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A comparison between the primary and secondary nature of guarantees

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When I enrolled for this degree in 2020 little did I know what the next two years would hold not only for me, but for mankind all over the world. The last two years were probably the most challenging two years of my life, managing studies, work and family life whilst being in the middle of a pandemic. I therefore want to extend a special thanks to those who made it possible for me to successfully complete this paper.

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ABSTRACT

The use of guarantees as a form of security is a common instrument in the world of lending, construction and transfer of property and date back as far as BC. Although the concept has been around for many years, little progress has been made in developing legislation relating thereto. Contributing to this is the intricate manner in which some guarantee agreements are drafted and the common practice of referring to a guarantee as a suretyship and *visa versa*. This has been the root of confusion when it comes to the interpretation of the parties' true intention. It might seem harmless to refer to a guarantee when suretyship is intended, however, it does hold severe consequences for the parties if their true intentions are not documented correctly. As will be discussed, the nature of a common law or primary guarantee, is autonomous whilst an agreement of suretyship is accessory in nature. The nature of a specific guarantee is key to the security it provides or obligation it creates. A common law guarantee is believed to provide a stronger form of security due to its primary nature compared to a suretyship agreement, being secondary in nature. The opposite can also be said, the obligation of a guarantor to perform in terms of a guarantee is more burdensome than the obligation of a surety in terms of a suretyship agreement. Cases such as *Desert Rose, Shabangu* and *Lombard Insurance Company* will show the important role that the primary and secondary nature of guarantees play when it comes to the enforcement of such agreement. This dissertation will therefore highlight the importance of knowing and understanding the nature of the agreement that is entered into as it may have some dire consequences at a later stage.

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CHAPTER 1
OVERVIEW

1.1 Conceptualisation of key terms

1.1.1 Credit guarantee: In this research paper reference will be made to a guarantee or credit guarantee interchangeably. In short, a credit guarantee is an agreement where a third party agrees to assume the obligations a principal debtor has towards a creditor or beneficiary and to discharge those obligations should the principal debtor fail to.

1.1.2 Creditor/credit providers: Refers to a natural or legal person to whom money is owed.

1.1.3 Principal debtor/debtor: A natural or legal person who enters into a credit agreement and who is obliged to settle the debt due to a creditor.

1.1.4 Surety/Guarantor: A third party who agrees to assume the obligations a principal debtor has towards a creditor and to discharge those obligations should the principal debtor fail to.

1.1.5 Obligation: A real right created by a pledge or promise between two or more persons, where the one party (known as the debtor), is obliged to do or refrain from doing something to or for the other party (known as the creditor).[1]

[1] For a comprehensive explanation on the concept of obligation, see Hutchison and Pretorius *The law of contract in South Africa* (2012) 7.

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1.2 Introduction and background to research problem

It is trite that the conclusion of credit agreements is a daily occurrence. These credit agreements are synonymous with a certain risk exposure to credit providers. To mitigate their risk, credit providers will often require some form of security from the debtor ensuring the fulfilment of the obligations in terms of the agreement. One such example is personal security provided by a third party in the form of a guarantee.

A guarantee can be in the form of a suretyship, demand guarantee or an indemnity agreement (also referred to as an indemnity guarantee). Irrespective of its form, a guarantee is an agreement in terms of which a third party assumes liability for the obligations of another. Over centuries guarantees have proven to be a highly effective form of security for creditors. The simple principle of a debtor providing personal security by persuading a third party to bind himself against a creditor for the fulfilment of the debtor's obligations, has in principle remained the same since the time of Justinian. The evolvement of the concept of suretyship has been gradual and very little legislation has been implemented to regulate suretyships.[2]

However, over the years and probably due to the intricate nature in which guarantees are drafted, it has become apparent that even though the concept of guarantees seem straightforward, various case law has shown that it is all but true.[3] The question that has presented itself is this: when exactly can a creditor or beneficiary of a guarantee, call on the surety or guarantor's obligation? Stated differently when does the obligation to settle the debt owed to a creditor or the obligation to compensate a beneficiary for loss caused, become the responsibility of the surety or guarantor? The answer seems to be straight forward. The right of a creditor or beneficiary to call on the performance of a guarantee, be it a suretyship, demand guarantee or an indemnity

[2] Forsyth and Pretorius "Recent developments in the law of suretyship" 1993 *SA Merc LJ* 181. For more information on the foundation of the law of suretyship see Forsyth and Pretorius *Caney's the law of suretyship* (2010) 26.

[3] See *Diners Club South Africa (Pty) Ltd v Durban Engineering (Pty) Ltd* 1980 (3) SA 53 (A) as an example of the different interpretations of the said subject. Rabie JA and Joubert JA saw the contract as one of suretyship, being accessory to the principal agreement (at 66H). According to Viljoen AJA the contract was not one of suretyship but rather one where the creditor and principal debtor had liability "*correi debendi* of equal state and equal liability" (at 81F). Kotzé JA and Botha JJA didn't find it necessary to classify the contract as the parties were jointly and severally liable (at 69G).

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agreement, is dependent on the nature of that specific guarantee. However not all guarantees share the same nature. In some instances, a guarantee is primary in nature and in other scenarios a guarantee will have an accessory nature. Not knowing or realising the nature of the agreement could have devasting results for the person relying on the performance thereof or alternatively for the party disputing his or her obligations.

1.3 Objective of study and desired outcomes

There are various factors that often cloud the distinction between the different forms of guarantees. Many will reason that the definition and characteristics of guarantees and suretyships are not reconcilable as the former refers to a primary obligation and the latter to an accessory nature. It is therefore imperative to examine the definition and nature of guarantees and suretyships.[4] Factors such as the use of language,[5] the intention of the parties and the particular use of the agreement are other aspects contributing to the near impossible task of differentiating between the different types of guarantees. The objective of the study is to first investigate the difference between the primary and secondary nature of guarantees. The aim is then to draw a distinction between each of the following types of guarantees namely: suretyships, common law guarantees, and indemnity agreements by classifying them either as primary or accessory in nature. By means of comparison this research paper aims at providing clarity on the nature of suretyships, common law guarantees, and indemnity agreements and ultimately affording a better understanding of when the provider of such guarantees may be held liable to perform.

1.4 Research questions

In achieving the objective of this paper, the following questions will be addressed:

1) What are the requirements of a guarantee?

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[4] Stoop and Kelly-Louw "The National Credit Act regarding suretyships and reckless lending" 2011 *PELJ/PER* 69.

[5] Pretorius "Suretyships and indemnity" 2001 *SA Merc LJ* 95.

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2) What is the nature of a guarantee? (What is the difference between primary and accessory nature?)
3) How does the nature of guarantees influence the surety or guarantor's obligation to perform?
4) How do the courts interpret the surety or guarantor's obligation to perform in terms of a guarantee?
5) Based on the study, what conclusion can be drawn between the nature of guarantees and obligations relating thereto?

1.5 Structure of chapters

The structure of this research paper will follow the order of the research questions. Chapter 2 will provide clarity on what the requirements are for a valid suretyship and guarantee and how they are regulated in terms of the common law, General Law Amendment Act[6] and National Credit Act.[7] Chapter 3 will examine the nature of guarantees and how we use the nature to distinguish between the various forms of guarantees. This chapter will also include what form of liability and/or obligation can be expected when dealing with a guarantee representing a primary- alternatively accessory nature. The law is not always a black and white scenario, and it is often left to the courts to bring clarification. Chapter 4 will therefore look at how the courts have interpreted the nature of credit guarantees and the duty to perform. Lastly, Chapter 5 will take all the aforementioned into account and provide a conclusion on the nature of guarantees and when one will be expected to perform in terms thereof.

[6] S 6 of the General Law Amendment Act 50 of 1956, hereafter "GLAA".
[7] National Credit Act 34 of 2005, hereafter "National Credit Act", "NCA" or "Act".

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CHAPTER 2

GUARANTEES IN TERMS OF COMMON LAW AND STATUTE

2.1 Introduction

One could say that due to our human nature our actions have the potential to cause damage or loss to others when parties enter a contractual relationship. The conclusion of a credit agreement is no exception to such probability and therefore one would find that the extension of credit is often dependent on devices available to secure the repayment of the debt. Banks and creditors will rarely extend credit without requiring some form of security to ensure the repayment thereof. The purpose of requesting security is to reduce or perhaps even eliminate the risk of loss or damage that might emerge as a result of default or insolvency.

The provision of security can be divided into two categories, namely real security and personal security (also known as a real right and a personal right).[8] Real security is the right to an asset that can be sold in execution by a creditor to settle unpaid debt. It is typically provided by means of a mortgage bond, notarial bond or a pledge.[9] Personal security on the other hand relates to a third party's liability or obligation. This form of security attaches to the person, hence referred to as a personal right. In the broad sense, personal security entails a third party to assume liability on behalf of the debtor *ob maiorem securitatem creditoris*.[10] Guarantees, suretyships and indemnity agreements are classic examples of personal security. Prior to the National Credit Act guarantees and suretyships were regulated by the common law and General Law Amendment Act respectively. The enactment of the NCA introduced the concept of "credit guarantees"

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[8] See Pretorius "Unlimited suretyships" 2012 *THRHR* 186. Also see Mendy "Mortgage and pledge" in Joubert *The law of South Africa* Vol 29 (hereafter "Mendy *LAWSA*").
[9] For more on real rights see Van Schalkwyk and Van Der Spuy *General principles of the law of things* (2012); Brits *Real security law* (2016) and Du Bois *Wille's principles of South African law* (2007) 630.
[10] Mendy *LAWSA* par 323 LAWSA.

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and, subsequently, guarantees in the general sense can either fall within the GLAA, common law, NCA or a combination of the aforesaid.[11] The application of these three sources of law is of utmost importance as it provides clarity on the requirements for a valid guarantee, the functioning thereof and possible defences available. In the discussion below I will examine the regulation of suretyships and guarantees in terms of the common law, GLAA, and NCA.

2.2 Common law

We frequently see that a guarantee is also referred to as suretyship and *visa versa* as in both cases a person (referred to as the guarantor or surety respectively) binds themselves towards the liability a principal debtor has or might have to a third-party creditor or beneficiary.[12] Guarantees are often used as security in lending agreements to secure the repayment of debt.[13] In modern times it has become general practise for banks to request personal security by means of a guarantee from the directors of companies applying for credit or loans.[14] It is, however, not only creditors that make use of guarantees as a form of security. It has become customary practice for parties to an agreement of sale for the transfer of property or parties to a building contract, to secure the performance of such agreement by means of suretyships or guarantees.

When security is provided in the form of a suretyship, the surety undertakes that the principal debtor will perform in terms of the principal agreement, and should the principal debtor fail to perform, the surety will perform the obligations of the principal debtor and/or indemnify the creditor. A guarantee in terms of the common law[15] is slightly different to a suretyship, as the guarantor indemnifies the creditor of loss or damages on the occurrence of a specific event, which event can be, but is not limited to, that of default.

