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IN THE HIGH COURT OF SOUTH AFRICA
(WESTERN CAPE HIGH COURT, CAPE TOWN)

CASE NO: 2083/2009

In the matter between:

ZANBUILD CONSTRUCTION (PTY) LTD	Applicant
and	
ABSA BANK LIMITED	1st Respondent
MINISTER OF TRANSPORT AND PUBLIC WORKS: PROVINCIAL GOVERNMENT OF THE WESTERN CAPE	2nd Respondent
THE HEAD OF THE DEPARTMENT OF TRANSPORT AND PUBLIC WORKS: PROVINCIAL GOVERNMENT OF THE WESTERN CAPE	3rd Respondent

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JUDGMENT DELIVERED ON THE 19th DAY OF JUNE 2009

LOUW, J:

[1] The applicant, a company which carries on the business of a building contractor seeks final relief on notice of motion against the respondents, ABSA Bank Limited (ABSA), a commercial bank and authorised financial service provider, the Minister of Public Works and Transport: Provincial Government of the Western Cape, who is cited in his capacity as the political head of the Department of Public Works and Transport (the department) and the third respondent who is the head of the department.

[2] ABSA abides the decision of the court. The second and third respondents (to whom I shall refer together as the respondent) oppose the application and have filed opposing papers. There is in my view correctly, no challenge to the applicant's standing to approach the court for the kind of relief sought by it.

[3] After a tender process the department awarded two separate but substantially identical construction contracts {the main contracts) to the applicant on 27 January 2007 to construct pathology laboratories at the Eben Donges Hospital in Worcester (the Worcester project) and the T C Newman hospital in Paarl (the Parl project).

[4] The terms of the main contracts are for present purposes identical and are to found in a number of documents, including the standard terms of clauses 1 to 41 of the JBCC Series 2000 Principal Building Agreement (Edition 4.1 of March 2005). Two versions of the JBCC contract appear in the papers. The one is put up by the applicant and the other by the department. The two versions differ in one material respect that is relevant to these proceedings:

1. The 'State substitutions' in clause 41 of the version attached to the applicant's founding papers deletes clause 14 and refers to a 'Replacement Addendum' (at page 16). The bill of quantities ('LB 17') includes the replacement clause 14, which 'replaces' the original clause 14 in the JBCC contract.
2. The JBCC version attached to the respondents' papers does not contain the exclusion and sets out a clause 14.

[5] The difference between these two versions is not critical, and it is not necessary to resolve which version is correct. Both versions require that the applicant provide separate construction guarantees in respect of each of the projects and set out different types of security to be chosen from and in

each case set out the steps necessary to exercise the guarantee chosen and the steps that must be taken to secure a claim made by the department for payment. It is made clear that the guarantees can be invoked to secure claims under clause 33 of the JBCC contract. Clause 33 in turn refers to various types of contractual claims including claims for expenses and loss, inter alia, flowing from the cancellation of the contract under clause 36 of the JBCC contract. Relevant to this case is clause 15.3 which requires the contractor to proceed with the work with

> 'due skill, diligence, regularity and expedition.

Section 36.1 of the construction contract provides that where the applicant fails to comply with clause 15.3, the department may cancel the contract. Clause 36.2 provides for the principal agent to issue a notice of default where the department considers cancelling the contract by reason of a failure to proceed with the work as provided for in clause 15.3.

Clause 36.3 provides that the principal agent may give notice of cancellation if the applicant should

> 'remain in default for ten (10) working days after the issue of such a notice of default.'

Finally, clause 36.5 sets out in detail the procedure to be followed in the event of a cancellation of the construction contract under clause 36.1.

[6] The applicant arranged for ABSA to issue two separate guarantees worded in identical terms, on 19 February 2007 to the department. The guarantees are signed by the representatives of ABSA and by the representative of the applicant who stated that the applicant 'agrees with

the terms and conditions of this guarantee'. The guarantees are not one of the options mentioned in clause 14 of the main contract.

