UNCONSCIONABILITY AND A BREACH OF A NEGATIVE STIPULATION IN THE UNDERLYING CONTRACT AS EXCEPTIONS TO THE AUTONOMY PRINCIPLE OF DEMAND GUARANTEES IN SOUTH AFRICA

by

TINY MUSESENGWA

submitted in accordance with the requirements for the degree of

DOCTOR OF LAWS

at the

UNIVERSITY OF SOUTH AFRICA

PROMOTER: PROF M KELLY-LOUW

JUNE 2022

ORIGINAL WORK DECLARATION

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…….

(SUPERVISOR)

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Name: Tiny Musesengwa

Student number: 61166480

Degree: Doctor of Laws

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This thesis is dedicated to God, without whom it would not have been possible.

PREFACE

First and foremost, I praise and thank God, who has granted me countless blessings and the opportunity to complete this thesis.

I extend my sincere thanks to my promoter, Prof M Kelly-Louw, for her guidance, motivation and other assistance during the drafting of this thesis.

Special thanks to my family for their encouragement, inspiration and unconditional love throughout this journey.

ABSTRACT

Demand guarantees are an established part of international trade and construction. They are traditionally simple instruments under which the obligation to pay a beneficiary a fixed or up to maximum sum arises merely upon presenting a demand in the prescribed form, sometimes with supporting documents if required thereunder. The autonomy/independence principle, which mandates non-interference with the obligation to pay under a demand guarantee on any ground extraneous to the demand guarantee itself, is a fundamental cornerstone of demand guarantees. It is complemented by their documentary nature which requires the determination of whether a demand is compliant and triggers a payment obligation to be based on the presented documents alone, as appraised against the requirements in the demand guarantee.

Over time a limited number of exceptions to the autonomy principle, e.g., fraud and illegality in the underlying contract, have gained recognition, including under South African law. Whether further exceptions should be recognised is a pertinent question and has arisen before South African courts, the answer to which is devoid of consensus. Recognising further exceptions to the autonomy principle carries significant consequences. Going too far in one direction would erode the autonomy principle and, consequently, the nature and utility of demand guarantees. Leaning too far in the opposite direction and doggedly applying the autonomy principle may promote abuse and undermine demand guarantees.

This thesis will examine how well (or not) the breach of negative stipulation and unconscionability exceptions are developed, their pros and cons and what further developments could enhance clarity regarding their position under South African law. Jurisdictions with more mature and established positions in respect of demand guarantees and exceptions, particularly Australia, and England which has historically influenced aspects of South African law, are useful sources of guidance. International rules/standards, the UNCITRAL Convention and any guidance they may offer will also be considered. How they address the two exceptions and what South Africa can learn will be examined. This thesis is intended to be a comprehensive resource and original contribution to crafting a clear South African law position in this regard.

KEY TERMS

Article 5 of the American Uniform Commercial Code (UCC); anti-beneficiary interdict; autonomy principle; bad faith; breach of a negative stipulation; demand guarantee; doctrine of strict compliance; documentary nature; documentary credit; exception to the autonomy principle; ICC Uniform Customs and Practice for Documentary Credits (UCP); ICC Uniform Rules for Contract Guarantees (URCG); ICC Uniform Rules for Demand Guarantees (URDG); International Standby Practices (ISP98); independence principle; injunction; interdict; lack of good faith; *mareva* injunction; performance guarantee; public policy considerations; standby letter of credit; *ubuntu*; UCP 600; UNCITRAL Convention; unconscionability; underlying contract; Uniform Commercial Code (UCC); and Article 19 of the United Nations Commission on International Trade Law's Convention on Independent Guarantees and Stand-by Letters of Credit (UNCITRAL Convention); and URDG 758.

LIST OF KEY ABBREVIATIONS AND ACRONYMS

A	Appellate Division
ABLR	Australian Business Law Review
AC	Law Reports Appeal Cases.
ACLR	Australian Company Law Reports
AD	Appellate Division
All ER	All England Law Reports
All SA	All South African Law Reports
ALR	Australian Law Reports
App Cas	Law Reports Appeal Cases
Aust Const LR	Australian Construction Law Reports
BCL Rev	Boston College Law Review
BLR	Building Law Reports
BR	West's Bankruptcy Reporter
Bank Law	Banking Law Journal
Banking & Finance L Rev	Banking and Finance Law Review
BCL	Building and Construction Law
BLR	Building Law Reports
BRICS	Brazil, Russia, India, China, and South Africa
Brook J Int'L L	Brooklyn Journal of International Law
CA	The Court of Appeal
CC	Constitutional Court
Ch D	Chancery Division
CILL	Construction Industry Law Letter
CILSA	Comparative and International Law Journal of Southern Africa

CLD	Juta's Commercial Law Digest
CLJ	Current Law Journal
CLR	Commercial Law Reports (Juta)
CLR	Commonwealth Law Reports
Colum L Rev	Columbia Law Review
Com L R	Commercial Law Reports
Com L J	Commercial Law Journal
Comm LR	Commercial Law Reports
Cth	Commonwealth
DCI (ICC)	Documentary credit Insight (The Trade Finance Quarterly of the International Chamber of Commerce)
De GM & G	De Gex, Macnaghten & Gordon's Bankruptcy Reports
ECG	Eastern Cape High Court in Grahamstown
EDC	Eastern District Court Reports, Cape of Good Hope
EU	European Union
EWCA Civ	England and Wales Court of Appeal (Civil Division) Decisions
EWHC (Comm)	England and Wales High Court (Commercial Court Decisions)
EWHC	England & Wales High Court
F	Federal Reporter or Supp Federal Supplement
F 2d	Federal Reporter, Second Series (part of the West's National Reporter Series)
F Supp	Federal Supplement
FCA	Federal Court of Australia (including Full Court until end 2001)
FCAFC	Federal Court of Australia - Full Court
FCR	Federal Court Reports

GJ	Gauteng Local Division, Johannesburg
GSJ	South Gauteng High Court, Johannesburg
HC	High Court
HCA	High Court of Australia
HL	House of Lords
ICCLR	International Company and Commercial Law Review
ICC	International Chamber of Commerce
ICLR	International and Comparative Law Review
Int J L M	International Journal of Law and Management
Int T L R	International Trade Law & Regulation
Int J Eco Res	International Journal of Economics and Research
Int'l Bus Lawyer	International Business Lawyer
Int'l Trade & Bus L Rev	International Trade and Business Law Journal
ISP98	International Standby Practices ICC Publication No. 590
J Corp L	Journal of Corporation Law
JBFLP	Journal of Banking and Finance Law and Practice
JBL	Journal of Business Law
JOL	Judgments OnLine
KB	King's Bench Division
LlLR	Lloyd's List Law Reports
LLD	Doctor of Laws
LLM	Master of Laws
Lloyd's Rep	Lloyd's Law Reports
Lloyd's Rep Bank	Lloyd's Law Reports Banking
LQR	Law Quarterly Review
MLJ	Malayan Law Journal

