REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA

GAUTENG LOCAL DIVISION, JOHANNESBURG

CASE NO: 2016/09191

DELETE WHICHEVER IS NOT APPLICABLE

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

23/6/2016
DATE

SIGNATURE

In the matter between -

ENGALA AFRICA (PTY) LTD	First Applicant
BASIL READ LIMITED	Second Applicant
BASIL READ HOLDINGS LIMITED	Third Applicant

and

LOMBARD INSURANCE COMPANY LIMITED	First Respondent
SEGP SOUTHERN AFRICA (PTY) LTD	Second Respondent

JUDGMENT

SARDIWALLA AJ

[1] Applicants seek a final interdict, interdicting the first respondent from acting on, and paying in terms of a demand made upon it by the second respondent. The second respondent called upon the first respondent to effect payment of the sum of R34 299 941.90 in terms of the performance guarantee issued by the first respondent. The interdict by the subcontractor aims to prevent payment to the contractor pending compliance with the contract relating to a national asset, based on the default of the respondent as the sub-contractor.

[2] In the alternate applicant seeks interim interdict preventing the first respondent from acting on and paying in terms of the demand, pending the finalization of the arbitration proceedings that have been instituted and an Arbitrator appointed.

NATURE OF THE APPLICATION

[3] The second respondent was commissioned to construct a Photovotaic plant at Boshoff, in the Free State. It appointed the First Applicant as its subcontractor to perform the necessary work. In terms of the subcontract, the First Applicant was obliged to procure a performance bond in respect of its obligations to the Second Respondent, and it procured the First Respondent, as an insurance company, to issue the performance bond as security for the proper performance by the First Applicant of its obligations and liabilities under the agreement. The bond is in an amount not exceeding R34 299 941.90 and is expressly payable on demand and by written statement by the Second Respondent that it is entitled to make a demand in terms thereof.

[4] The Second Respondent purported to call up the bond during March 2016 and on the basis that the First Applicant had breached its obligations in terms of the

subcontract. The First Applicant not only denies any entitlement to call up the bond but contends that the alleged breaches are *mala fide* and contrived, and that the call on the guarantee is fraudulent and that the deceit was admitted to a representative of the First Applicant by the Second Respondent's Head of Projects.

[5] Accordingly, this application was launched to prevent payment under the bond. The Second and Third Applicants' *locus standi* derives from the indemnity given by them to the First Respondent in the event that the bond is called up, and hence they are directly and adversely affected by any alleged fraud perpetrated in connection therewith. The Second Respondent denies that the call-up on the bond was fraudulent.

RELIEF SOUGHT

[6] The relief sought is a final interdict precluding the First Respondent from acting on and paying the sum of R34 299 941.90 in terms of the performance bond pursuant to the demand made by the Second Respondent for payment dated 11 March 2016. In the alternative, an interim interdict is sought pending the finalisation of arbitration proceedings to be instituted within 14 days of the granting of the order and pertaining to all alleged breaches of the subcontract by the First Applicant.

[7] The Applicants allege in the founding affidavit that the Second Respondent's Head of Projects advised the First Applicant's representative on 29 February 2016 and the Second Respondent intended to call up the performance bond to alleviate its cash flow difficulties, and not because the First Applicant was in breach of its obligations in terms of the agreement.

[8] In the answering affidavit the Second Respondent's Head of Projects contends that his advice to the First Applicant's representative has been

misconstrued (or unauthorized and a matter of opinion), but the replying affidavit provides corroborative evidence in support of the First Applicant's version.

The First Applicant contends that the dispute is not bona fide, and does not preclude the determination of the matter on the papers.

[9] However, to the extent that the above Honourable Court cannot so determine the matter, it should respectfully be referred to evidence or at least this narrow point, with interim relief precluding payment under the Bond until the matter is finally determined. In the alternative the Applicants will seek interim relief pending the outcome of the arbitration.

[10] The application was issued on 15 March 2016, and the relief sought in the notice of motion was divided into Part A and Part B. In Part A an interdict was sought preventing the First Respondent from paying under the performance bond pending the final determination of Part B, and in which the substantive relief was sought. Part A was set down on 22 March 2016 and Part B on 19 April 2016.

