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DISPUTE RESOLUTION
ALERT

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Court tells Eskom to explore all the options before cutting the lights to beleaguered municipalities on the brink of financial collapse

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Performance bonds: New developments on the call up of guarantees?

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Court tells Eskom to explore all the options before cutting the lights to beleaguered municipalities on the brink of financial collapse

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In October 2020, Pioneer Foods (Pioneer) sought to review and set aside Eskom's decision to interrupt bulk electricity supplied to the Walter Sisulu Local Municipality (the Municipality). Despite some effort to recover the debt owed to it by the Municipality, Eskom resorted to coercive methods to induce payment from its chronic defaulter with huge consequences for businesses and households reliant on the Municipality for power.

In this article, we offer a few guidelines — based on our reading of the latest caselaw — as to what a fair process should include.

From the outside, Pioneer's case appeared straightforward. One can sympathise with Pioneer, a dutiful paying customer now in the unenviable position of power cuts, while the Municipality and Eskom — both organs of state — fail to resolve the debt crisis between them; leaving businesses and households to suffer in the dark.

Curiously, however, the High Court dismissed Pioneer's application in *Pioneer Foods (Pty) Limited v Eskom Holdings SOC Limited* [2020] JOL 48702 (GJ) (Gauteng Local Division, Johannesburg, Case no.: 2018/16). Examining the relationships between the parties, the court found that the "*direct relationship*" between the Municipality and Eskom, stemming from an electricity supply agreement whereby Eskom supplies electricity to the Municipality, which the latter purchases from Eskom and resells to the local community, excluded the ultimate consumers of that electricity. On this view, the court concluded that Pioneer lacked standing to bring the application because it has no "*direct relationship*" with Eskom.

The court emphasised the importance of parties seeking orders that are practically implementable, and rebuked Pioneer for requesting an order directing the Municipality to pay Eskom, despite it knowing that the Municipality lacked the funds to settle its debts. The application was dismissed with costs; and Pioneer's hands were seemingly tied.

Yet, for all the emphasis placed on the importance of practicality in the judgment, it is unfortunate that the court did not advance practical solutions to a systemic problem and failed to address pertinent questions. For instance, is it lawful for a private entity to become collateral damage on the basis of a municipality's failure to adhere to its payment obligations?

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Court tells Eskom to explore all the options before cutting the lights to beleaguered municipalities on the brink of financial collapse...*continued*

This judgment is to be lauded. Its most significant effect is that organs of state must take all reasonable measures to resolve their disputes amicably and in the interests of the public before employing drastic measures that harm the public.

And should Eskom be permitted to cut electricity supply to innocent third parties, especially when those parties diligently pay their electricity bills?

The recent Supreme Court of Appeal (SCA) judgment handed down on 29 December 2020 in *Eskom Holdings SOC Ltd v Resilient Properties (Pty) Ltd and Others* and two other matters [2020] ZASCA 185, involved facts that mirrored those in Pioneer. The case, which concerned a staggering debt of R400 million, seems to have answered much of these concerns.

Importantly, the SCA highlighted Eskom's constitutional duty to ensure that municipalities are able to supply electricity to local communities, and accordingly not to take decisions that would "*undermine*" a municipality's ability to "*take all reasonable steps necessary*" to resolve disputes with municipalities before interrupting electricity supply. This judgment is to be lauded.

Its most significant effect is that organs of state must take all reasonable measures to resolve their disputes amicably and in the interests of the public before employing drastic measures that harm the public.

In our view, the appropriate and fair processes that should be taken prior to Eskom terminating or interrupting an electricity supply, as a result of a municipality's failure to meet its payment obligations, would include Eskom inviting and considering representations from all parties that may be adversely affected, and providing affected parties at least 30 days' notice of the planned termination or interruption.

Finally, and perhaps most importantly, Eskom must exhaust all available statutory and constitutional mechanisms designed to resolve disputes between organs of state, including working together with the National Energy Regulator of South Africa, the Treasury and relevant Premiers — in comity and in good faith — before plunging the rest of us into darkness for its failure to recover debts timeously.

Yana van Leeve and Lisa de Waal

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Performance bonds: New developments on the call up of guarantees?

The SCA was tasked with considering whether the law should be developed to recognise an exception (the underlying contract exception) to the effect that where the underlying construction contract restricts or qualifies a beneficiary's right to call up the construction guarantee, a contractor is entitled to interdict a beneficiary from doing so until the conditions in the underlying construction contract have been met.