NE	North Eastern Reporter
N Y App Div	New York Supreme Court, Appellate Division
NE	North Eastern Reporter
NSW	New South Wales
NSW Sup Ct	Supreme Court of New South Wales
NSWCA	New South Wales Court of Appeal
NSWLR	New South Wales Law Reports
NSWSC	New South Wales Supreme Court
Nw J Int'l L and Bus	Northwestern Journal of International Law and Business
NYS	New York Supplement
NYS 2d	New York Supplement, Second Series
NZLR	New Zealand Law Reports
P & CR	Property, Planning and Compensation reports
QB	Queen's Bench
QB (Com Ct)	Queen's Bench (Commercial Court)
QBD	Queen's Bench Division
Qd R	Queensland Reports
QSC	Queensland Supreme Court
S D Fla	United States District Court for the Southern District of Florida.
SA	South African Law Reports
SA Merc LJ	South African Mercantile Law Journal
SAJHR	South African Journal on Human Rights
SALC	South African Law Commission
SALJ	South African Law Journal
SASC	South Australia Supreme Court
SCA	Supreme Court of Appeal

SGCA	Singapore Court of Appeal
SGHC	Singapore High Court
Sing CA)	Singapore Court of Appeal
Sing HC	Singapore High Court
SKCA	Saskatchewan Court of Appeal (Canada).
SLR	Singapore Law Reports
TCC	Technology and Construction Court
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg /Journal of Contemporary Roman-Dutch Law
TPA	Trade Practices Act 1974
TS	Supreme Court of the Transvaal
TSAR	Tydskrif vir die Suid-Afrikaanse Reg/Journal of South African Law
UCC	Uniform Commercial Code of the United States (Revised UCC Article 5, Letters of Credit, 1995)
UCP	Uniform Customs and Practice for Documentary Credits (without referring to any specific version of it)
UCP 400	1983 Version of the Uniform Customs and Practice for Documentary Credits
UCP 500	1993 Version of the Uniform Customs and Practice for Documentary Credits
UCP 600	2007 Version of the Uniform Customs and Practice for Documentary Credits
UKEAT	United Kingdom Employment Appeals Tribunal
UKPC	UK Privy Council
UKSC	Supreme Court
UK	United Kingdom
UNCITRAL	United Nations Commission on International Trade Law

UNCITRAL Convention	United Nations Convention on Independent Guarantees and Stand-by Letters of Credit
U Pa J Int'l L	University of Pennsylvania Journal of International Law
URCG	Uniform Rules for Contract Guarantees, ICC Publication No 325 (1978)
URDG	Uniform Rules for Demand Guarantees
URDG 458	ICC Publication No. 458, Paris (1992)
URDG 758	ICC Uniform Rules for Demand Guarantees (ICC Publication No 758, Paris (2010))
URDG	Uniform Rules of Demand Guarantees (without referring to any specific version of it)
USA	United States of America
Vand J Transnat'l L	Vanderbilt Journal of Transnational Law
VCAT	Victorian Civil and Administrative Tribunal (Australia)
Vic Sup Ct	Victoria Supreme Court
VR	Victorian Reports
VSC	Supreme Court of Victoria
VSCA	Victorian Court of Appeal
WASC	Western Australia Supreme Court
ZAGPJHC	South Africa, Gauteng Province, Johannesburg High Court
ZAGPPHC	South Africa: North Gauteng High Court, Pretoria
ZAKZHC	South Africa: High Courts - Kwazulu Natal
ZAKZPHC	South Africa: Kwazulu-Natal High Court, Pietermaritzburg
ZASCA	Supreme Court of Appeal of South Africa
ZAWCHC	South Africa. (Western Cape High Court, Cape Town

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CHAPTER 1: INTRODUCTION AND THEME OF THESIS

1.1 INTRODUCTION AND THEME OF THE THESIS

1.1.1 Introduction

Generally, a demand guarantee is an independent undertaking given by a guarantor, commonly a bank or other financial institution, at the behest of and in respect of the obligations of the guarantor's customer (the applicant/principal) to pay a third party (known as the beneficiary) upon the third party's (beneficiary's) presentation of a demand (generally in writing) and with or without supporting documents which is compliant with the terms of the undertaking.

In addition to the "on demand" aspect by implication included in the above definition, a demand guarantee envisages two key characteristics, which have become tritely accepted as constituting the key elements of demand guarantees: the principle of autonomy (independence) and the documentary nature of demand guarantees.

1.1.2 Introductory Overview of the Principle of Autonomy in respect of Demand Guarantees

The principle of autonomy (independence) denotes the autonomous (independent) nature of the obligation of a guarantor set out in the demand guarantee itself to pay a beneficiary pursuant to a demand guarantee without regard to external factors such as a dispute between the applicant and the beneficiary based on their underlying contract, for instance, construction contracts or sales contracts.[1] A demand guarantee is also independent of any other contract, such as the indemnity between the applicant and the guarantor.[2] The principle of autonomy is also characteristic of commercial and standby letters of credit.

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[1] See Hugo, C "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal relating to Demand Guarantees" (2014), 4, *TSAR*, 661 at 662, for an explanation of the independence principle and the requirement for demands to comply with the requirements of a demand guarantee in the context of construction guarantees. See also *Hamzeh Malas and Sons v British Imex Industries Ltd* [1958] 2 QB where the court stressed that the autonomy principle imposed "an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to the contract or not". Also see *RD Harbottle (Mercantile) v National Westminster Bank* [1978] QB 146, para 155-156.

[2] An analogy making similar emphasis on the autonomy of demand guarantees from a South African law perspective was used in *Sulzer Pumps South Africa (Proprietary) Limited v Covec-MC Joint Venture* (1672/2013) [2014] ZAGPPHC 695 with reference to the following statement from O'Driscoll, PS "Performance Bonds, Bankers' Guarantees, and the Mareva Injunction", (1985-1986), 7, *Nw J Int'l L & Bus*, 380 at 384-385: "The courts have held that, as with the irrevocable letter of credit, the establishment of an unconditional performance bond or bank guarantee by the seller in favour of the buyer constitutes a contract between the seller and the seller's banker that is separate and distinct from the contract of sale between the seller and the buyer". See also *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & Others* 2010 (2) SA 86 (SCA), para 20 and *Loomcraft Fabrics CC v Nedbank Ltd & Another* 1996 (1) SA 812 (A), para 5-7.

South African courts acknowledge the principle of autonomy. For example, in *Dormell Properties 282 CC v Renasa Insurance Co Ltd*,[3] the court noted that a demand guarantee must be honoured as soon as a compliant claim against it is made upon the happening of a specified event in accordance with the demand guarantee.[4]

In *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd*,[5] the Supreme Court of Appeal underscored the importance of the autonomy principle to the commercial purpose of guarantees, finding that,

> "[t]he very purpose of the guarantee is so that the beneficiary can call up the guarantee without having to wait for the final determination of its rights in terms of accessory obligations. To find otherwise, would involve an unjustified paradigm shift and defeat the commercial purpose of performance guarantees."[6]

The independent obligation to pay of a demand guarantee is largely premised on the motif "pay now and litigate later".[7] In line with their autonomous and documentary nature, demand guarantees are considered an alternative that is "as good as cash"[8] and conducive to "fast and efficient realisation".[9] Notwithstanding its importance, the autonomy principle is not absolute.[10] The vulnerability of demand guarantees to abuse is largely dictated by the ease with which they can be exploited by unscrupulous beneficiaries seeking unlawful payment. This is a longstanding

[3] 2011 (1) SA 70 (SCA). See also Kelly-Louw, M "Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit", in Visser, C & Pretorius, JT (eds) *Essays in Honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, 2014, 197 at 199-200.

