelevant to the guarantee.

If all that were required of the plaintiff was to ‘state’ that it had ‘cancelled’ the principal construction

agreement, then I am sure that it what the parties would have agreed. However, the construction guarantee goes further than

that. Firstly, Clause 5.1 requires a reason to be given. If the underlying reason or the developments envisaged in the principal building agreement were irrelevant, then there would be no purpose in having inserted the words “due to the contractors default”. Secondly, the employer is not at liberty to call up the guarantee for any reason which it may choose to identify. It is limited to one reason only – “the agreement has been cancelled due to the contractors default”. That is the only ground of cancellation permitted in this guarantee. Thirdly, the cancellation of the principal agreement does not occur merely in conjunction with or associated with the default of the contractor. A cause and effect is required to be stated ie alleged viz that the cancellation is “due to the contractors default”.

The opportunity to call up the guarantee only in such specified circumstances limits the ability of the employer to cancel the principal agreement for any reason or no reason whatsoever and then rely upon the construction guarantee. The employer is constrained. As importantly, the liability of the insurer is equally circumscribed. To my mind this approach is not

inconsistent with the provisions of clause 8 of the guarantee .11

I have indicated that I understand the logic and the consistency of the approach of the Supreme Court of Appeal in the cases to which I have been referred. I do not see my views as, in any way, failing to follow the judgments to which I have referred above.

The Loomcraft supra judgment is distinguishable in two important respects from the facts in this case: firstly, that case was concerned with a letter of credit whereas the guarantee here is not such a document; secondly that case concerned an irrevocable letter where here the guarantee is conditional upon the eventuating of certain very narrowly defined events.

The Lombard supra judgment was concerned with a completely different triggering event and surrounding circumstances. The insurer had issued a guarantee on behalf of the contractor in favour of the employer for due fulfillment of the contractors liability. The guarantee fell due upon two events one of which was liquidation and the other was “default resulting in cancellation”.

Upon liquidation of the contractor, the insurer sued yet another set of entities which had executed suretyships in favour of the insurer in terms whereof they undertook to indemnify the insurer from all claims “of whatsoever nature” and “whether or not the contractor on whose behalf [the insurer] furnished the guarantee admitted the validity of the claim”. Those sureties refused to pay contending that insurer had been induced to pay through the fraud of the principal

agent for the construction contract.

The differences between Lombard supra and the present case are as follows. Firstly, the litigation was between the insurer and the sureties. Secondly, the sureties were liable for all claims “of whatsoever nature” whereas this insurer is not a surety and the liability is limited to cancellation due to contractors default. Thirdly, the liability of the sureties existed “whether or not the contractor on whose behalf the guarantee was furnished admitted the validity of the claim” whereas there is no such open-ended liability in the present case. Fourth, there was a fraud perpetrated by the principal agent for the construction project but investigation found that the employer had not colluded therein. . That fraud was relevant insofar as it was suggested that the insurer should not have paid the claim in Lombard supra and the finding that “Lombard, (the employer), it is accepted, did not collude in the fraud. There was no obligation on it to investigate the propriety of the claim”. There has been no averment of fraud in the present case

Fifth, the triggering event in Lombard supra was the liquidation of the employer. As to this event, the liquidation, the court held that “there was no obligation on the insurer to investigate the propriety of the claim”. The construction guarantee in the present matter also permits the guarantee to be called up on provisional sequestration or liquidation of the contractor¹². The demand for the guaranteed sum from the insurer must be accompanied by a copy of the court order. The fact of a court order

and the resulting liquidation is not a triggering event of the same kind as in the present case. Here more is required than merely a piece of paper showing a court and date and result. There must be a cancellation due to the contractors default which, as I have already discussed, has a cause and effect interdependency.

Sixth, since all that was required in Lombard supra was the fact of a liquidation, it is appropriate that the court found that guarantee to be “not unlike irrevocable letters of credit issued by banks and used in international trade”. That analogy was apposite in the case of a liquidation but in the present case we are concerned with something rather more complex - there must be (1) statement (2) that there is a cancellation

(3) due to (3) the contractors default. This trigger event is not like “irrevocable letters of credit”. As I have pointed out, the liability of the insurer is very limited.

The guidance given to this court by Lombard supra is that one must be careful in scrutinizing the trigger event which may permit a demand in terms of the guarantee. The obligation to pay arises “provided only that the conditions specified in the credit are met” The trigger event in the

present case is very different to that in Lombard supra. The wording of the guarantee is decisive and it is to that which one must have regard. In Lombard supra the trigger event, the liquidation, did not permit of any debate or doubt – it had occurred. The principal building agreement was irrelevant.