[11] After the service of the application, the parties engaged with each other to allow for sufficient time for the filing of answering and replying affidavits and on the basis that interim order would be in place precluding payment of the guarantee pending the date of set down of the hearing of Part B, and being 19 April 2016. By agreement, a consent order was granted preventing payment on the demand "pending" the final determination of Part A and Part B of the application.

[12] It is the contention of the Applicants that the interim relief remains in place until the "final determination" of the application. However, the Second Respondent contends that it expired on 19 April 2016.

APPLICANT'S CASE

[13] Applicant contends that the balance of convenience clearly favors the applicants and tips in favor of granting the interim interdict, if the disputes of fact cannot be resolved either on the papers or by oral evidence.

[14] The first respondent agreed to abide by the courts decision.

[15] The main issues in second respondent's case are:

(a) Which fact was misrepresented?

(b) Who knew that the fact was untrue?

(c) What factual allegations that support these two allegations.

[16] Applicant argues that the second respondent is not entitled to payment of the amount claimed as the amount represents the full amount of the guarantee. Second respondent has not quantified the specific amounts of the claim which relate to the dispute attributable to the lightning protection system and Transformers. Applicants contend that there is absolutely no basis on the purported breach by the applicant that entitles 2nd respondent the claim for the full amount of the guarantee and for that reason alone the interdict should be granted.

[17] The sub contract stipulates at paragraph 3(3)(q) that such contractor shall be entitled to make a claim under the performance bond in the event if:

(i) failure by the subcontractor to extend the validity of the performance bond in accordance with section 3 (q) in which event the contractor may claim the full amount of the performance bond;

(ii) Failure by the subcontractor to pay the contract or any unpaid amount within 14 days of such amount having originally been due and payable;

(iii) failure by the subcontractor to remedy default within 28 days of the latest date on which the default should have been performed so as not to result in the default under the agreement.

[18] The respondents contention is that the guarantee is unconditional and entire amount is payable on demand. In argument the respondent has taken the approach that there is no obligation on the respondent provide details of the breach, by providing the applicant with a breakdown and calculation of the claim upon which payment is claimed. In essence the payment of the entire amount guaranteed must be made on presentation of the guarantee.

[19] Respondent in its demand on 20 January 2016 demanded that the applicant upgrade the size of transforms from 1250KV a to 1380 kVA within seven days as a prelude to calling up the guarantee.

[20] The applicant's contention that demand does not make mention of the specifications of the agreement which are allegedly breached nor does it provide any basis for the demand for an upgrade. It is common cause that the second respondent specified 1250 kVA Transformers in terms of the contract. Hence applicant concludes that the demand was clearly in bad faith. The second respondent contends that the applicant failed to design, supply and install certain

transformers in terms of the subcontract agreement justifying the calling up of the guarantee.

[21] The significant aspect is that the specification for the design was presented by the applicant and approved by second respondent prior to the contract being concluded for the work on the project. The second respondent states as follows:

> *"in conclusion the requirements for substantial completion have still not been achieved by virtue of the:*
>
> *(1) Transformer defects*
>
> *(2) Lightning and surge protection system defects and*
>
> *(3) Provision for an increased performance guarantee*
>
> *(4) In the alternative the applicant failed as to date hereof to remedy certain defective works that is transformers and lightning and surge protection system as more fully set out in the expert reports."*

[22] The dispute between the parties clearly revolves around the conditions of the contract between the applicant and the second respondent and the second respondent's performance as well as the applicant's alleged breach thereof.

[23] The sub contract entered into between the applicant and the second respondent on 9 August 2013 stipulates at clause (25) that specific procedures relating to dispute resolution including negotiation and in respect of technical defects to be determined by an expert. At paragraph (25) (d) of the contract stated as follows:

> **"Binding Arbitration**
>
> Any dispute not designated under this agreement as a technical dispute which the parties to not agree in writing is suitable for an expert determination shall

be finally resolved by in accordance with the rules of the Arbitration Foundation of South Africa (AFSA).