[4] 2011 (1) SA 70 (SCA), para 39. See also *FirstRand Bank Ltd v Brera Investments CC* 2013 (5) SA 556 (SCA), para 11 and *Loomcraft Fabrics CC v Ned-bank Ltd and Another* 1996 (1) SA 812 (SCA), para 5-7.

[5] [2014] 1 All SA 307 (SCA), para 29.

[6] *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 29.

[7] Kelly-Louw, M "*Selective Legal Aspects of Bank Demand Guarantees: The Main Exceptions to the Autonomy Principle"*, LLD thesis, University of South Africa, 2008 (hereinafter "Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*"), at 25.

[8] *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443, para 7.

[9] Lukic, A "The Role and Importance of Bank Demand Guarantees in International Trade", (2014), v5i3, *Int J Eco Res*, 6. For a brief discussion of the historical development, role and purpose of demand guarantees, see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 1.

[10] Marxen, K "*Demand Guarantees in the Construction Industry: A Comparative Legal Study of Their Use and Abuse from a South African, English and German Perspective*", LLD thesis, University of Johannesburg, 2017 (hereinafter "Marxen, *Demand Guarantees in the Construction Industry*"). See also Kelly-Louw, M "Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit", in Visser, C & Pretorius, JT (eds) *Essays in Honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, 2014, 197 at 215.

challenge requiring balance to be sought between preserving the autonomy principle, to which demand guarantees owe a large part of their utility, and diminishing the vulnerability of demand guarantees to abuse by beneficiaries for unlawful ends. Exceptions to the autonomy principle constitute the latter part of this balance.

The autonomy principle is subject to a few exceptions, some of which are tritely recognised in most jurisdictions, such as fraud,[11] and others that are still developing or arguably emerging. Unconscionability and a breach of a negative stipulation fall within the latter category. Various jurisdictions take differing stances on these two exceptions, as will be discussed herein. Given the importance of the autonomy principle to the utility of demand guarantees, uncertainty in the form of a lack of clear delineation by courts or legislatures of the acceptable exceptions to the autonomy principle adversely affects the acceptability of demand guarantees.[12]

1.1.3 Documentary Nature of Demand Guarantees

Another fundamental characteristic of demand guarantees is that they are documentary in nature, which means that payment thereunder is solely dependent on whether a compliant demand is made with the documents called for in terms of the demand guarantee.[13] In support of the documentary nature of demand guarantees, demand guarantee transactions have been described as being transactions rooted in documents alone.[14] Apart from the documents presented pursuant to a demand, a guarantor is under no obligation to investigate external factors or authenticate documents to determine the validity of a demand.[15] Where documents presented with a demand are compliant with the terms of the demand guarantee and presented within the timeline stipulated under the terms of the demand guarantee, an absolute (or primary) obligation to pay the beneficiary arises. The documentary nature of demand guarantees is intertwined with the autonomous (independence) principle in this regard, as the former reinforces the autonomous nature of a guarantor's obligation to pay a beneficiary where a demand is supported with compliant

[11] See *Joint Venture Between Aveng (Africa) Pty Ltd and Strabag International GmbH v South African National Roads Agency SOC Ltd and Another* [2019] 3 All SA 186 (GP), para 5.

[12] *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443, para 7. See also Dixon, WM (2004) "As Good as Cash? The Diminution of the Autonomy Principle" (2004), 32(6), *Australian Business Law Review*, 391 at 2.

[13] *Phillips & Another v Standard Bank of South Africa Ltd & Others* 1985 (3) SA 301(W) and *Sztejn v J Henry Schroder Banking Corporation* 31 NYS 2d 631 (1941).

[14] Kelly-Louw, M "General Update on the Law of Demand Guarantees and Letters of Credit", in Hugo, CF (ed) *Annual Banking Law Update 2016: Recent Legal Developments of Special Interests to Banks,* 2016, 43 at 48.

[15] Ibid.

documentation.

The documentary nature of all documentary credits (i.e., demand guarantees, standby letters of credit and commercial letters of credit) is a widely accepted principle that has been adopted internationally, including under English law.[16] English law has greatly influenced the direction in which the South African law of documentary credits has developed.[17] Strict adherence to the documentary nature of documentary credits under South African law has been evidenced by the approach of the courts in cases such as *OK Bazaars 1929 Limited v Standard Bank of South Africa Limited*,[18] where the documentary principle was endorsed, albeit in the context of letters of credit. In this case, the court held that the interest of an issuer of a documentary credit was limited to ensuring that documents presented with a demand conform with the terms of the letter of credit. The court went on to unequivocally state that where the relevant documents conform with the terms of the letter of credit, the issuing bank is obliged to pay the beneficiary, but if not, the issuing bank is neither obliged nor entitled to pay the beneficiary. The case of *Loomcraft Fabrics CC v Nedbank Ltd and Another*[19] also encapsulated the documentary nature of documentary credits, noting that the obligation of a bank (issuer) to honour a credit arises only upon presentation to the bank of the documents specified in the credit.

1.2 TERMINOLOGY USED IN THIS THESIS

The term "documentary credits" will be used in the thesis where reference is made to principles that apply to demand guarantees, standby letters of credit and commercial letters of credit. This is because the key principles, characteristics and uses underpinning demand guarantees, standby letters of credit and commercial letters of credit, particularly the autonomy principle and their documentary nature, are similar.[20] As a result, a lot of case law regarding demand guarantees has drawn authority from case law and principles applied to standby and commercial letters of credit,

[16] In the English case of *AES-3C Maritza East 1 Eood v Crédit Agricole Corporate and Investment Bank and Another* [2011] EWHC 123 (TCC) failure to comply with the formal requirements of the guarantee (bond) itself, particularly providing the relevant supporting documentation required under the instrument, proved fatal to the validity of the demand.

[17] Kelly-Louw, M "General Update on the Law of Demand Guarantees and Letters of Credit" in Hugo, CF (ed) *Annual Banking Law Update 2016: Recent Legal Developments of Special Interests to Banks,* 2016, 43 at 43.

[18] 2002 (3) SA 688 (SCA).

[19] 1996 (1) SA 812 (SCA).

[20] *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA), para 10. See also *Lombard Insurance Company Limited v Landmark Holdings (Pty) Limited and Others* 2010 (2) SA 86 (SCA), para 20; *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 (CA); and *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (A), para 9.

and *vice-versa*.[21]

It is widely accepted that demand guarantees and letters of credit (commercial and standby) bear substantive resemblances regarding their nature and function.[22] The similarity between the different instruments has been recognised in South African case law. For example, in *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd*,[23] the court acknowledged that demand guarantees stand "on a similar footing" to letters of credit.[24] This view seems to have been embraced internationally,[25] including under English law.[26] Essential similarities between demand guarantees and letters of credit which have rationalised their similar treatment include the principle of autonomy and the documentary nature thereof.[27]

Notwithstanding the similarities, caution has been advised against a wholesale treatment of all demand guarantees as letters of credit and *vice versa* on the basis that consideration must be given to relevant circumstances in each case.[28] With due regard to the precaution, it is nevertheless submitted that the principles that underpin letters of credit are largely applicable to demand guarantees and *vice versa*. Though primarily focused on demand guarantees, the proposed study will proceed on this basis. Authority will be cited in respect of both demand guarantees and letters of credit to support views proffered in the thesis.

It is worth noting that one could distinguish between commercial letters of credit and standby letters of credit. A standby letter of credit is the most similar in nature and purpose to a demand

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[21] Ibid.

[22] Hugo, C, "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal relating to Demand Guarantees" (2014), 4, *TSAR*, 661 at 661.

