THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 68/2010

In the matter between:

THE MINISTER OF TRANSPORT AND PUBLIC WORKS: PROVINCIAL GOVERNMENT OF THE WESTERN CAPE	**FIRST APPELLANT**
THE HEAD OF THE DEPARTMENT OF TRANSPORT AND PUBLIC WORKS: PROVINCIAL GOVERNMENT OF THE WESTERN CAPE	**SECOND APPELLANT**
v	
ZANBUILD CONSTRUCTION (PTY) LTD	**FIRST RESPONDENT `**
ABSA BANK LIMITED	**SECOND RESPONDENT**

Neutral citation: *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* (68/2010) [2011] ZASCA 10 (11 March 2011)

Coram: Brand, Nugent, Lewis, Maya and Bosielo JJA

Heard: **17 February 2011**

Delivered: **11 March 2011**

Summary: **Interpretation of construction guarantee – whether liability of guarantor is limited to the contractor's liability under the construction contract – or whether it is for the full amount of the guarantee on demand by the employer.**

ORDER

On appeal from: Western Cape High Court (Cape Town) (Louw J sitting as court of first instance.)

The appeal is dismissed with costs.

JUDGMENT

BRAND JA (Nugent, Lewis, Maya and Bosielo JJA concurring):

[1] The outcome of this appeal turns on the interpretation of two construction guarantees that are identical in their material terms. The guarantees were issued by the second respondent, Absa Bank Ltd (Absa) in favour of the Western Cape Department of Transport and Public Works (the department), for which the two appellants hold responsibility. They were issued at the behest of the first respondent, Zanbuild Construction (Pty) Ltd (Zanbuild). Though Absa was joined as a party, both in the court of first instance and on appeal, it abides the decision of this court as it did in the court a quo.

[2] On 26 September 2008 the department demanded payment from Absa under the guarantees. When this demand came to the notice of Zanbuild, it approached the Western Cape High Court for an order, essentially interdicting the department from seeking – and Absa from making – payment under the guarantees. The matter came before Louw J who granted the interdict sought. Subsequently, he afforded the appellants leave to appeal to this Court against that order.

[3] The guarantees were issued with reference to two separate construction contracts entered into between the department and Zanbuild at the end of January 2007. As in the case of the guarantees themselves, these contracts (the construction contracts) were also identical in their material provisions. In terms of the construction contracts, Zanbuild undertook to construct pathology laboratories at the Eben Dönges Hospital, Worcester (the Worcester project) and the TC Newman Hospital in Paarl (the Paarl project). By express agreement, the construction contracts incorporated the standard terms proposed by the Joint Building Contracts Committee (the JBCC).

[4] Standard clause 14 of the JBCC deals with security to be provided by the contractor. That clause, however, is immaterial because the department in its letters accepting Zanbuild's tenders for the two projects required a guarantee in accordance with the department's standard guarantee form, which is not an option provided for in clause 14. But the department's standard guarantee form is also immaterial. The guarantees issued by Absa, which gave rise to the present dispute, were substantially different from the department's standard form. Nonetheless, they were issued with the acquiescence of Zanbuild and accepted by the department.

[5] Each guarantee is for an amount equal to 10 per cent of the value of the contract to which it pertains. Thus the guarantee relating to the Worcester project is for R1 181 104.80, while the guarantee linked to the Paarl project is for R1 106 500.00. Other than this, the terms of the two guarantees are identical. When it comes to the interpretation of these terms I shall refer to them in more detail. But continuation of the present narrative requires reference to one of these terms which 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 period expires.'

[6] Relying on this provision, Absa notified the department on 28 August 2008 that it wished to withdraw from the guarantees and that, consequently, the 'guarantees will be cancelled one month from the date of this letter on 28 September 2008 whereafter no further claims or payments will be considered'.

[7] Two days before the stipulated expiry date, ie on 26 September 2008, the department responded to this notice by demanding immediate payment of the full amount of both guarantees. Amongst other things the letter of demand stated that:

'The contractor has defaulted on both contracts, 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 . . . demands payment of the guaranteed amounts.'

[8] Annex 'A' referred to is a letter of 4 August 2008 by the architect acting as principal agent for the department in terms of the construction contracts, to Zanbuild. In essence it informed Zanbuild that:

- both the department and the principal agent were of the view that Zanbuild was in breach of the construction contracts in that it had failed to execute the works 'with due skill, diligence, regularity and expedition';
- Zanbuild was afforded a period of ten days to remedy its breach, 'failing which the employer may proceed and give you notice of cancellation'.

[9] As it happened, the department purported to cancel the construction contracts on 9 October 2008. Zanbuild disputed that it was entitled to do so, but chose to accept the purported cancellation as a repudiation by the department. The upshot is that on any account the construction contract came to an end before either of the projects had reached completion.

