THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 385/2012

In the matter between:

FIRST RAND BANK LIMITED **Appellant**

and

BRERA INVESTMENTS CC **Respondent**

Neutral citation:	*First Rand Bank v Brera* (385/2012) [2013] ZASCA 25 (25 March 2013)
Coram:	Lewis, Ponnan, Malan and Theron JJA and Plasket AJA
Heard:	**4 March 2013**
Delivered:	**25 March 2013**
Summary:	**Construction guarantee in favour of sub-contractor – interpretation of – liability not affected by events occurring after due date**

ORDER

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

The appeal is dismissed with costs.

JUDGMENT

Malan JA (Lewis, Ponnan and Theron JJA and Plasket AJA concurring):

[1] This is an appeal against the judgment and order of Nicholls J that the appellant (First Rand Bank Limited) pay a certain amount to the respondent, Brera Investments CC, in terms of a payment guarantee issued to the latter. The respondent had on 1 November 2007 entered into a Joint Building Contracts Committee N/S Subcontract Agreement with Spirit of Africa Developments (Pty) Ltd (the 'contractor') for the supply of materials and fittings and the installation of the electrical reticulation of residential units forming part of the Windmill Park Extension 12 development in Boksburg.

[2] On 3 October 2007 First Rand issued a payment guarantee to the respondent for the amount of R12 997 972,36 including VAT. The guarantee recorded in clause 1.1 that any reference to the agreement between the contractor and the respondent was for the purpose of convenience and –

'shall not be construed as any intention whatsover to create an accessory obligation or any intention whatsoever to create a suretyship.'

The guarantee is thus of the same nature as a performance guarantee, performance bond or letter of credit and consists of an undertaking to make payment of an amount of money on the happening of a specified event (see Cloete JA in *Dormell Properties 282 CC v Renasa Insurance Co Ltd & others* [2011] 1 All SA 557 (SCA), 2011 (1) SA 70 para 61). A guarantee of this nature must be paid according to its

terms and liability under it is not affected by the relationship between other parties to the transactions that gave rise to its issue, particularly not with the question whether the sub-contractor performed in terms of his contract with the contractor (see *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others* 2010 (2) SA 86 (SCA) paras 19 and 20; *Loomcraft Fabrics CC v Nedbank Ltd* 2010 (2) SA 86 (SCA) para 38 and *Minister of Transport and Public Works, Western Cape & another v Zanbuild Construction (Pty) Ltd & another* 2011 (5) SA 528 (SCA) paras 11-15). The words of the guarantee under consideration make it clear that it is not a suretyship but an independent, and not accessory, agreement that must be performed according to its terms (see also *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA) para 15).

[3] First Rand lent the necessary funds on mortgage bond to Spirit of Africa for the development of the township. In terms of this loan the respondent was required to waive in favour of First Rand any right of retention or lien that might arise from its execution of the works on the development. The guarantee under consideration only became effective after waiver of the lien by the respondent (clause 1.2.2.1).

[4] The sub-contract between the respondent and the developer provided for interim payments to the respondent on the issue of payment certificates by the principal agent (clause 31 of the sub-contract). The principal agent was obliged to issue an interim certificate every month until the issue of the final certificate (clause 31.1) and the contractor required to apply to the principal agent for payment to be made to a sub-contractor. The latter had to co-operate with and assist the contractor in the preparation of the claim by providing all the relevant documents and assessments of quantified amounts of works completed and materials and goods supplied (clause 31.2). The principal agent thereafter furnished the interim certificates to the contractor (clause 31.3). Within seven days of the issue of an interim certificate the contractor had to draw up a payment advice statement to be issued to the sub-contractor together with the amounts certified in the interim certificate (clause 31.5). The employer was obliged to pay the contractor the amount certified in an interim payment certificate within seven days of its issue. Payment to the sub-contractor became due on the date of the issue of the interim certificate and payment had to be made within seven days after the due date for payment by the employer to the contractor (clause 31.9).

