
DISPUTE RESOLUTION

ALERT

26 MAY 2014

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GUARANTEED CERTAINTY...
AT LAST!

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GUARANTEED CERTAINTY ... AT LAST!

In October 2011 the Supreme Court of Appeal (SCA) had occasion, in the matter of *Dormell Properties 282 CC vs Renasa Insurance Company Limited and Others NNO 2011 (1) SA 70 (SCA) (Dormell)*, to consider and pronounce upon the status and enforceability of a construction guarantee under circumstances where a dispute existed between the contractor and the employer in whose favour the guarantee had been issued.

There was no dispute that the employer had issued a proper demand for payment under the guarantee. What the majority decision of the court found, however, was that the enforcement of payment under the guarantee pursuant to such demand had been compromised and nullified by the fact that the dispute between the contractor and employer had, subsequent to the demand, been determined in favour of the contractor. The court accordingly excused the guarantor (Renasa) from making payment under the guarantee.

In doing so, the majority decision had regard to the relationship between the contractor and the employer to the exclusion of the relationship between the employer and the financial institution which had issued the guarantee. As a result, it departed from the long-accepted nature and effect of on-demand guarantees which require the guarantor to make payment once it has received a demand therefor, which is compliant with the terms and requirements of the guarantee, and irrespective of - and without reference to - the relationship between and the performance of the contractor and employer under the underlying contract.

The only exception to the guarantor giving effect to this obligation is where there is clear evidence that the demand is fraudulent. There was no such evidence in *Dormell*.

At the time, we expressed concern at the SCA's approach, which we saw as undermining the fundamental and essential nature and purpose of on-demand guarantees, and which we believed would open the door for guarantors, potentially assisted by contractors and suppliers, to evade their obligations under guarantees issued by them and which had been properly called up. This concern proved to be well placed as, since *Dormell*, there have been an increasing number of cases where guarantors have sought to introduce disputes between contractors or suppliers and employers to avoid paying under the guarantee. We expressed the hope that the SCA would reconsider its approach and rectify what we saw as a perilous misconstruction of the nature of on-demand guarantees, and the obligations thereunder.

continued

This, thankfully, the SCA has done in the recent decisions of *Guardrisk Insurance Company Limited and Others vs Kentz (Pty) Ltd* (94/2013) [2013] ZASCA 182 and *Coface South Africa Insurance Company Limited vs East London Own Haven t/a Own Haven Housing Association* (050/2013) [2013] ZASCA 202, which were handed down on 29 November 2013 and 2 December 2013 respectively. In the latter decision, the decision of the majority in *Dormell* was held to be clearly wrong and has been overturned. Both decisions have corrected and reaffirmed the principle that on-demand

guarantees create an absolute obligation on the part of the guarantor on the happening of a specific event, ie a demand for payment which meets the terms of the guarantee. The guarantor may not evade or delay payment because of a dispute between the contractor or supplier and employer.

This is good news indeed for employers and other parties who are the recipients of on-demand guarantees under underlying construction or other agreements, not to mention general contractual certainty and peace of mind.

Nick Muller



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 1st in General Corporate Finance Deal Value,
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