

IN THE HIGH COURT OF SOUTH AFRICA

KWAZULU-NATAL DIVISION, PIETERMARITZBURG

CASE NO: 15923/15

In the matter between:

LOMBARD INSURANCE COMPANY LIMITED
(Reg. No: 1990/001253/06)

APPLICANT

and

KENNETH LOGAN JOSEF STEWART

1ST RESPONDENT

KENNETH LOGAN JOSEF STEWART N.O.

2ND RESPONDENT

MOIRA STEWART N.O.

3RD RESPONDENT

J U D G M E N T

Delivered on : TUESDAY, 11 OCTOBER 2016

OLSEN J

[1] The applicant, Lombard Insurance Company Limited, is in the business of issuing what are commonly called construction guarantees. It issued one in favour of Umgeni Water relating to a construction contract concluded between Umgeni Water and a contractor called Cyclone Construction (Pty) Limited. Lombard had earlier secured an indemnity from Cyclone as well as undertakings (I use a neutral term, for the time being) from Mr Stewart, the first respondent, and two trusts, in terms of which, Lombard claims, those parties undertook to make good if Cyclone did not honour its indemnity.

[2] Lombard paid Umgeni Water R2 690 028,36 against a demand made under the construction guarantee, and now claims that amount from Mr

Stewart and one of the trusts (the other being incapacitated for want of the appointment by the Master of an additional trustee). The claims are made because Cyclone, which has gone into liquidation, did not honour its undertaking to indemnify Lombard when the latter paid Umgeni Water under the construction guarantee. The trust which is now properly before the court is the Bankenbrig Trust. It is represented by the second and third respondents as well as its attorney of record, Mr Geyser, who is the third of its three trustees. The Trust makes common cause in the defences raised by Mr Stewart in his answering affidavit. For the reason that the Trust is not in my view in precisely the same position as Mr Stewart, I will deal with the claim against him first.

[3] All the undertakings relied upon by Lombard are written. The proper construction of them, and the nature of the liabilities they impose, are in dispute. In addition Mr Stewart challenges the proposition that the indemnity furnished by Cyclone ever gained contractual force.

The Construction Guarantee

[4] In dealing with these issues it is convenient to start with the last executed of the various documents which feature in this case, namely the construction guarantee. It was issued by Lombard in favour of Umgeni Water on 28 March 2012. It provided for a maximum liability in the precise sum claimed in these proceedings. The letter conveying the demand for payment under the guarantee gave no explanation for the making of it other than the simple statement that Umgeni Water had terminated the contract with Cyclone.

[5] According to Lombard after some delay it paid Umgeni Water in accordance with the demand. The founding affidavit offers no explanation for the payment to Umgeni Water besides the fact that the latter had made the demand. There is no evidence before me to the effect that Cyclone owed anything to Umgeni Water. According to Lombard none is necessary, because the guarantee it provided is a so-called “on-demand guarantee”. Mr

Stewart disputes that. He contends that the construction guarantee is in fact a deed of suretyship conveying only an accessory obligation, the liability of Lombard thereunder having been entirely dependent on the existence of a due and undischarged principal obligation owed by Cyclone to Umgeni Water. Mr Stewart argues that as the founding affidavit does not allege the existence of such a principal obligation, it has not been established that Lombard was obliged to pay Umgeni Water.

[6] In *Minister of Transport v Zanbuild Construction* 2011 (5) SA 528 (SCA) at para [20] Brand JA accepted, for the purposes of the argument in that case, that the interpretation of construction guarantees is often bedevilled by loose language. That is the case here, where each of the interpretations advanced is generated by a focus upon one part of the document to the near exclusion of all else. Of course the focus of the conflicting interpretations is not the same.

[7] As pointed out in *Zanbuild* (at para [13]), the characteristics of an on-demand guarantee are that it specifies an event which generates a right to make a claim under it, and provides for payment on demand. Such a demand would be accompanied by notification that the specified event has occurred. Fraud aside, the guarantor must pay forthwith, without going behind the demand with a view to avoiding payment by challenging the assertion by the employer that payment is due. It is not a requirement of the guarantor's liability that anything should be owing by the contractor to the employer when the demand is made. (See *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras [10] to [25], and the cases referred to there.)