[23] 2012 (2) SA 537 (SCA), para 10. See also *Lombard Insurance Company Limited v Landmark Holdings (Pty) Limited and Others* 2010 (2) SA 86 (SCA), para 20.

[24] See also *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976, at 983.

[25] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantee*s, at 19, 73 and 187.

[26] *See RD Harbottle (Mercantile) v National Westminster Bank* [1978] QB 146; *Howe Richardson Scale Co Ltd v Polimex-Cekop*, [1978] 1 Lloyd's Rep 161 (1977); and *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159. Also see *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19 (CA) where Lord Justice Eveleigh stated that he did not regard Lord Denning, MR in *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 (CA) "as saying that one should approach every case upon the basis that the bond is a letter of credit and to have no regard to the circumstances which brought it into existence". See also, *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC).

[27] *Howe Richardson Scale Co Ltd v Polimex-Cekop* [1978] 1 Lloyd's Rep 161 (1977). See also *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 (CA) where the court held that the same principles apply to a demand guarantee as to letters of credit.

[28] *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19 (CA).

guarantee. For this reason, it will be the main category letter of credit referred to in this thesis. A standby letter of credit, based on its characteristics, can, therefore, be defined as an independent[29] undertaking generally issued by a financial institution, usually a bank, acting at the request of a customer (usually the person liable for an obligation under the principal contract), to pay an amount to the beneficiary upon the presentation of the stipulated documents irrespective of any dispute between the parties to the underlying contract (or transaction).[30] Standby letters of credit resulted from the need to circumvent an initial prohibition against the issuance of guarantees under the United States of America's ("USA")[31] banking legislation.[32] Standby letters of credit, being inherently similar instruments for demanding guarantees, albeit with a unique historical development, will be considered in conjunction with demand guarantees as part of the proposed thesis.

Due to the terms "guarantee" and "suretyship" sometimes being used synonymously under South African law,[33] the distinction between the two terms will be touched upon briefly to set clear parameters for the thesis. Neither demand guarantees nor suretyships have statutory definitions under South African law.[34] A fundamental difference between suretyships and demand guarantees is that a surety's obligation is accessory in nature to the underlying contract (principal debt) and triggered only upon actual default by the principal debtor, subject to any defences raised by the principal debtor.[35] A suretyship agreement is a secondary/accessory instrument. From a South African law perspective, it is firmly established that notwithstanding the terminology used in respect of a document, the true nature of such a document turns on the context and substance of

[29] *Casey and Another v First National Bank* 2013 (4) SA 370 (GSJ), para 20.

[30] Idem, para 14.

[31] Hereinafter "the USA".

[32] The United States' National Bank Act of 3 June 1864 (as amended). For a detailed discussion of the historical development of standby letters of credit, see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 1-3.

[33] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 30 and Kelly-Louw, M "Construction of Demand Guarantees Gone Awry: *Minister of Transport and Public Works v Zanbuild Construction*", (2013) 25 *SA Merc L J* 404-417.

[34] Forsyth, CF and Pretorius, JT *Caney's The Law of Suretyship*, 6 ed, Juta, 2010.

[35] Goode, R "Abstract Payment Undertakings and the Rules of the International Chamber of Commerce" (1995) 39 *Saint Louis University LJ* 725 at 726. See also Hapgood, M *et al Paget's Law of Banking* 12 ed (2003) 701 and in endnote 1 at 702. See also *Lombard Insurance Company Limited v Stewart and Others* [2016] ZAKZPHC 91, para 8 and *Lombard Insurance Company Limited v Landmark Holdings (Pty) Limited and Others* 2010 (2) SA 86 (SCA), para 19.

the relevant document.[36] Noting the distinction between suretyship agreements and demand guarantees, the focus of the proposed thesis will be on demand guarantees as constituting independent (primary) undertakings.

Demand guarantees tend to go by various names, such as "performance bonds/guarantees", "tender bonds/guarantees", "independent (bank) guarantees", "independent undertakings", "demand guarantees", "bank guarantees", "first demand guarantees", "default undertakings" and "standby letters of credit".[37] The term "demand guarantee" will be used in this thesis, as it is commonly used in a South African context.[38] As mentioned above, save where the context, for instance, where a specific case reference, requires it, the umbrella term "documentary credits" will be used to encompass all the various names by which independent undertakings, particularly demand guarantees, standby letters of credit and commercial letters of credit are referred to.

1.3 A BRIEF PROBLEM STATEMENT

1.3.1 Introduction

Given the use of documentary credits in South Africa and internationally, there is a need for certainty and consistency regarding the law in respect of such instruments. South Africa recognises fraud as an exception to the autonomy principle,[39] which position has been well evidenced and reinforced by extensive authority.[40] It has been argued that serious illegality in the underlying

[36] *List v Jungers* 1979 (3) SA 106 (A), para 119 and *Minister of Transport and Public Works, Western Cape, and Another v Zanbuild Construction (Pty) Ltd and Another* (SCA) 2011 (5) SA 528, para 14.

[37] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 5. See also *Minister of Transport and Public Works, Western Cape & another v Zanbuild Construction (Pty) Ltd & Another* (SCA) 2011 (5) SA 528, para 12-15 and *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 14.

[38] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*. See also Marxen, *Demand Guarantees in the Construction Industry*; Amaefule, C "*The Exceptions to the Principle of Autonomy of Documentary Credits*" PhD thesis, University of Birmingham, 2011 (hereinafter "Amaefule, *The Exceptions to the Principle of Autonomy*"). See also *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* (1672/2013) [2014] ZAGPPHC 695.

[39] *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), para 9-10; *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), para 38; and *Joint Venture Between Aveng (Africa) Pty Ltd and Strabag International GmbH v South African National Roads Agency SOC Ltd and Another* [2019] 3 All SA 186 (GP). Also see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees* for a detailed discussion of the fraud exception and Hugo, C, "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal relating to Demand Guarantees" (2014), 4, *TSAR,* 661 at 662.

[40] See Kelly-Louw, M "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees", (2009), 42(3), *CILSA*, 339; Mutandwa, V "*The Fraud Exception in Documentary Letters of Credit*", LLM dissertation, University of South Africa, 2015 (hereinafter "Mutandwa, *The Fraud Exception*"); Hugo, C, "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal relating to demand guarantees" (2014), 4, *TSAR*, 661 at 662 and Kelly-Louw, *Selective Legal Aspects of Bank Demand*

contract may also constitute a valid exception.[41] However, South African courts have not delivered a conclusive judgment on this aspect.[42] Furthermore, no certainty has been established on the South African law position regarding unconscionability and breach of a negative stipulation (i.e., an undertaking not to make a demand (or draw) on the guarantee) in the underlying contract or elsewhere as exceptions to the autonomy principle.