[7] For ease of reference I shall hereinafter refer to the main contracts and to the guarantees in the singular.

[8] The guarantee relating to the Worcester project, which has a contract value of R 11 811 048,00, secured 10% of the contract value – i.e. R 1 181 104,80. The second guarantee, relating to the Paarl project, which has a contract value of R 1 1 065 000,00, secured 10% of the contract value – i.e. R 1 106 500,00.

[9] The guarantee refers back to the main contract and records that the main contract requires the contractor to provide the employer with a bank guarantee of I0% of the contract value

> '. . . as security for the compliance of the Contractor's performance of obligations in accordance with the contract'.

and that ABSA is willing to provide such a guarantee

> '. . .which is equal to I0% of the contract value, under certain conditions stipulated hereafter . . .'

ABSA thereupon binds itself

> '. . . as guarantor for the due and faithful performance by the Contractor of all its obligations in terms of the said Contract subject to the following conditions:
>
> 1. The employer shall, without reference and/or notice to us have complete liberty of action to act in any manner

authorised and/or contemplate by the term of the said contract and/or to agree to any modifications, variations, alterations, directors, or extensions of the due completion date of the works under the said contract and his rights under this Guarantee shall no way be prejudiced, provided that should the Employer extend the due completion on date he will be required to request a new Guarantee from the Bank.

2. The employer shall be entitled without reference to us, to release any securities held by him to grant extension of time to/or compound or to make any arrangements with the Contractor. The Guarantee shall remain in full force and effect until date of expiry as set out in number 5 below.
3. Our total liability hereunder shall not exceed:
    - ...
    - ...(for purposes of this case, 10% of the contract value).
4. All payments issued by the Employer to the Contractor must be credited and paid directly to the Contractor's ABSA Bank Account Number […….].
5. This guarantee shall lapse upon the issue of a certificate of First Delivery by the EMPLOYER as stipulated in terms of the Contract number ...

This guarantee is neither negotiable nor transferable and must be surrendered to the THE BANK in the event of the full amount of the Guarantee being paid to the EMPLOYER.

With each payment under this Guarantee THE BANK'S obligation shall be reduced pro-rota.

Each claim by the EMPLOYER must be made in writing accompanied by a signed statement that the Contractor has

> failed to fulfil his obligations in terms of the Contract and shall be sent to THE BANK'S domicilium address as indicated below.
>
> …….
>
> THE BANK reserves the right to withdraw the Guarantee after the EMPLOYER has been given 30 (thirty) days written notice of its intention to do so, provided the EMPLOYER shall have the right to recover from THE BANK, the amount owing and due to the EMPLOYER by the Contractor on the date the notice expires.

[10] The commencement dates of the main contracts were 7 March 2007 and the initial completion dates were 24 and 30 March 2008, respectively. The completion dates were extended on more than one occasion and finally, despite negotiation regarding further extensions, the department purported to cancel both contracts on 9 October 2008 at a stage when the projects had reached 76,4% of completion on the Paarl project and 79,6% completion on the Worcester project, respectively.

[1 1] The applicant disputes that valid grounds existed for the department to cancel the main contracts, but has in turn accepted the purported cancellations as repudiations, and has cancelled the contracts. It is therefore common cause that the main contracts have come to an end.

[12] On 28 August 2008, ABSA exercised its right in terms of the guarantee to give written notice that the guarantee would come to an end at the expiration of the 30 days notice period on 28 September 2008.

[13] By letter dated on 26 September 2008 i.e. two days before the expiration of the notice period and also before the cancellation of the

construction contracts on 9 October 2008, the department gave notice to ABSA that it was calling up the entire amounts secured by the guarantees.