[8] The alternative form of construction guarantee is in the nature of a suretyship, or indeed a simple deed of suretyship. The guarantee may stipulate when, or in what circumstances, a demand for payment may be made, but the legitimacy of the demand depends on the existence of a principal debt owed by the contractor to the employer. It is uncontentioned that in our law a surety is entitled to raise any defence that the principal debtor

might raise. Given that, it would take clear language in such a construction guarantee to convey that, despite the fact that the right to demand payment depends on the existence of a debt owed by the contractor to the employer, the guarantor is not entitled to avoid payment by challenging the existence of the principal debt when called upon to pay by the employer.

[9] In *Zanbuild* the court concluded that the language employed in the guarantee in that case was akin to language associated with suretyships. In this case the language employed in the guarantee provided by Lombard is the language of suretyship. The preamble records that the construction contract required Cyclone to provide “security by way of suretyship for the due and faithful fulfilment” of the building contract by Cyclone. The operative provision in the guarantee records that Lombard’s representatives signing the document

“do hereby guarantee and bind [Lombard] jointly and severally as surety and co-principal debtor to [Umgeni Water] under renunciation of the benefits of division and excussion for the due and faithful performance by [Cyclone] of all the terms and conditions of the said contract subject to the following conditions: ...”

[10] Seven conditions follow this statement of the undertaking made by Lombard. Two of them are relevant to the present enquiry because they are relied upon by Lombard in contending that, despite what is set out immediately above, the guarantee it furnished to Umgeni Water is an on-demand guarantee, not dependent on the existence of a debt owed by Cyclone to Umgeni Water. They read as follows.

- “4. The guarantor’s total liability hereunder shall not exceed the sum of R2 690 028,36 (Two million six hundred and ninety thousand and twenty eight rand and thirty six cents) (10% of the contract price) which amount the guarantor agrees to hold at the employer’s disposal.
5. The guarantor declares that it is fully acquainted with the terms and conditions of the said contract and that the guarantor

waives the legal exceptions available to a guarantor and undertakes to pay the said amount or such portion thereof as may be demanded immediately on receipt of a written demand from you. A certificate issued by the employer shall be sufficient and satisfactory evidence as to the amount of the guarantor's liability for the purpose of enabling provisional sentence or any similar relief to be obtained against the guarantor."

[11] The first thing of importance to note is that these two clauses do not introduce or identify an event which will justify the making of the demand. As the document has already specified that the liability of Lombard is an accessory to the liability of Cyclone, that accordingly remains the position.

[12] Both conditions 4 and 5 record that the claim (or claims, presumably) may amount to less than Lombard's maximum liability under the instrument. That also supports the conclusion that the two clauses recognise that the amount which may be demanded may be restricted by some or other circumstance, which can only be the fact that the principal debt at the time of demand is less than the stipulated maximum. It is legitimate to ask why Umgeni Water would claim less than the stipulated maximum if the provisions of the instrument did not oblige it to do so. (See *Zanbuild*, para [20].)

[13] The argument for Lombard is in essence that the undertaking to pay immediately on receipt of a written demand makes this a demand guarantee. I do not agree. It is not provided that, as between Umgeni Water and Lombard, the making of a demand by Umgeni Water will be regarded as irrefutable proof of the existence of a co-extensive principal obligation owing by Cyclone to Umgeni Water.

[14] In my view the language of clauses 4 and 5 is reconcilable with the primary statement of Lombard's liability, namely that of a surety. The word "demand" is in my view employed in clause 5 to mean what it ordinarily means in common usage, such as when one says that any existing liability (for

instance an overdraft) is payable on demand. What the word conveys in the document now under consideration is that the amount must be paid, not seven days or a month after demand, but immediately upon demand. When used in that sense the word “demand” is not a necessary requirement for the creation of a debt, as it is in the case of a true on-demand guarantee.

[15] The construction guarantee in issue in this case stands in sharp contrast to the one issued by Lombard and considered in *Lombard Insurance Company Limited v Landmark Holdings (Pty) Limited and Others* 2010 (2) SA 86 (SCA), where a clause in the guarantee provided specifically that it should not be “construed as any intention whatsoever to create an accessory obligation or any intention whatsoever to create a suretyship”. Here the guarantee was expressed as a deed of suretyship. It is not an on-demand guarantee.

[16] As mentioned earlier Lombard has not attempted to establish that any principal debt was owed by Cyclone to Umgeni Water at the time when it (Lombard) paid Umgeni Water. Given my interpretation of the construction guarantee the conclusion must be that Lombard has failed to establish that it was obliged to pay Umgeni Water. The question as to whether that means that Lombard’s claims against Mr Stewart and the Trust must be denied depends on the provisions of the undertakings made in favour of Lombard by those persons and by Cyclone itself. I deal with the last mentioned undertaking first.