[5] The payment guarantee in this matter envisaged two situations where First Rand could incur liability to the respondent. The first is where the sum certified in a payment certificate was not paid by the contractor within seven days. Clause 2 provided for this eventuality:

'2.0 Subject to the Guarantor's maximum liability in terms of the Guaranteed Sum, the Guarantor hereby undertakes to pay the Subcontractor the sum certified upon receipt of the payment certificate which entitles the Subcontractor to receive payment in terms of the Agreement of the sum certified.

2.1 A copy of the first written demand issued by the Subcontractor to the Contractor stating that payment of the sum certified by the Principal Agent has not been made in terms of the Agreement and failing such payment within seven (7) calendar days, the Subcontractor intends to call upon the Guarantor to make payment in terms of 2.2.

2.2 A first written demand issued by the Subcontractor to the Guarantor at the Guarantor's *domicilium citandi et executandi* with a copy to the Contractor stating that a period of seven (7) calendar days has elapsed since the first written demand in terms of 2.1 and that the sum certified has still not been paid therefore the Subcontractor calls up the Payment Guarantee and demands payment in the sum certified by the Guarantor.'

[6] The second situation arises where the contractor fails to issue a payment certificate within seven days of a demand for it. This is the situation with which this appeal is concerned. Clause 3 deals with it:

'3.0 Subject to the Guarantor's maximum liability in terms of the Guaranteed Sum, and limitations recorded in 1.2 and 1.3, the Guarantor hereby undertakes to pay the Subcontractor the demanded sum upon receipt of the documents identified in 3.1 and 3.2.

3.1 A copy of a first written demand issued by the Subcontractor to the Contractor stating that the Subcontractor demands the issue of a payment certificate and failing such issue within 7 (seven) calendar days, the Subcontractor intends to call upon the Guarantor to make payment in terms of 3.2 of the demanded sum as set out in the demand.

3.2 A first written demand issued by the Subcontractor to the Guarantor at the Guarantor's *domicilium citandi et executandi* with a copy to the Contractor stating that a period of seven (7) calendar days has elapsed since the first written demand in terms of 3.1 and that the payment certificate has still not been issued therefore the Subcontractor calls up this Payment Guarantee and demands payment of the demanded sum from the Guarantor.'

[7] The written demand referred to in clause 3.1 for the issue of a payment certificate for R1 065 864,29 was made on 17 March 2011. The contractor was informed that should it fail to issue the certificate within seven calendar days, the respondent intended calling on First Rand to make payment in terms of clause 3.2. The payment certificate demanded was not issued within seven days. On 15 April 2011 the respondent issued a first written demand to First Rand in terms of clause 3.2 demanding payment of R1 065 864,29 and stating that a payment certificate was demanded from the contractor, that seven calendar days had elapsed from the date of the demand and no payment certificate had been issued. Despite these demands payment was not forthcoming and the application in the high court was launched on 14 July 2011. On 25 August 2011, however, a payment certificate for R60 909,79 was issued by a Mr R H Gardiner on behalf of the contractor. The certificate stated that the other amounts claimed were disputed and were not certified.

[8] Nicholls J based her judgment on the unambiguous words of clause 3 in terms of which First Rand undertook to pay 'upon receipt of the documents identified in 3.1 and 3.2'. As it was common cause that the demands referred to in clauses 3.1 and 3.2 were made and that at the time the payment guarantee was called up the payment certificate had not been issued, she found that the 'trigger event' on which liability is based had occurred. In her judgment in the application for leave to appeal her reasons for making the order sought were articulated more clearly: liability was incurred because the payment certificate was not furnished *timeously*. I agree.

