THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

JUDGMENT

Case no: 343/08

LOMBARD INSURANCE COMPANY LIMITED	Appellant
and	
LANDMARK HOLDINGS (PTY) LTD	First Respondent
HAY TREVOR BRUCE	Second Respondent
THE TRUSTEES FOR THE TIME BEING OF THE PRINGLE BAY TRUST	Third Respondent

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Neutral citation: *Lombard v Landmark & others* (343/08) [2009] ZASCA 71 (1 June 2009)

CORAM: Navsa, Nugent, Lewis, Jafta *et* Ponnan JJA

HEARD: **21 May 2009**

DELIVERED: **1 June 2009**

CORRECTED:

SUMMARY: **Construction guarantee and indemnities – construed independently of construction contract – undertaking to pay upon the happening of an event – obligation to honour undertaking.**

ORDER

On appeal from: High Court, Cape Town (Potgieter AJ sitting as court of first instance).

1. The appeal is upheld with costs, including the costs occasioned by the employment of two counsel.

2. The order of the court below is set aside and substituted as follows:

'Judgment is granted against the first, second, and third respondents, jointly and severally, the one paying the others to be absolved in accordance with prayer 1 of the notice of motion.'

JUDGMENT

NAVSA JA (Nugent, Lewis, Jafta and Ponnan JJA concurring):

[1] This appeal, with the leave of the court below, turns on the interpretation and application of certain documents. The background is set out hereafter.

[2] The appellant company (Lombard) is registered as a short-term insurance company in terms of the Short Term Insurance Act 53 of 1998 and is thus entitled to issue guarantee policies as defined in that Act.[1] During 2002 the appellant issued a construction guarantee on behalf of Landmark Construction (Pty) Ltd (Landmark), a construction company, in favour of the South African Maritime Training Academy (the Academy). The basis for the guarantee was a construction contract[2] concluded between Landmark and the Academy, with the latter being the employer and the former the contractor. The building work undertaken was a two-storey training centre for the

[1] In terms of s 1 of the Act 'guarantee policy' means 'a contract in terms of which a person, other than a bank, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the policy as a risk relating to the failure of a person to discharge an obligation, occurs.'

[2] The agreement was a JBCC series 2000 contract.

Academy. In terms of the construction contract the principal agent was Herbert Penny (Pty) Ltd (HP).

[3] The construction contract records that the Academy shall have the right to select security for the fulfilment of the contractor's obligations. Clause 14.5 of the contract records that the security 'shall be for the due fulfilment of the contractor's liability in terms of the agreement'. The guarantee referred to in para 2 above was the security selected by the Academy. It is in the form of a variable construction guarantee in terms of which the maximum liability is limited to the diminishing amounts of the guaranteed sum in relation to certificates of completion, as provided for in the guarantee itself.

[4] Subject to the maximum liability provided for, Lombard bound itself as principal debtor in favour of the Academy. It undertook to pay the Academy, on demand, the guaranteed sum or the full outstanding balance upon the happening of one of two eventualities, namely, default by Landmark resulting in cancellation, or a liquidation order being granted against Landmark.

[5] The following clause in the guarantee is of importance:

'3. The Guarantor hereby acknowledges that:

3.1 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

3.2 Its obligation under this Guarantee is restricted to the payment of money

3.3 Reference to a practical completion certificate or to a final completion certificate shall mean such certificate as issued by the Principal Agent.'

[6] On 14 October 2003, HP issued a certificate of practical completion, but prior to that Landmark was placed in liquidation.

[7] On 17 March 2004 the Academy called up the guarantee, recording in its demand that Landmark had been placed in liquidation, that a final completion certificate had not been issued and that consequently an amount

of R241 429.77 was due to it by Lombard, purportedly the value of work done post the issue of the practical completion certificate.

[8] Prior to all of this, during April 1999, the first respondent, Landmark Holdings (Pty) Ltd (LH), executed a document entitled 'RECIPROCAL INDEMNITY AND SURETYSHIP' in favour of Lombard, in terms of which LH undertook to 'indemnify and keep indemnified [Lombard] and hold it harmless from and against all and any claims, losses, demands, liabilities, costs or any other expenses of whatsoever nature, including legal costs as between attorney and client, which [Lombard] may at any time sustain or incur by reason or in consequence of having executed or hereafter executing any guarantees...'. Further, LH undertook and agreed to pay Lombard on demand any sum which the latter may have been called upon to pay under any guarantee, whether or not the contractor on whose behalf Lombard furnished the guarantee admitted the validity of the claim.

[9] During April 1999, Hay and the third respondent, the trustees for the time being of the Pringle Bay Trust (the trust), executed two written documents in similar terms in favour of Lombard. Although both documents bear the title 'DEED OF SURETYSHIP' they have the following identical feature. In both, Hay and the trust undertook as principals, to 'indemnify' Lombard against 'any claims of whatsoever nature' which Lombard may incur by reason of it having executed or in the future executing any guarantee.

[10] On 25 March 2004, subsequent to the demand referred to in para 7 above, Lombard paid the Academy the amount of R241 429.77.

