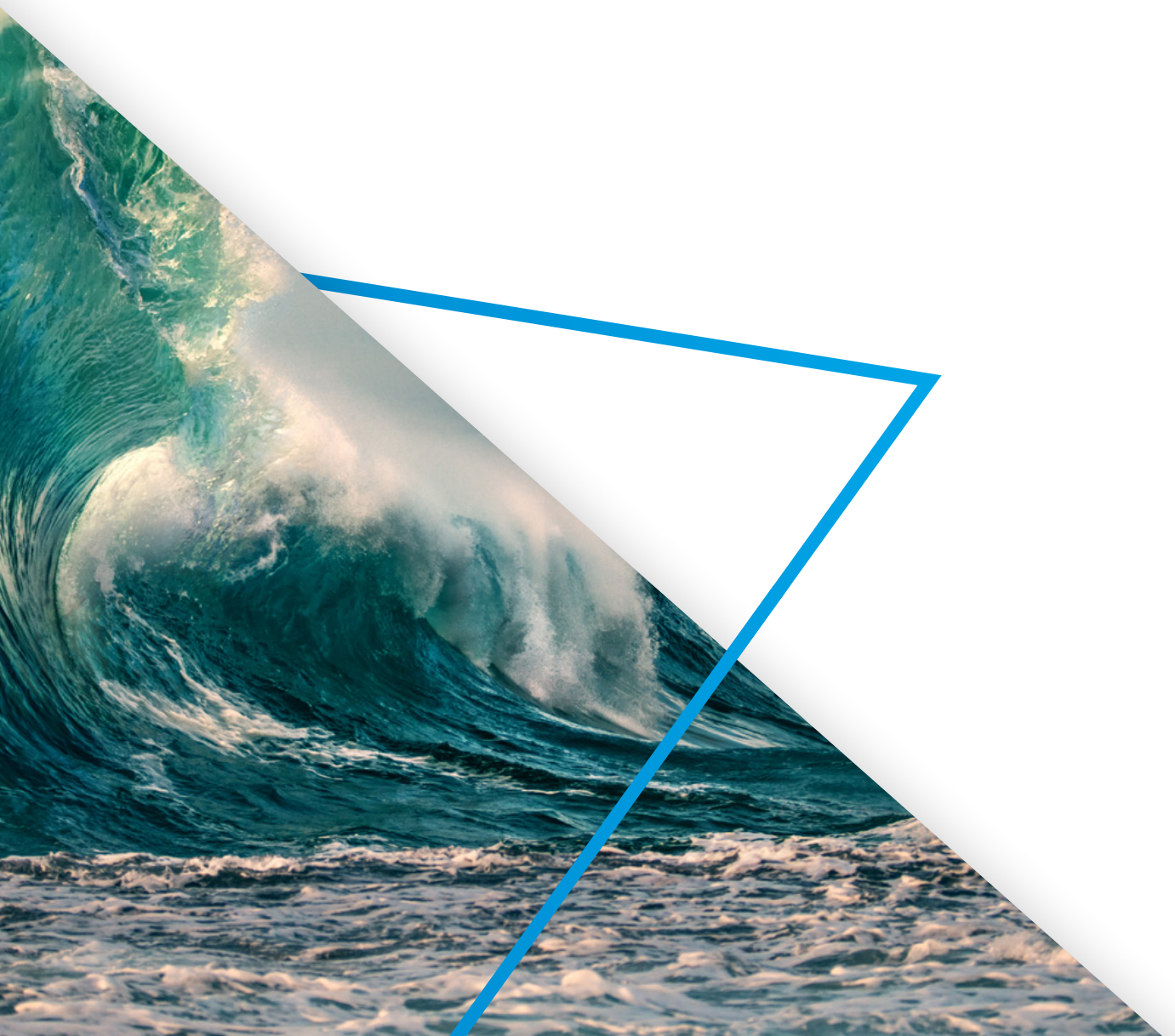
Dispute Resolution

ALERT | 27 August 2024



In this issue

SOUTH AFRICA

- The issue of procedural rights and settlement agreements in the adjudication of the defence of fraud against the enforcement of a performance guarantee
- Appealing or Rescinding? That is the question when dealing with judgments granted against a person without their knowledge