[14] The relevant part of the demand reads as follows:

> The contractor has defaulted, see attached Annex 'A ', but the contracts have not been cancelled yet. In terms of your letter of Withdrawal of Guarantees dated 28 August 2008, you intend to cancel the guarantees on 28 September 2008.The department therefore in accordance with the terms of the Guarantee which affords us the right to recover this amount from the Bank after receiving 30 days notice of withdrawal of Guarantees demands payment of the guaranteed amounts.

[15] The Annex 'A' referred to in the notice to the bank is a letter by the principal agent under the construction contracts written to the applicant on 4 August 2008, recording that on visits to the Paarl and Worcester sites on 29 July 2008, minimal progress of the work was noted and that the department, with retention of its right cancel in terms of clause 36. 1. 1 of the contract, a further extension period of 1O days is granted to the applicant. It is further stated that the Jetter serves

> 'as notice of default giving you a further ten (10) working days .. to remedy the said ...default'.

[16] The applicant contends that Annexure 'NPL 4' is not a notice of any breach and that it is at best an information letter indicating that a notice could follow. The letter is also contains no detail and while it contains the allegation that the applicant was not acting with 'diligence, expedition and regularity', it does not indicate any basis for this allegation.

[17] The department continues to seek payment of the full amounts under the guarantees from ABSA. In turn. ABSA has indicated that it is prepared to pay a significant, but reduced amount to the department from the guarantees.

[18] The department contends that the only requirements for its claim under the guarantee are to be found in the terms of the guarantee itself and that this requires no more than that the department give notice, as it contends it has done, to ABSA that the applicant has breached its obligations under the construction contract.

[19] Mr Tsegarie who appeared on behalf of the department contends that it is not necessary for the department to allege or show that the applicant's breach of its obligations has caused any quantifiable loss to the department at all, and that it is the making of the demand itself that obliges ABSA to pay in full. He further contends that there is no need to follow the procedures outlined in clause 14 of the main contract.

[20] Mr Borgstrom who appeared on behalf of the applicant contends that the guarantee must be read in it context, which includes the terms of the contract; that in the absence of any allegation or evidence by the department of any claims for the payment of money by the department which are secured by the guarantee, the attempt to call up the full amount of the guarantee is not sanctioned by the terms of the guarantee read with the terms of the main contract. The department is consequently not entitled

to any amount under the guarantee. He contends that the department's demand for payment is unlawful for four reasons:

1. Clouse l of the conditions under which the guarantees were issued provides that if the department should extend the due completion date of the projects beyond that envisage at the time of the issue of the guarantees, it (i.e. the department) is required to request new guarantees from ABSA. At the date of the issue of the guarantees, the completion date was on 24 March 2008. Despite the completion date being extended on at least two occasions, the department never sought new guarantees. In the circumstances, it is contended, the guarantees lapsed and are no longer valid or enforceable at the behest of the deportment;

2. Even if the guarantees hove remained valid, the department first purported to call up the guarantees in its demand of 26 September 2008. i.e. before the contract was cancelled. At this stage the department had however not suffered any loss which could – in terms of the construction contracts – be claimed against the guarantees. The department's right to call up the guarantees had therefore not been triggered by 26 September 2008 or any time before the cancellation of the contracts. The department had never demanded unpaid penalties or interest and the department does not claim to have actually spent any amount to employ alternative contractors to make good inferior work and/or to complete the projects, nor have the department given any

contract instruction pointing to any specific work which it alleged was unsatisfactory.

