REPUBLIC OF SOUTH AFRICA

SOUTH GAUTENG HIGH COURT
JOHANNESBURG

CASE NO: 2009/12141

(1) REPORTABLE: YES / NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED.

11.9.2012
DATE

SIGNATURE

In the matter between:

EAST LONDON OWN HAVEN
t/a OWN HAVEN HOUSING ASSOCIATION Plaintiff

and

COFACE SOUTH AFRICA INSURANCE CO LTD Defendant

J U D G M E N T

LAMONT, J:

[1] Prior to the commencement of the trial the defendant brought an application to amend the defendant's plea.

[2] The plaintiff instituted proceedings against the defendant claiming payment of money due and owing under a construction guarantee. Under and in terms of the guarantee the defendant was to make payment to the plaintiff of R1 172 583,80 in the event of the principal building agreement concluded between the plaintiff and the contractor being cancelled for default on the part of the contractor. Payment was to be effected in full:

> *"Upon receipt of a first written demand from the employer to the guarantor at the guarantor's domicilium citandi et executandi 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 ... The demand shall enclose a copy of the notice of cancellation. The construction guarantee with the required demand notices 'shall be regarded as a liquid document for the purpose of obtaining a court order'."*

[3] In the amendment the defendant sought to introduce a defence to the claim on the basis that:

3.1 The final amount payable by the contractor to the plaintiff was finally determined by the issue of a final payment certificate (incorrectly labelled interim payment certificate) which certificate purported to set out an amount constituting the recovery of an overpayment by the plaintiff to the contractor which is due by the contractor to the plaintiff.

3.2 That a recovery statement had been issued simultaneously with that certificate reflecting an amount of R nil recoverable by the plaintiff from the contractor as damages.

3.3 That the issue of the certificate finally determined that the contractor did not owe any amount to the plaintiff as a result of the alleged breach of contract by the contractor.

3.4 In the premises the defendant was not obliged to make the payment in terms of the guarantee as the indebtedness due to the plaintiff by the contractor did not fall within its terms.

[4] Initially in its affidavit motivating the application the defendant claimed that the payment certificate was a final certificate as it had been described as such by the plaintiff. The defendant for purposes of the argument accepted that there had been a misdescription by the plaintiff and that the payment certificate in question was an interim certificate as contemplated by the building contract. Under and in terms of the recovery statement (a document which is to be read together with the payment certificate as it is the underlying document) nil amount, was shown as being due by the contractor to the plaintiff in respect of damages (this was Certificate 6 dated 10 October 2008).

[5] The parties accepted that the construction guarantee contract was of the type pursuant to which the plaintiff would be entitled to payment from the defendant upon compliance with the requirements triggering the obligation for payment which have been set out above namely the receipt of the first written demand stating the matter which is required and a copy of the notice of cancellation. (See for example *Ocean Diners (Pty) Ltd v Golden Hill*

Construction CC 1993 (3) SA 331 (A)). This characterization of the nature of the guarantee is correct.

[6] On the face of it the defendant was obliged to make payment on receipt of the relevant documentation and was not entitled to raise a defence of the nature it seeks now to introduce.

[7] The defendant submitted however that Certificate 6 though it is an interim certificate reflected a nil balance (for present purposes) and that notwithstanding its status as an interim certificate it had become a final certificate by reason of no further certificate ever having been issued. The defendant submitted that in accordance with *Shelagatha Property Investments CC v Kelly Wood Homes (Pty) Ltd; Shelfaerie Property Holdings CC v Midrand Shopping Centre (Pty) Ltd* 1995 (3) SA 187 (A) at 192 that the rights contained with in the interim certificate constituted accrued rights. Even if there was a right to change the interim certificate by reason of its temporary nature such change had not been effected.

[8] Founded on this submission the defendant submitted further that the right which had accrued to the contractor was to make R nil payment in respect of damages for its breach of contract. Hence, to compel it to make payment to the plaintiff would be an academic exercise without practical effect as the plaintiff would be obliged immediately on receipt to repay the full amount as it had no entitlement thereto. This submission was based squarely

upon *Dormell Properties 282 CC v Renasa Insurance Co Ltd and Others* [2011] 1 All SA 557 (SCA).