As was said in Lombard supra, “The bank’s liability to the seller is to honour the credit. The bank undertakes to pay provided only that the conditions specified in the credit are met.”. I cannot see that the insurer, the defendant in this case, is not entitled to enquire and question and critique whether or not the conditions specified in the present guarantee have been met.

The guarantee may require no more of the employer in formulating its demand to the insurer than to “state” the fact of the cancellation and the reason therefore. That does not preclude the insurer from disputing such statement or defending any claim by challenging any one of the jurisdictional facts ie that there has been a cancellation and whose fault that is. The insurer cannot be precluded from ensuring that “the conditions specified” are met.

Absent the opportunity to plead any disputes concerning or the merits of the cancellation of the principal agreement, it would be open to any employer to cancel the principal building agreement as and when it chose, without justifiable or bona fide grounds, where there may be no default or where default may exist but not bring about or contribute to the cancellation and thereby be entitled to demand payment from the insurer and receive payment within seven days thereof.

That question arose in Dormell supra where there was a construction guarantee in identical terms to the one presently before the court¹³. There were delays in construction and the principal construction agreement was cancelled. However, the matter went

to arbitration where it was found that the employer had not been entitled to cancel the principal building agreement. The majority judgment referred to both Lombard supra and Loomcraft supra and concluded that in principle, the guarantee must be honoured as soon as the employer makes a proper claim against it upon the happening of a specified event. However, because the arbitration resulted in finding that the employer was not entitled

to cancel the building contract, the majority of the court found that “Its [the employers] repudiation of the building contract was held to have been unlawful. As a consequence, [the employer] has lost the right to enforce the guarantee.....”

The majority of the court in Dormell supra certainly had regard, explicitly, to the fate of the underlying building agreement and the dispute which had given rise to the cancellation. The court did not adopt a purely formalistic approach and accept that the employer, having sent a demand stating it had cancelled due to the contractors default, was therefore entitled to the guaranteed amount. Notwithstanding, that which was said in both Loomcraft supra and Lombard supra, the majority of the court in Dormell supra found that the principled approach must also be mindful of the factual situation.

In *Dormell supra* the majority of the court did not comment that *Loomcraft supra* was concerned with irrevocable letters of credit whilst *Lombard supra* was concerned with a liquidation as a trigger event. Nevertheless, it would seem that the approach in *Dormell supra* recognizes that the principles enunciated in the other judgments should not be slavishly followed irrespective of the relevant facts. One should be concerned to ensure that formalism in application of legal principles does not lead to a result that is either unfair or unjust or ineffective or patently inequitable.

In the present case, the fact is that there is only one ground permitted for cancellation which would render the insurer liable. That ground is the statement that cancellation is due to the contractor's default. All that is required is a statement. But, as has been exemplified in *Dormell supra*, that statement can be successfully challenged and the employer may be denied its claim to the guaranteed sum.

I am not persuaded that the defence set out in the defendant's plea, to which the plaintiff has excepted is a defence which is either precluded by the provisions of the guarantee or by our law as set out in the judgments to which I have referred.

It may be that there is more to be argued on the interpretation of the provisions of clauses 5 and 5.1 of the construction guarantee. It is understandable that the courts are generally reluctant to decide questions of interpretation at the time and in the course of exception proceedings. In the present case, I believe that to allow the defence to stand would enable a proper airing of this dispute. I cannot say that 'unnecessary evidence' would be led as a result. It may well be essential evidence which will dispose of the matter.

The plaintiff, as excipient, has pleaded that it will be prejudiced if it has to plead to defendant's plea as currently framed. Plaintiff submits that it will have to traverse the terms of the principal building agreement and the conduct of the

parties, ie the contractor and the employer, relevant to the termination in circumstances. Plaintiff maintains that such issues

are irrelevant to plaintiff's claim and any defences thereto. I am not so persuaded. The *Dormell* result is an example that one must always allow for the unexpected.

ESTOPPEL

Paragraph 3 of the defendant's plea was amended¹⁴ reading as follows:

"3.2 The defendant pleads, however, that, prior to the issue of the demand guarantee, the plaintiff, with the intent to persuade the defendant to issue the said guarantee, represented to the defendant that, in the event that the contract is cancelled with the contractor, the plaintiff irrevocably and unconditionally consented to Tusk Construction Support Services (Pty) Ltd and/or

National Urban Reconstruction and Housing Agency (Sect 21) and/or Joint Equity Investments in Housing (Pty) Ltd assuming all or any of the contractors responsibilities arising from the building contract.