(a) Any party may initiate arbitration proceedings pursuant to this section (20) by issuing a notice to the other party pursuant to the rules.

(b) the parties hereby consent to the arbitration being dealt with on an urgent basis in terms of the rules should either party by written notice to the other party require arbitration to be held in urgent basis."

[24] It is common cause that the dispute has been referred to the Arbitration Foundation of South Africa and the arbitrator appointed by the institution on 6 May 2016.

[25] The applicant has submitted its statement of claim and the second respondent responded filed its responding statement of defence relating to the dispute that is before this court. It is noteworthy that the stipulation in the contract relating to arbitration is specifically referred to as "binding arbitration" and suggesting that arbitration is not discretionary but peremptory.

[26] It is common cause that experts for both parties have investigated the allegations and opposing expert reports have been filed in the arbitration.

SECOND RESPONDENTS CASE

[27] The second respondent contends that the application must be decided on the papers before the court and not be referred to arbitration. The rationale behind this approach is that the applicant alleges that the demand for payment is made on fraudulent grounds and that the arbitrator's authority is to deal with the dispute and the arbitrator is precluded from making a finding on issues relating to fraud.

[28] Respondent takes the view that ultimately arbitration will at best determine which of the two sets of experts are correct relating to the alleged breach. The arbitration will not determine default base on fraud. This suggests that the arbitration process will not determine the right to interdict the payment on the guarantee based on fraud but simply make a determination on whether there was fraud the by subcontractor.

[29] Applicant further contends that the balance of convenience clearly favors the applicants as has been revealed by the second respondents head of projects Erasmus, who, on the 29th February 2016, personally informed Jeffery Pipe an independent consultant to the second respondent and the applicant, that the second respondent was experiencing substantial cash flow difficulties and it was for this reason it decided to call on the performance bond ,even though there were no legitimate grounds for doing so, to alleviate the cash flow difficulties. Applicant argues that the second respondent is not entitled to payment of this the amount claimed as the amount represents the full amount of the guarantee.

[30] Second respondent has not quantified nor quantified the specific amount of claim which based on performance and the stage of completion of the project.

[31] The second respondent further contends that the issue of the Lightning protection and the Transformers is not attributable to it and the breach is on the part of the applicant. Applicant's response is that there is absolutely no basis upon which the claim for the full amount of the guarantee can be justified and for that reason alone the interdict should be granted.

[32] The applicant contends that "substantial completion" is achieved after test results have been obtained confirming substantial completion. Even if second respondent is entitled to make a call on performance on the guarantee ,which the applicant denies, this can only be made on the bases that the warranty phase has been achieved and that the performance guarantee has automatically been reduced to 5% of the contract sum, that being the amount of seven teen R17 149970, 95. Despite this the second respondent claims the full 10% indicating bad faith on the part of the second respondent.

[33] Any demand for payment must contain your director's signature which must be authenticated by its bankers or by a notary public. On the 11 March 2016 first respondents attorneys are addressed a letter of demand to the second applicant in the following terms: –

> *".....Consequently, we are instructed to demand, as we hereby do, that you immediately make payment to our client, of the aforementioned amount of R34 299 941.90 (Thirty Four Million Two Hundred and Ninety Nine Thousand Nine Hundred and Forty One Rand and Ninety Cents), as you are required to do in accordance with the provisions of Clause 2 and 3 of the Deed of Indemnity annexed hereto. Kindly make immediate payment to our trust account."*

[34] It is the respondents contention that the guarantee is unconditional and the entire amount is payable on demand. In argument the respondent has taken the approach that there is no obligation on the respondent provide details of the of breach by the applicant, nor a breakdown as to the calculation of the claim upon which payment is demanded.

[35] Respondent in its demand on 20 January 2016 demanded that the applicant upgrade the size of transforms from 1250KVA to 1380KVA within seven days as a

prelude to calling up the guarantee. Applicant's contention is that demand makes no mention of the specifications in the agreement which were allegedly breached, nor does it provide any basis for the demand for an upgrade. All it does was to attach a report stipulating that the second respondent specified 1250 kVA Transformers.