[11] Guarantees in the general sense refers to the collective noun, which can either mean a common law or primary guarantee or alternatively a suretyship. See par 3 for a further discussion on the distinction between a primary guarantee and a suretyship.
[12] Stoop and Kelly-Louw 2011 *PELJ/PER* 74.
[13] Goode *Guide to the ICC Uniform Rules for demand guarantees: ICC Publication No. 510* (ICC Paris 1992) 15.
[14] See the minority decision of Navsa JA in *Brink v Humphries & Jewell (Pty) Ltd* 2005 (2) SA 419 (SCA) par 35; *Slip Knot Investments 777 (Pty) Ltd v Du Toit* 2011 (4) SA 72 (SCA) par 12; *Roomer v Wedge Steel (Pty) Ltd* 1998 (1) SA 538 (N) 543F–G; *Absa Bank Ltd v Trzebiatowsky* 2012 (5) SA 134 (ECP) par 23.
[15] Hereafter “common law guarantee” or “primary guarantee”.

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Demand guarantees or indemnity agreements are familiar examples of common law guarantees.

Although the distinction between common law guarantees and suretyships seem straightforward, it is easier said than done. Through the years the words suretyship and guarantee have by means of common practice, been used interchangeably. Various case law has shown that the word guarantee is frequently used as a collective noun that can either refer to contracts of suretyship[16] or primary guarantees.[17] For example, in *List v Jungers*[18] the defendant gave a letter to the plaintiff wherein the defendant "warrant and guarantee" payment of the purchase price due to the plaintiff by a certain date.[19] The court held that when one looks at the word "guarantee" as used in the context of the letter it was not an undertaking to stand surety but an undertaking as principal debtor.[20] The undertaking given in this instance was therefore a primary guarantee. In another matter, *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd,*[21] a JBCC construction guarantee was issued in terms of which an agreed sum was to be paid should there be "nonperformance or breach" of contract on the part of the second respondent.[22] The court held that if the guarantee and building contract was read as one, it was clear that the undertaking was intended as a suretyship agreement even though the words guarantor and contract guarantee were used.[23]

Common law dictates that regardless of whether the word "suretyship" or "guarantee" is used to describe a third party's obligation to perform, it will be the context in which the word is used that will be of foremost importance in establishing the true

[16] Also referred to as a true guarantee or traditional guarantee.
[17] Kelly-Louw "Construction of demand guarantees gone awry: *Minister of Transport and Public Works v Zanbuild Construction*" 2013 *SA Merc LJ* at 404-405.
[18] 1979 (3) SA 106 (A), hereafter "List-Jungers".
[19] 1979 (3) SA 106 (A) at 125: - "On behalf of this company and on my own personal behalf, I hereby warrant and guarantee that the purchase price due to you in respect of the purchase of your joint interest with Mr van de Ghinste in the 119 units in the *MariaMartina* will be paid to you by the end of December 1970…"
[20] 1979 (3) SA 106 (A) at 126.
[21] 2001 (2) SA 760 (C), hereafter *Basil Read-Beta Hotels"*.
[22] A JBCC construction guarantee is a guarantee in the form prescribed by The Joint Building Contracts Committee (JBCC), which guarantees a contractor's performance in terms of a building contract.
[23] 2001 (2) SA 760 (C) at 766D.

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intention of the parties. Kriek J echoes this as follows in *Hermes Ship Chandler (Pty) Ltd v Caltex Oil (SA) Ltd*:[24]

> "The passages from the various judgments I have mentioned deal with the popular or ordinary meaning of the word 'guarantee', but it seems to me that they demonstrate only that the word is capable of bearing different meanings depending upon the context in which it is used. It seems to me also that when the meaning of the word in a particular document is being considered, it is undesirable to commence the enquiry on the basis that any of its possible meanings predominates, and that the proper approach to the question is to be alive to the various meanings which it can bear and by a consideration of the context in which it is used (together with such other circumstances as may be permissible) to decide which meaning must be attributed to it in that context."

It is interesting to note, as stated by Stratford CJ in *Hazis v Transvaal and Delagoa Bay Investments Co Ltd*[25] that: "The word [guarantee] is usually and more properly employed by a surety who promises to saddle himself with an obligation if the principal obligor defaults." Thus, even though the circumstance in which the word guarantee is used will determine the intention of suretyship or primary guarantee, it seems that if one had to give meaning to and look at the contractual context in which the word guarantee is most often used, parties' intentions lean towards that of a suretyship.[26]

2.3 GLAA

Prior to the enactment of the GLAA, there were no mandatory requirements to conclude a valid suretyship agreement. However, the GLAA prescribes a number of formalities that has to be adhered to when a suretyship agreement is concluded and as of 22 June 1956

> "[n]o contract of suretyship entered into after the commencement of this Act, shall be valid, unless the terms thereof are embodied in a written document signed by or on behalf

[24] 1973 (3) SA 263 (D) at 267. Also see *List-Jungers* at 118; *Sassoon Confirming and Acceptance Co (Pty) Ltd v Barclays National Bank Ltd* 1974 (1) SA 641 (A) at 646 where Jansen JA held that "The first step in construing a contract is to determine the ordinary grammatical meaning of the words used by the parties (*Jones v Anglo-African Shipping Co. (1936) Ltd*, 1972 (2) SA 827 (AD) at 834E). Very few words, however, bear a single meaning, and the 'ordinary' meaning of words appearing in a contract will necessarily depend upon the context in which they are used, their interrelation, and the nature of the transaction as it appears from the entire contract. It may, for example, be quite plain from reading the contract as a whole that a certain word or words are not used in their popular everyday meaning, but are employed in a somewhat exceptional, or even technical sense. The meaning of a contract is, therefore, not necessarily determined by merely taking each individual word and applying to it one of its ordinary meanings."
[25] 1939 AD 372 at 382.
[26] *Mouton v Mynwerkersunie* 1977 (1) SA 119 (A) at 126A. Also see *Basil Read-Beta Hotels*; *ABSA Bank Limited v Zurich Risk Financing SA Limited* 2009 ZAGPJHC 85; *List-Jungers* at 108D: "… the word 'guarantee' is most commonly (and properly) used in the sense of an undertaking to stand surety for the performance of, or to make good, someone else's obligation."

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> of the surety: Provided that nothing in this section contained shall affect the liability of the signer of an aval under the laws relating to negotiable instruments."[27]

Thus, for a suretyship agreement to be valid it must be a written agreement, identifying the creditor, principal debtor and surety, the principal debt and the nature of the agreement. Although the creditor's signature is not required, the agreement must be signed by the surety or on behalf of the surety. These requirements need not all be contained in one document. However, it is essential that the terms are easily ascertained.[28]

One could ask why the legislature, after all these years, found it necessary to finally enact the terms of a contract of suretyship? Whilst considering the legislature's motivation one cannot help but refer to the words of Proverbs: "Whoever puts up security for a stranger will surely suffer, but whoever refuses to shake hands in pledge is safe."[29] The very thought of someone agreeing to stand in for the debt of another does not seem rational and one would hope that a person who stands surety is well informed of the risk associated with such undertaking.[30] It is due to this onerous obligation that the legislature probably felt the necessity to enact section 6 of the GLAA as considered by Miller JA in *Fourlamel (Pty) Ltd v Maddison*:[31]

> "However many objects the Legislature may have had in mind in enacting sec 6 of Act 50 of 1956, one of them was surely to achieve certainty as to the true terms agreed upon and thus avoid or minimize the possibility of perjury or fraud and unnecessary litigation. This is a purpose which, despite differences in wording, is common to the enactments relating, respectively, to contracts for the sale of land …, and to agreements of hire-purchase … . The Legislature may also have been influenced by other considerations, for example that suretyship being an onerous obligation, involving as it does the payment of another's debts, would-be sureties should be protected against themselves to the extent that they should not be bound by any precipitate verbal undertakings to go surety for another but would be bound only after the undertaking had been recorded in a written document and signed by them or on their behalf."

It is to be noted that in terms of the wording of section 6 ("No contract of suretyship"), these formalities only apply to suretyship agreements in terms of which the performance of the principal debtor is guaranteed, and not to common law guarantees.[32]

[27] S6 of Act 50 of 1956.
[28] See Du Bois 1020; Forsyth and Pretorius 67-81; Bradfield *Christie's law of contract in South Africa* (2016) 149-153; *Sapirstein and Others v Anglo African Shipping Co (SA) Ltd* 1978 (4) SA 1 (A) at 12B-D, "*Sapirstein"; Lategan and Another NNO v Boyes and Another* 1980 (4) SA 191 (T) at 203F.
[29] Proverbs 11:15 NIV.
[30] Pretorius 2012 *THRHR* 187-188.
[31] 1977 (1) SA 333 (A) at 342-343. Also see Hutchison and Pretorius (2012) 160.
[32] Bradfield 149.

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2.4 National Credit Act

With the enactment of the National Credit Act[33] came the regulation of basically all credit agreements,[34] which includes a credit guarantee.[35] Section 8(5) defines a credit guarantee as follows:

> "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act applies."

A credit guarantee is therefore a guarantee in terms whereof the principal debt agreement falls within the definition of a credit agreement to which the Act applies. Credit guarantees are, however, only regulated by the NCA in as far as the credit facility[36] or credit

[33] The Act became effective on 1 June 2006, 1 September 2006 and 1 June 2007. Proc 22 in *GG* 28824 of 11 May 2006.

[34] See Van Zyl and Otto and Renke in Scholtz (ed) *Guide to the National Credit Act* (2008) chs 4 and 8 respectively for the field of application of the National Credit Act.

[35] In terms of s 8(1) "an agreement constitutes a credit agreement for the purpose of this Act if it is-
- (a) a credit facility, as described in subsection (3);
- (b) a credit transaction, as described in subsection (4);
- (c) a credit guarantee, as described in subsection (5); or
- (d) any combination of the above".

[36] S 8(3) defines a credit facility as follows: "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2) or section 4(6)*(b)*, constitutes a credit facility if, in terms of that agreement-
- (a) a credit provider undertakes-
  - (i) to supply goods or services or to pay an amount or amounts, as determined by the consumer from time to time, to the consumer or on behalf of, or at the discretion of, the consumer; and
  - (ii) either to-
    - (aa) defer the consumer's obligation to pay any part of the cost of goods or services, or to repay to the credit provider any part of an amount contemplated in subparagraph (i); or
    - (bb) bill the consumer periodically for any part of the cost of goods or services, or any part of an amount, contemplated in subparagraph (i); and
- (b) any charge, fee or interest is payable to the credit provider in respect of-
  - (i) any amount deferred as contemplated in paragraph *(a)*(ii)*(aa)*; or
  - (ii) any amount billed as contemplated in paragraph *(a)*(ii)*(bb)* and not paid within the time provided in the agreement."

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transaction[37] that the credit guarantee relates to, falls within the ambit of the Act.[38] Stated differently, if the Act does not apply to the credit facility or credit transaction, it will not apply to the credit guarantee.[39] It is important to establish whether a guarantee falls under the umbrella of the NCA as the surety or guarantor will enjoy the same NCA protection and defenses as a principal debtor, should the Act apply. A guarantee that does not meet the criteria of section 8(5) will be regulated by common law.[40]

This brings us to a very important and contentious issue. As mentioned previously, the terms guarantee and suretyship are often used interchangeably. When we look at the definition of a credit agreement in terms of section 8(1)(c), we notice that it only refers to a credit guarantee and not a credit suretyship. The question has therefore been raised whether the definition of a credit guarantee in terms of the Act include a contract of suretyship.