In a fairly recent case, S*ulzer Pumps South Africa (Proprietary) Limited v Covec-MC Joint Venture*[43] a South African High court considered the possibility of accepting unconscionability and breach of a negative stipulation as exceptions to the autonomy principle. The court, in this case, referred to unconscionability and breach of a negative stipulation, alongside fraud, as valid grounds upon which court interference with payment under demand guarantees would be warranted. By simply invoking Australian law authority,[44] the court in *Sulzer Pumps* held and accepted that South African courts would, in addition to fraud, also intervene to prevent a demand under a demand guarantee in cases of unconscionability and a breach of a negative stipulation in the underlying contract.[45]

The *Sulzer Pumps* ruling has fuelled calls for certainty regarding recognising unconscionability and a breach of negative stipulation in the underlying contract as further exceptions to the autonomy principle under South African law. It highlights uncertainty in this area of law. Against this backdrop, the proposed thesis will evaluate whether, under South African law, unconscionability, and a breach of a negative stipulation, either in the underlying contract itself or elsewhere, should be recognised as additional exceptions to the autonomy principle of demand

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Guarantees, at 7-8. See also *Lombard Insurance Company Limited v Landmark Holdings (Pty) Limited and Others* 2010 (2) SA 86 (SCA) at 20.

[41] See *Mattress House (Proprietary) Ltd v Investec Property Fund Ltd* [2017] *ZAGPHC* 298; and see Kelly-Louw, M "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees", (2009), 42(3), *CILSA*, 339 and Lupton, C and Kelly-Louw, M "Emergence of Illegality in the Underlying Contract As an Exception to the Independence Principle of Demand Guarantees" (2020) 53(3) *CILSA* 1 for a detailed discussion of South African law. See also Kelly-Louw, M "Validity of the Underlying Contract and the Independence Principle of Demand Guarantees" in Hugo, C (ed) *Annual Banking Law Update 2021: Recent Legal Developments of Special Interests to Banks* (2021) Juta & Co Ltd: Claremont, 112, at 112, 113 and 122-124.

[42] Ibid.

[43] (1672/2013) [2014] ZAGPPHC 695.

[44] Whitten, M "Calling on a Performance Security: As Good as Cash?" presented on 18 June 2013 to the *Victorian Bar, Commercial Bar Association, Construction Law Section*, Neil McPhee Room, Owen Dixon Chambers East, 205 William Street, Melbourne. See also *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136.

[45] *Sulzer Pumps South Africa (Proprietary) Limited v Covec-MC Joint Venture* (1672/2013) [2014] ZAGPPHC 695, para 41. See also *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136.

guarantees. A comparative analysis of the approach taken by jurisdictions which have considered and, to various degrees, established a stance on these exceptions, particularly England and Australia, is undertaken in this thesis.

The choices and challenges faced by South African law regarding exceptions in the context of demand guarantees and the autonomy principle are not dissimilar to what has been faced under English and Australian law. This thesis examines how well each of the unconscionability exception and the breach of a negative stipulation exception, respectively, is developed from a South African law perspective. Consideration is also given to what barriers exist to their recognition and what more may be done under South African law to clarify its position regarding these two exceptions in relation to demand guarantees. The research undertaken as part of this thesis is intended to culminate in a comprehensive resource to guide the crafting of a clear South African law position in this regard.

South Africa has an opportunity to forge its own pathway in this regard, drawing upon guidance which can be gleaned from the significantly more mature English and Australian law regarding these two selected exceptions in relation to demand guarantees.

Consideration is also given to whether international rules offer any guidance in this regard, as well as whether the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) ("UNCITRAL Convention"),[46] particularly Article 19, which addresses the subject of exceptions to the autonomy principle, provides any baseline standards which would be beneficial to adopt under South African law.

1.3.2 Jurisdictions Covered

It is generally accepted that South African courts tend to take their cue from English law, where documentary credits and the recognition and defences to non-payment thereunder are concerned.[47] Sometimes reliance will be placed on other laws, such as American and Singaporean law. Although the possibility of other exceptions to the autonomy principle, besides the fraud exception, has been, to some extent, acknowledged in English case law,[48] the question of whether unconscionability and/or a breach of a negative stipulation are indeed acceptable exceptions to the

[46] Hereinafter "UNCITRAL Convention".

[47] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 43.

[48] See, e.g., *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC) and *Sirius International Insurance Company v FAI Insurance Ltd* [2002] EWHC 1611 (Ch); [2003] EWCA Civ 470; [2003] UKHL 54.

autonomy principle has not authoritatively been answered under the English law. Due to the significant influence of English law on the development of South African law in general, particularly in relation to documentary credits, it is imperative for the purposes of the proposed thesis to refer to English Law when considering demand guarantees in South Africa.

As Australia[49] is a leading common-law jurisdiction which has taken a decidedly clearer view on unconscionability and breach of negative stipulation as constituting valid exceptions, Australian law is considered in an attempt to find guidance as to how they should be dealt with under South African law. Furthermore, since the South African High Court in the *Sulzer Pumps* case suddenly decided to incorporate and adopt the Australian position into South African law, it needs to be explored whether this is truly a reflection of South African law.

With English law, Australian law and potentially international rules and the UNCITRAL Convention as points of reference, it is useful to consider what South Africa can learn from the iterations of the unconscionability and breach of a negative stipulation exception recognised (or not recognised, as applicable) in these jurisdictions, international rules and convention.

1.3.3 Sources of the Law Relating to Demand Guarantees and International Practice Rules and Conventions

In South Africa there is no legislation that governs documentary credits,[50] which is also true for several other jurisdictions, including England. The legal principles controlling the South African law relating to documentary credits are found in a number of sources.[51] As a result, the law and disputes must largely be addressed under specific contractual provisions, unwritten rules, principles of contract and commercial law, case law, legal writings and custom.[52] Other common sources of the law of documentary credits, because of their highly international nature, are also

[49] See *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136.

[50] Van Niekerk, JP and Schulze, WG *The South African Law of International Trade: Selected Topics*, 4 ed., SAGA Legal Publications CC, 2016 (hereinafter, "Van Niekerk and Schulze, *The South African Law of International Trade*"), at 248.

[51] See Van Niekerk and Schulze, *The South African Law of International Trade*, at 248–56; Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees* in Chapter 3; and Kelly-Louw, M "The Law Applicable to Demand Guarantees and Standby Letters of Credit" (2010) 24(2) *Speculum Juris* 1.

[52] De Ly, F "The UN Convention on Independent Guarantees and Stand-by Letters of Credit" (Fall 1999) *International Lawyer* 831at 833.

often international banking practices and usages/customs in international trade.[53]

The USA is one of the few jurisdictions with a domestic legislative framework that governs documentary credits and has codified the autonomy principle and documentary nature of letters of credit, among other *essentialia* of documentary credits in their Uniform Commercial Code ("UCC").[54] The UCC, originally produced in the 1950s, was revamped in 1995 to address deficiencies and is considered a success, as reflected by its adoption by the American states. It is unique in that it exemplifies the codification of documentary credit law.

To illustrate the effect of codification on documentary credit law and the added certainty it provides, where the autonomy principle would apply under common law in the main jurisdictions being considered in this thesis, being Australia, England and South Africa, the USA would apply the same principle pursuant to Article 5 of section 5-109 of their UCC. In addition to providing a better degree of explicit certainty than common law, the UCC also provides a solid alternative to negotiating and relying on rules and standards incorporated by reference in a documentary credit on a case-by-case basis. Such negotiation and reliance on the incorporation of international rules to govern a documentary credit on a case-by-case basis can result in protracted negotiations on which rules to use or foster inconsistencies due to different rules being elected by parties, in some cases for the same type of documentary credit.

