



THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Not reportable
Case No: 208/2015

In the matter between:

**MUTUAL & FEDERAL INSURANCE COMPANY
LIMITED**

FIRST APPELLANT

**AQUA TRANSPORT & PLANT HIRE (PTY)
LIMITED**

SECOND APPELLANT

and

**KNS CONSTRUCTION (PTY) LIMITED
(In liquidation)**

FIRST RESPONDENT

K2012020306 (SOUTH AFRICA) (PTY) LIMITED

SECOND RESPONDENT

Neutral citation: *Mutual & Federal v KNS Construction* (208/15) [2016]
ZASCA 87 (31 May 2016)

Coram: Lewis, Tshiqi and Willis JJA, Fourie and Tsoka AJJA

Heard: 13 May 2016

Delivered: 31 May 2016

Summary: Building contract: performance guarantee found to be conditional guarantee akin to suretyship.

ORDER

On appeal from: Gauteng Local Division of the High Court, Johannesburg (Twala AJ sitting as court of first instance).

- 1 The appeals of the first and second appellants are upheld.
- 2 The respondents are declared liable, jointly and severally, for the costs of the appeal, including the costs of two counsel where so employed.
- 3 The cross appeal of the first respondent is dismissed with costs, including the costs of two counsel where so employed.
- 4 The order of the court a quo is set aside and replaced with the following:
 - ‘(a) The application is dismissed.
 - (b) The first and second applicants are ordered to pay the respondents’ costs, jointly and severally, including the costs of two counsel.’

JUDGMENT

Tsoka AJA (Lewis, Tshiqi and Willis JJA and Fourie AJA concurring)

[1] This appeal concerns the interpretation of a construction guarantee. In 2011, South African National Roads Agency Limited (SANRAL) awarded to the first respondent, KNS Construction (Pty) Limited (KNS Construction), a contract for the construction of road works at Ballito interchange, National Route 2, KwaZulu-Natal (the main contract). In turn, on 22 March 2011, KNS Construction appointed Aqua Transport & Plant Hire (Pty) Ltd (Aqua), as a sub-contractor. In terms of the

sub-contract, Aqua was required to provide a performance guarantee (the guarantee) to the value of 15 per cent of the main contract: the guarantee was not to have an expiry date. The first appellant, Mutual and Federal Insurance Company Limited (Mutual & Federal), as guarantor, issued the guarantee on behalf of Aqua for the due fulfilment of its obligation to KNS Construction pursuant to the sub-contract entered into between Aqua and KNS Construction.

[2] On 5 April 2011, Mutual & Federal issued the guarantee, the relevant terms of which are:

‘1. . . Mutual & Federal Insurance Company Limited (Reg. No: 1970/00619/06) (hereinafter referred to as “the Guarantor”) do hereby hold at your disposal the amount of R3 423 850.49 (Three million, four hundred and twenty three thousand, eight hundred and fifty rand and forty nine cents) for the due fulfilment by Aqua Transport & Plant Hire (Pty) Ltd (Reg No. 2003/007768 (hereinafter referred to as “the sub-contractor”) of its obligations to KNS Construction (Pty) Ltd Reg. No: 2004/013912/07 thereafter referred to as “KNS” [Construction] in terms of the above stated contract between the Sub-Contractor and KNS [Construction].

2. The Guarantor hereby renounces the benefits of the exceptions *non numeratae pecuniae*, *non-causa debiti*, excussion and division, the meaning and effect whereof we declare ourselves to be fully conversant.

3. The Guarantor undertakes to pay KNS the said amount of R3 423 850.49 (Three million, four hundred and twenty three thousand, eight hundred and fifty rand and forty nine cents) or such portion as may be demanded on receipt of a written demand from KNS [Construction] which demand may be made by KNS [Construction] if, (in your opinion and at your sole discretion), the said Contractor fails and/or neglects to commence the work as prescribed in the contract or if he fails and/or neglects to proceed therewith or if, for any reason, he fails and/or neglects to complete the services in accordance with the conditions of contract, or if he fails or neglects to refund to KNS [Construction] any amount found to be due and payable to KNS [Construction], or if his estate is sequestrated or if he surrenders his estate in terms of the Insolvency Law in force within the Republic of South Africa’.

[3] Pursuant to the issuing of the guarantee, KNS Construction experienced financial problems with the result that it was not able to perform in terms of the main contract. In September 2011, its diesel supplies ceased because of its inability to pay the suppliers and it was also unable to pay its staff. As a result, it could not continue with its obligations which it was required to perform before Aqua could render its services in terms of the sub-contract: the surfacing work consisting of applying prime coat and the asphalt base and surfacing. It also failed to pay Aqua its first invoice for work already performed, promising to settle the invoice by 15 December 2011 by which date it had hoped to have concluded an empowerment transaction. Its financial situation did not improve and it placed itself under voluntary winding-up in terms of a special resolution registered by the Master of the High Court on 13 December 2011. By 14 December 2011 the site was closed resulting in no work being carried out. Its insurers, who had issued a performance guarantee on its behalf to SANRAL, were informed of the dire financial situation. This led to SANRAL cancelling the main contract and issuing a new tender for the completion of the remaining earthworks.