3. The main contract dictates a series of pre-requisite procedural steps which have to be followed by the department before it can make any claim against the amounts secured under the guarantee. These procedural steps required the department to quantify the amounts actually spent to employ other contractors to make good defects or finish the contract, and to demand these amounts from the applicant. These steps were not followed before the department purported to called up the guarantees on 26 September 2008 or at any time thereafter. The department has instead simply called up the entire amounts in the guarantees without any statements recording the alleged bases for their claims and quantifying the alleged damages suffered; and

4. To the extent that the department may claim that it has a separate or new entitlement to amounts under the guarantees to offset alleged damages flowing from the cancellation of the contract, it has failed to follow the procedural pre-requisites to quantify and demand its claims for damages before resorting to the guarantees. In addition a dispute has arisen as to whether the department was entitled to cancel the contract which dispute can not be resolved on the papers. The applicant contends, in the alternative, that payment under the guarantees should in the circumstances be prevented until the resolution of action proceedings – to be

instituted by the applicant within 30 days of any order granted by the Court – regarding the cancellation of the contract. The applicant contends that only if it is found in those proceedings that the department properly cancelled the contract and suffered quantifiable losses as a result, and if the procedural requirements to claim the amounts as set out in the contracts have been fulfilled, the department will be entitled to rely upon the guarantees.

[21] On these bases the applicant initially sought a rule *nisi* calling upon the respondents to show cause why an order should not be granted:

1. Declaring that the guarantees have lapsed and are ineffective;

2. Interdicting the department from taking any further steps to call up the guarantees or seek payment of any amount under the guarantees;

3. Interdicting ABSA from paying out any amounts to the department under the guarantees pursuant to the department's demand of 26 September 2008 or any other claims by the department; and

4. In the alternative, and to the extent that any specified claims by the department are based on alleged damages flowing from the cancellation of the contract, granting the interdicts in paragraphs 2 and 3 above on an interim basis pending the finalisation of action

proceedings to be instituted within 30 days of any order of the Court.

[22] The applicant also sought interim interdictory relief that paragraphs 2 and 3 above have the effect of interim interdicts pending the return day of the rule nisi. The application was initially launched as a matter of urgency on 5 February 2009. Interim relief was granted by agreement and it was subsequently extended. The applicant now seeks final relief. In view of the attitude taken by the department in the answering papers that it is not relying on the purported cancellation of the construction contracts as a basis for its right to call up the full amount of the guarantees, the applicant is no longer proceeding with the alternative relief set out above.

[23] During the course of argument, Mr Borgstrom handed up a draft of more restricted relief sought by the applicant in the alternative. In response, Mr Tsegarie sought leave after the hearing to file further written submissions on behalf of the department. By agreement between counsel, I shall have limited regard to these further submissions.

[24] This matter essentially concerns the proper construction of the terms of the guarantee. This will determine the enforceability and lawfulness, on the facts of this case of the department's demands for payment of the full amount of the guarantees.

[25] Broadly speaking, the contentions of the parties revolve around the question whether the guarantee provided by ABSA is what has become

known as a conditional performance guarantee on the one hand or an unconditional or on demand bond or guarantee, on the other. Under the former, the claimant has to least, depending on the terms of the guarantee, to allege and/or to prove both the default by the contractor and the resultant damages incurred by the claimant. In the case of the latter, the guarantee is, barring fraud, enforceable simply on demand once the default is stated to have occurred. In the end, it turns on the construction of the particular guarantee in question.

[26] The applicant's contention is that, on the authority of the judgment of this court in **Basil Read (Pty) ltd v Beta Hotels (Pty) Ltd** 2001(2) SA 760 (C) at 766 L – G, the guarantee must be read in conjunction with the construction contract to which they relate, in a manner akin to the relationship between a suretyship agreement and the main agreement. Only once the department has demonstrated that it has a quantified claim for the payment of money under the main contract, does the department have a right to make a demand on the amount guaranteed and to payment of a specified amount. In addition, the applicant contends, the department is bound by the procedures set out in the main contract for the making of a claim under the guarantee.

[27] It is common cause on the papers that the deportment did not, at the stage that it mode a claim to the guaranteed amount, have any outstanding or unpaid monetary claims against the applicant and that the department did not, in making the claims, follow the procedures laid down the main contract.