[9] On behalf of the appellant, however, it was contended that it was entitled to rely upon events that occurred after demand had been made. In particular it was argued that the word 'still' in clause 3.2 had the effect that, if at any stage after the expiry of the seven day period referred to in clause 3.1 a payment certificate was issued, the respondent's entitlement to demand payment would fall away and it would only be entitled to the certified sum, if any. Liability is thus based, so the argument went, on the continued failure by the principal agent to issue a payment certificate. To my mind, this construction is artificial. The event on which liability depends is set out in clause 3.0, that is 'upon receipt of the documents identified in 3.1 and 3.2'. The obligation to pay arises the moment the provisions of clause 3.0 are met, and not on the continued failure of the principal agent to issue the payment certificate. The words in clause 3.2 'and that the payment certificate has still not

been issued' do not detract from this conclusion. The use of the word 'still' in clause 3.2 simply means that the payment certificate was not issued within the seven day period referred to in clause 3.1. The interpretation of First Rand, that it means that liability depended, not on the conditions set out in clause 3, but on the continued failure to provide the payment certificate at all is strained. It would mean that the subsequent provision of a payment certificate (that is, after the seven day period set out in clause 3.1) would extinguish or exclude the guarantor's liability or limit it to the amount certified. The express words used in the clause exclude such a construction.

[10] It was submitted on behalf of First Rand that the majority decision of this court in *Dormell Properties* above established a party's right to rely on events that occurred after demand for payment was made. In that case, Bertelsmann AJA posed the question whether a party was entitled to enforce a building guarantee notwithstanding the fact that it was decided in arbitration proceedings that it had repudiated the underlying construction agreement which was lawfully cancelled by the other party. He held (para 41):

'The arbitration has established that Dormell is in the wrong. Its repudiation of the building contract was held to have been unlawful. As a consequence, Dormell has lost the right to enforce the guarantee. There remains no legitimate purpose to which the guaranteed sum could be applied.'

Because it was found that judgment in favour of the party enforcing the guarantee (Dormell) would, in the circumstances of that case, have had no practical effect (since any amount paid under the guarantee would have to be repaid) the appeal was dismissed. The facts of this matter are distinguishable and concern an interim payment under an interim payment certificate. There was no final arbitration award as in *Dormell*. No question of mootness arises. In any event, I consider that the better approach in that case is that of Cloete JA with whom Mpati P concurred:

'Once the appellant [the beneficiary] had complied with clause 5 of the guarantee, the first respondent [the guarantor] had no defence to a claim under the guarantee. It still has no defence. The fact that an arbitrator has determined that the appellant was not entitled to cancel the contract, binds the appellant – but only *vis-à-vis* the second respondent [the employer]. It is *res inter alios acta* so far as the first respondent is concerned. As the cases to which I have referred above make abundantly clear, the appellant did not have to prove that it was entitled to cancel the building contract with the second respondent as a

precondition to enforcement of the guarantee given to it by the first respondent. Nor does it have to do so now' (para 64).

For these reasons, it is not in my view bad faith for an employer, who has made proper demand in terms of a construction guarantee, to continue to insist on payment of the proceeds of the guarantee, when the basis upon which the guarantee was called up has subsequently been found in arbitration proceedings between the building owner and the contractor to have been unjustified. I would add that the fact that the arbitrator's award is final as between the appellant and the second respondent does not mean that it is correct, or that the appellant would have to set it aside before calling up the guarantee, much less that the appellant is acting in bad faith in seeking to enforce payment under the guarantee against the first respondent' (para 65).

[11] The autonomy of letters of credit, demand guarantees, performance bonds and similar documents is well recognised (see *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others* 2010 (2) SA 86 (SCA) paras 19 and 20). It is only where fraud is involved that the issuing institution may decline liability. In *Sztejn v J Henry Schroder Banking Corporation* (1941) 31 NYS 2d 631, a judgment concerning an irrevocable letter of credit, Shientag J formulated the 'established fraud rule' as follows:

'No hardship will be caused by permitting the bank to refuse payment where fraud is claimed, where the merchandise is not merely inferior in quality but consists of worthless rubbish, where the draft and the accompanying documents are in the hands of one who stands in the same position as the fraudulent seller, where the bank has been given notice of the fraud before being presented with the drafts and documents for payment, and where the bank itself does not wish to pay pending an application of the rights and obligations of the other parties.'

See also *Phillips & another v Standard Bank of South Africa Ltd & others* 1985 (3) SA 301 (W) at 301A-J and *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 (CA) at 983*b-d*. No question of fraud arises in this matter.

12] In the result the appeal is dismissed with costs.

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F R Malan
Judge of Appeal

APPEARANCES:

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