THE SUPREME COURT OF APPEAL OF SOUTH AFRICA
JUDGMENT

Case No: 139/2013
Reportable

In the matter between:

ESKOM HOLDINGS SOC LIMITED **APPELLANT**

and

HITACHI POWER AFRICA (PROPRIETARY) LTD **FIRST RESPONDENT**

HITACHI POWER OF EUROPE GMBH **SECOND RESPONDENT**

Neutral citation: *Eskom Holdings v Hitachi Power Africa* (139/2013) [2013] ZASCA 101 (12 September 2013)

Coram: Mthiyane AP, Brand, Shongwe, Majiedt and Petse JJA

Heard: **15 August 2013**
Delivered: **12 September 2013**

Summary: Interpretation of a demand guarantee – Notice to contractor not necessary for employer to present guarantee for payment to the bank in the case of an on demand or call guarantee.

ORDER

On appeal from: South Gauteng High Court, Johannesburg (Kgomo J sitting as court of first instance):

The appeal is upheld and the order of the court below is set aside and replaced with the following:

'The application is dismissed.'

JUDGMENT

MTHIYANE AP (BRAND, SHONGWE, MAJIEDT AND PETSE JJA CONCURRING):

[1] The outcome of this appeal turns on the interpretation of demand guarantees that were issued by Mizhuo Corporate Bank Limited of Japan (the Bank) in favour of the appellant (Eskom) to secure performance by the respondents (Hitachi) of their obligations under a construction contract concluded between Eskom and Hitachi during October 2007, for the construction of certain of the Works at the Medupi Power Station (Medupi). The guarantees were issued at the instance of Hitachi. Medupi is a massive new electrical power generating station that is being constructed in the North Western part of the Limpopo Province near the rural town of Ellisras. It is agreed between the parties that the first of its six power generating plants should be online in 2013 and the last of them by July 2015.

[2] Hitachi has elected not to oppose the appeal and to abide the decision of this court. In turn Eskom is not seeking an order for costs against Hitachi.

[3] In terms of the construction contract, Hitachi provided six guarantees drawn on the Bank. Three of these guarantees are in the sums of R300 384 946.13, £21 273 236.13 and US$445 838.25, amounting in total to a South African Rand equivalent of over R600 million.

[4] On 12 February 2013, Eskom presented these three guarantees to the Bank for payment. Before the presentation of the guarantees a number of disputes had arisen between the parties concerning the performance by Hitachi of its obligations under the construction contract. Eskom alleged that Hitachi had been guilty of material and ongoing breaches of the construction contract. It complained that Hitachi had delayed the completion of the first operating unit at Medupi. It also claimed that in view of the said material breaches, it was entitled to demand payment under the guarantees.

[5] The correspondence placed before the high court revealed that since September 2012 there had been on-going discussions between the parties, aimed at averting the calling up of the guarantees by Eskom. The disputes that ensued culminated in Eskom addressing a letter to Hitachi on 1 February 2013, accusing them of a failure to effect certain corrections to the construction work. It alleged that these corrective steps should have been undertaken by 31 January 2013. Eskom complained that all these failures affected its ability to plan work timeously and negatively impacted directly or indirectly on the work of other projects by other contractors. The letter recorded that Eskom was aware of Hitachi's

specific challenges to correct all matters of quality to Eskom's satisfaction in accordance with their obligations. Eskom indicated that it was prepared to postpone its decision to demand payment of guarantees up to and until 28 February 2013, on condition that in the meantime Hitachi remedied the breaches.

[6] In their response, Hitachi disputed Eskom's entitlement to demand payment of the guarantees. In their letter of 8 February 2013, Hitachi denied the allegations that they lacked clear direction about the management of matters critical to Medupi. Referring to earlier discussions between the parties, that had taken place on 11 December 2012, 16 January 2013 and during the meeting of 6 February 2013 at which quality issues were discussed, Hitachi expressed the hope that an agreement with respect to quality would be reached on or before 28 February 2013. Hitachi not only disputed that Eskom had the right to claim against payment under the guarantee but insisted on their alleged claim being met by Eskom. Hitachi claimed that they had previously called upon Eskom to procure an engineer to determine all of its outstanding claims which were long overdue. The letter is however silent on Hitachi's attitude to the grace period extended by Eskom not to present demand guarantees up to and until 28 February 2013.