This may occur due to the absence of comprehensive domestic laws relating to documentary credits or sometimes simply due to the choice of the parties involved. International standards and practice rules of the International Chamber of Commerce ("ICC")[55] such as the ICC Uniform Customs and Practice for Documentary Credits ("UCP 600"),[56] ICC Uniform Rules for Demand Guarantees ("URDG 758")[57] and International Standby Practices ("ISP98")[58] are available for incorporation into demand guarantees and other documentary credits. There is also a UNCITRAL convention that may apply to demand guarantees. Selective aspects of these international rules and

[53] See Ellinger, EP "The Uniform Customs and Practice for Documentary Credits (UCP): Their Development and the Current Revisions" (2007) *Lloyd's Maritime and Commercial Law Quarterly* 152.

[54] Uniform Commercial Code (1995), Article 5 (hereinafter "the UCC").

[55] Hereinafter "the ICC".

[56] ICC Publication No 600, Paris 2006 (hereinafter "the UCP 600").

[57] ICC Uniform Rules for Demand Guarantees (ICC Publication No 758, Paris (2010)) (hereinafter the "URDG 758").

[58] ICC Publication No 590, Paris 1998 (hereinafter "the ISP98").

the UNCITRAL Convention are considered to the extent that they offer guidance as to how, if at all, they deal with the issues under discussion in the thesis (i.e., unconscionability and a breach of a negative stipulation as possible exceptions to the autonomy principle).

1.3.4 The Unconscionability Exception

In Australia, unconscionability is statutorily recognised[59] as a defence against non-payment (i.e., an exception to the autonomy principle) in respect of demand guarantees. This has been invoked in a number of cases where injunctions were granted based on unconscionability.[60] Unconscionability, in the context of demand guarantees, is an amorphous concept without a universally accepted single definition. One definition of unconscionability that has been embraced by Australian courts, which has subsequently been invoked and arguably adopted further to the South African case of *Sulzer Pumps,* is that it entails "taking advantage of a special disadvantage of another",[61]"unconscientious reliance on strict legal rights"[62] or "action showing no regard for conscience, or that [is] irreconcilable with what is right or reasonable".[63]

While there is abundant case law supporting and cementing the unconscionability exception in jurisdictions like Australia, the unconscionability exception has largely failed to gain sufficient traction or clear acceptance elsewhere, particularly under English law.[64] Although South African courts have, at times, such as in the case of *Sulzer Pumps,* invoked Australian case law in relation to the unconscionability exception, no definite position has been established under South African law. The precise status of unconscionability thereunder remains uncertain.

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[59] Section 51AA of the Australian Trade Practices Act 1974 (Cth) which is now the Competition and Consumer Act 2010 (Cth), have adopted the equitable concept of unconscionability as a separate ground from that of fraud restraining the enforcement of on-demand guarantees and states that, "[a] person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law, from time to time".

[60] See *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27; *Boral Formwork v Actionmakers* [2003] NSWSC 713, *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd* (2002) FCAFC 4; 117 FCR 301; 189 ALR 76 and *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136. See Wooler, GC "*Lifting the Veil of Autonomy: Unconscionable Conduct as Grounds for Injunctive Relief in Australia and Singapore – A Study in the Context of Independent Trade Finance Instruments*", PhD thesis, The University of Queensland, 2017 (hereinafter "Wooler *Lifting the Veil of Autonomy*"), for a detailed discussion on this topic.

[61] *Sulzer Pumps South Africa (Proprietary) Limited v Covec-MC Joint Venture* (1672/2013) [2014] ZAGPPHC 695 referring to Michael Whitten "Calling on a Performance Security: As Good as Cash?" presented on 18 June 2013 to the *Victorian Bar, Commercial Bar Association, Construction Law Section*, Neil McPhee Room, Owen Dixon Chambers East, 205 William Street, Melbourne, para 40–41. See also section 3.3.6 in Chapter 3 of this thesis.

[62] Ibid.

[63] Ibid.

[64] See section 4.2 in Chapter 4 of this thesis for a detailed discussion of unconscionability under English law.

Under English law, the acceptance of unconscionability as an exception to the autonomy principle is not entirely clear, with courts in a number of cases acknowledging that circumstances other than fraud, including those related to bad faith, could form the basis of additional exceptions to the autonomy principle.[65] In *TTI Team Telecom International Ltd v Hutchison,*[66] unconscionability was acknowledged as a possible reason for overlooking the autonomy principle under English law. However, the case did not unequivocally indicate the English law stance on the matter. Despite the apparent hesitance by English courts to explicitly recognise the unconscionability exception, some commentators have optimistically construed court cases such as the *TTI Team Telecom International Ltd* case as a clear inclination towards the recognition of the unconscionability exception under English law.[67]

Supporters of the unconscionability exception have advanced the argument that, if applied within an appropriate procedural framework, it would not necessarily erode the autonomy principle to an unjustifiably adverse degree.[68] It has also been suggested that the unconscionability exception is viable in jurisdictions with a legislative platform to support its proper application.[69] However, unconscionability has also been criticised for being a nebulous concept,[70]which is generally impracticably abstract and difficult to prove.[71]

Under South African law, unconscionability has been considered with reference to the principles of fairness and ubuntu.[72] There is, however, no definitive position regarding its parameters and whether unconscionability is an acceptable exception to the autonomy principle under the South African law of demand guarantees. The gap in the development of South African law of

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[65] *Potton Homes Ltd v Coleman Contractors* (1984) 28 BLR 19 (CA); *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC) and *Elian and Rabath v Matsas and Matsas* [1966] 2 Lloyd's Rep 495 (CA).

[66] 3G UK Ltd [2003] EWHC 762.

[67] Amaefule, *The Exceptions to the Principle of Autonomy* at 176-177.

[68] Jones, R and Gabriel A. Moens, *International Trade and Business Law Review*, Volume XI, Routledge-Cavendish, 2008.

[69] Davidson, A "Unconscionability in Letters of Credit and Demand Guarantee Transactions" (2012) 1(2), *International Journal of Technology Policy and Law*, 183 at 183.

[70] Woolf, HS "*The Doctrine of Unconscionability as an Independent Exception to the Doctrine of Independence in Documentary Credit Practice*", LLM dissertation, University of Johannesburg, 2014 at 52.

[71] Burnett, R and Bath, V *Law of International Business in Australasia*, Federation Press, 2009. See also Enonchong, N "The Problem of Abusive Calls on Demand Guarantees", (2007), *Lloyd's Maritime and Commercial Law Quarterly*, 83 at 105.

[72] *Juglal NO and Another v Shoprite Checkers (Pty) Ltd t/a OK Franchise Division* 2004 (5) SA 248 (SCA).

documentary credits in this regard was highlighted by the mere invocation of Australian case law and authority regarding the unconscionability exception in the South African case of *Sulzer Pumps.* Although it is noted that *Sulzer Pumps* does not deal with letters of credit, this case serves as relevant authority due to their similarity with demand guarantees. The seemingly blind adoption of Australian law into South African law in the *Sulzer Pumps* case has been criticised as not reflecting the South African law position.[73] This exception is considered in the study, which further investigates the situation that prevails in South Africa or at least should prevail in South Africa. Furthermore, a specific analysis of the unconscionability exception is undertaken in this thesis for its connotations from a South African law perspective to be fully understood.

1.3.5 Breach of a Negative Stipulation Exception or Underlying Contract Exception and Terminology Used in this regard

A breach of a negative stipulation is another debated and not universally recognised exception to payment under documentary credits, particularly demand guarantees. As exemplified by cases such as *Sulzer Pumps*, the breach of a negative stipulation exception is sometimes referred to as the underlying contract exception. This is likely because the breach in question relates, in most cases, to a restrictive term in the principal underlying contract itself, which limits the circumstances in which the documentary credit may be called up. Although this seems to be the case in most instances, it is not so in all cases. As exemplified by some cases considered in the following chapters, a negative contractual stipulation may be located in a separate document or contract instead of being in the underlying contract.