[36] Hence applicant concludes that the demand was in bad faith as second respondents allegations are contrary to the agreement and therefore does not justify the calling up of the guarantee.

[37] The specification for the design was presented to the second respondent and was approved by it prior to the contract being concluded for the work on the project.

[38] The dispute between the parties revolves around the conditions of the contract between the applicant and the second respondent and the second respondent's performance as well as the applicant's alleged breach thereof.

[39] The sub contract entered into between the applicant and the second respondent on 9 August 2013 stipulates:

> *"the contract envisages at clause 25 specific procedures relating to dispute resolution including negotiation and in respect of technical defects a determination by experts. Paragraph 25 6d of the contract reads:*
>
> *" Binding arbitration".*

Any dispute not designated under this agreement as a technical dispute which the parties to not agree in writing is suitable for an expert determination shall be finally resolved by in accordance with the rules of the arbitration foundation of South Africa (AFSA).

(a) the party may initiate arbitration proceedings pursuant to this section 20)(5)(d) by issuing a notice to the other party pursuant to the rules.

(b) the applicant has submitted its statement of claim in the second respondents statement of defence relating to the dispute that is before this court. It is noteworthy that the stipulation in the contract relating to arbitration is "binding arbitration" clearly suggesting that it is not discretionary at all."

[40] It is common cause that experts for both parties have investigated the allegations and opposing expert reports have been filed.

[41] The respondents contention is that the guarantee is unconditional and the entire amount is payable on demand. In argument the respondent has taken the approach that there is no obligation on the respondent provide details of the breach or breakdown as to how has to the calculation of the claim upon which payment is claimed. In essence the payment the demand is made for payment on presentation of the guarantee.

[42] The respondent in its earlier demand on 28 January 2016 demanded that the applicant upgrade the size of transforms from 1250KV to 1380K within seven days as a prelude to calling up the guarantee.

[43] The applicant's contention that demand does not make mention of the specific aspects of the agreement that were allegedly breached nor does it provide any contractual basis to demand an upgrade. It does was to attach a report on the1250 kVA Transformers. Hence applicant contends that the demand was clearly in bad faith whilst second respondent contends that the plaintiff failed to design, supply and

install certain transformers in terms of the subcontract agreement to justify the calling up of the guarantee.

[44] The dispute between the parties clearly revolves around the conditions of the contract between the applicant and the second respondents' performance as well as the applicant's alleged breach thereof.

[45] On the aspect of arbitration, second respondent's argument is that the applicant alleges that the demand for payment is on fraudulent grounds and that the arbitrator's authority is limited to deal with the dispute and precluded from making a finding on issues relating to fraud. It takes the view that ultimately arbitration will at best determine which of the two sets of expert has the correct opinion and that and that the arbitration will not determine whether the contract is alliance on the opinions in support of the default is fraudulent not. This effectively suggests that the arbitration process will not determine the right to interdict payment on the guarantee based on fraud but simply make a determination on whether there was the fraud on the part of the subcontractor.

CASE LAW

[46] In the case of ESKOM HOLDINGS SOC LIMITED and HITACHI POWER AFRICA Construction Brand J stated that:

> "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*

[1] *Dornell properties 2882 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); Basis Read (Pty) Ltd v Beta Hotels (Pty) Ltd & Others 2001 (2) SA 706 (C).*

> *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 guarantees' 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".

[47] 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.

[48] 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".

[49] 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.

[50] The recital of its terms are set out in clause 3 of the Performance Bond issued by the Bank. The clause read as follows:

> *'3 A demand for payment under this guarantee shall be made in writing at the Banks 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.'*

[51] 11 March 2016, Lombard received yet another demand from SunEdison in which it specified what it contended were breached by Engala (referred to in the letters as "the Principal") that:

> *"a. The principal has failed to design, supply and install certain transformers and lightning and surge protection in terms of the subcontract (hereinafter referred to as "the defects").*
>
> *b. By virtue of the aforesaid conduct by the Principal, certain of the transformers in the Project have failed; furthermore the Project suffered substantial damage from lightning strikes.*
>
> *c. The Principal was place on terms to comply with certain remedial actions to remedy the aforesaid defects. The Principal has refused to comply.*
>
> *d. In the circumstances, the Principal has breached its obligations in terms of the contract".*

[52] On 11 March 2016, Lormbard's addressed a letter to the second applicant calling upon it (in terms of a deed of indemnity) to pay to it R34 299 941.90. In terms of the indemnity, the second and third applicants undertook to pay any sums of money which Lombard was called upon to pay under the guaranteed so issued.