> *"[38] A guarantee couched in the exact terms as the one under discussion, a JBCC Series 2000 pre-printed guarantee, and the circumstances under which a claim could be made on it, was described by this court in Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd and Others 2010 (2) SA 86 (SCA) at para 20, where Navsa JA said:*
> *'[20] The guarantee by Lombard is not unlike irrevocable letters of credit issued by banks and used in international trade, the essential feature of which is the establishment of a contractual obligation on the part of a bank to pay the beneficiary (seller). This obligation is wholly independent of the underlying contract of sale and assures the seller of payment of the purchase price before he or she parts with the goods being sold. Whatever disputes may subsequently arise between buyer and seller is of no moment insofar as the bank's obligation is concerned. 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. The only basis upon which the bank can escape liability is proof of fraud on the part of the beneficiary. This exception falls within a narrow compass and applies where the seller, for the purpose of drawing on the credit, fraudulently presents to the bank documents that to the seller's knowledge misrepresent the material facts.*
> *[21] In the present case Lombard undertook to pay the Academy upon Landmark being placed in liquidation. Lombard, it is accepted, did not collude in the fraud. There was no obligation on it to investigate the propriety of the claim. The trigger event in respect of which it granted the guarantee had occurred and demand was properly made.'*
> *In Loomcraft Fabrics CC v Nedbank Ltd and Another 1996 (1) SA 812 (A) ([1996] 1 All SA 51) at 815G - J Scott AJA said:*
> *'The system of irrevocable documentary credits is widely used for international trade both in this country and abroad. Its essential feature is the establishment of a contractual obligation on the part of a bank to pay the beneficiary under the credit (the seller) which is wholly independent of the underlying contract of sale between the buyer and the seller and which assures the seller of payment of the purchase price before he parts with the goods forming the subject-matter of the sale. 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 or confirming the credit, the bank undertakes to pay the beneficiary provided only that the conditions specified in the credit are met. The liability of the bank to the beneficiary to honour the credit arises upon presentment to the bank of the documents specified in the credit, including typically a set of bills of lading, which on their face conform strictly to the requirements of the credit. In the event of the documents specified in the credit being so presented, the bank will escape liability only upon proof of fraud on the part of the beneficiary.'*
> *See further Petric Construction CC t/a AB Construction v Toasty Trading t/a Furstenburg Property Development and Others 2009 (5) SA 550 (ECG) para 27.*

[39] 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. In the present case there is no suggestion that Dormell did not properly demand payment of the guaranteed sum. In the normal course of events payment should have been effected within seven days of demand.
[40] However, the facts of this matter are unusual because the arbitration of the dispute between Dormell and Synthesis resulted in the finding that the appellant was not entitled to cancel the building contract. The arbitration is final, not subject to appeal, and has not been taken on review. A second leg of the arbitration, dealing with outstanding claims arising from the building contract, was also decided in Synthesis' favour. The question must thus be answered whether Dormell is entitled to persist in claiming payment of the guarantee, notwithstanding the fact that it has been held to have repudiated the contract which was lawfully cancelled by the second respondent.
[41] There is no longer any dispute about the cancellation of the underlying agreement that still has to be resolved. The arbitration has established that Dormell is in the wrong. Its repudiation of the building contract was held to have been unlawful. As a consequence, Dormell has lost the right to enforce the guarantee. There remains no legitimate purpose to which the guaranteed sum could be applied.
[42] If it were to be ordered to honour the guarantee, Renasa or Synthesis would be entitled to repayment of the full amount guaranteed. Hudson & Wallace Hudson's Building and Engineering Contracts 11 ed para 17.078, quoted in Cargill International SA and Another v Bangladesh Sugar and Food Industries Corp [1996] 4 All ER 563 (QB Com Ct) at 570b - f states:
'It is generally assumed, and there is no real reason to doubt, that the Courts will provide a remedy by way of repayment to the other contracting party if a beneficiary who has been paid under an unconditional bond is ultimately shown to have called on it without justification . . . . In cases where there has been no default at all on the part of the contractor, there would additionally be a total failure of consideration for the payment.'
See further General Surety & Guarantee Co Ltd v Francis Parker Ltd (1977) 6 BLR 18 (QBD Commercial List) at 20.
Further written argument after the hearing
[43] In the light of the above considerations, the court requested the parties to present further written argument on the question whether, if the appellant were to succeed, the resultant judgment would have any practical effect or not, as any payment made by Renasa would have to be repaid by Dormell. Reference was made to clause 7 of the guarantee in this regard. Counsel for Synthesis pointed out that Renasa or Synthesis' claim to repayment does not arise from this clause, but from the fact that Dormell is no longer entitled to payment. The court is indebted to counsel for their further heads of argument.
[44] Dormell submits that the guaranteed sum could and should be devoted to the payment of claims that might be found to exist once a final certificate is prepared, regardless of the question whether the enforcement of the guarantee was indeed justified by a breach on the part of the contractor or not. Reference was made to a number of clauses in the construction contract in this regard. The short answer to this submission is that the guarantee is intended to enable the employer to complete the contract in case of default by the contractor. Claims arising after a breach by the employer are matters for arbitration. The guarantee is not intended to provide a source of funds for the payment of any outstanding amounts that might be due by the contractor to the employer - of which there is no evidence in any event, apart from an oblique reference to potential future claims by the employer against the contractor in correspondence.