For more insight into our expertise and services

The issue of procedural rights and settlement agreements in the adjudication of the defence of fraud against the enforcement of a performance guarantee

The parties to a construction contract often agree to the conclusion of separate financial arrangements with third parties for the purposes of ensuring financial security and project success. Where such an agreement is in place, the contractor procures an undertaking furnished by a guarantor, who is an authorised financial services provider, to pay a specified amount to the employer where the contractor (or subcontractor) fails to perform in terms of the contract. This undertaking is known as a performance guarantee.

The recent Supreme Court of Appeal (SCA) case of *Bonifacio and Another v Lombard Insurance Company Ltd* (247/2023) [2024] ZASCA 86 (4 June 2024) centred on the issue of performance guarantees. Specifically, the case examined whether third parties who indemnified a guarantor against payment are liable to the guarantor where the guarantor had made payment based on a settlement and whether settlements deprive third parties of procedural advantages that might excuse them from liability.

The salient facts

DBT Technologies (Pty) Ltd (DBT) was appointed as a subcontractor for the fabrication, painting and erection of six ACC units at the Kusile Power Plant. DBT further subcontracted its works to TCP, which procured an on-demand guarantee in favour of DBT. Lombard Insurance Company Limited (the insurer) issued the guarantee in favour of DBT for an amount of R128,375,851.20. The guarantee provided that the insurer held this amount at the disposal of DBT and undertook to pay it on a written demand for payment, signed on behalf of DBT by an executive director, stating that the amount demanded was payable in terms of the subcontract with TCP and the circumstances of TCP's breach under the subcontract.

On 7 June 2019, the first and second appellants executed a deed of suretyship and indemnity in favour of the insurer. The appellants indemnified the insurer:

> *"[A]gainst any claims, losses, demands, liabilities, costs and expenses of whatsoever nature, and legal costs as between attorney and client, which the insurer may at any time sustain as a result of having executed any guarantee on behalf of TCP."*

The appellants were to pay any sum which the insurer may be called upon to pay on demand. The indemnity further permitted the insurer to enter into compromises and/or accept settlements.

A written demand for the full guarantee amount was submitted by DBT to the insurer on 13 January 2020. The insurer, in compliance with the indemnity, demanded payment of the amount from the appellants on 15 January 2020. Following the insurer's failure to pay in terms of the demand, DBT launched an application against the insurer for an order *inter alia* directing compliance with the guarantee.

The issue of procedural rights and settlement agreements in the adjudication of the defence of fraud against the enforcement of a performance guarantee

CONTINUED

The High Court

TCP and the insurer opposed the relief sought by DBT. The parties alleged that the demand was fraudulent as the guarantee amount covered work already completed and in respect of which taking-over certificates should have been issued which in turn ought to have reduced the guaranteed amount. The insurer served third-party notices on 10 third parties, including the appellants. The parties were advised that they were required to give notice of their intention to oppose the insurer's claim to an indemnification or DBT's claim against the insurer. The appellants did not give such notice or take any steps in advancing their defences on the basis that TCP and the insurer were opposing the claim.

Later, TCP was liquidated, and the appellants' broker informed them that the insurer was reluctant to continue opposing the main application in TCP's absence, as it had misgivings advancing a fraud defence of which it had no personal knowledge. Consequently, the insurer concluded a settlement agreement with DBT for payment in the amount of R100 million (the settlement). The settlement was made an order of court by the High Court.

Pursuant to the order, the appellants delivered a counterapplication in which they applied for condonation, filed answering affidavits opposing the third-party relief claimed by the insurer, asked that the dispute between them and the insurer be referred for trial, and claimed rectification of the indemnity. In the answering affidavits, the appellants opposed the claims against them on the basis that the calling up of the guarantee had been fraudulent.