[7] On 13 February 2013 at 23h00, Hitachi launched an urgent application in the South Gauteng High Court (Kgomo J), seeking a final order (a) interdicting Eskom until 28 February 2013 from demanding payment of the guarantees; and (b) to the extent that the guarantees may have been paid, directing Eskom to revoke the said demand and instruct the Bank accordingly and ancillary relief.

[8] The application for an interdict was founded on two propositions which are summarised in the founding affidavit as being, first, a failure on the part of Eskom to comply with the terms of the construction contract, and second, a breach of promise made by Eskom, namely that it would not present the guarantees prior to 28 February 2013. In respect of the first of these causes of action, that is, that the demand was made in circumstances contrary to the contract, Hitachi relied on the contention that prior to making demand, Eskom was first required to give Hitachi notice under sub-clause 2.5 of the construction contract. The clause reads as follows:

'If the Employer considers himself to be entitled to any payment under any Clause of these Conditions or otherwise in connection with the Contract, the Employer or the Engineer shall give notice and particulars to the Contractor. However, notice is not required for payments due under Sub-Clause 4.19 [*Electricity, Water and Gas*], under Sub-Clause 4.20 [*Employer's Equipment and Free-Issue Material*], or for other services requested by the Contractor.

The particulars shall specify the Clause or other basis of the claim, and shall include substantiation of the amount to which the Employer considers himself to be entitled in connection with the Contract.

The Employer may set off such amounts against moneys due to the Contractor (or to become due) but only to the extent that such amounts are liquid and payable to the Employer by the Contractor under any Clause of these Conditions or otherwise in connection with the Contract. This amount may, without limiting the Employer's other rights to recover amounts due to him from the Contractor (including by having recourse to the Performance Security and Retention Money or Retention Money guarantee provided for in Sub-Clause 14.9 [Payment of Retention Money]), be included as a deduction in the Contract Price and Payment Certificates. Without limiting or derogating from the Contractor's other rights under the Contract, if the Employer sets off any amounts due to the Contractor which are not due and/or payable the Employer shall be liable to the Contractor for the interest thereon, calculated at the Stipulated Interest Rate.'

I will return to the meaning and effect of sub-clause 2.5 later in the judgment. The second cause of action was premised on the proposition that Eskom had in its letter of 1 February 2013 agreed to waive its rights to make demand upon the guarantees up to and until 28 February 2013.

[9] Hitachi's contention in respect of the first of these two causes of action found favour with the high court, and the application for an interdict as indicated in paragraph 7, was granted in its favour. The finding was based on the high court's reading of clause 2.5 as requiring Eskom to give Hitachi notice of its intention to demand payment of the guarantees. The sub-clause was interpreted to mean that if Eskom considered itself entitled to any payment under the contract or in connection with the contract it (Eskom) or its engineer should give notice and particulars to Hitachi, except where sub-clauses 4.19 and 4.20 (which are not relevant here) are concerned. The court further found that the sub-clause required Eskom to specify the clause or other basis of the claim, and should include substantiation of the amount to which the employer (Eskom) considers itself entitled in connection with the contract.

[10] The court concluded that in its view, once negotiations break down or any indulgence granted was withdrawn, Hitachi should have been given proper and timeous notice of Eskom's intention to proceed with the presentation of the guarantees for payment. It rejected Eskom's contention that it was not required to give notice before calling up the demand guarantees.

[11] As to Hitachi's second cause of action, relating to Eskom's undertaking not to call up demand guarantees up to and until 28 February 2013, the court rejected the argument advanced on Eskom's behalf, that

its concession to postpone a call on the performance securities until 28 February 2013 was merely a proposal that was to be responded to by Hitachi. The court favoured a construction contended for by Hitachi, as to the meaning and effect of the concession, which was that Eskom was prepared to hold its horses up to and until 28 February 2013.