[53] In England for example there is no public policy requiring issues of fraud to be decided by the courts. Therefore, accusations of fraud are in principle capable of falling within the scope of an agreement to arbitration.

[54] At the outset of any contractual relationship, a party would not usually be anticipating fraud from its counter-party and hence, it is unlikely to expressly include language covering fraud in the arbitration agreement. However, the broad construction of arbitration clauses under English law may assist.

[55] If a party claims that the main contract itself was induced by fraud, the doctrine of separability applies and in such circumstances the arbitration clause will be unenforceable. Even in circumstances where a party to arbitration alleges that fraud has occurred, it is not uncommon to find that there may be parallel court proceedings.

[56] On the other hand, the right of an arbitral tribunal to stay proceedings is not universally established. Alexis Mourre in "Arbitration and Criminal Law: Jurisdiction, Arbitrability and Duties of the Arbitral Tribunal" notes that:

> *"In most jurisdictions, an arbitral tribunal has no obligation to stay the proceedings when a criminal investigation is pending on facts which might be relevant for the arbitration. This principle was embedded by a resolution of the International Law Association adopted in 1996".*

He argues that whilst criminal law ought not to be used to disrupt the arbitration, equally arbitrators should not let themselves be used as a tool for fraud.

[57] Allegations of fraud and corruption are increasingly encountered in arbitrations but there is at times a perception that in arbitration, which is by nature a private and consensual dispute resolution mechanism, is ill-equipped to handle the challenges thrown up by such allegations. This is particularly so when looking at arbitral procedure. Is this perception justified or is arbitration flexible enough a tool to overcome these challenges.

[58] I am of view that arbitration in this country has reached a level of maturity and professionalism that the boundaries are clearly defined relative to litigation. Issues arising during arbitration that are the strict domain of litigation can be identified and if prescriptive or peremptory on any issue, the aspect must be referred to the appropriate forum.

[59] The arbitrator in these circumstances if satisfied that any aspect arises from a fraudulent transaction may be obliged to stay proceedings on the specific aspect and refer same to civil proceedings; he is to do so after weighing the relative inconvenience and prejudice that would be suffered by the parties.

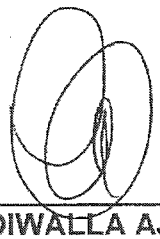
[60] The cause of action arises from a guarantee issued in terms of a construction contract and the dispute is riddled with allegations of breaches and non-compliance. There are allegations of spurious disputes and cognizable disputes of fact. The veracity of the allegations relating to fraud have not been adjudicated upon conclusively.

[61] These issues in my view are not for adjudication by me in this application. The arbitration process would be the appropriate forum to adjudicate on the factual

[62] I accordingly make the following order:

62.1 The First Respondent will not act on or make payment in terms of a demand made upon it by the Second Respondent dated 11 March 2016 wherein the Second Respondent called upon the First Respondent to effect payment of the sum of R34 299 941.90 in terms of a performance guarantee, being Lombard Guarantee No. C2013/48029 dated 29 August 2013, as reissued, pending the finalisation of the Arbitration proceedings between the first applicant and the second respondent and the handing down of the arbitration award.

62.2 The application is granted with costs.



SARDIWALLA AJ
ACTING JUDGE OF THE HIGH COURT
GAUTENG LOCAL DIVISION

Appearances:

Counsel for the Applicant:	Adv. S. Symon SC Adv. X. Stylianou
Instructed by:	Ramsay Attorneys
Counsel for the 2nd Respondent:	Adv. L.J. Van Tonder SC
Instructed by:	Tiefenthaler Attorneys
Date of hearing:	24 May 2016
Date of judgment:	23 June 2016