> *[45] It would amount to an academic exercise without practical effect if Dormell were to be granted the order it seeks. It would immediately have to repay the full amount to Renasa or Synthesis. Such an order would, at best, cause additional cost and inconvenience to the parties, without any practical effect. In terms of s 21A of the Supreme Court Act 59 of 1959 the court must exercise its discretion against Dormell: Port Elizabeth Municipality v Smit 2002 (4) SA 241 (SCA).*

[9] In that *Dormell* matter there was no dispute between the parties about the fact that the plaintiff had no entitlement (paragraph [41]). In that case the documentation founding the claim certified the cancellation of the underlying agreement by the owner pursuant to a breach by the contractor. An arbitration was held. The outcome of the arbitration was a finding that the owner had repudiated the contract. As a consequence no damages could ever be due by the contractor to the owner. The guarantee had been issued to enable the owner to recover damages in the event it correctly cancelled the contract in consequence of a breach by the contractor. The submission of the defendant is that the facts in the present case are the same. The interim certificate recognises that there is no amount due by the defendant to the plaintiff, hence the plaintiff is not entitled to recover payment from the contractor, and hence the defendant should be allowed to raise this defence.

[10] In order to decide whether or not I should allow the defendant the amendment I must come to the conclusion that the allegations in the amendment establishes incontrovertibly that running the trial constitutes an academic exercise without practical effect as any finding that the defendant should pay will immediately be overtaken by an obligation on the plaintiff to repay any amount paid.

[11] The plaintiff has set out facts in an affidavit disputing the claims of the defendant that the judgment sought constitutes academic relief.

[12] Does the fact that there is a dispute between the parties as to the right of the defendant to repayment, affect the right of the defendant to the amendment? If there is a dispute, can it be said that from the state of affairs pleaded to run a trial will be an academic exercise without practical effect? It is apparent from the affidavits and submissions that there is a dispute between the parties as to the effect and status of the documents the defendant seeks to introduce. Normally a pleader would not have to prove that which he pleads; he need only set out allegations which if proven would constitute a defence. If however the allegation necessary to raise the defence is that as a fact there is no dispute, the pleader may have to plead and show that the facts on which he relies cannot be challenged. If the facts are capable of challenge it may be that the pleader has not pleaded that the facts required to found the defence have been established.

[13] The purpose of the construction guarantee contract is to enable the plaintiff to readily obtain payment by production of the documents required containing the matter required. It would relegate the "*demand bonds*" to "*conditional bonds*" were it different. See the discussion in *Minister of Transport and Public Works Western Cape and Another v Zanbuild Construction (Pty) Ltd* 2011 (5) SA 528 (SCA) paragraph [13] and following.

[14] This demand guarantee is enforceable according to its terms. See for example *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 at paragraph [10] and following. The introduction of extraneous issues as a defence is save for the very limited exceptions (like fraud) impermissible. The reason for this is readily ascertainable. Building contracts are constructed to facilitate a regular cash flow to the contractor during execution of the works. (In terms of a contract that does not contain express terms regulating payment, the contractor until the last brick has been laid, even in a multimillion Rand contract, is not entitled to be paid a cent). There are checks on the right of a contractor to interim payments which are contractually set up in the form of the certifying process (usually by a third party). In this way there is a strict relationship maintained between the payments and the extent to which works have been satisfactorily completed. The third party needs to be able to adjust interim certification from time to time to maintain the relationship between amount paid and the value of the works and is able by way of the issue of further interim certificates from time to time to maintain that relationship. Overvaluations and undervaluations are able to be and often are adjusted. There is a great flexibility in this process. As flexible as that process is, so rigid is the consequence of certification when it comes to payment. Each certification independently creates rigid payment obligations. This rigidity ensures the regular cash flow while the flexibility (by way of the issue of late certificates) relating to state of work maintains the relationship between money paid and work done. The interim certificate does not finally determine the final indebtedness due. It is merely an instrument triggering a payment. It is fallacious for this reason to perceive an interim

certificate as finally determining the amount of the debt due: it only determines an amount provisionally due on the basis of an interim valuation and is the trigger for the payment of that amount. The fact that a certificate reflects the damages due by the contractor to the plaintiff as being R nil at best determines that provisionally R nil is due and no more. It does not finally determine whether or not damages have been suffered or any of the underlying facts which would result in an amount of damages being due.

[15] In *Dormell's* case it was common cause what the outcome of the hearing would be as it was common cause that it was impossible for the plaintiff to establish an entitlement to the funds which underlay its claim for payment. In the present matter the entitlement of the plaintiff to payment is not finally determined by the interim Certificate 6. An interim certificate is subject to variation. There is accordingly not final determination as to the entitlement of the plaintiff to be paid damages.

[16] The interim certificate did not become a final certificate by reason of no further certification.