[28] The department's contention is that while the guarantee is ancillary to the main contract, it must be read separate from the main contract and that the guarantee gives rise to o distinct and separate right to claim once a claim is made that the applicant is in breach of the main contract. In this regard, the department's claim is based on the assertions made in correspondence that the applicant has failed to proceed with the construction work under the main contract with

> 'due skill, diligence, regularity and expedition',

as is required of it in terms of clause 15.3 of the main contract.

[29] Mr Tsegarie submitted that the guarantee in this case is akin to what has become known as an on demand performance bond and that its enforceability depends (subject to the proof of fraud)

> 'upon a demand or call, irrespective of its accuracy or justification, provided that call itself complies with the precise terms contemplated by the instrument of guarantee'.[1]

In this regard Mr Tsegarie pointed out that the guarantee provides that

> 'Each claim by the EMPLOYER must be mode in writing accompanied by a signed statement that the Contractor has foiled to fulfil his obligations in terms of the Contract and shall be sent to THE BANK'S domicilium address as indicated below.'

The department's claim complies with this clause, he contended.

[30] The contention on behalf of the deportment is that the purpose of the guarantees are to recompense the department in the event of a

[1] Hudson's Building and Engineering Contracts lllh Edition 1995 volume 2 paragraph 17-003 at 1497

possible

financial loss that might occur as a result of defaults committed by the applicant and that the undertaking by ABSA is no different from the obligation undertaken by an issuing bank by way of a letter of credit. Mr Tsegarie referred to the following dictum of **Lord Denning in Edward Owen Engineering Ltd v Barclays Bank International Ltd Umma Bank** that

> 'when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents ore in order and the terms of the credit are satisfied. Any dispute between the buyer and the seller must be settled between themselves. The bank must honour the credit.'[2]

In addition he referred to the following dictum in J.E. **Contractors Ltd v Lloyds Bank PLC and Rafidain Bank**[3]

> The first principle which the cases establish is that a performance bond, like a letter of credit, will generally be found to be conditioned upon the presentation of one or more documents, rather than upon the actual existence of facts which those documents assert. If the letter of credit or bond requires a document asserting that goods have been shipped or that a contract has been broken, and if such a document is presented, the bank must pay. It is nothing to the point that the document is untruthful, and that the goods have not been shipped or the contract not broken. The only exception is what is called established or obvious fraud. This doctrine had been laid down in recent years by cases too numerous to mention. The justification for it is said to be that bankers can check documents, but do not have the means or the inclination to check facts, at any rate for the modest commission which they change on a letter of credit or performance bond.
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> ...

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2 [1978] 1 Lloyds LR 166(CA) at 170

3 [1990] 2 Lloyds LR 496 (CA) at 499

> On the other hand there is no reason why a performance bond should not depart from the usual pattern, and be conditioned upon the existence of facts rather than the production of a document asserting those facts. It might be inconvenient for the bank, but it is a perfectly lawful contract if the parties choose to make it.

As appears from the above dictum, it remains, ultimately, a question of the proper interpretation of the terms of the guarantee.

[31] I do not agree with Mr Tsegarie's contentions. In my view, the guarantee must, on a proper construction, be read with the main contract. However, it is not necessary for the purposes of this case to go so far since, even on the terms of the guarantee read on their own as submitted by Mr Tsegarie , the department is not entitled to call up the guarantee on the facts of this case without at the very least alleging that it has a quantified claim in a specific amount for moneys due and owing to it by the applicant. The answer to the department's claim under the guarantee in this case can to be found in the words of the guarantee itself and in the terms of the claim put forward by the department.

[32] It is in my view clear from the wording of the guarantee read as a whole, that it is contemplated that only a specific amount or amounts relating to the breach/es relied upon, are claimable under the guarantee and that it is not intended that for any breach of the main contract, the full amount of the guarantee may be claimed without any reference to an amount which is related to the breach in question. It is true that the guarantee is stated to serve

> 'as security for the compliance of the Contactor's performance of obligations in accordance with the Contract'

and that ABSA bound itself

> 'as guarantor for the due and faithful performance by the Contractor of all its obligations in terms of the said Contract'.