According to Mostert the definition of a credit guarantee as it currently stands does not provide for a suretyship agreement.[41] He argues that the words "on demand"[42] caters for those agreements that are not dependent on the performance of a principal liability, but rather on the obligation to perform when demanded to, such as indemnity agreements or demand guarantees. As will be discussed in paragraph 3, suretyships are dependent on a valid principal agreement which makes it accessory in nature. A guarantee agreement on the other hand is an independent agreement which is not subject to a valid principal agreement, thus making it primary in nature. Mostert argues that the key factor distinguishing suretyships from guarantees is its accessory nature. The surety's

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[37] S 8(4) defines a credit transaction as follows: "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit transaction if it is-
(a) a pawn transaction or discount transaction;
(b) an incidental credit agreement, subject to section 5(2);
(c) an instalment agreement;
(d) a mortgage agreement or secured loan;
(e) a lease; or
(f) any other agreement, other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred, and any charge, fee or interest is payable to the credit provider in respect of-
(i) the agreement; or
(ii) the amount that has been deferred."

[38] S 4(2)(c). See *Nedbank Ltd v Wizard Holdings* 2010 (5) SA 523 (GSJ), hereafter *"Wizard Holdings"*.

[39] See s 4 for more detail on the application of the NCA.

[40] Stoop and Kelly-Louw 2011 *PELJ/PER* 82.

[41] Mostert "Must suretyship agreement comply with the NCA" 2009 June *De Rebus* 53.

[42] S 8(5).

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obligation to perform is dependent on the principal obligation. If the principal obligation is invalid or the principal debtor is not liable, the surety will not be liable either as the surety will be protected by the same defence raised by the principal debtor. Mostert further says that due to the fact that a surety's obligation is subject to default by a principal debtor (which is only possible where there is a valid principal agreement and the principal debtor is liable), a surety can never be "… a person [who] undertakes or promises to satisfy 'upon demand' any obligation of another consumer…"[43] Mostert's interpretation of section 8(5) of the NCA is that the legislature's intention was to only include agreements where the creditor had a choice to claim the debt from either the principal debtor or third-party guarantor without having to wait for the principal debtor to default. The essence of Mostert's argument is that the nature of a guarantee is in contrast with that of a suretyship[44] and it could therefore not have been the legislature's intention, by implication, to include suretyships in the definition of a credit guarantee.[45]

Despite Mostert's extensive argument that section 8(5) does not include a suretyship, it seems that his perspective was not presented to the court when the matter of *Firstrand Bank Ltd v Carl Beck Estates (Pty) Ltd*[46] was heard.[47] The court in an *obiter dictum* held that section 8(5) included suretyships. The facts before the court were *inter alia* that the second respondent, in his personal capacity, entered into an unlimited suretyship agreement with the plaintiff (Firstrand Bank Ltd) in which the second respondent committed himself as surety and co-principal debtor for all the first respondent's (the principal debtor and a juristic person) debt in terms of a mortgage agreement. The second respondent raised the defense that as surety and co-principal debtor he enjoyed the same protection as the principal debtor, afforded by the NCA, and was thus regarded as a consumer to whom the section 129 notice procedure[48] applied.[49]

[43] S 8(5). See Mostert 2009 *De Rebus* 53.
[44] See par 3.
[45] Mostert 2009 *De Rebus* 53.
[46] 2009 (3) SA 384 (T), hereafter "Carl Beck Estates".
[47] Otto and Renke in Scholtz (ed) par 8.2.4.
[48] S 129 prescribes the mandatory procedure to be followed by a credit provider when a consumer is in default, also known as the "section 129(1)(a) -notice". In terms of this s a creditor needs to give notice to a consumer who is at least 20 business days in arrears with his payment(s), that legal action will be taken should the consumer not act on the notice. See s 2(5) for the definition of "business days".
[49] *Carl Beck Estates* at 389.

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Satchwell J found that although the obligations in terms of a suretyship fell within the definition of a credit agreement (in the form of a credit guarantee), the merits of the matter excluded it from the application of the Act, either in terms of section 4(1)(a)(i) alternatively section 4(1)(b).[50] It was subsequently found that because section 8(5) requires a credit guarantee to secure the "obligation[s] of another consumer in terms of a credit facility or credit transaction to which this Act applies", the second respondent as surety, could not rely on the protection of the NCA.[51] In coming to this conclusion Satchwell J, in her *obiter* remark, accepted that a credit guarantee in terms of section 8(5) included a suretyship:

> "There is no doubt that the suretyship obligations of the second respondent theoretically fall within the definition of a credit agreement which encompasses a credit guarantee in terms whereof a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction."[52]

Although the view that a credit guarantee includes a suretyship has been accepted and supported in other cases as well, such as *Wizard Holdings*[53] where a similar defence was raised as in *Carl Beck Estates*, and *Structured Mezzanine Investments (Pty) Ltd v Davids,*[54] there are some authors that acknowledge that Mostert's opinion has merit and is yet to be tested in court.[55]

There are however authors that disagree with Mostert's argument such as Stoop and Kelly-Louw, who reiterates the key principles of interpretation when stating that "the definition of credit guarantee has to be interpreted by giving the words their ordinary meaning in the context of the statute read in its entirety. If the definition then remains

[50] S 4(1): "Subject to sections 5 and 6, this Act applies to every credit agreement between parties dealing at arm's length and made within, or having an effect within, the Republic, except
(a) a credit agreement in terms of which the consumer is –
(i) a juristic person whose asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds the threshold value determined by the Minister in terms of section 7 (1);
(ii) …; or
(iii) …;
(b) a large agreement, as described in section 9 (4), in terms of which the consumer is a juristic person whose asset value or annual turnover is, at the time the agreement is made, below the threshold value determined by the Minister in terms of section 7 (1)."

[51] *Carl Beck Estates* 390.

[52] *Carl Beck Estates* 390.

[53] *Wizard Holdings* pars 4, 9 and 10.

[54] 2010 6 SA 622 (WCC) pars 16 and 17, hereafter *"Davids"*.

[55] Otto and Otto *The National Credit Act explained* (2016) 32. See also Otto and Renke in Scholtz (ed) par 8.2.4.

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ambiguous, regard must be had to indicators of the legislature's intention."[56] According to Stoop and Kelly-Louw, Mostert in his interpretation of section 8(5) read the words "upon demand" too literally, over-emphasised them and gave them a special meaning which was unnecessary.[57] Their view is that section 8(5) merely implies that an agreement constitutes a credit guarantee if a third party (surety or guarantor) promises to pay any obligation of a principal debtor when the credit provider calls for payment, thus when the credit provider informs the surety or guarantor of the principal debtor's default and demands payment from the surety or guarantor.[58]

When it comes to the interpretation of legislation one must consider the language of the provision and the context in which it was written, not forgetting the aim thereof.[59] This marries well with section 2(1) of the NCA, which provides that "[t]his Act must be interpreted in a manner that gives effect to the purpose set out in section 3". If one considers the aim of the NCA[60] it would seem counter-productive to only include a

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[56] Stoop and Kelly-Louw 2011 *PELJ/PER* 78.
[57] Stoop and Kelly-Louw 2011 *PELJ/PER* 79.
[58] Stoop and Kelly-Louw 2011 *PELJ/PER* 80. Stoop and Kelly Louw also argue that one should consider the role s 4(2)(c) plays in the interpretation of credit guarantees. As mentioned previously, s 8(5) is subject to s (4)(2)(c) in that the Act will only apply to the credit guarantee if the Act applies to the principal agreement. They are of the opinion that this may imply that the Act is only applicable to suretyship agreements and not to common law guarantees as a latter is not concerned with the underlying or principal agreement. Although the authors have a point, it should be kept in mind that even though a common law guarantee is not reliant on a valid principal agreement, it still relates thereto, and it can therefore be argued that there is an underlying agreement as referred to in s 4(2)(c).
[59] In *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) par 18, the SCA dealt extensively and specifically with the interpretation of statutes and said when it came to the interpretation of statutes, "[t]he 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document".
[60] S 3: "The purposes of this Act are to promote… a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers, by

(a) promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions;
(b) ensuring consistent treatment of different credit products and different credit providers;
(c) promoting responsibility in the credit market by
    (i) encouraging responsible borrowing, avoidance of over-indebtedness and fulfilment of financial obligations by consumers; and
    (ii) discouraging reckless credit granting by credit providers and contractual default by consumers;
(d) promoting equity in the credit market by balancing the respective rights and responsibilities of credit providers and consumers;
(e) addressing and correcting imbalances in negotiating power between consumers and credit providers by-
(i) providing consumers with education about credit and consumer rights;

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guarantee that is primary in nature, and not a suretyship which is more commonly used, in its ambit.[61]

The matters of *Carl Beck Estates*, *Wizard Holdings* and *Davids* were all decided shortly after the enactment of the NCA. Over the years the courts have had some time to deliberate the point at issue and the recent Supreme Court of Appeal verdicts in *Mostert v Firstrand Bank t/a RMB Private Bank*[62] and *Shaw v Mackintosh*[63] show the courts' inclination to agree with their predecessors. In *Shaw* the court had to decide whether the agreement titled "The Suretyship" was a credit guarantee as defined by section 8(5), or a credit transaction as defined in section 8(4)(f) of the Act.[64] The court found that in terms of clause 5 of the Suretyship Agreement, the appellant (Shaw) "undertook or promised to pay on demand" which brought the wording in line with that of section 8(5). In coming to this conclusion Mathope JA said the following:

> "An essential precondition to the operation of s 8(5) of NCA is that it applies to the obligations of another. The language of the section, refers both to an undertaking and a promise to satisfy the obligation of another. It makes no reference to a suretyship or guarantee or any similar word."[65]

The Court's interpretation of clause 5 of the agreement and section 8(5) of the Act marries well with that of Stoop and Kelly-Louw.

It is evident that it is no easy task to ascertain whether the concept "credit guarantee" as defined by the NCA includes a contract of suretyship and until section 8(5) is redefined by the legislature it will remain a matter of interpretation. However, as proven by various judgments, it is widely held that a contract of suretyship clearly meets the definition of a credit guarantee in terms of the NCA, if the surety undertakes or promises

(ii) providing consumers with adequate disclosure of standardised information in order to make informed choices; and
(iii) providing consumers with protection from deception, and from unfair or fraudulent conduct by credit providers and credit bureaux; …"

[61] Otto and Renke in Scholtz (ed) par 8.2.4. See also Stoop and Kelly-Louw 2011 *PELJ/PER* 78.
[62] 2018 (4) SA 443 (SCA) par 28: "It suffices to say that s 8(5) includes a suretyship in respect of the obligations in terms of a credit facility or credit transaction."
[63] 2019 (1) SA 398 (SCA), hereafter *"Shaw"*.
[64] A credit transaction as defined in s 8(4)(f) of the Act is "any other agreement, other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred, and any charge, fee or interest is payable to the credit provider in respect of-
i) the agreement; or
ii) the amount that has been deferred".
[65] *Shaw* par 10.

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to satisfy the obligation of a principal debtor, which obligation falls within the ambit of the NCA.

2.5 Preliminary remarks

The purpose of this chapter is to ascertain what statutes or other sources of law regulate guarantees. The rationale of the analysis is to be informed of any requirements that may exist for the enactment of a valid guarantee and to be abreast with possible defences available to the provider of such security. The common practice of referring to a guarantee and suretyship as substitute for one another does, however, complicate matters.

This chapter touched on the fact that there is a distinction to be made between a suretyship agreement and what is referred to as a common law guarantee. The patent difference between a suretyship and common law guarantee is its nature. Chapter 3 will focus on the primary and accessory nature of guarantees and the obligations relating thereto.