The appellants contended that they had been released from their obligations prior to being joined as third parties and that the settlement deprived them of a procedural advance to present their defences to the claim of the insurer and DBT. Lastly, they contended that the insurer was stopped from claiming from them. The insurer denied the defences raised by the appellants and the rectification claim. It contended that it had not colluded in any alleged fraud by DBT and accordingly the issue of fraud had to be resolved as between DBT and the appellants.

The court *a quo* concluded that it did not have to make a finding regarding: the alleged fraud; that the insurer sought indemnity based on a change in factual circumstances instead of an adverse finding against it by the court; that the matter did not need to be referred to trial where DBT, which allegedly acted fraudulently, was no longer a party in the main application; and that the appellants were liable to indemnify the respondent.

The issue of procedural rights and settlement agreements in the adjudication of the defence of fraud against the enforcement of a performance guarantee

CONTINUED

The appeal

The SCA had to consider whether it was competent for the High Court to enquire into the issue of any fraud on the part of DBT on the affidavits/pleadings after the settlement between the insurer and DBT was made an order of court. The appellants contended that the High Court ought to have found that the settlement did not entitle the insurer to obtain an indemnity in terms of the third-party procedure as that procedure entitled the appellants to contest the claim by DBT against the insurer, but the appellants' right had been affected by the settlement to their prejudice.

The SCA referred to *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* [2009] 4 All SA 322 (SCA) where the court affirmed that the obligations arising out of a guarantee are not affected by any disputes that arise between the parties during the execution of the underlying contract. The insurer's obligation remains to honour the guarantee and pay where the conditions of the guarantee are met. The appeal court found that the liability of the insurer arose as a consequence of a written demand for payment by DBT to the insurer as contemplated by the guarantee on 13 January 2020. This liability was unaffected by any disputes between the parties.

The court held that the only basis upon which the insurer could avoid liability under the guarantee would be where there was fraud on the part of DBT. TCP would have had to demonstrate that DBT knowingly presented a written demand that misrepresented the true facts. For the appellants to avoid a claim for an indemnity based on fraud, they would have to demonstrate fraud on the part of the insurer; that the written demand by DBT was fraudulent; and that the insurer paid a claim which it knew was not due and thereby colluded in the fraud of DBT.

The SCA found that the appellants had not alleged any fraud on the part of the insurer and accordingly held that the High Court was correct that it did not have to consider the question of fraud. In respect of any allegations of fraud against DBT, the court stated that DBT would be an essential party to any proceeding which sought to enquire on whether it acted fraudulently when calling up the guarantee. A finding of fraud could not be made in DBT's absence.

On the question of whether the settlement denied the appellants a right in Rule 13(6) to file an affidavit to contest the claim of DBT against the insurer, the court stated that the appellants were aware, at the latest, by November 2020, if not October, that the insurer had decided to settle with DBT. At that stage they had the opportunity to take steps to establish any procedural rights they might have had for the fraud allegations to be ventilated fully, including filing an affidavit to contest the claim of DBT (in terms of Rule 13(6)).

The issue of procedural rights and settlement agreements in the adjudication of the defence of fraud against the enforcement of a performance guarantee

CONTINUED

However, the appellants did not take any steps. The court accordingly found that they were to blame for losing their opportunity to file the affidavit when the settlement was made an order of court on 1 February 2021.

The SCA found that the appellants still retained other procedural rights following the settlement. However, the appellants had also failed to exercise these procedural rights. It stated that the appellants could have opposed the claim by the insurer, pursued a joinder of DBT in terms of the provisions of Rule 24, or even issued a third-party notice against DBT to ensure that DBT became party to the proceedings. However, the appellants did not take any of these steps. This meant that there were no proceedings between DBT and the appellants where the issue of fraud could be addressed by the court.

In the circumstances, the SCA held that the issue of any fraud on the part of DBT was not an issue which properly arose for determination by the High Court and the High Court was correct to not consider it as it was not competent to do so on the pleadings. The appeal was accordingly dismissed with costs.

