REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA
(GAUTENG LOCAL DIVISION, JOHANNESBURG)

APPEAL CASE NO: A5067/2016
GLD CASE NO: 13787/2015

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

8 December 2017
DATE

SIGNATURE

In the matter between:

BRYTE INSURANCE COMPANY LIMITED — Appellant (Respondent *a quo*)

and

RAUBEX CONSTRUCTION (PTY) LIMITED — Respondent (Applicant *a quo*)

J U D G M E N T

FISHER J (VAN OOSTEN and WEINER JJ CONCURRING):

[1] This is an appeal against the judgment of this court (*per* Hulley AJ). The appeal is with the leave of the court *a quo*.

[2] The respondent (Raubex) is a construction company. It entered into a contract with Eskom to carry out construction works at a price of approximately R47.3m. Raubex subcontracted a portion of these works to Peakstar 133 (Pty) Ltd, trading as Dolphin Construction (Dolphin), at a price of approximately R16.8m. The subcontact comprised the construction of offices, a visitors centre, a workshop and a sub-station for Eskom.

[3] The application *a quo* involved Raubex's claim for payment by the appellant (Bryte), under what is known in the construction industry, as a *retention guarantee*, given in terms of the subcontract. The purpose of such a guarantee is to secure the obligations of a contractor to remedy defects in its workmanship, found *after* completion of the works. It differs in this respect from a *performance guarantee* in that the purpose of the latter is usually to exact performance under a contract *before* completion of the works.

[4] The relevant part of the guarantee in issue (the guarantee) reads as follows:

> 'The Guarantor renounces the benefits of excussion and division and undertakes to pay to the Main Contractor upon demand all such monies as the Main Contractor may require to be paid to it in lieu of any retention monies which have been repaid by the Main Contactor to the Subcontractor and which the Subcontractor would otherwise be liable to pay to the Main Contactor under and in terms of the Subcontract, and such monies shall be paid by the guarantor conditionally upon receipt of demand from the Main Contractor that any such retention monies are due and payable to the Main Contractor by the Subcontractor as provided for in terms of the Subcontract, provided however, that the liability of the guarantor hereunder shall not exceed the sum of R1 686 721.89 (One Million Six Hundred and Eighty Six Thousand Seven Hundred and Twenty One and Eighty Nine cents) and is subject to the following further terms and conditions;
>
> 1. Each demand by the main Contractor shall be in writing signed by the main Contractor and delivered to the Guarantor at 2nd floor, ONE Building, Woodmead North Office Park, 54 Maxwell Driver, Woodmead or such other address in Johannesburg as it shall in writing notify to the Main Contractor, and shall be accompanied by a certificate complying with clause 2, signed by the Main Contractor's authorized representative.

2. Each demand by the Main Contractor shall certify;
   (a) That the signatory is the Main Contractor authorized representative;
   (b) That the Subcontractor is in breach of his obligations under the Subcontract and that the Main Contractor is entitled to be paid amounts for which the Subcontractor is liable under the Subcontract; and
   (c) That the amount demanded, which amount the certificate shall specify:
      (i) Does not exceed the amount of Retention monies which, but for this Guarantee, would have been retained by the Main Contractor as Retention Monies in terms of the Subcontract at the date of the certificates, less the aggregate of the amounts, if any, of retention money and other securities actually retained or held by the Main Contractor in terms hereof and;
      (ii) Does not exceed a good faith estimate of the costs to the Main Contractor of having the breach referred to in paragraph (b) remedied less the aggregate of any amounts withheld by the Main Contractor from payment due to the Subcontractor in terms of the Subcontract by reason of the breach referred to, and any amount of Retention money actually held by the Main Contractor save to the extent that the same had been deducted from any previous demand in terms hereof.
3. The Guarantor shall within 21 days after its receipt of a demand complying with the provisions of Clauses 1 and 2 make payment to the Main Contractor of the amount demanded at such address as the main Contractor shall in writing notify the Guarantor.
4. Subject to compliance with the provisions hereof, the Guarantor's liability to make the payment herein referred to shall be unconditional and shall not be affected or diminished by any disputes, claims or counterclaims between the Main Contractor and the Subcontractor.'

[5] Raubex sought payment under the guarantee of an amount of R1 409 726.11 and interest. The issue in the case is whether the appellant was obliged to make payment to the respondent under the guarantee. The court *a quo* found that it was so obliged and ordered payment accordingly.