[12] Construction guarantees have been the subject of discussion in a number of decisions of this court and the high court.[1] It is necessary to establish at the outset the nature of the guarantee involved in the present matter. In *Minister of Transport and Public Works, Western Cape, & another v Zanbuild Construction (Pty) Ltd & another* 2011 (5) SA 528 (SCA) para 14, Brand JA noted that our law is familiar with two types of guarantees: the 'conditional guarantee' and the 'on demand guarantees' (referred to in English law as 'conditional bonds' and 'on demand bonds' respectively). There are differences between the two. A claimant under a conditional guarantee is required, not only to allege but sometimes also to establish liability on the part of the contractor for the amount claimed. An on demand guarantee requires no allegation of liability on the part of the contractor under the construction contracts. All that is required for payment is a demand stating the claimant's compliance with the terms of the guarantee.

[13] The question in this appeal is whether the demand guarantee issued in favour of Eskom is, on a proper interpretation of its terms, an on demand guarantee or a conditional guarantee.

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[1] *Dormell Properties 282 CC v Renasa Insurance Company Ltd & others NNO* 2011 (1) SA 70 (SCA); *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others* 2010 (2) SA 86 (SCA); *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd & others* 2001 (2) SA 760 (C).

[14] In *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others* 2010 (2) SA 86 (SCA), Navsa JA had occasion to discuss the nature of an 'on demand' or 'call guarantee', where he said the following (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.'

[15] The demand guarantee in question in this appeal has all the characteristics of an 'on demand' or 'call guarantee', which is independent of the construction contract. The recital of its terms are set out in clause 3 of the Performance Bond issued by the Bank. The clause reads as follows:

'3. A demand for payment under this guarantee shall be made in writing at the Bank's address and shall:

3.1 be signed on behalf of Eskom by the managing director of an Eskom division (including, for the avoidance of doubt, the managing director of Eskom's Enterprises Division or his successor in title or the managing director of Generation Division or his successor in title) or by any board director of Eskom;

3.2 state the amount claimed ("the Demand Amount");

3.3 state that the Demand Amount is payable to Eskom in the circumstances contemplated in sub-clause (a), (b), (c) or (d), as applicable of clause 4.2 of the Contract.'

In terms of this clause Eskom is not required to give notice nor is the Bank required to investigate whether notice was given and whether

Eskom has complied with the construction contract. In my view it makes business sense for the terms of the guarantee not to have required the Bank to embark on this exercise. A bank is in the business of handling money, not assessing and evaluating the merits or demerits of contracts. The interpretation contended for by Hitachi and endorsed by the court below would have required the bank, which was not even a party to the proceedings, to traverse areas which fall outside the scope of its authority. Giving effect to the plain meaning of the clause, I do not read it as imposing such an onerous duty on the Bank. It merely had to satisfy itself that the three requirements set out in clauses 3.1, 3.2 and 3.3 quoted above had been met. The high court's insistence that Eskom should have given Hitachi notice before making a demand guarantee was erroneous. Clause 4.2(d) of the construction contract entitled Eskom to claim under the guarantees in the event of circumstances which entitled it to terminate the construction contract under clause 15.2 irrespective of whether notice of termination had been given. In the letters of demand, under cover of which Eskom called upon the Bank to make payment under the guarantee, Eskom invoked the provisions of clause 4.2. The clause reads as follows:

'The Employer shall not make a claim under a Performance Security, except for amounts to which the Employer is entitled under the Contract in the event of:

(a) failure by the Contractor to extend the validity of the Performance Security as described in the preceding paragraph, in which event the Employer may claim the full amount of the Performance Security and retain the proceeds as cash security,

(b) failure by the Contractor to pay the Employer an amount due, as either agreed by the Contractor or determined under Sub-Clause 2.5 [*Employer's Claims*] or Clause 20 [*Claims, Disputes and Arbitration*], within 42 days after this agreement or determination,

(c) failure by the Contractor to commence to remedy a default within 42 days after receiving the Employer's notice requiring the default to be remedied and thereafter diligently continuing to pursue the remedy of the default, or

(d) circumstances which entitle the Employer to termination under Sub-Clause 15.2 [*Termination by Employer*], irrespective of whether notice of termination has been given.

If it is determined that the Employer has made a claim under a Performance Security that it was not entitled to make, the Employer shall refund the excess amount claimed and pay interest thereon to the Contractor, calculated at the Stipulated Interest Rate from the date on which the amount was paid to the Employer to the date on which it is refunded to the Contractor.