[11] On 5 April 2004 Lombard addressed a demand to LH, Hay and the trust, in terms of the Reciprocal Indemnity and Suretyship documents referred to in paras 8 and 9 above.

[12] They all refused to pay, resulting in an application to the Cape High Court in terms of which Lombard claimed against them, jointly and severally,

the one paying the other to be absolved, payment in the sum of R241 429.77 with interest, and costs on the scale as between attorney and client.

[13] The application was opposed on a number of grounds. The only one with which we need be concerned and on which this appeal turns is that the claim in respect of which Lombard paid was invalid due to a fraud perpetrated by HP with the consequence, so it was alleged, that neither Lombard nor the respondents were liable to pay. The details of the fraud are set out in the following two paragraphs.

[14] Although Landmark was responsible for performing remedial work it did not have an obligation, in terms of the construction contract, to do work in relation to a change in design specifications. This would be work beyond the terms of the construction contract. It was uncontested that the work in respect of which the claim was made upon Lombard related to the replacement of glass and other materials in an atrium within the Academy training centre. The glass and materials that were replaced were within the design specifications of the construction contract. The problem was that, after the atrium was completed, it proved unsuitable in that it was too hot and required further ventilation. It required glass that was substantially thicker and other materials in order to overcome the original design flaws in the construction contract. A further significant design change was that horizontal sliders were to replace vertical sliders, apparently to facilitate ventilation.

[15] The redesigning of the atrium, with the concomitant change in constituent materials, was beyond the terms of the construction contract and Landmark's responsibility. HP, in order to overcome the problem, appears to have perpetrated a fraud in order to obtain the benefits of the construction guarantee. HP framed the claim as one relating to remedial work, which it clearly was not.

[16] The court below, in dealing with the application, referred one issue to oral evidence, namely, whether Lombard had colluded in the fraud

perpetrated by HP. Evidence was led and, upon its conclusion, the parties accepted that collusion had not been proved.

[17] Before Potgieter AJ, it was contended on behalf of Lombard, that the documents executed by Lombard and the respondents were self-contained and created obligations distinct and separate from those created by the construction contract. In terms of the guarantee Lombard undertook to pay upon the occurrence of an event that materialised, namely, the liquidation of Landmark. It was submitted that Lombard was obliged to pay when called upon to do so by the Academy and the three respondents were in turn obliged to pay Lombard.

[18] The court below decided the matter on the basis that the guarantee must be interpreted in conjunction with the construction contract. With reference to clause 14.5 referred to in para 3 above, the court below held that Lombard was only obliged to pay a claim under the guarantee if the claim was within the terms of the construction contract. It reasoned that, because the claim did not fall within that purview, Lombard was not obliged to pay and, consequently, neither was any one of the respondents.

[19] In my view the court below misconstrued the nature of the guarantee and the indemnities provided by the three respondents. The terms of the guarantee by Lombard referred to in paras 2, 3 and 4 above are clear. The guarantee creates an obligation to pay upon the happening of an event. The guarantee itself records that reference to the construction contract is solely for the purpose of convenience and that there is no intention to create an accessory obligation or suretyship. Clause 14.5 of the construction contract merely records that security exists in respect of the contractor's obligations. The guarantee was to protect the Academy in the event of default by Landmark and it is to the guarantee that one should look to determine the rights and obligations of the Academy and Lombard.

[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 misrepresents the material facts.[3]

[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.

[22] The same applies to the undertaking by the three respondents. They undertook to indemnify Lombard in the event that it paid a claim based on the guarantee provided by it. That event occurred and the respondents were thus likewise liable.

[23] In light of the reasoning set out above there is no need to address the constitutionality of the wording of the indemnities provided by the three respondents. It was contended that the wording was such as to render the clauses in question unconscionable, unduly harsh and prejudicial, against public policy, *contra bonos mores* and offensive to the respondents' constitutional rights. This submission was based on a mistaken view of the basis of the indemnity. Nothing further need be said on this issue.

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[3] *Loomcraft Fabrics CC v Nedbank Ltd & another* 1996 (1) SA 812 (A) at 815G-816G.

[24] There is one final aspect in respect of costs to be considered. It was contended on behalf of the appellant that the decision in the court below materially affected the manner in which it did business, that it impacted on the industry as a whole and that it was consequently necessary to employ two counsel. I agree.

[25] In the result the appeal should succeed. The following order is made:

1. The appeal is upheld with costs, including the costs occasioned by the employment of two counsel.
2. The order of the court below is set aside and substituted as follows:

‘Judgment is granted against the first, second, and third respondents, jointly and severally, the one paying the others to be absolved in accordance with prayer 1 of the notice of motion.’

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M S NAVSA
JUDGE OF APPEAL

APPEARANCES:

For Appellant:	Panayiotis Stais SC C J McAslin Instructed by Frese, Moll & Partners c/o Butler Blankenberg Cape Town Webbers Attorneys Bloemfontein
For Respondent:	Peter J Berthold SC Instructed by DLA Cliffe Dekker Hofmeyer Cape Town McIntyre & Van der Post Bloemfontein