[6] Bryte's central contention is that, when Raubex made the claim against the guarantee, it had knowledge that it was not entitled to the payment demanded *inter*

alia because Raubex's estimation of the costs of having Dolphin's alleged breaches remedied, was not *bona fide*. On this basis it raises two arguments:

(a) First, that this has the effect that the demand made was not in accordance with requirements of the guarantee and, specifically, not in accordance with clause 2(c)(ii), which required a certification that the amount demanded did not exceed a good faith estimate of the costs of having the breach rectified, and
(b) Second, that the lack of *bona fides,* in any event, constituted fraud and thus Bryte had no obligation to comply with the demand.

[7] The terms of a guarantee will determine its nature and whether or not it is an accessory obligation or an independent contract that must be fulfilled on its terms (cf *Compass Insurance Co Limited v Hospitality Hotel Developments (Pty) Limited* 2012 (2) SA 537 (SCA) par [15]).

[8] Despite its obvious accessory nature, the parties expressly made the guarantee unconditional, subject only to compliance with the terms and conditions in relation to the demand to be made.

[9] Upon compliance with the terms of a retention guarantee, the guarantor cannot escape liability thereupon, unless proof of fraud on behalf of the beneficiary is established (*Loomcraft Fabrics CC v Nedbank Limited and Another* 1996 (1) SA 812 (A) 815J; *Minister of Transport and Public Works, Western Cape, and Another v Zanbuild Construction (Pty) Limited and Another* 2011 (5) SA 528 (SCA) para [15]).

[10] On the undisputed facts, insurmountable difficulties arise for Raubex in relation to the veracity of the estimate of the costs of remedying the alleged breach. In this regard, it appears clear from the estimate which was attached to the papers in the application, that many alleged defects which formed the basis for the estimate, were discovered and dealt with *before* the practical completion envisaged in the subcontract, and were thus not costs covered by the guarantee. Strikingly, a very large proportion of the costs which are claimed are alleged to have been incurred by a third party electrician for remedying defects but, on closer inspection, are revealed to be in relation to costs already incurred in respect of Raubex itself, in the form of past expenses, such as salaries, cell phone charges, diesel costs, accommodation

and travel costs. Mr *Grobler*, in argument on behalf of Raubex, sensibly conceded that the estimate in the circumstances could not be said to be a proper estimate of the costs to remedy the alleged breaches.

Was the demand made in terms of the requirements of the guarantee?

[11] It is the case of Raubex that the admitted lack of veracity in relation to the estimate, is irrelevant to the case in that the guarantee requires only that the demand be made in the terms specified. It contends that the form of the demand that was made complied with the requirements of the guarantee and that thus, regardless of the veracity or otherwise of the certifications in the demand, the payment obligation was triggered.

[12] Bryte, on the other hand, contends that the guarantee and, specifically clause 2(c)(ii), must be interpreted as meaning that Raubex had to show that the estimate founding the demand was made in *good faith.*

[13] Our courts have strictly applied the principle that a bank faced with a valid demand in respect of a guarantee, is obliged to pay the beneficiary thereof without investigation of the underlying contractual position (*Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* 2013 JDR 2727 (SCA) para [28]).

[14] Nugent JA, in *OK Bazaars (1999) Ltd v Standard Bank of South Africa Ltd* 2002 (3) SA 688 (SCA) para [25], had the following to say in relation to the obligations of an issuing bank in regard to a letter of credit issued by it (which is analogous to a guarantee of the type in issue herein):

> '...[the issuing bank's] interest is confined to insuring that the documents that are presented conform with its client's instructions (as reflected in the letter of credit) in which event the issuing bank is obliged to pay the beneficiary. If the presented documents do not conform with the terms of the letter of credit the issuing bank is neither obliged nor entitled to pay the beneficiary without its customer's consent. The obligation of the issuing bank was expressed as follows in *Midland Bank Limited v Seymour* [1955] 2 Lloyds Rep 147 at 151:
>
> > There is, of course, no doubt that the bank has to comply strictly with the instructions that it is given by its customer. It is not for the bank to reason why. It is not for it to say: 'This, that or the other does not seem

> to us very much to matter'. It is not for it to say: 'What is on the bill of lading is just as good as what is in the letter of credit and means substantially the same thing'. All that is well established by authority. The bank must conform strictly to the instructions which it receives.'

[15] In a similar vein, Lord Denning MR, in *Edward Owen Engineering Limited v Barclays Bank International Limited* [1978] QB 159 (CA); [1978] 1 All ER 976 (QB) 983B-D and 171A- B, stated the following:

> 'A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor the question whether the supplier has performed his contractual obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.'

[16] Similarly, in *Lombard Insurance Company Ltd v Landmark Holding (Pty) Ltd* 2010 (2) SA 86 (SCA), Navsa JA, explained (para [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). ... 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 ..."

[17] The meaning of the requirement of *bona fides* in the context of the guarantee must accordingly be determined before it can be decided whether the demand *in casu* complied with the terms.