The Employer shall return each Performance Security to the Contractor within 21 days after receiving a copy of the Performance Certificate for the applicable Section.'

[16] Clause 15(2)(a) to (g) of the construction contract posit a number of discrete situations which would entitle Eskom to terminate the construction contract. The grounds for termination include a material breach of the construction contract by Hitachi together with the failure on their part to remedy such a breach within 30 days after Eskom giving notice of such event or such longer period as Eskom may determine. Eskom's reliance on sub-clause 15.2(g) and the uncontested allegations of material breaches on the part of Hitachi entitled it to call up the guarantees. That clause reads as follows:

'The Employer shall be entitled to terminate the Contract if the Contractor:

. . .

(g) materially breaches the Contract and fails to remedy the same within 30 days after the Employer giving written notice of the occurrence of such event (or, if such remedy cannot be completed in such time, such longer period as the Employer may determine).'

Clause 15.2 of the construction contract provides that Eskom is entitled, on the happening of any of the events described in clauses 15.2(a) to (g)

coupled with the giving of 30 days notice, to terminate the construction contract. On the plain meaning of clause 4.2 the giving of notice was not a requirement for the calling up of the guarantee. Similarly, the requirement of notice under clause 15.1[2] has no bearing in relation to the material breach under clause 15.2(g).

[17] Finally under the requirement of notice provisions of clause 2.5, it has relevance only in relation to a claim under the guarantee made in terms of sub-clause 4.2(b), dealing with the circumstances entitling the employer to terminate under sub-clause 15.2, irrespective of whether notice of termination has been given.

[18] The requirements of clause 2.5 are not to be read into the whole of clause 4.2 ─ as did the high court ─ otherwise the specific reference to clause 2.5 in sub-clause 4.2(b) would become tautologous. Eskom in this regard makes no claim for payment under the construction contract, but in exercising a right which it has, under the construction contract, to make demand upon the Bank in terms of the guarantees themselves. Hence the obligation to pay arises from the terms of the guarantee and not from the conditions of the construction contract to which the Bank is not a party. Furthermore the provisions of the guarantees, which gives rise to an entirely separate cause of action to which Hitachi is not a party, do not incorporate whether by reference or at all, clause 2.5 of the construction contract nor any like provision.

[19] If one has regard to the terms of the guarantee in question in the present matter, the threshold requirement that Eskom had to meet for claiming payment under the demand guarantees was low. All that it was

[2] 'If the Contractor fails to carry out any obligation under the Contract, the Engineer may by notice require the Contractor to make good the failure and to remedy it within a specified reasonable time.'

required to show in order to claim was that the demand for payment under the guarantee: (a) was signed on behalf of Eskom by the Manager or Director of an Eskom Division (including for avoidance of doubt, the Managing Director of Eskom's Enterprise Division or his successor); (b) stated the amount claimed (the demand amount) and (c) that the demand amount was payable to Eskom in the circumstances contemplated in sub-clauses (a), (b), (c) or (d), as applicable in clause 4.2 of the contract. (See clauses 3.1, 3.2 and 3.3 of the performance bond.) On the plain meaning of the clause it is clear that what was required for a claim to be made under the demand guarantee was a signature on the demand guarantee, an indication of the amount demanded and an assertion by Eskom that the demand amount is payable as set out in clause 3.1, 3.2 and 3.3 and this would have been sufficient. It is clear why this is so. Clause 4.2 of the construction contract expressly contemplates that Eskom might make a demand upon a guarantee in circumstances where it is not entitled to do so. On a proper interpretation of the demand guarantee, Eskom's entitlement to make a call upon a guarantee need not be proven at the time the demand is made. Clause 4.2 provides instead that if Eskom makes a claim under a guarantee and it is subsequently shown that it was not entitled to make such a demand, it would be obliged to refund the excess amount claimed and to pay interest thereon to Hitachi, calculated at the Stipulated Interest Rate from the date on which the amount was paid until it is refunded (see *Dormell Properties 282 CC v Renasa Insurance Company & others NNO* 2011 (1) SA 70 (SCA) para 42 where this court dealt with a demand guarantee in which there was a similar provision). The plain meaning of the guarantee allows for no conclusion other than that the guarantee in question in these proceedings is an on demand or call guarantee (see *Zanbuild Construction* para 12). The interpretation contended for by Hitachi, which found favour with the high

court, suggesting that Eskom was required to give notice before claiming payment upon a demand guarantee was erroneous and flew in the face of the plain meaning of the terms of the guarantee as set out in clauses 3.1, 3.2 and 3.3 read with clause 4.2(d) of the construction contract (see *Coopers & Lybrand & others v Bryant* 1995 (3) SA 761 (A) at 767E-768E).