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CHAPTER 3

THE NATURE AND OBLIGATIONS OF GUARANTEES

3.1 Introduction

In Chapter 2 it was established that reference to a guarantee can either refer to a contract of suretyship or a primary guarantee as the term guarantee is often used as a collective noun.[66] This is a practice that is entrenched in our law, however, it has not gone without criticism.[67] Mostert argued that in terms of the National Credit Act, suretyship does not fit the definition of a credit guarantee due the difference in nature of the two instruments: "The suretyship has one conspicuous element that distinguishes it from other agreements, namely the element of accessoriness."[68] Forsyth and Pretorius are also of the opinion that although it is accepted that the two concepts are referred to interchangeably, when one looks at the nature of a suretyship and that of a guarantee, they are in fact two very different instruments.[69] A suretyship has an accessory and/or secondary nature that is subject to default of the principal debtor in terms of a principal agreement. Whilst a guarantee has an independent and/or primary nature that is not dependent on an underlying agreement but prompted by a demand to perform.

The obligor's liability to perform is directly linked to the nature of the instrument used. It is therefore important to understand the nature of the various types of guarantees as this may restrict the holder of the security's ability to call on the liability of the obligor. This chapter will therefore address the nature of suretyships, guarantees and indemnity agreements and the obligations relating thereto.

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[66] See par 2.2 above. Because these two terms are often confused with one another, it is imperative to look at the wording and context of the agreement to establish the parties' true intention.
[67] Stoop and Kelly-Louw 2011 *PELJ/PER* 70; Forsyth and Pretorius 28 fn 7.
[68] Mostert 2009 June *De Rebus* 53. See also par 2.4 above.
[69] Forsyth and Pretorius 28-29.

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3.2 The definitions

3.2.1 Defining suretyship

Before we can understand the nature of guarantees, we need to understand the notion of both suretyships (the accessory guarantee) and common law guarantees (the primary guarantee).

What does it mean for someone to stand surety? As discussed in Chapter 2, prior to the GLAA there were no formal requirements to conclude a contract of suretyship and no formal definition existed to describe what constituted a suretyship.[70] Section 6 of the GLAA introduced a handful of formalities to adhere to when entering a contract of suretyship. Unfortunately, it failed to define the term suretyship.[71] The only clarity afforded on what was considered a suretyship agreement was by Roman-Dutch jurists who described it as an accessory obligation that required the existence of a primary obligation, as a suretyship could not exist independently.[72]

Without an official definition it was left to the courts to form their own interpretation of what is considered a suretyship. Innes CJ attempted formulating a definition in *Corrans v Transvaal Government and Coull's Trustee,*[73] which was subsequently accepted in *Hutchinson v Hylton Holdings.*[74] Innes CJ summarised the early jurists' definitions as follows:

> "[T]hat the undertaking of the surety is accessory to the main contract, the liability under which he does not disturb, but it is an undertaking that the obligation of the principal debtor will be discharged, and, if not, that the creditor will be indemnified."[75]

Innes CJ thus understood a suretyship to be an undertaking that is subject to a principal agreement, which did not discharge the principal debtor's liability, but rather assured the creditor that the principal debtor will honour his liability towards the creditor. However, should the principal debtor act to the contrary, the surety will indemnify the creditor.

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[70] See par 2.3; De Villiers *The Suretyship and the Indemnity Contract Differentiated,* LLM dissertation, Unisa (not dated) 3.
[71] For a discussion on the formalities see Forsyth and Pretorius 65-81.
[72] Forsyth and Pretorius 27 and Stoop and Kelly-Louw 2011 *PELJ/PER* 71.
[73] 1909 TS 605, hereafter "Corrans". Also see Forsyth and Pretorius 27 and Stoop and Kelly-Louw 2011 *PELJ/PER* 72.
[74] 1993 (2) SA 405 (T), at 410H.
[75] *Corrans* at 602.

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Forsyth and Pretorius later provided their own definition of a contract of suretyship, reiterating the essentials of a suretyship as captured by Innes CJ.[76] In terms of their definition, which was endorsed by the Supreme Court of Appeal (previously known as the Appellate Division),[77] a suretyship is:

> "an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and, secondarily, that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor".[78]

What Forsyth and Pretorius are basically saying in their interpretation of a suretyship is that a surety is someone who makes two promises to the principal debtor. The first being that the principal debtor will perform his obligations towards his creditor. The second promise is that should the principal debtor fail to meet his or its obligations towards to the principal debtor, the surety undertakes to step into the shoes of the principal debtor. Forsyth and Pretorius' definition of suretyship is however criticised by Lotz.[79] He argues that it is futile to refer to a "primary" and "secondary" obligation. Lotz reasons that the surety's assurance that the principal debtor will honour his obligations does not create an obligation between the creditor and surety. There is only one obligation, the surety will perform should the debtor fail to. Lotz goes further and state that at the time of contracting, both the creditor and surety believe that the debtor will perform or else none of the parties will contract with one another. To silence their critics and avoid further confusion, Forsyth and Pretorius later amended their definition of suretyship by omitting the words primary and secondary.[80] However, as explained by Forsyth and Du Plessis,[81] it was never Forsyth and Pretorius' intention to place an additional burden on a surety by referring to

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[76] Forsyth and Pretorius 28 described the essentials as: "a principal obligation to which the suretyship is accessory and the undertaking by the surety that the principal obligation will be discharged, upon failure of which the creditor will be indemnified".

[77] *Trust Bank of Africa Ltd v Frysch* 1977 (3) SA 562 (A) 584F, hereafter "*Frysch*"; *Sapirstein* 11H; *Nedbank Ltd v Van Zyl* 1990 (2) SA 469 (A) 473I, "*Van Zyl*" and *Basil Read-Beta Hotels* 766F. See Forsyth and Pretorius 28 and Stoop and Kelly-Louw 2011 *PELJ/PER* 72 for a discussion on the criticism received from Stegmann J in *Carrim v Omar* 2001 (3) All SA 71 (W) par 57.

[78] Forsyth and Pretorius 28-29.

[79] Lotz "Suretyship" in Joubert (ed) *The Law of South Africa* vol 26 par 191, *"Lotz LAWSA"*. Also see Forsyth and Pretorius 29 fn 10.

[80] Forsyth and Pretorius now refer to a suretyship as "an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), that the principal debtor, who remains bound, will perform his obligation to the creditor and, that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor".

[81] Forsyth and Du Plessis "Suretyship, guarantee and Islamic Banking" 2002 *SALJ* 671 at 675.

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the surety's obligations as primary and secondary. Forsyth and Pretorius' reference to the surety's primary and secondary obligation is indicative of the nature of a suretyship, which in return, is the key aspect that differentiate a contract of suretyship from a common law guarantee.

3.2.2 Defining the primary guarantee

The closest form of any formal definition we have of a primary guarantee is the definition of a credit guarantee as found in section 8(5) of the National Credit Act.[82] If one had to modify the definition of a credit guarantee to describe a primary guarantee, it would read more or less as follows: a guarantee is an agreement, irrespective of its form, in terms whereof a person undertakes or promises to satisfy upon demand any obligation another person has in terms of a principal agreement. The only requirement for a primary guarantee is the presence of a principal agreement in terms whereof the principal debtor is liable, and performance must be demanded from the guarantor. A primary guarantee does not guarantee the performance of the principal debtor, nor does it require default on the part of the principal debtor. Both these aspects are key requirements of a suretyship, which is probably why Pretorius and Forsyth referred to them as primary and secondary obligations. It indicates the difference in nature of a suretyship versus a primary guarantee.

3.3 Suretyship: Accessory in nature

From the definitions by Innes CJ in *Corrans* and Forsyth and Pretorius, it is evident that there are two essential elements to a suretyship namely that:

i) the contract of suretyship is subject to a valid principal agreement and;

ii) secondary to the liability of the principal debtor.

[82] To reiterate s 8(5) of the NCA describes a credit guarantee as "[a]n agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act applies".

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An agreement that is subject to a principal agreement creates an accessory obligation, which means that the obligation is dependent on the existence or coming into existence of a valid and effective principal obligation.[83] If no principal obligation exists or come into existence or, if the principal obligation is invalid for some reason, the nexus between the principal agreement and suretyship is broken.[84] The contract of suretyship will be unenforceable as a suretyship cannot exist independently. The creditor will not be able to hold the surety liable for performance seeing that there is no nexus and where there is no nexus there is no liability.[85] Nienaber JA quite correctly describes it as "[g]uaranteeing a non-existent debt is as pointless as multiplying by nought".[86] Hence, we refer to a suretyship as being accessory in nature.[87]

The undertaking given by a surety as per the definitions in *Corrans* and Forsyth and Pretorius are twofold. Not only is a contract of suretyship accessory in nature but it is also secondary to the liability of the principal debtor. The secondary nature of a suretyship agreement emanates from the intention of the parties. The surety assures the creditor that the debtor will perform and only in case of non-performance, will the surety step into the shoes of the principal debtor. The intention of the surety is thus to only become liable should the debtor fail to perform.[88] Stated differently, without calling on the

[83] Stoop and Kelly-Louw 2011 *PELJ/PER* 73. See *Desert Star Trading 145 (Pty) Ltd v No 11 Flamboyant Edleen CC* 2011 (2) SA 266 (SCA) at 271, hereafter "*Desert Star*"; *Kilroe-Daley v Barclays National Bank Ltd* 1984 (4) SA 609 (A) at 622I, "*Kilroe-Daley"* and *Corrans* at 612.
[84] The principal obligation may result from parties contracting thereto, alternatively due to delict or any other cause where the debtor is bound to another. The principal agreement is not required to be in existence at the time of concluding the suretyship. It may already exist at the time that the suretyship is entered into, or the principal agreement and contract of suretyship can be entered into simultaneously. Alternatively, the suretyship may be provided in terms of a principal agreement that is yet to come into existence. Due to the accessory nature of a suretyship, a surety's obligation will only be of effect once the principal obligation is created. See Forsyth and Pretorius 39, 46-47 and Pretorius 2012 *THRHR* 188.
[85] V 46.1.3 (*Commentarius ad Pandectas* (1968), translated by P Gane as *The Selective Voet* (1955) The promissor cannot be sued by the creditor, for there is no nexus between them.
[86] *African Life Property Holdings (Pty) Ltd v Score Food Holdings Ltd* 1995 (2) SA 230 (A) at 238F.
[87] Forsyth and Pretorius 29-30 explain the accessory nature of a suretyship as follows: "The fact that the surety's obligation is an accessory obligation is often invested with an air of mystery that apparently justifies without further explanation many aspects of suretyship. In fact the concept is relatively straightforward. It means simply that for there to be a valid suretyship, between surety and creditor, there has to be a valid principal obligation, between the debtor and the creditor. The suretyship is said to be accessory to the transaction which creates the obligation of the principal debtor. Put another way, every suretyship is conditional upon the existence of a principal obligation".
[88] Lubbe "Die onderskeid tussen borgtog en ander vorme van persoonlike sekerheidstellings" 1984 *THRHR* 383 at 385: Suretyship "… is 'n kontrak tussen 'n borg en 'n skuldeiser ingevolge waarvan eers-genoemde daarvoor instaan dat die hoofskuldenaar sy verpligtinge teenoor die skuldeiser sal nakom en onderneem om self teenoor laasgenoemde te presteer indien die hoofskuldenaar dit nie doen nie".