[18] In *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA), Wallis JA, in regard to the canons of interpretation, summarised the present state of our law as follows (para [18]):

> 'Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the

> context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context it is to make a contract for the parties other than the one they in fact made. The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.'

[19] The guarantee requires a certification that the specified amount demanded does not exceed a *good faith* estimate of the costs of having the breach remedied. The Shorter Oxford English Dictionary defines *certification* as *the action or an instance of certifying the truth of something.*

[20] The introduction of the requirement of *good faith* in this context, would seem to suggest that the parties intended that the certification contemplated not be of a mere rote estimate but one which allows for, and indeed, requires a substantive specification or statement in the call-up or demand, to enable an objective assessment whether the estimate is made on a proper basis, in respect of future expenses and costs to be incurred to remedy the defects and that the claim is properly founded.

[21] The interpretation contended for by Raubex would, to my mind, result in negating the purpose of the document and, specifically, undermines the substantive concept of *good faith.* The parties, by inserting in the guarantee the element of good faith, clearly intended to eliminate and avoid a false or mala fide estimate.

[22] It was thus not enough for Raubex to show that there had been a formal certification of good faith: it also had to show that the certification was, in fact, made in the honest belief that it was a correct estimate of what it was entitled to be paid under the guarantee. This it failed to do.

Has fraud been established?

[23] In any event, as I have alluded to, Bryte relies on fraud as a defence to the claim. The onus rests on Bryte to establish the fraud exception.

[24] In *United Trading Corporation SA v Allied Arab Bank* 1985 2 Lloyd's Rep 554 (CA) 561, the nature of the fraudulent act in this context, was stated thus:

> 'That it is seriously arguable that, on the material available, the only realistic inference is that ... [the beneficiary] could not honestly have believed in the validity of its demands on the performance bonds.'

[25] In *Guardrisk Insurance Company Ltd and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA) para [17], Theron JA, stated as follows:

> 'It is trite that where a beneficiary who makes a call on a guarantee does so with knowledge that it is not entitled to payment, our courts will step in to protect the bank and decline enforcement of the retention guarantee in question. This fraud exception falls within a narrow compass and applies where: '... the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his (the seller's) knowledge are untrue'. [Footnote omitted]

[26] As aforesaid, Raubex concedes that the basis for the amount claimed was incorrect in a number of respects. It however had another string to its bow: it contended that, aside from this, Bryte needed to show a state of mind, that, notwithstanding the conceded lack of accuracy, it was necessary to show actual intention to mislead. The fact that Bryte raised details and facts which suggest possible *mala fides* in making this admittedly materially inaccurate estimate would, it seems to me, in the absence of a proper explanation for the false representation, imply that it was made with knowledge of the lack of veracity in the certification.

[27] It must be understood that this is not a matter where there may be a legitimate dispute as to whether the demand is a proper one or not. In this instance the estimate is based on items in respect of which there can be no dispute whatsoever that they are not related to and, indeed, irrelevant to a claim for the rectification of the breach relied on after completion of the works, hence the concession that the estimate is not correct.

[28] One would expect, in circumstances where a patently incorrect or false estimate is given, that there would be some attempt to explain the reason why this has occurred. Indeed, the present circumstances called for an explanation. There is none forthcoming. The deponent to the replying affidavit, who also made the demand on behalf of Raubex, formulated the estimate, and certified that the estimate was in good faith, does not suggest any mistake or misunderstanding on his part nor does he proffer any explanation for submitting the patently false certificate. He contents himself with stating baldly in relation to the falsities having been exposed and detailed in Bryte's answering affidavit, and the basis for it: *There is nothing fraudulent or mala fide about this.* He notably is a director of Raubex, a fully qualified engineer, and has been in the construction industry for many years. On his own admission, he regards himself as an expert in the construction industry and he is, moreover, well versed in the purpose and import of retention guarantees generally, and, of course, the guarantee we are here concerned with. And yet, on his own version, more than 90% of the estimate, pertained to costs relating to employees of Raubex, in the form of salaries, cell phone charges, accommodation, travel costs, and diesel, most of which, in any event, were in respect of work done in the course of the contract and thus could not possibly have related to work to be performed to remedy defects discovered after completion. This is not in dispute.

[29] In the circumstances, there can be no inference other than the claim and certification was made with knowledge that there was no entitlement thereto and none was suggested by or on behalf of Raubex.

[30] Accordingly, for all these reasons, the application should have been dismissed with costs.

Order

[31] In the result, the following order is made:

1. The appeal is upheld.

2. The order of the court *a quo* is set aside and is substituted with:

'The application is dismissed with costs'.

3. The respondent is to pay the costs of the appeal.

P/P D FISHER
JUDGE OF THE HIGH COURT

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