[20] In my view the high court misread the demand guarantee and imposed the requirement of notice which was not provided for in its terms.

[21] As to the reliance by Hitachi on the undertaking given by Eskom not to call up the demand guarantees up to and until 28 February 2013, it does not appear that the high court made any specific finding in this regard but merely made a passing reference by remarking that Hitachi's interpretation of what was said about 28 February 2013 was more plausible than Eskom's interpretation of the demand guarantee. Nowhere does the high court say that Eskom was bound by the undertaken given. If regard is had to the wording of Eskom's letter of 1 February 2013 and Hitachi's response to it, it cannot be said that Eskom waived its rights to claim on demand guarantees up to and until 28 February 2013. Instead of indicating that it was accepting Eskom's extension of time until 28 February 2013, Hitachi elected to unleash on Eskom a litany of issues, comprising of denials and claims. Hitachi never addressed itself to the question whether it was prepared to rectify matters raised by Eskom before the cut-off date of 28 February 2013. I do not think that it lies in the mouth of Hitachi to now rely on the indulgence given by Eskom in order to avoid the consequences of the call up of a demand guarantee. It follows that Hitachi must also fail on this cause of action.

[22] There is yet another question that needs consideration, and that is the question of mootness. The cut-off date (28 February 2013) by which the call up of the guarantee had to be made has come and gone. It may be said that the matter has therefore become moot and that any judgment or order that this court might make will have no practical effect. In terms of s 21A(1) of the Supreme Court Act 59 of 1959, this court is empowered in those circumstances to dismiss an appeal on that ground alone. There can be no question however that it is in the public interest for this court to pronounce on the question of guarantees in this matter. Eskom is a public body, dealing with a matter which is of great public interest in this country ─ the supply of electricity ─ and is currently involved in a number of similar contracts. It is important for this court to offer guidance on the interpretation and application of similar demand guarantees Eskom has concluded with other contractors. In my view despite the suggestion that this matter might be moot, there is a practical need for this court to express a view on the interpretation of the demand guarantees in question in this appeal on a matter of wide public interest. (Cf *Western Cape Education Department & another v George* 1998 (3) SA 77 (SCA) at 84E-E; *Natal Rugby Union v Gould* 1999 (1) SA 432 (SCA) at 24J.)

[23] It also bears mention that Hitachi sought and was granted a final interdict, in circumstances where it failed to satisfy the requirements for the granting of a final interdict. In my view the application should have been dismissed on that ground as well. The most obvious missing elements in Hitachi's case was its failure to establish that it had suffered 'irreparable harm' and 'the absence of any other remedy or relief', leaving aside the question of a 'clear right' see *Director of Public*

Prosecutions (Western Cape) v Midi Television (Pty) Ltd t/a E TV 2006 (3) SA 92 (C) para 34. The high-water mark of Hitachi's case on the requirement of irreparable harm was that they would have had to pay interest on the guarantees. This part of Hitachi's case, however, flounders in the face of that portion of clause 4.2 which allowed Hitachi to recover not only the capital amount paid out under the guarantees, but additionally interest paid at the stipulated rate. The contract also made provision for dispute resolution mechanisms and there can therefore be no question of Hitachi having met the requirements of absence of any other remedy or relief for them to claim entitlement to a final interdict. In my view Hitachi should have failed on all fronts in the high court.

[24] In the result the appeal is upheld and the order of the court below is set aside and replaced with the following:
'The application is dismissed.'

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K K MTHIYANE
ACTING PRESIDENT

APPEARANCES

For Appellant: B E Leech SC (with him E Mokutu)

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