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debtor to perform and the debtor subsequently failing to do so, the surety cannot be held liable. If explained in contractual terms, a suretyship can be described as a guarantee with a suspensive condition. This suspensive condition is that for the creditor to rely on the surety's liability, there must be default on part of the principal debtor. Without default, the suspensive condition in terms of the suretyship is not fulfilled and the agreement between the creditor and surety does not come into effect.[89] The liability of the surety is therefore conditional or subject to a breach of contract by the principal debtor.[90] Without an enforceable principal agreement, there can be no breach of contract and subsequently the surety's liability will fall away.[91] This is what distinguishes suretyship from a primary guarantee, or an indemnity as will be seen in paragraph 3.4. A contract of suretyship is seen as an additive indebtedness and not a substitution of the debtor's obligation.[92]

The risk of a creditor not being able to call on the surety's undertaking due to the accessory and secondary nature of the undertaking is often overcome by requesting the surety to renounce certain rights and benefits, such as excussion[93] and division.[94] Although the surety can expressly contract to relinquish these benefits, it often happens that this is done tacitly by means of binding the surety as surety and co-principal debtor. By assuming liability as surety and co-principal debtor, gives effect to the doctrine of *intercessio.*[95] *Intercessio* can take two forms, the first by means of *novatio*[96] where the surety assumes liability in lieu of the principal debtor. The surety steps into the shoes of the debtor. The alternative is when the surety assumes liability alongside the principal debtor. In this instance the surety does not replace the principal debtor but rather provides cumulative security to the creditor.[97] In the latter scenario we refer to the surety as surety

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[89] Lubbe 1984 *THRHR* 386.
[90] Lubbe 1984 *THRHR* 383 at 386; Forsyth and Pretorius 30.
[91] Stoop and Kelly-Louw 2011 *PELJ/PER* 74.
[92] Stoop and Kelly-Louw 2011 *PELJ/PER* 74.
[93] Excussion or *beneficium ordinis seu excussionis* refers to the surety's right to demand that the creditor exhaust all his legal remedies against the principal debtor for due performance and payment, before turning to the surety. See Du Bois 1023.
[94] Division or *beneficium divisionis* applies where there is more than one person liable for the same debt. Any one of the debtors or co-sureties can request that the liability for payment is proportioned and divided amongst the co-debtors or co-sureties. See Du Bois 1024.
[95] *Intercessio* or intercession means to act on behalf of someone or to assume liability on behalf of someone. Suretyships, guarantees, and indemnity agreements are all examples of the doctrine of *intercession*.
[96] *Novatio* or novation means to substitute an existing obligation with another or substituting an existing party to an agreement with a new party. See Bradfield 521.
[97] Lubbe 1984 *THRHR* 384.

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and co-principal debtor. Whether a person assumes liability in lieu of or alongside a principal debtor will depend on the language of the agreement.[98] An example where a person binds himself as surety and co-principal debtor would be as follows:

Suretyship

I/we, the undersigned,

Identification/registration number

Physical address

hereby bind myself/ourselves as surety and co-principal debtor jointly and severally together with

XXX DEBTOR
("the debtor")

in favour of ABC Bank for the repayment on demand of any sum of money which the debtor now owes or may hereafter owe to the Bank arising from whatever coarse and for the due fulfilment of all obligations of the debtor to the Bank of such indebtedness subject to the following conditions:

Joint and several liability

All signatories to this document shall be liable to the bank jointly and severally as debtor surety or co-principal debtor for the obligations of the debtor.

An agreement binding a third party as surety and co-principal debtor is a unique undertaking as it finds itself between that of a suretyship and a primary guarantee or indemnity agreement. The surety's obligation to perform is still accessory to a principal agreement, however, the liability is no longer a condition subsequent to breach of contract by the principal debtor as the surety assumes the role of co-principal debtor.[99] What does this mean? A person who accepts the obligation of surety and co-principal debtor is still a surety, as far as the creditor is concerned, however, his liability is co-equal to that of the principal debtor and therefore no longer secondary in nature.[100] Differently stated, the surety's obligation to perform is still subject to a valid principal agreement, but it is no longer dependent on a breach of contract. The accessory nature of the surety and co-principal obligation was confirmed in *Kilroe-Daley.*[101] In this matter the appellant bound

[98] Forsyth and Pretorius 56.
[99] Lubbe 1984 *THRHR* 387; See also Sonnekus "Borg én tegelyk medehoofskuldenaar is 'n *contradictio in terminis* en onversoenbaar" 2018 *THRHR* 256.
[100] Forsyth and Pretorius 56-57; Du Bois 1022.
[101] See also *Trans-Drakensberg Bank Ltd v The Master* 1962 (4) SA 417 (N) at 422 and *Carl Beck Estates* pars 22-24.

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herself as surety and co-principal debtor for the debts of another known as Dodo Shipping Co (Pty) Ltd. To secure her position as surety, she registered a bond in favour of the respondent. Due to the principal debtor, Dodo Shipping Co (Pty) Ltd, not being able to honour its obligations, a winding up order was issued. The respondent then turned to the appellant in terms of her liability as surety and co-principal debtor. In her special plea the appellant argued that the claim against her had prescribed as the summons was served on her long after the initial claim against the principal debtor prescribed. The respondent argued that the appellant had a bond registered in its favour and that a claim in terms of that bond only prescribed after 30 years and thus the appellant remained liable. The court held that the appellant's liability as surety and co-principal debtor was accessory to the principal debt and that the bond was purely registered to secure the accessory obligation, and not the principal debt, therefore securing the obligations the appellant had in a scenario where it had to perform. Since the principal debt became prescribed, the appellant's liability followed suit. The bond securing the appellant's obligations was therefore unfeasible.[102]

The benefit of binding a surety as co-principal debtor means that the surety's obligation becomes enforceable at the same point and time as that of the principal debtor, as the surety tacitly renounces the benefits of excussion and division.[103] The implication of a person giving an undertaking as surety and co-principal debtor also came up in the matter of *Union Government v Van der Merwe,*[104] where Wessels JP pointed out as follows:

> "We must give some meaning to the words 'co-principal debtor'. That the addition of these words operate*(s)* as a renunciation of the benefits of the surety is clear, but they have a still greater force. The addition of these words shows that the surety intends that his obligation shall be co-equal in extent with that of the principle (*sic*) debtor: or otherwise expressed, that his obligation shall be *of the same scope and nature as that of the principal debtor*."

[102] See *Millman NO v Masterbond Participation Bond Trust Managers (Pty) Ltd (under curatorship)* 1997 (1) SA 113 (C).

[103] In *Neon and Cold Cathode Illuminations (Pty) Ltd v Ephron* 1978 (1) SA 463 (A) 472 B-C the court simplified the difference between the liability as a surety and the liability of a surety and co-principal debtor. The court held that "generally the only consequence … that flows from a surety also undertaking liability as a co-principal debtor is that *vis-à-vis* the creditor he thereby tacitly renounces the ordinary benefits available to a surety, such as those of excussion and division, and he becomes liable jointly and severally with the principal debtor".

[104] 1921 TPD 318 at 322.

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3.4 Guarantee: Primary in nature

As previously mentioned,[105] the closest formal classification we have of a guarantee in South African Law is found in section 8(5) of the National Credit Act. In terms hereof, a common law guarantee is an agreement whereby a person assumes liability of another person's debt and promises to satisfy that debt, when demanded thereto. In general, it is quite difficult to draw a line of distinction between a contract of suretyship, a guarantee, and an indemnity agreement. In some cases, the distinction is so marginal that it comes down to a matter of interpretation which can go either way.[106] Forsyth and Pretorius were criticised for their initial definition of a suretyship as they referred to a surety's primary and secondary obligations.[107] I believe it is this primary and secondary obligation that contributes to the distinction between a suretyship and guarantee. Unlike a contract of suretyship, a common law guarantee does not guarantee the performance of the principal debtor, nor does it require default on the part of the principal debtor. The question is then, what function does a guarantee perform in terms of security?

A guarantee, contrary to a suretyship, only has one and not two obligations. The obligation is to indemnify the beneficiary (creditor) on the happening of a certain event, which is referred to as the condition(s) of guarantee. Should the specific event occur, then the guarantor will become liable.[108] Note that the guarantor does not guarantee that the event will not happen, but rather that if the event does happen, the beneficiary (creditor) will be indemnified.[109] These conditions of guarantee can include a wide range of events for instance:

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[105] Par 3.2.2.

[106] Hahlo and Khan *The Union of South Africa: The development of its laws and Constitution* (1960) 705-706.

[107] According to Forsyth and Pretorius 28-29 a suretyship is "an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and, secondarily, that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor". The words "primarily" and "secondarily" were later omitted from the definition. See par 3.2.1.

[108] See *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd* 2009 (ZASCA) 71 as discussed in Ch 4, hereafter *"Lombard Insurance Company"*. Also see *Guardrisk Insurance Company Ltd and others v Kentz (Pty) Ltd* 2014 (1) All SA 307 (SCA); *Dormell Properties 282 CC v Renasa Insurance Co Ltd and others* 2011 (1) All SA 557 (SCA) and *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA).

[109] Forsyth and Pretorius 32; Pretorius 2001 *SA Merc LJ* 98. In case of a suretyship, the surety undertakes that the principal debtor will perform in terms of the principal agreement, stated differently that the principal

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i) The transfer of property

This amount will be paid, free of exchange into the bank account, the details of which are reflected above, upon receipt by us of advice in writing from **AAA Attorneys** of the registration of the following transactions in the appropriate Deeds Registry:

2.1 Cancellation of all existing bonds registered over **SECTION 54 THE MIX;**
2.2 Registration and transfer of the property referred to in 2.1 above, into the name of **XYZ;**

ii) A tenant defaulting on a lease agreement

Payment of the Guaranteed Amount shall be made by the Bank into the Landlord's bank account, the details of which are as set out above, upon receipt by the Bank of the following:

2.1 the Landlord's first written demand stating that the Tenant is in breach of its obligations under the Lease Agreement and that accordingly, the Guaranteed Amount, or any lesser portion thereof, is now due and payable; and

2.2 the guarantee.

The Bank will pay on written demand and will not determine the validity of the demand or become party to any claim or dispute of any nature which any party may allege.

iii) Advanced payment on a building contract

1.0 The **Guarantor** hereby acknowledges that:-

1.1 Any reference in this Payment Guarantee to the **Agreement** is made for the purpose of convenience and shall not be construed as any intention whatsoever to create an accessory obligation or any intention whatsoever to create a suretyship.

1.2 Its obligation under this Payment Guarantee is restricted to the payment of money.

1.3 Reference to a Certificate of Practical Completion or to a Certificate of Final Completion shall mean such certificate issued by the Principal Agent.

2.0 Subject to the **Guarantor**'s maximum liability in terms of the **Guaranteed Sum**, the **Guarantor** hereby undertakes to pay the **Contractor** the sum certified upon receipt of the documents identified in 2.1 to 2.3:-

2.1 A copy of a first written demand issued by the **Contractor** to the **Employer** stating that payment of a sum certified by the **Principal Agent** has not been made in terms of the **Agreement** and failing such payment within seven (7) calendar days, the **Contractor** intends to call upon the **Guarantor** to make payment in terms of 2.2, a copy of which shall be served on the **Guarantor** at the time the **Contractor** delivers same to the **Employer**;

2.2 A first written demand issued by the **Contractor** to the **Guarantor** at the **Guarantor**'s physical address with a copy to the **Employer** stating that a period of seven (7) calendar days has elapsed since the first written demand in terms of 2.1 and that the sum certified has still not been paid to date and that the **Contractor** herewith calls up this Guarantee for Payment and demands payment of the sum certified from the **Guarantor**;

2.3 A copy of the payment certificate which entitles the **Contractor** to receive payment in terms of the **Agreement** of the sum certified in 2.0.

