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## CONSTRUCTION LAW BULLETIN

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### CESSION OF RIGHT TO PAYMENT

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#### INTRODUCTION

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Financially strapped contractors often have to resort to funding contracts and the purchase of necessary materials by raising money or buying materials on the security of a cession of the right to receive payments from the Employer.

The Supreme Court of Appeal ("SCA") in March this year dealt with the validity of such cessions and the consequences where an Employer fails to comply with the cession.

#### FACTS

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In 2007 the Oudtshoorn Municipality ("the Municipality") awarded a contract to Silver Buckle Trade (Pty) Ltd trading as Yethu Projects ("the Contractor") for the construction of 663 houses.

The Contractor lacked the necessary working capital which necessitated it raising bridging finance.

Nurcha Finance Company (Pty) Ltd ("Nurcha") agreed to assist the Contractor with its funding requirements on condition that the Contractor ceded its right to payment under the contract to Nurcha as security for the Contractor's loan indebtedness. The funding agreement provided for a dedicated bank account ("the Project Account") in the name of the Contractor to be set up and for all future payments by the Municipality to be effected into the Project Account.

The building contract contained the usual provisions relating to the issue of interim certificates to the Contractor.

Following conclusion of the funding agreement, the Municipality's Project Manager issued 39 interim payment certificates.

All but three of these certificates were paid by the Municipality into the Project Account.

Contrary to the arrangement between the parties, the Municipality paid certificates 7, 8 and 20, amounting in aggregate to some R4m, not into the Project Account but into another account in the Contractor's name.

The Contractor's financial fortunes took a turn for the worse and it was placed into final liquidation in April 2010.

At the time of its liquidation, the Contractor owed Nurcha some R2,7m arising from the funding agreement.

In light of the Contractor's liquidation, Nurcha was unable to recover its claim against the Contractor.

Nurcha claimed the R2,7m from the Municipality on the grounds that it was guilty of a breach of contract in having paid the three certificates to the Contractor and not into the Project Account.

The Municipality disputed liability and litigation ensued culminating in the case being heard by the SCA.

## **THE LEGAL POSITION**

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When the Municipality consented to the cession and provided Nurcha with an undertaking to effect future payments into the Project Account, a contract came into existence between Nurcha and the Municipality.

Nurcha argued that, in the light of this, the Municipality was bound to give effect to that arrangement, and its failure to do so in respect of certificates 7, 8 and 20 amounted to a breach of contract. As a result of this breach, Nurcha had suffered a loss in an amount of R2,7m representing the amount it had been unable to recover from the Contractor which would not have been the case had the Municipality adhered to its contractual obligations.

The Municipality's defence was that the payment certificates concerned were interim payment certificates, and in light of the Contractor having been placed into final liquidation, the right to enforce payment of the certificates fell away based on the principles established by the Thomas Construction case.<sup>1</sup>

In the Thomas Construction case the liquidators of Thomas Construction sought to enforce payment of an interim certificate after a valid cancellation of the contract by the Employer.

The court held that the liquidators were not entitled to payment as interim certificates were issued on account of the final contract price payable which in this case could not be determined until the contract was completed by other contractors and the final cost to the Employer established. It would only be at that point and after taking into account any extra costs incurred by the Employer in completing the contract that it could be established whether anything was still due to Thomas Construction. This would be calculated based on the actual value of work executed by Thomas Construction versus payments made after due allowance for extra costs incurred by the Employer in completing the job.

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<sup>1</sup> Thomas Construction (Pty) Ltd (in liquidation) v Grafton Furniture Manufacturers (Pty) Ltd 1988(2) SA 546 A.

The SCA picked up on the obvious flaw in the Municipality's argument which it appears neither the court a quo<sup>2</sup> nor the parties' legal representatives had appreciated, namely that Nurcha's claim was not based on an unpaid interim certificate but on payment certificates in respect of which the Municipality had acknowledged liability and which it had already paid.

It is trite that interim payment certificates are valid and binding and ordinarily provide a self standing and distinct right to payment.<sup>3</sup> Interim payment certificates are seen as analogous to on demand guarantees.<sup>4</sup>

In this case, upon the amounts being certified as due and payable in terms of the relevant payment certificates, the Municipality became contractually obliged to pay the amounts concerned into the Project Account. Its failure to do so was a breach of contract. Whatever the rights and obligations might be between the Contractor and the Municipality following on from the cancellation of the building contract were irrelevant to the Municipality's contractual obligations owed to Nurcha.

In the result, the SCA upheld Nurcha's claim against the Municipality and ordered it to make payment of Nurcha's damages in the sum of R2,7m together with interest and costs.

## CONCLUSION

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Cessions of payments under building contracts are enforceable and our courts will give effect to them, even in cases involving public sector Employers.

However, it is advisable to obtain the express consent of the Employer and to put into place some type of payment regime as had been agreed to by the parties in this case, namely payments into a dedicated project account.

Some building contracts prohibit cessions of a right to payment. In such cases, absent the Employer's express consent, any cession of payment will be unenforceable.

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<sup>2</sup> The court that rendered the first decision in the case and against whose judgment Nurcha appealed to the SCA.

<sup>3</sup> See Mouton v Smith 1977(3) SA 1A and Thomas Construction at 562 E-F.

<sup>4</sup> State Bank of India v Danel SOC Ltd [2015] 2 All SA 152 SCA.