Cyclone’s Undertaking

[17] The written undertaking furnished by Cyclone is headed “Deed of Indemnity”. In the document Cyclone is called the “guarantor”. The document was signed on 11 August 2006, and was executed on behalf of Cyclone by Mr Stewart who, on the same day, executed the undertaking upon which he is sued in these proceedings.

[18] In the preamble to the document it is recorded that Lombard had agreed to execute or procure the execution of guarantees for Cyclone and that it did so upon the strength of the security and indemnity provided by Cyclone in the document. Cyclone's undertaking follows that preamble.

[19] The body of the document defines "guarantees" to include suretyships. Clause 2 is the principal statement of the undertaking. Omitting words which make no contribution to its understanding in the present context, it provides as follows.

"In consideration of the insurance company executing or procuring the execution of any guarantee or guarantees, the guarantor hereby indemnifies and keeps indemnified the insurance company and holds it harmless from and against all claims, liabilities, costs, expenses, damage and/or losses (including loss of interest) of whatsoever nature sustained or incurred by the insurance company under or by reason or in consequence of having executed or procured or hereafter executing or procuring any guarantee or guarantees,... There shall be no obligation upon the insurance company to resist or defend any claim in terms of a guarantee."

[20] In paragraph 3 of the document Cyclone undertook and agreed to pay to Lombard

"immediately on first written demand any sum or sums of money which the insurance company may be called upon to pay under the guarantee/s, whether or not the insurance company at such date shall have made such payment, and whether or not the guarantor admits the validity of such claim against the insurance company under the guarantees; ..."

[21] The obligations of Cyclone are expressed in the widest possible terms in clause 2 of the undertaking. Umgeni Water undoubtedly made a claim under Lombard's guarantee. We do not know whether it was capable of being resisted. But clause 2 provides that Lombard was under no obligation to

resist any claim; which must mean that (fraud aside) it was entitled to pay the claim. (There is no suggestion in this matter that any fraud is involved.)

[22] The guarantee renders the undertaking made by Cyclone an equivalent of the “on-demand guarantees” discussed earlier. Lombard was called upon to pay under its guarantee. That is the event which triggered Lombard’s right to deliver a demand to Cyclone. Cyclone was then obliged to pay, and for the sake of clarity clause 3 records that such payment would be due even if Cyclone did not admit the validity of the claim against Lombard.

[23] I accordingly conclude that Cyclone became obliged to meet Lombard’s claim against it whether or not Lombard would have been entitled to resist the claim made by Umgeni Water upon the basis that it was in fact not ancillary to an underlying principal debt then owed by Cyclone to Umgeni Water under the construction contract concluded between those parties.

[24] Mr Combrink, arguing for the respondents, contends that, whatever its proper construction, the contract of indemnity between Lombard and Cyclone did not ever gain contractual force. The argument is structured around the proposition that the form of indemnity signed by Cyclone also provided for the document to be signed by Lombard, which was not done. With reference *inter alia* to *Goldblatt v Fremantle* 1920 AD 123, Mr Combrink argues that this is a case where the parties had decided that their contract be reduced to writing, and that it would only come into existence once it had been signed by both of them. The relevant passage in the judgment of Innes CJ in *Goldblatt* appears at pages 128 – 129. (References are excluded in the quotation below.)

“Subject to certain exceptions, mostly statutory, any contract may be verbally entered into; writing is not essential to contractual validity. And if during negotiations mention is made of a written document, the court will assume that the object was merely to afford facility of proof of the verbal agreement, unless it is clear that the parties intended that the writing should embody the contract. At the same time it is always open to parties to agree that their contract shall be a written one; and

in that case there will be no binding obligation until the terms have been reduced to writing and signed. The question in each case is one of construction.”

[25] Accepting that it is a question of construction, Mr Combrink argues that the document is unlike a unilateral indemnity such as a suretyship, and was intended to impose positive obligations on Lombard. He refers in this regard to the contents of the preamble which I have already mentioned. He argues that signature by both parties must have been contemplated as the only method of creation of enforceable rights and obligations because the contract imposes reciprocal obligations.

[26] The operative provisions of the indemnity signed by Cyclone deal only with promises made by Cyclone. I call this section of the document the operative one because it is introduced by the words

“NOW THIS DEED WITNESSES AND IT IS HEREBY AGREED as follows:”.