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debtor will not default and if he does, that the guarantor will perform *in lieu* of the principal debtor. In a guarantee scenario there is not such promise.

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The second element that differentiates a guarantee from a suretyship is that a guarantee gives the holder thereof (the beneficiary/creditor) the option to approach the guarantor directly without first instituting action against the principal debtor, granted the conditions of guarantee have been met. Each guarantee will have its own conditions for performance and the guarantor will become liable as soon as those conditions have been met. The guarantor's obligation is therefore linked to the conditions of the guarantee and are not affected by the *status quo* of any underlying contract that exists between the principal debtor and beneficiary (creditor).[110] By providing a common law guarantee, the guarantor automatically renounces the benefit of excussion.

The most important characteristic that differentiates a guarantee from a suretyship is that the obligation in terms of a guarantee is autonomous or independent and consequently not reliant on a valid principal agreement.[111] Hence, a guarantor's liability is not based on a debtor's breach of contract as in the case of a suretyship. The guarantor's liability can however be subject to a debtor's non-performance. At first sight this might seem like one and the same action, however, it is not. Breach of contract might be a result of non-performance by one of the parties, but non-performance does not necessarily establish a breach of contract. A breach of contract can only occur in terms of a valid agreement. Therefore, if a party defaults in terms of an agreement, but the agreement is found to be void, breach of contract is unattainable although default or non-performance is still present. Because a guarantee is not conditional to a debtor's breach of contract, which we saw is only possible in terms of a valid principal agreement, a guarantor will remain liable for due performance or losses suffered by a beneficiary of a guarantee, even though the principal debt might turn out to be invalid or non-existing.[112] A guarantor's liability in terms of a guarantee is thus separate and independent from any underlying agreement. This confirms the principle of autonomous, associated with a contract of guarantee.

A problem that often presents itself in practice is when the conditions of guarantee (the event that is guaranteed against) relates to the repayment of debt by the principal

[110] Stoop and Kelly-Louw 2011 *PELJ/PER* 74.
[111] Lotz *LAWSA* par 195.
[112] Lubbe 1984 *THRHR* 391; Pretorius 2001 *SA Merc LJ* 98.

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debtor. This gives the impression that the guarantee is subject to a valid agreement between the principal debtor and beneficiary (creditor). Such a scenario makes it exceedingly difficult to distinguish whether the undertaking is that of a suretyship or a guarantee. The matter of *Diners Club South Africa (Pty) Ltd v Durban Engineering (Pty) Ltd*[113] illustrates the difference in opinion when it becomes necessary to determine the nature of an undertaking. Here the respondent accepted joint and severable liability for the debt incurred by one of its employees in terms of a credit card issued by the appellant. The appellant assumed liability by signing the application form where it was stated that "I/We accept joint and several responsibility with the person named here for all charges incurred pursuant to the issue of a Diners Club card to the above". After the employee left the service of the respondent, he not only neglected to return the card but continued to use it unlawfully. The respondent discussed the matter with an employee of the appellant and subsequently cancelled the agreement in writing. The question before the court was whether there was a valid cancellation of the agreement, in respect of which the majority of the court was in agreement. Though, when it came to the interpretation of the nature of the undertaking, the result was not unanimous. Rabie JA and Joubert JA agreed that the nature of the agreement between the appellant and respondent was one of suretyship and co-principal debtor. In the minority judgment of Viljoen AJA it was held that the agreement was not a contract of suretyship as the respondent assumed liability as principal debtor. It is suggested that Viljoen AJA's view is correct as nowhere in the agreement did the respondent promise performance by its employee, or that the respondent would step into the shoes of the employee should the employee fail to honour his obligations.[114] The agreement also failed to mention that the respondent would become liable on the happening of a certain event. The respondent was thus liable for the debt incurred as principal debtor and not as surety or guarantor.

In further attempts to distinguish a guarantee from a suretyship, some writers are of the opinion that a guarantee relates to a promise to perform in terms of something other

[113] 1980 (3) SA 53 A.
[114] Forsyth and Pretorius 34; Pretorius "Diners Club South Africa (Pty) Ltd v Durban Engineering 1980 (3) SA 53 (A) *Borgkontrak of vrywaringskontrak?*" 1982 *THRHR* 74-75. For examples of decisions where it was held that the obligation was primary in nature and therefore a guarantee, see *Schoeman v Moller* 1951 (1) SA 456 (O) at 472; *Harman's Estate v Bartholomeuw* 1955 (2) SA 302 (N) at 303, 309.

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than the payment of debt.[115] Noted otherwise, there are some who are of the view that a guarantee cannot secure the repayment of debt as that will constitute a suretyship. Lubbe's argument, which is supported by Pretorius, is however that if the aforesaid was true, it would be arbitrary as the key feature of a guarantee is that it is autonomous from any other agreement. By limiting a guarantor's liability to a specific form of event, or by excluding a specific form of event, would effectively mean that the guarantee is made subject to a certain type of agreement between the principal debtor and beneficiary (creditor). Such action will imminently be in direct conflict with the nature of a guarantee.[116]

3.5 Indemnity agreements

Another form of security that is closely related to a suretyship and guarantee and worth mentioning is a contract of indemnity. An indemnity can be described as an obligation that a person assumes by indemnifying another from loss suffered by virtue of engaging in a certain activity.[117] An example would be where a third party indemnifies a creditor for providing credit to a certain individual or an insurer indemnifying a third party for building work done by its client. Similar to a guarantee, an indemnity is a principal agreement wherein the indemnifier assumes a primary obligation, promising to perform on the occurrence of a certain event. At face value it seems like a guarantee and a contract of indemnity is one and the same security as they are both primary obligations in terms whereof the liability is triggered by the happening of a certain event. Although some writers follow this thinking, there are others who see a contract of indemnity as an adaptation of a common law guarantee.[118] Upon careful investigation it appears that there might be one slight variant distinguishing a guarantee from a contract of indemnity. In

[115] De Wet & Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg* (1992) 344 at 391.
[116] Lubbe 1984 *THRHR* 391; Pretorius 2001 *SA Merc LJ* 98.
[117] Forsyth and Pretorius 35. According to the *Oxford English Dictionary* vol IV at 606, the words indemnify, and indemnity are described as:

> Indemnify: "Protect, secure (person from, against, harm or loss); secure (person) against legal responsibility (for actions); compensate (persons for loss, expenses incurred, etc.)" and
> Indemnity: "Security against damage or loss; legal exception from penalties etc. incurred; compensation for loss incurred; sum paid for this, …"

[118] See Forsyth and Pretorius 35; Lubbe 1984 *THRHR* 391; Grove *Die Formaliteitsvereistes van Borgstelling* LLM dissertation, UP (1984) at 78-79.

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terms of a guarantee the guarantor assumes liability for the performance of another. A contract of indemnity cast a slightly wider net as it is not only used to guarantee the liability of another, but can also be used to confirm the obligations of the indemnifier himself.[119] To quote Caney, on the *Law of Suretyship* as Snyman J did in *Northern Assurance Co Ltd v Delbrook-Jones*[120] "[a] contract to indemnify a person against the consequences of his own act or omission is not suretyship. If that person be regarded as a creditor, there is no principal debtor, other than the indemnifier".[121]

The operation of a contract of indemnity is illustrated in the matter of *Lombard Insurance Company,* where a third party provided an indemnity in favour of the guarantor of a guarantee. The indemnity would become due in the event of the guarantor becoming liable for payment in terms of the guarantee.[122]

3.6 Preliminary remarks

The aim of this chapter is to define and study the definition, nature and obligations relating to both a suretyship agreement and a contract of guarantee. Without a legislative definition to define a suretyship and guarantee it was left to academics and the courts to provide an acceptable interpretation of suretyships and guarantees.[123] Even though Forsyth and Pretorius' definition[124] of suretyship, which is also referred to as the accessory guarantee, did not go without criticism, it seems to be the definition referred to in many reported cases.[125] While we do not have a similar scenario with common law guarantees, also referred to as primary guarantees, we at least have section 8(5) of the National Credit Act. This section provides an outline of what can be regarded as a guarantee in general, even though the section's purposes is to define a credit guarantee for purposes of the NCA. The elements or characteristics of these security instruments are of great importance when ascertaining the nature and obligations relating thereto.

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[119] Pretorius 1982 *THRHR* 75.
[120] 1966 (3) SA 176 (T).
[121] At 180D.
[122] See par 4.3 for a full discussion of the matter. Also see *Taurog and Others NNNO v General Accident Insurance Co of SA Ltd* 1978 3 All SA 543 (W).
[123] *Corrans* 602 and Forsyth and Pretorius 28.
[124] See par 3.2.
[125] *Frysch* 584F; *Sapirstein* 11H; *Van Zyl* 473I and *Basil Read-Beta Hotels* 766F.

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The point of this chapter is to illustrate the dissimilarities between primary and accessory guarantees, the most vital difference being the nature of the two instruments. The nature of a suretyship and that of a guarantee has a direct effect on the surety/guarantor's obligation to perform in terms of the agreement.

Consideration was also given to a scenario where a person enters into an agreement as surety and co-principal debtor, which further complicates the distinction between the primary and secondary nature of guarantees. It has been established that providing security as surety and co-principal debtor does not change the contract to any other agreement than a suretyship. The result of binding oneself as surety and co-principal debtor is that the benefits of excussion and division, that would usually be available to the surety, are renounced. To conclude when the difference between a contract of suretyship, suretyship and co-principal debtor and a common law guarantee is summarised, it can be described as follow:

i) a suretyship is seen as "secondary in both form and intent";[126]

ii) an undertaking as surety and co-principal debtor is secondary in form but primary in intent;[127]

iii) a guarantee is primary in form and secondary in intent.[128]

Now that we have drawn a comparison between the nature of suretyships and guarantees and the liability they represent, the next chapter will focus, by means of case law, on the impact that the nature of these obligations has on the agreements they are ultimately supposed to secure.

[126] Stoop and Kelly-Louw 2011 *PELJ/PER* 71.
[127] *Kilroe-Daley* at 611B.
[128] Stoop and Kelly-Louw 2011 *PELJ/PER* 71. I do however think there is room for argument when it comes to the secondary intent to pay concerning guarantees. Let's take the classic example of a guarantee securing the purchase price of a property. This would take the form of a demand guarantee. The intention is never to approach the purchaser (the person who instructs the guarantee) first and demand payment. The seller will demand payment directly from the bank, as the bank issued the guarantee on instructions of the purchaser to secure the payment of the purchase price, subject to certain conditions being met. Those conditions will always include the successful registration of the property. Once the guarantee conditions are met, payment under the guarantee becomes due. It is not intended that it first be demanded of the purchaser to pay. It can perhaps be argued that a guarantee will always be primary in form but that the intent may vary between primary and secondary depending on the facts of the scenario.