[17] The contract provides what should happen in the event of cancellation. The terms of the contract must be considered, in considering what the effect of the acts performed under it is. See: *Thomas Construction (Pty) Ltd (in Liquidation) v Grafton Furniture Manufacturers (Pty) Ltd* 1988 (2) SA 546 (A).

[18] Paragraph 36.5 of the contract provides for the following:

"*36.5 Where this agreement is cancelled in terms of 36.0 the following shall apply:*

...

36.5.2 *The principal agent shall forthwith compile a report on the status of the portion of the works executed by the contractor and shall issue such a report to the employer and the contractor.*

36.5.3 *On completion of the status report the principal agent shall commence forthwith and complete a final account within a reasonable time.*

36.5.4 *The contractor shall not be relieved of any of his liabilities concerning that portion of the works executed by the contractor.*

36.5.5 *The employer may employ other parties to safeguard the works, complete the outstanding work and rectify defects in that portion of the works executed by the contractor. The cost of work thus carried out shall be certified by the principal agent and paid direct to such parties in terms of 35.0.*

...

36.5.7 *When instructed by the principal agent the contractor shall remove from the site* [various equipment] *within such reasonable time as determined by the principal agent, in default of which the employer, without being responsible for any loss or damage may have the same removed and sold. The nett profit or loss of such sale shall be for the account of the contractor.*

36.5.8 *Where applicable in terms of 30.1 the employer shall be entitled to apply the penalty up to the date of cancellation and thereafter may recover damages from the contractor including but not limited to extra costs incurred in the completion of the outstanding work.*

36.5.9 *The principal agent shall issue no further payment certificates until the quantum of damages in terms*

> *of 36.5.8 has been determined and the final account in terms of 36.5.3 has been completed. The final payment certificate shall then be issued."*

[19] It is apparent from the aforegoing terms that the parties contemplated that subsequent to the interim certificate a variety of steps would take place which once they had reached completion would result in further certification of amounts. Those steps have never been taken in relation to the contractor. The fact that those steps have not been taken does not in my view convert the interim certification into a final certification. The contract itself contemplates that the rights of the parties are not finally determined by the interim certificate and that no further payment certificates (a reference to interim certificates) shall be issued.

[20] In the light of this finding I am unable to find that:

1. the fact that no further certificate was issued rendered interim certificate number 6 a final certificate,
2. the fact that R nil is reflected as being due as and by way of damages finally determined the right of the plaintiff both as to extent and quantum of damages due to the plaintiff,
3. allegations have been made establishing that to run a trial will be an academic exercise on the basis that whatever amount is paid will have to be repaid.

[21] The proposed amendment does not make allegations to set up the defence contemplated by *Dormell's* case.

[22] It is in addition common cause that the facts with which I have been furnished are the relevant facts which it would be proposed to produce at the hearing. If those facts were produced at the hearing in my view no defence would be made out.

[23] It remains to consider the question of prejudice. The refusal to permit the defendant to raise the defence it seeks to raise in the present hearing does not bar the defendant from in due course making such claims as it may wish, to recover payments made. It at best suffers the prejudice of being compelled to pay and being out of pocket pending success in its claim assuming it can establish that no damages were suffered by the plaintiff.

[24] The very reason the construction guarantees are concluded is to determine who should have money at the expense of whom pending the finalisation of any dispute as to the entitlement thereto ultimately. In the present case the contract as framed was designed to ensure payment to the plaintiff leaving the defendant free to take whatsoever further steps it wishes in relation thereto. Implementation should be given by this Court to that intention. In *Trans-Drakensberg Bank Ltd (under judicial management) v Combined Engineering (Pty) Ltd and Another* 1967 (3) SA 632 (D) the aim of allowing an amendment was to do justice to the parties by enabling the ventilation of the real issues between them. The real issues do not include the issues the defendant seeks to raise.

[25] The parties are in agreement that if I refuse the application for amendment the plaintiff is entitled to judgment in the terms set out below.

[26] I make the following order:

1. The application to amend is dismissed.

2. The defendant is to pay the costs of the application including the costs consequent upon the employ of senior counsel.

3. The defendant is ordered to pay the plaintiff:

   3.1 Payment of R1 172 583-80;

   3.2 Interest on the aforesaid amount at the rate of 15.5% per annum from 6 February 2009 to date of payment;

   3.3 Cost of suit including the qualifying fees of Dean Arthur Jacoby.

C.G. LAMONT
JUDGE OF THE SOUTH GAUTENG
HIGH COURT, JOHANNESBURG

COUNSEL FOR APPLICANT : Adv. Ford SC

APPLICANT'S ATTORNEYS	:	Geo Isserow & T L Friedman Inc
COUNSEL FOR RESPONDENT	:	Adv. Ellis SC
RESPONDENT'S ATTORNEYS	:	Larson & Falconer Inc
DATE OF HEARING	:	28 August 2012
DATE OF JUDGMENT	:	13 September 2012