It does not, in my view, however, follow that by simply making a claim on the basis that the applicant has failed to fulfil its obligations in terms of the main contract, the full amount of the guarantee has become claimable. Such an interpretation would in my view not accord with the fact that the guarantee interms provides that

> 'with each payment under this Guarantee, THE BANK'S obligation shall be reduced pro rate,'

In order to give meaning to this provision, the guarantee must be read to mean that specific claims for the payment of specific amounts are envisaged.

[33] Mr Tsegarie, submitted that the guarantee prescribes only two conditions, namely that each claim must be in writing and be

> **accompanied** by a signed statement that the Contractor has failed to fulfil his obligations in terms of the Contract (my emphasis)

I do not agree. The quoted term means no more than that a claim must be accompanied by a statement that the contractor has defaulted. Non constat, that it is the only requirement, apart from being in writing, for a valid claim.

[34] In making the claim, the department refers in terms to ABSA's letter of withdrawal of the guarantees of 28 August 2008 and continues:

> 'The Department therefore in accordance with the terms of the Guarantee which affords it the right to recover **this amount** from the Bonk otter receiving 30 days notice of withdrawal of Guarantees, demands payment of the guaranteed amounts.' (my emphasis}

[35] The clause in the guarantee upon which the department bases its claim for payment of the total amount guaranteed, has been quoted earlier. It reads as follows:

> 'THE BANK reserves the right to withdraw the Guarantee after the EMPLOYER has been given 30 (thirty) days written notice of its intention to do so, provided the EMPLOYER shall have the right to recover from THE BANK, the amount owing and due to the EMPLOYER by the Contractor on the date the notice expires.'

[36] The words used are clear and unambiguous. The department is entitled to recover

> 'the amount owing and due to the EMPLOYER by the contractor on the date the notice period expires'.

[37] On its own case as it appears in the papers, is clear that the department is entitled, not to the whole of the amount guaranteed, but only to what is 'owing and due on the date the notice expires'. It follows that the department has to show what amount is 'owing and due' and that it cannot, as it has done here, without at least claiming that any amount is owing and due, simply allege a default and then claim the full amount guaranteed.

[38] Since the department has neither alleged nor made any attempt to establish what amount, if any, was owing and due to the department by the applicant on 28 September 2008, being the date of the expiry of the notice of withdrawal, I hold that, on the facts of this case, the department is not entitled to recover the whole or any part of the amount of the guarantees.

[39] In view of the conclusion that I have come to, it is not necessary to consider the application to strike out certain passages from the applicant's replying affidavit. It is also not necessary to discuss and decide any of the other interesting issues raised on behalf of the parties and I decline to do so.

[40] It follows from what I have set out above that the appropriate relief in this case would be in accordance with the amended relief sought by the applicant during the course of argument. There is also no reason why the costs should not follow the event, save that in regard to the application to strike out, each party shall bear its own costs.

[41] I therefore make the following order which is based on the alternative relief sought by the applicant, a draft of which was handed up by Mr Borgstrom on behalf of the applicant during argument.

1. The Department of Transport and Public Works in the Provincial Government of the Western Cape ("the Department") is interdicted from taking any further steps to seek payment of any amount from the first respondent ("ABSA") under the guarantees issued by ABSA with

numbers [……] and [……] ("the guarantees"), unless the Department evidences that such an amount was due and payable to it on 28 September 2008 in terms of the main construction agreements concluded between the applicant and the department under numbers 261/06 and 265/06 "the main construction agreements");

2. ABSA is interdicted from paying out any amount under the guarantees, unless the department evidences that such an amount was due and payable to it on 28 September 2008 in terms of the main construction agreements;

3. Save that each party shall pay its own costs in regard to the application to strike out, the costs of this application shall be paid by the second and third respondents.

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W. J. LOUW, J