The position is that not all words contained in a written agreement or undertaking are intended to be the expression or embodiment of rights and obligations which are granted and imposed by the document concerned. Cameron JA put it as follows in *ABSA Bank Limited v Swanepoel* NO 2004 (6) SA 178 (SCA), para [6].

“At its simplest, a contract is an enforceable promise to do or not to do something. But when parties record an agreement in writing, they often add provisions that do not embody such promises. A contract may have a preamble. It may contain ‘recordals’ and ‘recitals’. It may document prior events, or record the parties’ future intentions. It may contain clarificatory or explanatory statements. The parties may place on record matters that bear on the interpretation of what they have undertaken. It is therefore wrong to approach a written contract as though every provision is intended to create contractual obligations.”

[27] In plain words the two paragraphs of the preamble or recital which precede the operative part of the deed of indemnity record what the insurance company has already done. They record that the insurance company “has agreed” to provide guarantees for Cyclone and that it “has agreed” to execute them on the condition that it receives the indemnity from Cyclone. In my view these were records not intended to be the embodiment of promises made by Lombard which, to gain contractual force, required that Lombard sign the document in question.

[28] In my view it is beyond question that Lombard accepted the indemnity furnished by Cyclone. The document was delivered by Cyclone to Lombard. The undertaking upon which Mr Stewart is sued in this case was signed on the same day as Cyclone’s indemnity, and in it he records that Cyclone “has agreed to indemnify” Lombard. Subsequent to the execution of the indemnity Lombard provided guarantees for Cyclone. In his answering affidavit Mr Stewart states that

“the applicant never signed the document and certainly did not convey its acceptance of the terms thereof either to Cyclone or any one of the respondents”.

Mr Stewart does not explain this statement by illustrating any terms or mode of business subsequently conducted between Cyclone and Lombard which are inconsistent with those set out in Cyclone’s indemnity. Neither does he explain the inconsistency between the undertaking he signed and the proposition that Cyclone had not on the very same day indemnified Lombard. To the extent that it may be said that there is a dispute of fact concerning the question as to whether Lombard accepted Cyclone’s indemnity, I do not regard it as *bona fide*.

Mr Stewart’s Undertaking

[29] Mr Stewart’s undertaking is embodied in a document which is headed “Deed of Suretyship”. In its preamble it records that Lombard has undertaken

to provide construction guarantees for Cyclone, that Cyclone has agreed to indemnify Lombard in respect of those guarantees, and that Mr Stewart has agreed to bind himself as surety and co-principal debtor with Cyclone for the due payment by Cyclone to Lombard on demand of amounts which Cyclone may be liable to pay to Lombard under the indemnity. The operative provisions appear under those recitals.

[30] Despite the heading to Mr Stewart's undertaking, it is more than a suretyship. In clause 1, having bound himself as surety, Mr Stewart's undertaking proceeds further with the words

“...and [I] further indemnify and keep indemnified [Lombard] and hold it harmless from and against all and any claims, losses, demands, liabilities, costs and expenses of whatsoever nature, including legal costs between attorney and client which it may at any time sustain or incur by reason or in consequence of having executed or hereafter executing any guarantee on behalf of the contractor, ...”.

[31] The clause then goes on further as follows.

“And I/we further undertake and agree to pay to the insurance company on demand any sum or sums of money which the insurance company may be called upon to pay under any guarantee whether or not the insurance company shall, at such a date, have made such payment, and whether or not the contractor or me/us admit the validity of such claims against the insurance company under the guarantee.”

[32] On the plain wording of the written undertaking provided by Mr Stewart, he bound himself not only as surety, but also as an indemnifier of Lombard in much the same way as did Cyclone. In both the answering affidavit and in argument the complaint was advanced that the provision for an indemnity brings about that the document incorporates both principal and accessory obligations, which is unfair (and indeed in the answering affidavit it is said to be unconstitutional, without any explanation for that contention), and therefore unenforceable. However it is not stated in the answering affidavit that Mr

Stewart, a civil engineer who proclaims his understanding of these matters, was misled in any respect as regards the content of the undertaking which he signed.

[33] In my view his undertaking is enforceable, and given my finding regarding the liability of Cyclone, it is enforceable whether Mr Stewart is regarded as Cyclone's surety or Lombard's indemnifier. This is made clear in clause 7 (a) of the document which reads as follows.