Conclusion

The case affirms the trite law that performance guarantees are enforceable, except where there is fraud on the part of the party that seeks to enforce the guarantee. However, as the case demonstrates, the party that raises the defence of fraud must have personal knowledge of these facts. In the absence of a valid defence, the guarantor is required to honour its obligations under a guarantee.

The case further confirms that the conclusion of a settlement agreement for the purposes of complying with a demand for payment under a performance guarantee does not in itself impede the procedural rights of a third party to raise any valid defences against the claim by the indemnified party.

Joe Whittle, Zodwa Malinga, Kananelo Sikhakhane and Marco Neto

Appealing or Rescinding? That is the question when dealing with judgments granted against a person without their knowledge

The Uniform Rules of Court direct that any document initiating legal proceedings must be served by the Sheriff of the High Court on a defendant/respondent. The purpose of this rule is to bring to the attention of the defendant/respondent that legal proceedings have been brought against them. The Uniform Rules of Court, however, do not always require the document instituting the legal proceedings to be personally served on the defendant/respondent. This can lead to a situation where judgment is granted against a person without their knowledge.

The general rule is that a judgment is final and cannot be altered, amended or modified, and can be enforced by the party that obtained the judgment in its favour. The Courts do recognise two exceptions to this rule - the first exception is when a judgment is rescinded, and the second exception is when an appeal against a judgment is upheld.

The High Court in the matter of *Lee v Road Accident Fund* (22812/2020) [2023] ZAGPJHC 1068 was required to determine whether a judgment or order granted in default appearance is appealable.

In this case, Lee instituted action proceedings against the Road Accident Fund for damages suffered from a motor vehicle collision. The Road Accident Fund did not dispute liability for Lee's damages but failed to enter an appearance to defend the action proceedings. Lee consequently applied for and was granted default judgment for R13,5 million.

Lee thereafter instituted an application to compel payment of the R13,5 million. In response, the Road Accident Fund instituted an application for leave to appeal the default judgment on the basis that the judgment was granted in its absence.

Lee opposed the application for leave to appeal on the basis that it was an irregular step and that the correct application that should have been instituted was a rescission application. Lee relied on the case of *Pitelli v Everton Gardens Projects CC* [2010] (5) SA 171 (SCA), which held that *"a court order is not appealable until it becomes final. A court order does not become final if it is rescindable. It follows that an order that can be rescinded is not appealable."*

The Road Accident Fund disagreed with Lee's contention and referred to the case of *Moyana v Body Corporate of Cottonwood and others* [2017] ZAGPJHC 59 (17 February 2017) (Cottonwood), which the Road Accident Fund contended departed from *Pitelli*. The High Court held in *Cottonwood* that a party could waive their right to rescind an order by bringing an appeal against the order, as a party who is in willful default of appearance should be allowed to appeal a matter rather than explain their default.

Appealing or Rescinding? That is the question when dealing with judgments granted against a person without their knowledge

CONTINUED

The High Court considered the general principles relating to an application to appeal and an application for rescission and stated that the function of an appeal is to reconsider cases that have been fully argued in the initial instance, which cannot be the case in a default judgment. The appeal court would as a result be asked to decide a case as a court of first and final instance, or remitting the case to the court a quo, which is what would happen should a rescission application be successful. The court further stated that appeals hold no procedural advantage over rescissions, in that a party may approach a court to exercise its powers to suspend the execution of the order while the rescission application is heard, much like the automatic suspension of the order when a case is appealed.

In conclusion, a party to a judgment who did not have knowledge of the legal proceedings must be cautious to institute the correct application to set aside the judgment. In the circumstances when a judgment or order is granted in default of appearance, the correct application is an application to rescind the judgment or order. Instituting the correct application will avoid wasted legal costs and time in bringing the matter to finality.