The defendant, acting on the basis of the correctness of the aforesaid representation, issued the said guarantee. The aforesaid representation was false, in that the plaintiff did not intend to and in fact did not allow the aforesaid parties to assume the contractor's responsibilities under the building contract. In issuing the aforesaid guarantee pursuant to the aforesaid misrepresentation, the defendant acted to its detriment by assuming

a risk it would otherwise not have assumed. In the premises the plaintiff is barred, alternatively estopped from relying on the aforesaid guarantee."

Plaintiff has excepted to the plea, firstly on the basis that defendant cannot found an estoppel by representation by reference to intention or future intention and secondly, that these allegations amount to an attempt to introduce a term into the construction

guarantee which is in conflict with the terms thereof.

I am in agreement that these purported representations are in conflict with the written terms of the construction guarantee.

Should the defendant wish to rectify the guarantee then it must take the appropriate steps. It cannot plead an estoppel on these allegations.

Accordingly, I do not need to decide on whether or not the plea as set out in clause 3 deal with 'present fact' or 'future intention'.

COSTS

Normally costs would follow the result. In this application both parties have been substantially successful. The exception taken to paragraph 5 of the plea was the more complex and took both longer to argue and to consider. In that respect, the plaintiff (as excipient) has perhaps been more successful. However, to attempt to compute the matter by time would be clumsy.

I am mindful that this matter is coming to trial and then the wisdom and correctness of the matters raised in paragraph 5 of the plea will be adjudicated upon. However, I do not think there would be merit in reserving the costs of the exception for that time – what has been at issue now is not the merits of the dispute but the raising thereof. In any event this possibility was not argued before me.

Accordingly, I shall make no order as to costs.

ORDER

The exception to paragraph 5 of the Defendants amended plea is dismissed.

The exception to paragraph 3 of the Defendants amended plea is upheld, paragraph 3.2 – 3.6 are struck out.

There is no order as to costs.

Satchwell J

Date of hearing: 1 February 2011

Date of Judgment: 22 March 2011

Plaintiffs Attorneys: Bax Kaplan Incorporated

Plaintiffs Counsel: E A S Ford SC

Defendants Attorneys: Larson Falconer Inc

Defendants Counsel: A J Troskie SC

1 The papers comprising the court file are a total mess. In the morass of loose pleadings and documents I have been unable to find, for instance, the principal building agreement. By reason of the workload of this division and my presiding without pause in court each day since the hearing of this matter, I have not spent time tidying up the file or arranging for an attorney so to do.

2 Annexure A to the Particulars of Claim.

3 Annexure B to Particulars of Claim.

4 It is possible that words are missing from the photocopied version of Annexure B.

5 Annexure C to Particulars of Claim.

6 What is identified as the “Defendants amended Plea” in the Index at pages 17 -22 has no court stamp, and the last page is simply dated “.....December 2009”.

7 This is apparently a reference to clause 3.1 of the guarantee which provides that “any reference in this Guarantee to the Agreement is made for the purpose of convenience and shall not be construed as any intention whatsoever to create an accessory obligation or any intention whatsoever to create a suretyship”.

8 In both Lombard supra and Dormell supra were found clauses, as in the present case, that any reference to the principal construction

agreement in the guarantee was for convenience only and created no accessory or suretyship obligations.

9 Reference to Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd and others 2001(2) SA 760 C is of no assistance since the guarantee in that case quite obviously did not have the same clause as in Lombard supra, Dormell supra and the present matter to the effect that any reference to the principal construction agreement was for convenience only and created no accessory or suretyship obligations. In Basil Read supra, the court found that “the guarantee is in the nature of a suretyship and any obligation of the insurer to the employer was accessory to that of the contractors” with the result that the “insurer is liable to the employer only if and to extent the contractor is liable to the employer”.

10 In discussion of the system of irrevocable documentary credits.

11 Clause 8 provides that the plaintiff “shall have the absolute right to arrange his affairs with the contractor in any manner which [the plaintiff] deems fit and [the defendant] shall not have the right to claim his release from this construction guarantee on account of any conduct alleged to be prejudicial to [the defendant]”.

12 Clause 5.2

13 Attached to and for use with the JBCC Principal Building Agreement.

14 Again on an unknown date

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