[10] The department does not contend that at present it has an identifiable monetary claim under the construction contract against Zanbuild. In this regard clause 33 of the construction contracts provides for different potential claims sounding in money against the contractor. Pertinent amongst these are penalties for late completion and claims for expenses and loss flowing from the need to employ an alternative contractor. But the department does not allege that any claim of this nature arose against Zanbuild when the guarantees expired on 28 September 2008. In fact, the last payment certificates issued under the construction contracts on the eve of their termination (8 October 2008) tend to show otherwise.

[11] This brings me to the analysis of the guarantees. According to the interpretation contended for by Zanbuild – which found favour with the High Court – the guarantees are inextricably linked to the construction contracts in a manner akin to a suretyship agreement. Hence, so Zanbuild argued, Absa's liability under the guarantee is limited to the extent that the department can demonstrate a monetary claim against Zanbuild under the construction contracts. Because Absa did not even allege that it had any claim in terms of the construction contracts, it follows that it had no claim against Absa under the guarantees.

[12] The contrary interpretation contended for by the department is that the guarantees are independent from the construction contracts in a manner comparable to irrevocable letters of credit issued by banks where the obligation of the bank is wholly independent of the underlying contract of sale. Hence, so the department contended, the guarantees can be invoked without any allegation or evidence of any claim against Zanbuild under the construction contracts. All the department had to do to procure payment of the full amounts guaranteed was to submit a statement to Absa that Zanbuild was in default in terms of the construction contracts.

[13] In the parlance of the English authorities[1] the dispute can be usefully paraphrased as being whether the guarantees are 'conditional bonds'[2] (as suggested by Zanbuild) or 'on demand bonds' (as suggested by the department). The essential difference between the two, as appears from these authorities, is that a claimant under a conditional bond is required at least to allege and – depending on the terms of the bond – sometimes also to establish liability on the part of the contractor for the same amount. An 'on demand' bond, also referred to as a 'call bond', on the other hand, requires no allegation of liability on the part of the contractor under the construction contracts. All that is required for payment is a demand by the claimant, stated to be on the basis of the event specified in the bond.

[14] Our law is familiar with the distinction. In *Dormell Properties 282 CC v Renasa Insurance Co Ltd & others NNO*[3] and *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd,*[4] for example, the construction guarantees involved were construed by this court as 'on demand' bonds while in *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd & others*[5] the guarantee was interpreted to create conditional liability akin to that of a surety. In English law, as in our law, it is accepted that the question whether the guarantee under consideration constitutes the one or the other is dependent on the interpretation of the terms of that guarantee.

[15] As support for its contention that the guarantees under consideration constitute 'on demand' or 'call' guarantees, the department relied on the statement in *Lombard Insurance*[6] that:

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[1] See eg LN Duncan Wallace *Hudson's Building and Engineering Contracts* Vol 2 11 ed (1995) paras 17.003-17.009 at p 1497-1501; *Trafalgar House Construction (Bregions) Ltd v General Surity and Guarantee Co Ltd* [1995] 3 All ER 737 (HL) at 742j-743d; *Vossloh Aktiengesellschaft v Alpha Trains (UK) Ltd* [2010] EWHC 2443 (Ch) paras 19-28.

[2] Since the liability of the bondsman is conditional upon the liability of the contractor for the same amount. See eg *Vossloh Aktiengesellschaft supra.*

[3] 2011 (1) SA 70 (SCA).

[4] 2010 (2) SA 86 (SCA). See also *Petric Construction CC t/a AB Construction v Toasty Trading t/a Furstenburg Property Development & others* 2009 (5) SA 550 (ECG).

[5] 2001 (2) SA 760 (C).

[6] *Supra* 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). 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 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.'

[16] In addition the department also sought to rely on certain statements in *Dormell Properties*[7] which essentially endorsed the approach in *Lombard Insurance*. It is clear to me, however, that the statements relied on by the department must be confined to the terms of the guarantees considered in those cases. The exact terms of the guarantee in *Lombard Insurance* do not appear from the reported judgment. But examination of the record of that case filed in this court shows that the terms of the *Lombard* guarantees were, for present purposes, exactly the same as those of the guarantee in *Dormell Properties,* which are in turn fully recorded in the latter judgment.[8]

[17] Moreover, it appears that the terms of the guarantees in *Lombard Insurance* and *Dormell Properties* are essentially identical to those of the standard guarantee that the department called for in its letters accepting the Zanbuild tenders for both projects. But, as we know, what the department wanted is not what the department got. A comparison of the terms of the department's standard guarantee, as appears from the judgment in *Dormell Properties,* on the one hand, with those of the guarantees in this case – to which I will presently return – on the other hand, reveals substantial differences. The consequence of these differences is, in my view, self-evident. The Absa guarantees cannot be interpreted, as the department sought to do, with reference to the terms of the

[7]Paras 38 and 63-66.
[8]Para 5.

standard guarantee, or, indirectly, with reference to statements in *Lombard Insurance* and *Dormell Properties* with regard to those terms.