“This deed shall be enforceable against me/us in accordance with the tenor thereof, whether as an indemnity or otherwise, notwithstanding that the indemnity may in any way be invalid or unenforceable against [Cyclone].”

[34] I accordingly conclude that the claim against Mr Stewart must succeed. It includes a claim for interest which has elicited no objection from the respondents.

The Trust's Undertaking

[35] The position of the Trust is a little different. In its content the undertaking signed on behalf of the Trust is in all material respects precisely the same as the one signed by Mr Stewart. However the Trust's undertaking was signed in 2002, four years or so before Cyclone signed the indemnity in favour of Lombard. The founding affidavit does not deal at all with the arrangements which subsisted before the Cyclone indemnity and Mr Stewart's undertaking were signed on 11 August 2006; that is save for the fact that it was recorded that at that time (August 2006) Lombard had already undertaken to provide guarantees for Cyclone. According to Mr Stewart, for many years prior to 11 August 2006 Lombard and Cyclone had conducted business without any formal agreement being in place.

[36] Accordingly, the papers do not disclose the terms of the indemnity under which Cyclone was obliged to Lombard as at November 2002, the

breach whereof would have brought about the Trust's obligation as Cyclone's surety. In other words the principal debt upon the existence of which the Trust's obligation as surety rests has not been proved.

[37] The founding papers do not specifically address the question as to whether the indemnity provided by Lombard to Umgeni Water may properly be regarded as a construction guarantee which fell within its undertaking to provide such guarantees for Cyclone prior to the execution of the Trust's undertaking in 2002.

[38] Having said the foregoing, I am nevertheless satisfied that Lombard's claim against the Trust must succeed for the following reasons.

- (a) The founding affidavit does assert that the Trust's obligations set out in its written undertaking (in the same terms as the undertaking of Mr Stewart) operate with respect to the contract guarantee furnished by Lombard to Umgeni Water, and to the claim for reimbursement of Lombard's expenditure under that guarantee.
- (b) In its terms the undertaking made by the Trust operates indefinitely, subject to its right in terms of clause 9 to give notice to terminate its undertaking in respect of guarantees postdating such a notice.
- (c) The defences raised on behalf of the Trust do not extend beyond those raised on behalf of Mr Stewart. There is no allegation to the effect that the Trust's undertaking was terminated. There is no allegation that the contract guarantee furnished to Umgeni Water is not one which falls within the ambit of the indemnity provided by the Trust, despite the fact that on the plain wording of the indemnity, it does.
- (d) In the absence of such challenges specific to the position of the Trust (as opposed to Mr Stewart) it seems to me that Lombard's assertion that the Trust is also liable must be upheld, but only in the Trust's capacity as indemnifier.

The Order

[39] The Trust's undertaking in respect of interest is expressed with respect to the prime overdraft rate of ABSA, and not of Nedbank, as is the case with Mr Stewart's undertaking. The prayer for interest makes reference to the prime overdraft rate of Nedbank. I have already mentioned that no objection is taken to it, and I assume that, as far as the Trust is concerned, the absence of objection signifies that it is satisfied with its obligation for interest being expressed with respect to the prime overdraft rate of Nedbank.

[40] The Trust and Mr Stewart are not found liable as co-sureties, but as debtors each individually responsible for the same debt. Payment by one will release the other, but not in circumstances where there is an automatic right of contribution. The order must be framed accordingly.

[41] As to costs, they are claimed on the attorney and client scale. In my view a proper construction of the undertakings made by Mr Stewart and the Trust does not support that claim. Attorney and client costs are mentioned only in the statement of the indemnity given with respect to losses incurred in consequence of Lombard having executed guarantees. The costs in the present proceedings are incurred in consequence of Mr Stewart and the Trust refusing to pay in terms of their own undertakings. The documents are silent on the question as to the scale of costs in such proceedings. The prayer for costs does not extend to joint and several liability.

The following order is made.

- 1. Each of the first respondent and the Bankenbrig Trust (represented by its trustees in their nominal capacities) are ordered to pay to the applicant the sum of R2 690 028,36, together with interest thereon from 11 December 2013 to date of payment at a rate 2% above the prime overdraft rate charged from time to**

time by Nedbank Limited (Fox Street branch), the one paying, the other to be absolved.

2. The first respondent and the said trust are ordered to pay the costs of this application.

OLSEN J

Date of Hearing: TUESDAY, 20 SEPTEMBER 2016

Date of Judgment: TUESDAY, 11 OCTOBER 2016S

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