[4] On 24 January 2012, KNS Construction was placed under provisional winding up at the instance of one of its creditors. The provisional order was made final on 5 March 2012 whereafter on 8 March 2012, provisional liquidators were appointed. The appointment was made final on 11 July 2012. Prior to the two winding up applications, in 2010 one of its creditors had instituted a winding up application in the North Gauteng High Court, Pretoria, which application was dismissed. The creditors in that application, being dissatisfied with the dismissal, lodged an appeal to the full bench. On 19 September 2012, the full bench upheld

the appeal and placed KNS Construction in final winding up retrospective to 8 October 2010.

[5] In spite of these insurmountable difficulties, and the fact that the site was abandoned with no work being carried on in terms of the main contract, KNS Construction, on 14 December 2011, a day after it had placed itself under voluntary winding up, purported to cancel the sub-contract with Aqua, giving Aqua 14 days' notice to rectify its performance, failing which it intended calling up the performance guarantee. The threat to call up payment of the guarantee was followed up by the liquidators on 10 May 2012 and 11 July 2012. The basis for the calling up of payment of the guarantee was alleged to be the failure to commence, proceed with or complete the project.

[6] On 28 May 2012, Aqua launched an application in the South Gauteng High Court, Johannesburg interdicting Mutual & Federal from effecting payment in terms of the guarantee. By agreement between the parties, Mutual & Federal was interdicted from honouring the guarantee pending resolution of proceedings to be instituted within 30 days by KNS Construction. In due course, KNS Construction launched an application which came before the court a quo demanding payment of the guarantee on the basis that, as the guarantee was a 'call or on demand guarantee' it had become payable. Aqua on the other hand contended that the guarantee was a 'conditional guarantee', inextricably linked to the sub-contract, and as Aqua was not in breach of the sub-contract, the guarantee was not due and payable.

[7] The Gauteng Local Division of the High Court, Johannesburg (Twala AJ) held that the guarantee was a ‘call or on demand’ guarantee, and that Mutual & Federal was, on demand by KNS Construction, obliged to pay in terms thereof as long as the latter complied with the terms of the said guarantee. Mutual and Federal and Aqua now appeal with leave of the court a quo, while KNS Construction cross-appeals the order with regard to the date when mora interest began to accrue.

[8] The main issue raised as a ground of appeal is that the guarantee is a ‘conditional guarantee’ that is inextricably linked to the underlying contract, and therefore akin to suretyship and not an ‘on demand’ or ‘call guarantee’ as found by the court a quo. In the first alternative it is contended that even if this court were to find that the court a quo was correct in holding that the guarantee was ‘a call guarantee’, the demand did not comply with the terms of the guarantee. In the second alternative it is submitted that the demand was mala fide or tainted by fraud.

[9] In order to resolve the question whether the guarantee is ‘a call guarantee’ or ‘a conditional guarantee’, it is apt to restate what this court said about interpreting documents. In *Novartis SA v Maphil Trading*,¹ this court said:

‘. . . the interpretative process is one of ascertaining the intention of the parties – what they meant to achieve. And in doing that, the court must consider all the circumstances surrounding the contract to determine what their intention was in concluding it. . . and the court should always consider the factual matrix in which the contract is concluded – the text to determine the parties’ intention.’

¹ *Novartis SA v Maphil Trading* 2016 (1) SA 518 (SCA) paras 27.

[10] In assessing whether the guarantee is a call or on demand guarantee as opposed to a conditional guarantee, it is helpful to refer to some of the previous decisions of this court.

[11] In *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others*,² this court was required to interpret a guarantee in terms of which Lombard bound itself as principal debtor. In terms of the guarantee Lombard undertook to pay, on demand, the guaranteed sum or full outstanding balance upon the happening of two eventualities. Clause 3 of that guarantee provided:

‘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.

The court in interpreting that guarantee stated:

‘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 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

² *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others* [2009] ZASCA 71; 2010 (2) SA 86 (SCA) paras 19 and 20.

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.'

[12] In *Minister of Transport and Public Works, Western Cape, & another v Zanbuild Construction (Pty) Ltd & another*,³ this court was also required to interpret the terms of a performance guarantee. Unlike the one in *Lombard* the court stated that the guarantee gave rise to liability akin to that of a surety and said: 'The first indicator in that direction is the assertion at the outset that the guarantee provide "security for the compliance of the contractor's performance of obligations in accordance with the contract". And in the body of the document the bank guarantees "the due and faithful performance by the contractor". This accords with language associated with suretyships.'