Whilst contractors have been adversely impacted by the effects of the COVID-19 pandemic, employers have not escaped unscathed. Employers, both public and private, have had significant pressure placed on their cash flows. In an effort to release this pressure, such employers may seek to find ways of calling upon construction guarantees provided by contractors under the various construction contracts.

Whilst COVID-19 and the associated lockdowns have internationally been treated as force majeure or events of supervening impossibility, new arguments may be developed going forward relating to the foreseeability of such events and their effect on the rights of the parties under a construction contract. Such arguments could potentially be used by employers to establish grounds for a call under a construction guarantee.

In Joint Venture between *Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* (577/2019) [2020] ZASCA 146, the Supreme Court of Appeal (SCA) recently revisited the principles applicable to construction guarantees under South African law. The case concerned an appeal by the joint venture against the decision of the Gauteng Division of the High Court, Pretoria, which dismissed the joint venture's application for an interdict restricting SANRAL from demanding payment in terms of a performance guarantee issued in its favour.

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At the outset, the SCA confirmed the well-established South African law position that a construction guarantee is autonomous from the underlying contract and that the issuer of such guarantee is bound to pay in accordance with the terms of the guarantee, unless fraud on the part of the beneficiary is established.

With the above principle established, the SCA embarked on a consideration of Australian and English law, as well as the previous decisions of South African courts, to determine whether room existed for the incorporation of the underlying contract exception. Ultimately, the SCA decided that a contractor may, without alleging fraud, restrain an employer from calling up an unconditional construction guarantee issued pursuant to a construction contract, if the contractor can show that the employer would breach a term of the construction contract by doing so, subject to the proviso that the terms of the construction contract should not readily be interpreted as conferring such a right.

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Performance bonds: New developments on the call up of guarantees?...*continued*

Although the decision of the SCA does not depart materially from previous jurisprudence, it has confirmed an additional ground, outside of fraud, which may be relied upon by contractors to restrain employers from calling up construction guarantees.

The joint venture's appeal was ultimately dismissed by the SCA which found that the joint venture had failed to show that the parties had intended anything other than that SANRAL would be entitled to payment before any underlying dispute between them was determined.

Although the decision of the SCA does not depart materially from previous jurisprudence, it has confirmed an additional ground, outside of fraud, which may be relied upon by contractors to restrain employers from calling up construction guarantees. In calling up construction guarantees, employers will therefore need to ensure that they guard against the possibility of the contractor raising this additional ground or face the risk that their call may be interdicted.

Due to the uncertainties intimated above and the likelihood that employers will seek to adopt increasingly creative grounds for the calling up of construction guarantees to supplement their cash flow, there is no doubt that the underlying contract exception will become an area of future litigation and our courts could be called on to consider and expand upon this exception in the near future.

Clive Rumsey and Kyle Bowles

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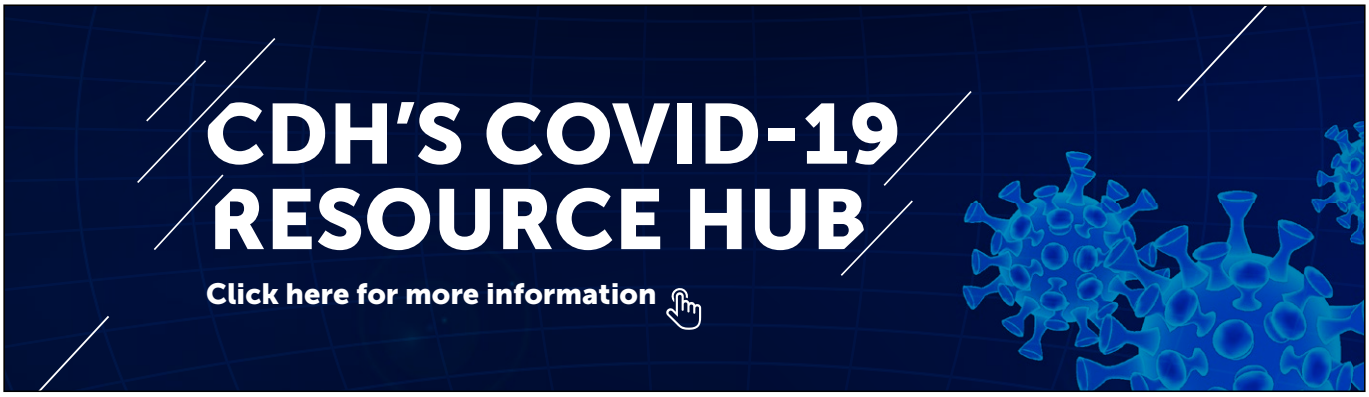

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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