The term "underlying contract exception", where used in this thesis, is merely used in a general sense in light of the typical scenario, namely where the negative stipulation is housed in the underlying contract. However, the use of the term is not intended to limit the remit of any possible exception to negative stipulations to the underlying contract only. To avoid doubt, this thesis considers negative stipulations generally. It does not confer any significant weight upon the location of the negative stipulation and the distinction between a negative stipulation in an underlying contract and one in another or a secondary document. Aspects and authority referenced herein regarding an underlying contract exception are generally considered to apply similarly where the broader term used is a breach of a negative stipulation exception, which covers a

[73] Kelly-Louw, M "Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture" (1672/2013) [2014] ZAGPPHC 695 (2 September 2014) [South Africa] (May 2015) Vol 19(5), *Documentary Credit World*, 17-22.

negative situation regardless of whether it is in the underlying contract or elsewhere.

A breach of a negative stipulation exception arises where calling on the demand guarantee would be in breach of an express or implied negative stipulation in the underlying contract[74] or elsewhere. The breach of a negative stipulation in the underlying contract is characterised by competing contractual rights, which position has been succinctly described as follows:[75]

> "there are two conflicting contractual rights in question: the beneficiary's autonomous right to demand the independent guarantee amount and the applicant's right under the underlying contract which restricts the beneficiary's right to demand. The question which arises in this context … is which contractual rights should prevail".

The breach of a negative stipulation exception is capable of construction as a tale of two different formulations: restriction of a beneficiary from making a demand, and restriction of a guarantor or issuer from making payment following receipt of a compliant demand. It is submitted that the only viable formulation, which is considered further in this thesis, is the former (i.e., anti-beneficiary formulation whereby a beneficiary is prevented from making a demand in breach of contract). In subsequent chapters of this thesis dealing with the breach of a negative stipulation in relation to demand guarantees in English, Australian and South African law, support is given to and expanded upon regarding the rationale for the anti-beneficiary formulation being the only valid formulation.

The discourse regarding whether the breach of a negative stipulation exception constitutes a true exception, i.e., an exception to the autonomy principle, is covered in the subsequent chapters of this thesis. The phrase "exception to the autonomy principle" is considered misleading. The reference to the autonomy principle creates difficulties of perception by implying a relationship between the exception and the autonomy principle. The position that the breach of a negative stipulation exception is not a true exception and has no bearing on the autonomy principle is fully rationalised in this thesis. The terminology used in this thesis can plausibly be for the sake of uniform taxonomy and familiarity of terminology built by common usage, referred to as a "breach of a negative stipulation exception". This term exception in this context is used generically to denote any circumstance that is disruptive to, and, therefore, constitutes an exception to, the main

[74] Whitten, M "Calling on a Performance Security: As Good as Cash?" presented on 18 June 2013 to the *Victorian Bar, Commercial Bar Association, Construction Law Section*, Neil McPhee Room, Owen Dixon Chambers East, 205 William Street, Melbourne.

[75] Alawamleh, KJA "*Documentary Credits and Independent Guarantees: A Critique of the 'Fraud Exception' Position in English and Jordanian Law*", PhD thesis, University of Central Lancashire, 2013 (hereinafter "Alawamleh, *Documentary Credits and Independent Guarantees*"), at 194.

event which triggers the obligation for payment under a demand guarantee or other documentary credit, namely a demand by the beneficiary. It is worth emphasising that the use of the term exception in this thesis when referring to a breach of a negative stipulation does not connote a "true" exception to the autonomy principle, for instance, such as a fraud exception would connotate.

The enforcement of a negative stipulation regarding a demand guarantee illustrates the conflicting contractual interests arising from demand guarantees, on the one hand, and the underlying or other relevant contracts, on the other. This interaction between such a negative stipulation and the autonomy principle of demand guarantees has been analysed by various authorities with reference to specific case law.[76]

This exception has been recognised in several English law cases, with *Lumely v Wagner*[77] and *Doherty v Allman*[78] being considered pioneering cases in this regard.[79] The case of *Sirius International Insurance Company v FAI Insurance Ltd*[80] is also seminal for its analysis and a potential endorsement of the recognition of the breach of an agreed negative stipulation as a ground upon which an injunction may be issued to block the beneficiary from calling up a documentary credit. In particular, the *Sirius* case examined the pertinent question of whether a court could grant an injunction restraining a beneficiary from drawing under a letter of credit in breach of a condition in another agreement or whether the autonomy principle overrode any other agreement restricting a beneficiary's entitlement to claim under a documentary credit.[81] A similar question arose in the case of the South African case of *Sulzer Pumps,* where an interdict was sought in respect of a beneficiary's demand under a demand guarantee. Arguments supporting the enforcement of

[76] See Mutandwa, "*The Fraud Exception"* and Hugo, C "Documentary Credits and Independent Guarantees", a paper delivered at the 2011 *Annual Banking Law Update*, 116, at 123. See also Hugo C "Construction Guarantees and the Supreme Court of Appeal (2010–2013)" in Visser, C and Pretorius, JT (eds) *Essays in Honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, 2014, 159 at 170 and Marxen, *Demand guarantees in the construction industry* at 244.

[77] 1852 1 De GM & G 604.

[78] (1878) 3 App Cas 709. See also the cases of *RD Harbottle (Mercantile) v National Westminster Bank* [1978] QB 146 and *Themehelp Ltd v West and Others* [1996] QB 84 (CA), para 98-99 which touched on a breach of a negative covenant exception and highlighted that the law in respect of the remit of the autonomy principle is unsatisfactory.

[79] Alavi, H "Exceptions to the Principle of Independence in documentary Letters of Credits" Universitat Autonoma de Barcelona, Spain, Faculty of Law, Department of Private Law, Thesis for the Degree of Doctor of Philosophy, under the Direction of: Professor Cale Gorriz Lopez, June 2018.

[80] [2002] EWHC 1611 (Ch); [2003] EWCA Civ 470; [2003] UKHL 54.

[81] See *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd and Others* [2004] UKHL 54, para 14.

express negative covenants, including that such covenants merely restrain a beneficiary from doing what he has agreed not to do (i.e., claiming or making a demand under a demand guarantee),[82] are examined in more detail in the study.

More recently, the court, in the English case of *Simon Carves Ltd v Ensus UK Ltd*[83] upheld an injunction preventing a beneficiary from making a call on the performance guarantee (bond) on the basis that the underlying contract clearly and expressly prevented the beneficiary from making a demand under the guarantee[84] thereby depicting the recognition of the breach of a negative stipulation as a ground for an anti-beneficiary injunction preventing a beneficiary from making a demand under English law. However, the recognition of this exception under English law appears to be restricted to instances where an express term in an underlying contract limits the entitlement of a beneficiary to draw on a documentary credit.[85] This limitation was emphasised in the case of *Deutsche Ruckversicherung Aktiengeslleschaft v Walbrook Insurance Co Ltd*,[86] where the court held that it was wrong to "imply a term into the underlying contract that the beneficiary will not draw on the letter of credit unless payment under the underlying contract is due".[87] Therefore, the breach of a negative stipulation exception is grounded in the sanctity of the contract and its terms. Thus, if not expressly included in a contract, it will not readily give rise to the exception.