Neha Dhana and Claudia Moser

OUR TEAM

For more information about our Dispute Resolution practice and services in South Africa and Kenya, please contact:

Rishaban Moodley
Practice Head & Director:
Dispute Resolution
Sector Head:
Gambling & Regulatory Compliance
T +27 (0)11 562 1666
E rishaban.moodley@cdhlegal.com

Tim Fletcher
Chairperson
Director: Dispute Resolution
T +27 (0)11 562 1061
E tim.fletcher@cdhlegal.com

Imraan Abdullah
Director:
Dispute Resolution
T +27 (0)11 562 1177
E imraan.abdullah@cdhlegal.com

Timothy Baker
Director:
Dispute Resolution
T +27 (0)21 481 6308
E timothy.baker@cdhlegal.com

Eugene Bester
Director:
Dispute Resolution
T +27 (0)11 562 1173
E eugene.bester@cdhlegal.com

Neha Dhana
Director:
Dispute Resolution
T +27 (0)11 562 1267
E neha.dhana@cdhlegal.com

Denise Durand
Director:
Dispute Resolution
T +27 (0)11 562 1835
E denise.durand@cdhlegal.com

Claudette Dutilleux
Director:
Dispute Resolution
T +27 (0)11 562 1073
E claudette.dutilleux@cdhlegal.com

Jackwell Feris
Sector Head:
Industrials, Manufacturing & Trade
Director: Dispute Resolution
T +27 (0)11 562 1825
E jackwell.feris@cdhlegal.com

Nastascha Harduth
Sector Head: Corporate Debt,
Turnaround & Restructuring
Director: Dispute Resolution
T +27 (0)11 562 1453
E n.harduth@cdhlegal.com

Anja Hofmeyr
Director:
Dispute Resolution
T +27 (0)11 562 1129
E anja.hofmeyr@cdhlegal.com

Tendai Jangara
Director:
Dispute Resolution
T +27 (0)11 562 1136
E tendai.jangara@cdhlegal.com

Corné Lewis
Director:
Dispute Resolution
T +27 (0)11 562 1042
E corne.lewis@cdhlegal.com

Nomlayo Mabhena-Mlilo
Director:
Dispute Resolution
T +27 (0)11 562 1743
E nomlayo.mabhena@cdhlegal.com

Sentebale Makara
Director:
Dispute Resolution
T +27 (0)11 562 1181
E sentebale.makara@cdhlegal.com

Vincent Manko
Director:
Dispute Resolution
T +27 (0)11 562 1660
E vincent.manko@cdhlegal.com

Khaya Mantengu
Director:
Dispute Resolution
T +27 (0)11 562 1312
E khaya.mantengu@cdhlegal.com

Richard Marcus
Director:
Dispute Resolution
T +27 (0)21 481 6396
E richard.marcus@cdhlegal.com

Burton Meyer
Director:
Dispute Resolution
T +27 (0)11 562 1056
E burton.meyer@cdhlegal.com

Desmond Odhiambo
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E desmond.odhiambo@cdhlegal.com

Lucinde Rhoodie
Director:
Dispute Resolution
T +27 (0)21 405 6080
E lucinde.rhoodie@cdhlegal.com

Clive Rumsey
Sector Head: Construction & Engineering
Director: Dispute Resolution
T +27 (0)11 562 1924
E clive.rumsey@cdhlegal.com

Belinda Scriba
Director:
Dispute Resolution
T +27 (0)21 405 6139
E belinda.scriba@cdhlegal.com

Tim Smit
Sector Head:
Consumer Goods, Services & Retail
Director: Dispute Resolution
T +27 (0)11 562 1085
E tim.smit@cdhlegal.com

Marelise van der Westhuizen
Director:
Dispute Resolution
T +27 (0)11 562 1208
E marelise.vanderwesthuizen@cdhlegal.com

Joe Whittle
Director:
Dispute Resolution
T +27 (0)11 562 1138
E joe.whittle@cdhlegal.com

Roy Barendse
Executive Consultant:
Dispute Resolution
T +27 (0)21 405 6177
E roy.barendse@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE
This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com