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CHAPTER 4: THE NATURE OF GUARANTEES ILLUSTRATED BY CASE LAW

4.1 Introduction

In the previous chapter the nature of primary and accessory guarantees was discussed. From this discussion it is evident that without a clear definition of both concepts, it is left to a matter of interpretation to establish the true intention of the parties as both these instruments of security have different requirements in enforcing the obligor's liability. It has been mentioned that the heading of an agreement does not necessarily portray the intention of the parties nor the nature of the intended obligation. It is due to these aspects and the fact that some agreements are drafted with such ambiguous wording, that the task often falls on our courts to intervene in the interpretation of guarantees. But the question beckons: what is the significance in establishing the nature of a guarantee and why such emphasis on the importance thereof?

A surety or guarantor's liability to perform in terms of a guarantee is directly linked to the nature of the agreement. The obligation of a surety is triggered by the non-performance of the principal debtor whilst a guarantor's liability falls due on the happening of a certain event or compliance with what is known as the conditions of guarantee. A suretyship, known as an accessory guarantee, is subject to the principal agreement between the creditor or beneficiary and the principal debtor and provides the surety with the same protection and defences available to the principal debtor. This was perfectly illustrated in the case of *Shabangu v Land and Agricultural Development Bank of South Africa.*[129] A common law guarantee, better known as a primary guarantee, is completely autonomous and therefore not reliant on the validity of any other agreement. This was

[129] 2019 ZACC 42, hereafter "Shabangu".

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made clear by the court in *Lombard Insurance Company*. Both these cases will be addressed below.

Since a guarantee secures the repayment of debt or indemnifies the beneficiary thereof against loss or damage that might emerge due to default or insolvency, the beneficiary should know at what point they can rely on the enforcement thereof.[130] For instance, in the case of *Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd*[131] the appellant requested and intended to receive primary guarantees to secure two building contracts concluded with the respondent. What the appellant was presented with and accepted turned out to be accessory guarantees, causing the liability of the obligor to be subject to default by the principal debtor in terms of the principal agreement between the appellant and respondent.[132]

4.2 *Shabangu*

The nature of a suretyship and the subsequent liability of the surety was the crux of the matter in *Shabangu v Land and Agricultural Development Bank of South Africa*.

4.2.1 Facts of the case

The applicant together with eight others signed surety for debt that arose from a loan agreement that was entered into between the Land and Agricultural Development Bank of South Africa[133] and a company known as Westside Trading 570 (Pty) Ltd,[134] who was in the business of urban property development. Sometime after concluding the loan agreement and advancing the funds, the Land Bank was advised that the agreement was concluded beyond the scope of the Land Bank's powers which was restricted to the facilitation and development of agricultural land by previously disadvantaged persons.[135]

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[130] It is important to reiterate that a primary guarantee is not subject to default but can cover an event of default.
[131] 2011 (5) SA 528 (SCA), hereafter "Zanbuild Construction".
[132] Zanbuild Construction at par 17. See Kelly-Louw 2013 *SA Merc LJ* at 413-415.
[133] Hereafter "Land Bank".
[134] Hereafter "Westside Trading".
[135] Shabangu par 1.

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The loan agreement, as the principal agreement between the Land Bank and Westside Trading was therefore invalid.

According to the Land Bank the total amount of debt at this stage equated to R95 million which amount was disputed by Westside Trading. The financial director of Westside Trading signed, as full and final settlement, an acknowledgement of debt in which Westside Trading acknowledged its liability for the repayment of R82 million in terms of the loan agreement. Westside Trading subsequently defaulted on its repayment to the Land Bank and a claim was instituted against Westside Trading and the sureties. Westside Trading went into liquidation shortly thereafter. The Land Bank continued with its claim against the sureties, claiming liability in terms of the acknowledgement of debt and not in terms of the principal agreement.[136]

It was common cause that the loan agreement as principal debt was invalid, however, the court *a quo* found that this did not necessarily invalidate the deed of suretyship[137] and referred to the SCA case of *Panamo Properties v Land and Agricultural Development Bank of South Africa.*[138] The court *a quo* also found that the acknowledgment of debt was properly proven and that the debt it acknowledged was secured by the suretyship.[139]

The applicant then turned to the Constitutional Court and in his application submitted that the acknowledgement of debt only acknowledged the liability of the principal debtor in terms of the loan agreement, which was agreed to be invalid. It did not extend to cover any possible enrichment claim and therefore suffered from the same taint as the invalid loan agreement. The Land Bank argued that the acknowledgement of debt constituted a compromise and not a novation and was therefore not tainted by the invalidity of the principal obligation.[140]

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[136] Shabangu pars 2-4.
[137] *Land and Agricultural Development Bank of South Africa v Meisel N.O.,* unreported judgment of the GNP, Case No 23733/12 (6 October 2017) par 5.
[138] *Panamo Properties 103 (Pty) Ltd v Land and Agricultural Development Bank of South Africa* 2015 ZASCA 70; 2016 (1) SA 202 (SCA), hereafter *"Pamamo"*. It needs to be said that the security agreement in this matter was a mortgage bond and not a suretyship and that the mortgage bond specifically stated that it would cover existing and future debt.
[139] Shabangu pars 5-7.
[140] Shabangu pars 8 and 10.

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4.2.2 Questions to be answered

The question before the court was twofold. First the court had to give clarity on the effect the invalid principal agreement had on the validity of the acknowledgement of debt. The second aspect was what liability the sureties had in terms of their suretyships with regards to the acknowledgement of debt.[141]

4.2.3 Findings by the court: The effect of the invalid principal agreement on the acknowledgement of debt

It was trite between the parties that the original loan agreement was invalid due to the lack of authority by the Land and Agricultural Development Bank of South Africa to fund urban development projects and that the acknowledgement of debt was signed after both parties were informed of the invalidity of the principal agreement. It is important to note the following clauses of the acknowledgement of debt:

> "1. The company has successfully negotiated an offer of R82 million in full and final settlement of its indebtedness with [the] Land Bank. Notwithstanding, for your records we attach a schedule of the company's loan balance as at 31 January 2009 amounting to R94 900 589.32...
> 2. The company has undertaken to repay [the] Land Bank on conclusion of the transaction with the third party interested in buying the development and with whom a Deed of Sale has been signed;
> 3. Land Bank has informed the company that the loan advanced to the company fell outside of the Land Bank's mandate...
> [I]t is imperative that the outstanding balance of the loan be repaid in full by the end of April 2009."[142]

The indebtedness referred to in the acknowledgement of debt clearly arose from the invalid principal agreement between the parties as clause 1 refers to the company's loan balance. The Land Bank was therefore attempting some form of recourse to recover the funds advanced to Westside Trading 570 (Pty) Ltd. On this point Froneman J stated that "[a] subsequent agreement between… parties that seeks to resuscitate an invalid agreement itself remains tainted with invalidity, even if the invalidity does not stem from illegality or immorality".[143]

[141] Shabangu par 13.
[142] Shabangu par 19.
[143] Shabangu par 22.

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To support this statement, the court referred to the matter of *Gibson v Van Der Walt*[144] where Fagan JA drew the following conclusion:

> "The test in such a case, to my mind, should be whether the Court is asked, in effect, to enforce the unenforceable claim; in other words, is the later transaction on which the plaintiff relies merely a device for enforcing his original claim, is it merely his original claim clothed in another form or with some term or condition added to it, or a ratification or even novation of the original claim which leaves its essential character unchanged; if so, the plaintiff must fail." [145]

The court concluded that even dressed as a compromise, the acknowledgement of debt still rooted from the tainted principal agreement and that the agreement to repay a lessor amount did not change the nature of the obligation.[146]

4.2.4 Findings by the court: The role of the acknowledgement of debt with regards to the sureties' liability

According to the wording of the suretyship agreements the extent of the sureties' liability was limited to the indebtedness of the principal debtor in terms of the principal agreement. It did not cover any other form of eventuality, for instance the liability due to possible enrichment. Once agreed that the principal agreement was invalid, it automatically released the sureties from their obligations due to the accessory nature of the suretyships. With no valid agreement in place, no default could exist which subsequently released the sureties from their obligations. Without a valid principal agreement, there is no nexus linking the principal obligation with the sureties' liability. The Land Bank could therefore not rely on the sureties' liability in terms of the principal agreement. Even if one could argue that the sureties' liability could be stretched to cover any liability under the acknowledgement of debt, it still left one with no nexus as the acknowledgement of debt was based on the nature of the principal agreement which in return was found to be invalid. [147]

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[144] *Gibson v Van der Walt* 1952 (1) SA 262 (A).
[145] *Gibson v Van der Walt* 1952 (1) SA 262 (A) par 270.
[146] Shabangu par 23 and 31. See *Weltmans Custom Office Furniture (Pty) Ltd (In Liquidation) v Whistlers CC* 1999 (3) SA 1116 (SCA) par 16.
[147] Shabangu pars 34-37.

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4.2.5 Preliminary remarks

Shabangu concerned a principal agreement for the repayment of debt in terms of a loan agreement and subsequent suretyships to secure the indebtedness of the principal debtor. The suretyship agreements being accessory in nature could only be relied on if the principal agreement was found to be valid, which it was not. Therefore, without a valid principal agreement, no nexus existed between the principal obligation and the sureties' liability. The Land Bank could thus neither rely on the liability of the sureties in respect of the obligation to perform in terms of the principal agreement nor in terms of the acknowledgement of debt.[148]

4.3 *Lombard Insurance Company*

Lombard Insurance Company is a prime example illustrating that a primary or common law guarantee as well as an indemnity agreement, is primary in nature and thus autonomous from any other agreement.

4.3.1 Facts of the case

During 2002 Landmark Construction (Pty) Ltd[149] concluded a construction contract with South African Maritime Training Academy[150] to build a training facility. To secure the obligations of Landmark Construction in terms of the agreement, it provided the Academy with a construction guarantee, issued by Lombard Insurance Company (Pty) Ltd.[151] Lombard Insurance therefore committed itself as principal debtor in favour of the Academy and undertook to pay the guaranteed sum or outstanding balance thereof in relation to the certificate of completion, when demanded thereto. The guarantee was subject to the happening of two events, namely default by Landmark Construction

[148] For further case law examples relating to the accessory nature of a suretyship agreement see *Desert Star* and *Thomani v Seboka NO* 2017 (1) SA 51 (GP).
[149] Hereafter "Landmark Construction".
[150] Hereafter "the Academy".
[151] Hereafter "Lombard Insurance".