[13] In the present matter, the language used in the guarantee and its purpose reveal the true intention of the parties. The language used is similar to that in *Zanbuild*. Clause 1 states that it is issued for the 'due fulfilment' by Aqua of its obligations to KNS Construction in terms of the sub-contract. Clause 3 of the guarantee states that the guarantee amount is payable ' . . . on receipt of a written demand from KNS [Construction], which demand may be made by KNS [Construction] if (in your opinion and at your sole discretion) the said Contractor [Aqua] fails and/or neglects to commence the work as prescribed in the contract or if he fails and/or neglects to proceed therewith or if, for any reason, he fails and/or neglects to complete the services in accordance with the conditions of contract. . .

³ *Minister of Transport & Public Works, Western Cape, & another v Zanbuild Construction (Pty) Ltd & another* [2011] ZASCA 10 (SCA); 2011 (5) SA 528 para 19.

[14] Although the guarantee is payable in the discretion of KNS Construction, and that payment in respect thereof may be demanded ‘at any stage’, the true purpose was to guarantee the due performance by Aqua. It was only payable if Aqua breached the sub-contract as expressly stated in the guarantee. I am fortified in my reasoning by the fact that on completion of the construction, it was to be returned to Mutual & Federal (as in the case of suretyship) and once the principal debt was discharged, the surety would be released from its obligations. The ineluctable conclusion is that the present guarantee is not autonomous, but inextricably linked to the underlying contract.

[15] The fact that the demand was at the discretion of KNS Construction does not affect the nature of the guarantee. The discretion vested in KNS Construction was to be exercised *‘arbitrio bono viri’*,⁴ the trigger event being Aqua’s failure to commence, proceed with or complete the sub-contract. It is not clear from the letters of demand seeking to rely on the performance guarantee which of the grounds it seeks to rely on. They do not specify which breach Aqua is alleged to have committed. It is thus not clear on what basis KNS Construction alleged it was entitled to payment. KNS Construction did not and could not perform its own obligations in terms of the sub-contract and therefore it did not meet any of the conditions imposed, before payment can be held to be due and payable.

[16] The fact that the guarantee was not accompanied by any document before payment was demanded, but depended on breach of the sub-contract by Aqua in either failing to commence, proceed with or complete the project, lends credence to

⁴*NBS Boland Bank Ltd v One Berg River Drive CC & others; Deeb & another v Absa Bank Ltd; Friedman v Standard Bank of SA Ltd* (4) SA 928 (SCA) para 25.

the fact that the guarantee is inextricably linked to the sub-contract and therefore akin to a suretyship. The inescapable conclusion is therefore that the guarantee is akin to suretyship (like that in *Zanbuild*), and thus a conditional guarantee and not a call or demand guarantee. Therefore the court a quo erred in holding that the guarantee is a demand and not a conditional guarantee.

[17] The appellants contended, in the alternative, that in the event the guarantee is found to be a call or demand guarantee, then there was fraud on the part of KNS Construction in seeking payment in terms of the guarantee. However, having concluded that the guarantee is a conditional guarantee, it is unnecessary to pronounce on this issue save to state that the demand by KNS Construction and the Liquidators, while KNS Construction was in dire financial difficulties, after it had placed itself in voluntary liquidation and knowing that it would not be able to fulfil its own obligations in terms of the sub-contract with Aqua, constituted misrepresentation. The appeal must thus succeed. It follows that the cross appeal falls to be dismissed.

[18] The following order is made:

- 1 The appeals of the first and second appellants are upheld.
- 2 The respondents are declared liable, jointly and severally, for the costs of the appeal, including the costs of two counsel where so employed.
- 3 The cross appeal of the first respondent is dismissed with costs, including the costs of two counsel where so employed.
- 4 The order of the court a quo is set aside and replaced with the following:
 - ‘(a) The application is dismissed.

- (b) The first and second applicants are ordered to pay the respondents' costs, jointly and severally, including the costs of two counsel.'

M Tsoka
Acting Judge of Appeal

APPEARANCES:

For First Appellant:

AO Cook SC (with him JJ Meiring)

Instructed by:
Hogan Lovells (South Africa), Johannesburg
Symington & De Kok, Bloemfontein

For Second Appellant:

P Stais SC (with him JE Smit)

Instructed by:
Cox Yeats Attorneys, Johannesburg
Symington & De Kok, Bloemfontein

For Respondent:

M v R Potgieter SC

Instructed by:
Senekal Simmonds Inc, Johannesburg
Phatshoane Henny, Bloemfontein