[18] I now turn to the terms of the guarantees under consideration. In relevant part they provide:

'. . . whereas it is stipulated in the [construction] contract that the contractor [ie Zanbuild] shall provide the employer [ie the department] with a bank guarantee of 10% of the contract value . . . as security for the compliance of the contractors performance of obligations in accordance with the contract,

and whereas the bank [ie Absa] is willing to agree to guarantee an amount . . . which is equal to 10% of the contract value under certain conditions stipulated hereafter . . . .

Now therefore we the undersigned . . . in our capacities as [employees of] the bank do hereby guarantee and bind the bank 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 . . .

With each payment under this guarantee the bank's obligation shall be reduced pro rata.

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 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 period expires.'

[19] Construing the Absa guarantees as a whole, I agree with the view of the High Court that they support the interpretation contended for by Zanbuild. In other words, that they do not constitute 'on demand' bonds, but that they give rise to liability on the part of Absa akin to suretyship. 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.

[20] In argument the department's answer to this indicator was twofold. First, that the interpretation of guarantees of this kind is often bedevilled by loose language. For the sake of argument, I accept that this is so.[9] The second answer was that the Absa guarantees contain an indicator to the contrary. This answer relied solely on the stipulation that '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'. What this provision means, so the department contended, was that, in order to obtain payment of the guarantees in full, the department has to do no more than to submit two documents to the bank: (a) a claim in writing and (b) a signed statement that the contractor is in default under the construction contract. This, so the department's argument concluded, renders the guarantee payable on demand whenever the contractor is in default, irrespective of liability on the part of the contractor.

[21] What goes against this interpretation is that the provision upon which the department relies as the sole basis of its argument, contemplates more than one claim under the guarantee. This is also in line with the provision that 'with each payment under this guarantee the bank's obligation shall be reduced pro rata'. The department's interpretation, on the other hand, leaves no room for more than one claim. Any breach of contract by the contractor would render the full amount of the guarantee due and payable on demand. In argument the department sought to overcome this difficulty by reference to the example of a payment certificate, issued by the principal agent, reflecting a penalty owing to the department in a specific amount. In that event, so the argument went, the department would probably only claim the amount of the penalty under the guarantee. But that is not the point. The point is that on the department's argument, it is entitled to claim the full amount of the guarantee on the basis of a single default. If this is so, I can think of no reason why the department would claim less than what it is entitled to.

[9] As also appears to be the position in English law. See eg *Vossloh Aktiengesellschaft supra* para 20.

[22] Finally there is the provision that reserves the right to the bank to withdraw from the guarantees after 30 days notice, which was as we know, invoked by the Absa. That provision expressly limits the liability of the bank to the amount owing by the contractor under the construction contract. Counsel for the department conceded, rightly in my view, that the bank's liability in terms of this provision is clearly akin to that of a surety.

[23] The interpretation of the provision contended for by counsel for the department was, however, that it only applies where the employer demands payment after the expiry of the 30 day period. Departing from that premise, the argument proceeded as follows. After expiry of the guarantee the liability of the bank is limited to that of the contractor at the time of expiry. But prior to the expiry of the guarantee the employer is entitled to claim the full amount of the guarantee on demand. In this case the department demanded payment before the expiry of the 30 days notice of termination by Absa. Demand was therefore made prior to the expiry of the guarantee. In consequence the department was entitled to the full amount of the guarantees. Had the demand been made after the 30 day period and thus after the expiry of the guarantee, the department would only be entitled to payment of the amount for which the contractor was liable or the date that the notice period – and consequently, the guarantee itself – had expired.

[24] I do not accept this argument. It would mean that the 30 days' notice changes the whole nature of the guarantee. Prior to the expiry of the period, the guarantee is the equivalent of a letter of credit. After expiry it retrospectively converts into a suretyship. I can simply find no basis for this interpretation in the wording of the guarantee. The 30 days' notice provision, as I see it, is one typically found in suretyships for an indefinite period. It affords the right to the surety to terminate the suretyship by not less than a stated period of notice to the creditor.[10] The effect of the notice is rather obvious. The surety is not liable for

[10]CF Forsyth and JT Pretorius *Caney's The Law of Suretyship*, 6ed at 112.

amounts that become due by the principal debtor after expiry of the notice period. Yet the surety's liability for amounts owing by the principal debtor before expiry of the period, remain unaffected.[11] That, I believe, is the effect of the 30 days notice provision in the Absa guarantees. The notice does not change the liability of the bank prior to the expiry of the notice period. The bank remains liable, as it always was during the currency of the guarantee, for the amounts due to the employer by the contractor under the construction contracts. Since the department had established no amount due to it by Zanbuild during the currency of the guarantees, the High Court rightly held that it was not entitled to demand payment under the guarantees from Absa.

[25] For these reasons the appeal is dismissed with costs.

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F D J BRAND

JUDGE OF APPEAL

[11]See eg *Kalil v Standard Bank of South Africa Ltd* 1967 (4) SA 550 (A) at 555.

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