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resulting in cancellation of the contract, alternatively Landmark Construction being placed under liquidation.[152] The guarantee contained the following important clause:

> "3. The Guarantor hereby acknowledges that:
> 3.1 Any reference in this Guarantee to the Agreement is made for the purpose of convenience and shall not be construed as any intention whatsoever to create an accessory obligation or any intention whatsoever to create a suretyship
> 3.2 Its obligation under this Guarantee is restricted to the payment of money
> 3.3 Reference to a practical completion certificate or to a final completion certificate shall mean such certificate as issued by the Principal Agent."[153]

On 17 March 2004, the Academy demanded payment of the guarantee after Landmark Construction was placed in liquidation. In its demand the Academy stated that Landmark Construction was placed in liquidation prior to the issue of a final completion certificate. The Academy claimed an amount of R241 429.77 which related to remedial work that had to be done after the practical completion certificate was issued. The guarantee issued by Lombard Insurance in favour of the Academy was in return secured by an "Indemnity and Suretyship" agreement issued by Landmark Holdings (Pty) Ltd. In terms of this agreement Landmark Holdings (Pty) Ltd was committed to indemnify Lombard Insurance for any sum it had to pay in terms of a guarantee issued, when demanded thereto, irrespective of the validity of the claim. Two similar suretyship agreements were concluded by a Mr Hay and Pringle Bay Trust in favour of Lombard Insurance. Lombard Insurance paid the guarantee called upon by the Academy and subsequently turned to Landmark Holdings (Pty) Ltd, Mr Hay and Pringle Bay Trust to honour their commitments towards Lombard Insurance in terms of the suretyship agreements. When the parties denied liability, Lombard Insurance brought an application against all three parties claiming an amount of R241 429.77 together with interest and costs. The respondents opposed the application *inter alia* by alleging fraud on behalf of Herbert Penny (Pty) Ltd who was the principal agent responsible for so-called remedial work required on site in terms of the construction obligations of Landmark Construction.[154] The court *a quo* ruled in favour of the respondents by referring to clause 14.5 of the construction contract which stated that the security, thus the guarantee, "shall be for the due fulfilment of the contractor's liability in terms of the agreement". The court *a quo* found the claim for

[152] Lombard Insurance Company par 2-4.
[153] Lombard Insurance Company par 5.
[154] Lombard Insurance Company pars 7-13.

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payment not to be in terms of the agreement and therefore found that none of the respondents to be liable for payment.[155]

4.3.2 Questions to be answered

The Supreme Court of Appeal ("SCA") had one primary task, to interpret the nature of the guarantee provided by Lombard Insurance in favour of the Academy and subsequently the nature of the so-called suretyship agreements between Lombard Insurance and the respondents.

4.3.3 Findings by the court

The SCA found the terms of the guarantee unambiguous in that the purpose of the guarantee was to secure the obligations Landmark Construction had towards the Agency in terms of a construction contract and that the guarantee would become payable should Landmark Construction default in terms of the contract, alternatively be placed in liquidation. The guarantee by Lombard Insurance became payable the moment Landmark Construction was placed in liquidation, being one of the two trigger events. The guarantee was thus primary in nature and clause 14.5 of the construction agreement was therefore irrelevant to the interpretation of the guarantee. The SCA found that the court *a quo* erred when it interpreted the nature of the guarantee as being accessory to the construction contract.[156]

The court further stated that although it was found that no fraud was present, as alleged by the respondents, it was in fact irrelevant to establish the presence of fraud in terms of the construction agreement as the guarantee was not subject to the terms of the construction agreement.[157]

Lastly with regards to the liability of the respondents in terms of their respective suretyships, the court stated the following:

[155] Lombard Insurance Company par 18.
[156] Lombard Insurance Company par 19.
[157] Lombard Insurance Company pars 19 and 21.

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> "The same applies to the undertaking by the three respondents. They undertook to indemnify Lombard in the event that it paid a claim based on the guarantee provided by it. That event occurred and the respondents were thus likewise liable."[158]

4.3.4 Preliminary remarks

The guarantee provided by Lombard Insurance was to secure the obligations of Lombard Construction in the event of the construction company defaulting on its obligations, resulting in the cancellation of the contract, alternatively Lombard Construction being placed in liquidation. What the guarantee did not do was to guarantee the performance of Lombard Construction in terms of the principal agreement it had with the Academy. The guarantee would therefore become payable should one of the conditions of guarantee be met, in this case Lombard Construction being placed in liquidation. Stated differently, although the guarantee was provided in terms of the obligations Lombard Construction had towards the Academy, it was not subject to the principal agreement between Lombard Construction and the Academy. Therefore, any reference to a clause in the principal agreement between the Academy and Lombard Construction would be irrelevant. If such thinking was pursued, it would misconstrue the whole nature of the guarantee, making it accessory as opposed to autonomous. The same principles applied to the indemnity and suretyship agreements provided by the respondents in favour of Lombard Insurance. Because these agreements were payable subject to the pay out of any guarantee by Lombard Insurance, it was linked to the happening of a certain event and not subject to any principal agreement. The indemnity agreements were therefore primary in nature and did not concern itself with the validity of any other agreement between the relevant parties.

[158] Lombard Insurance Company pars 19 and 22.

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CHAPTER 5 CONCLUSION

5.1 Introduction

Guaranteeing the obligations of a third party is a form of security commonly used to secure or mitigate the risk exposure that is synonymous with *inter alia* credit agreements. It is said that the strength of a chain is as strong as its weakest link and the same can be said with regards to guarantees. By not understanding what you are undertaking as a guarantor or surety or by accepting a guarantee as security without understanding the nature of the agreement, might land you in a scenario you never intended to be in. Although common law guarantees and suretyships are grouped under the same umbrella term "guarantees", there is a distinguishable difference in the type of security they provide due to their various natures.[159]

The purpose of this paper was to compare the primary and secondary nature of guarantees and to subsequently understand the obligations relating to each diverse nature, ultimately providing the reader with better insight into when one can rely on the performance of the obligor in terms the guarantee.[160]

To draw a conclusion, this paper considered the requirements for a valid guarantee and the regulation thereof in terms of the common law, the GLAA, and the National Credit Act.[161] It went on to establish the nature and obligations associated with common law guarantees, suretyships, and indemnity agreements by unpacking the definition and elements of each type of guarantee.[162]

[159] Par 1.2.
[160] Par 1.3.
[161] Pars 2.2 – 2.4.
[162] Pars 3.2 – 3.5.

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Finally, *Shabangu* and *Lombard Insurance* were discussed to illustrate the primary and secondary nature of guarantees and the duty it creates for the obligor to honour his commitment.[163]

5.2 Summary of findings

This paper identified that guarantees and suretyships are regulated in terms of common law, the GLAA, or the National Credit Act. The problem that presents itself relates to the interchangeable use of the words suretyship and guarantee as these two instruments of security are not necessarily regulated by the same legislation. By referring to a suretyship when a common law guarantee is meant, and *visa versa*, leads to uncertainty with regards to the requirements applicable and defences available in terms of legislation. Common law dictates that regardless of whether the word suretyship or guarantee is used to describe a third party's obligation to perform, it will be the context in which the word is used that will be of foremost importance in establishing the true intention of the parties.[164] The second hurdle is establishing which Act is applicable to which form of guarantee. The GLAA prescribes several formalities that must be adhered to when a suretyship agreement is concluded. Section 6 clearly states that theses formalities only apply to suretyship agreements in terms of which the performance of the principal debtor is guaranteed, and therefore primary guarantees are not included.[165] The application of the NCA appears to be a contentious issue. Due to the wording of section 8(5) of the Act, there are authors like Mostert that are of the opinion that the NCA only includes a primary guarantee and not a contract of suretyship. Mostert's view is that the words "on demand" as seen in the definition of a credit guarantee, refers to those agreements that are not reliant on default of the principal debtor but rather on the guarantor's obligation to perform when demanded thereto.[166] Mostert's argument has been supported and dismissed by several authors, however, in terms of current case law it appears that the courts are

[163] Pars 4.2 – 4.3.
[164] Par 2.2.
[165] Par 2.3.
[166] Par 2.4.

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inclined to disagree with Mostert and have found that the wording of section 8(5) of the NCA does make provision for the inclusion of suretyships.

Next the focus was turned to the definition, nature and obligations of guarantees. In the absence of a legislative definition of suretyship, Forsyth and Pretorius' definition has been regarded as the preferred definition and is therefore described as

> "an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and, secondarily, that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor".[167]

Similar to a suretyship, a primary guarantee is yet to be defined in terms of any Act. However, we could refer to the definition of a credit guarantee as defined in section 8(5) of the NCA as a point of reference as it refers to the two elements of a primary guarantee, namely that it secures the debt of another and that performance by the guarantor must be demanded.[168] The definition of a primary and secondary guarantee is important as it portrays the nature of the two instruments. Following that, the nature of guarantees has a direct effect on the guarantor's or surety's obligation to perform. From the definition of a suretyship, two conditions can subsequently be identified, namely that there must be a valid principal agreement and the surety's liability to perform must be secondary to that of the principal debtor. Stated otherwise, to enforce a surety's obligation to perform, there must be an enforceable principal agreement in terms of which the principal debtor defaulted. A surety's obligation to perform will not be enforceable should one of these two conditions be unaccounted for. If the elements of a suretyship are interpreted to describe the nature thereof it is clear and indicative that a suretyship is accessory in nature.[169] In contrast to an agreement of suretyship, a common law guarantee only has one condition. Whilst a common law guarantee still secures the obligations of another in terms of an underlying agreement, it is not subject to the validity of that agreement. The only condition of a primary guarantee is that performance in terms of the guarantee, must be demanded. The right to demand performance will be in terms of the happening of a certain event. Considering that a common law guarantee is neither subject to the validity of an

[167] Forsyth and Pretorius 28-29.
[168] Par 3.2.
[169] Par 3.3.

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underlying agreement nor default on the part of the debtor, it is regarded as being primary in nature. The guarantor's obligations will become enforceable once performance is demanded in terms of the conditions of guarantee.[170] The last form of guarantee discussed was an indemnity agreement which shares the same elements as a common law guarantee. Similar to a common law guarantee, an indemnity agreement is a principal agreement where the provider thereof assumes a principal obligation to perform on the happening of a certain event and when demanded thereto. The only difference highlighted is that an indemnity agreement does not only guarantee the performance of another, but can also guarantee the performance of the indemnifier himself.[171]

Finally, the cases of *Shabangu* and *Lombard Insurance Company were* considered to illustrate that a surety's or guarantor's liability to perform is directly linked to the nature of the specific guarantee. *Shabangu*, which related to agreements of suretyship, concluded that due to the accessory nature of a suretyship, the surety's obligation could only be enforceable if the principal agreement was found to be valid. The nexus between the principal obligation and the surety's liability is therefore lost once the principal agreement is tainted.[172] *Lombard Insurance Company* concerned a guarantee, that secured the obligations of a construction company on the happening of two certain events. The court found that the guarantee was primary in nature as it did not guarantee performance of the underlying agreement but rather secured the obligations of the construction company when demanded thereto and on the happening of a certain event. The guarantor's obligation to perform was therefore autonomous from any other agreement and the guarantor was due to perform the moment the conditions of guarantee were met.[173]

5.3 A final word

This paper aims to illustrate the difference between the primary and secondary nature of guarantees. The need for such distinction derives from the fact that the nature of

[170] Par 3.4.
[171] Par 3.5.
[172] Par 4.2.
[173] Par 4.3.

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guarantees influences the obligations that relate thereto. The difference in nature is illustrated by comparing three familiar types of guarantees, namely common law guarantees, suretyships and indemnity agreements, and classifying each one's nature as primary or accessory. An assessment of the current legislation available regulating guarantees has identified the need for much needed amendments to existing legislation, alternatively drafting and implementation of new regulations. For instance, section 6 of the GLAA only addresses requirements for suretyship agreements but is silent on primary guarantees and section 8(5) of the National Credit Act refers to a credit guarantee, although there is much debate that section 8(5) also includes a suretyship. Regardless of the shortage of proper legislation, the intricate drafting of guarantees and the confusion caused by the interchangeable use of the words guarantee and suretyship, the nature of primary and secondary guarantees is clear. This paper should subsequently provide clarity and certainty on the obligations relating to the various types of guarantees.

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