The Australian case of *Pearson Bridge Pty Ltd v State Rail Authority of New South Wales*[88] is

[82] Fayers, R "Sulzer Pumps Prompts another Sirius Look", (2015), Volume 19, Number 7, *Documentary Credit World*, 39 at 41.

[83] [2011] EWHC 657 (TCC). See also *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136.

[84] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC), para 33. One of the earliest English law cases in which an injunction was granted to enforce a negative covenant (albeit not in the context of documentary credits) is the case of *Lumley v Wagner* (1852) 42 ER 687. The later case of *Doherty v Allman* (1878) 3 App Cas 709, at 720 expanded on the rationale for this stance, *per* the remarks of Lord Cairns that "if parties, for valuable consideration, with their eyes open, contract that a particular thing shall not be done, all that a court of equity has to do is to say, by way of injunction, that which the parties have already said by way of covenant, that the thing shall not be done; and in such case the injunction does nothing more than give the sanction the process of the Court to which already is the contract between the parties. It is not then a question of the balance of convenience or inconvenience, or of the amount of damage or of injury—it is the specific performance, by the Court, of that negative bargain which the parties have made, with their eyes open between themselves." An injunction was not granted in *Doherty* for reasons specific to that case (i.e., a determination that there was no negative covenant in place).

[85] Enonchong, N, *The Independence Principle of Letters of Credits and Demand Guarantees*, Oxford University Press, 2011, at 217.

[86] [1994] 4 All ER 181 (QBD).

[87] Idem, para 162-163.

[88] [1982] 1 ACLR 81 (NSWSC).

considered to have been one of the earliest cases to consider and grant an injunction in circumstances where a breach of negative covenants relating to a demand guarantee was viewed as overriding the autonomy principle. For purposes of this thesis, Australia has been selected as a comparative common-law jurisdiction because it exemplifies the application of the notion that "there is an exception for the principle of autonomy where there is an underlying contract between the applicant for the guarantee and the beneficiary which restricts the beneficiary's power to demand payment under the guarantee".[89] The clarity of the Australian law position on recognising the breach of a negative stipulation has made it a reference point regarding such matters.[90] Like English case law, the Australian case law also distinguishes between an express prohibition and implied prohibition in a contract for the purposes of acknowledging a valid breach of a negative stipulation exception.[91]

In South Africa, there is a universally established legal position regarding whether the breach of a negative stipulation exception is recognised. In the case of *Sulzer Pumps,* both unconscionability and breach of negative stipulation in the underlying contract were seemingly both recognised as exceptions to the autonomy principle. Therefore, the proposed thesis addresses a few main questions regarding the latter exception. Firstly, whether or not a breach of a negative stipulation in a contract should be accepted as an exception in relation to demand guarantees. Secondly, if so accepted, within which parameters such an exception should be accepted and developed under South African law. Until the *Sulzer Pumps* case, South African courts had not explicitly indicated a stance on this exception. The recognition of the breach of a negative stipulation in South Africa as an exception was also argued for, albeit not determined conclusively, in the case of *Group Five Power International (Pty) Ltd v Cenpower Generation Company Ltd.*[92] A negative stipulation in

[89] Alawamleh, *Documentary Credits and Independent Guarantees* at 195, citing *Lane-Mullins v Warrenby Pty Ltd* [2004] NSWSC 817, at [53]. The view that the impregnability of the autonomy principle can be compromised by a contractual stipulation was also recognised by Rolfe J in the Australian case of *Barclays Mowlem Construction Limited v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451, at 458. See also *Fletcher Construction Australia Ltd* v *Varnsdorf Pty Ltd* [1998] 3 VR 812, at 826*; Bachmann Pty Ltd* v *BHP Power New Zealand Ltd* [1999] 1 VR 420, para 30; and *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136, para 77.

[90] See the South African case of *Kwikspace Modular Buildings Ltd v Sabodala Mining Co SARL and Another* 2010 (6) SA 477 (SCA), paras 11-12 and 22, in which the court succinctly summed up the Australian law position, but did not venture further to extrapolate a South African law position from it.

[91] See *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812 and *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443.

[92] (2008/41068) [2018] ZAGPJHC 663 (16 November 2018) [South Africa]. For a full discussion of this case, see Kelly-Louw, M "*Group Five Power International (Pty) Ltd v Cenpower Generation Company Ltd* (2008/41068) [2018] ZAGPJHC 663 (16 November 2018) [South Africa]", (February 2019) 23(2) *Documentary Credit World*, 18-23.

an underlying contract was also pitted against the autonomy principle in the case of *Joint Venture Between Aveng (Africa) Pty Ltd and Strabag International GmbH v South African National Roads Agency SOC LTD and Another*.[93] While a decision was not made on the South African law position regarding the exception, Makhuvele J remarked, with reference to the *Sulzer Pumps* case, that if recognition of the negative stipulation exception had been the sole matter to be decided, the applicant would have been entitled to interdictory relief preventing a claim under the guarantees in question because the beneficiary was in breach of the contractual terms required to be met before a demand under the guarantee.[94] In addition to noting the importance of academic writings and foreign law in seeking to determine points of law, Makhuvele J highlighted the need for higher courts to "pronounce on the so-called lacuna" left by the unanswered question.[95] The *Joint Venture* case proceeded to the Supreme Court of Appeal,[96] which appeared to endorse or at the very least open the door to recognition of a breach of a negative stipulation exception. The proposed thesis seeks to clarify the current position and suggest a feasible direction in which South African law should address this exception.

1.4 HYPOTHESIS

The proposed thesis is premised on the hypothesis that the autonomy (independence) principle is a valid and necessary gatekeeper to preserve the commercial utility of demand guarantees. The principle of independence should thus not be lightly diluted by a proliferation of unnecessary exceptions, which would undermine the autonomy principle and hinder the use of demand guarantees. The two potential exceptions to the autonomy principle central to this thesis are unconscionability and breach of a negative stipulation. The term unconscionability is not one with a clear-cut definition, and it lends itself to subjectivity. The inauguration of unconscionability into the ranks of recognised exceptions to the autonomy principle may erode the utility of demand guarantees under South African law. Generally, exceptions to the autonomy principle should be accepted only if absolutely necessary and, on the whole, all in all beneficial. Even then, any additional exceptions to be recognised must be developed fully and within clear parameters.

However, the breach of a negative stipulation exception seems to have undergone a beta-testing of sorts and developed along broadly consistent lines in jurisdictions such as England and Australia.

[93] [2019] 3 All SA 186 (GP).

[94] Idem, para 120.

[95] Idem, para 119.

[96] 2021 2 SA 137 (SCA).

The breach of a negative stipulation exception, based on reasonably discernible and consistent parameters, is grounded on the law of contract. Unlike the unconscionability exception, the breach of a negative stipulation exception is capable of application without affecting the autonomy principle, which is a factor that may contribute significantly to its recognition under South African law. Also, recognising a breach of a negative stipulation exception could be a worthwhile measure to curtail abusive demands that constitute a breach of a contract or a negative stipulation by a beneficiary. From an English and Australian law perspective, a detailed analysis to support or rebut these suppositions in respect of both the unconscionability exception and the breach of a negative stipulation exception will be undertaken in subsequent chapters of this thesis to provide recommendations for the development of South African law.

1.5 STRUCTURE OF THE THESIS

This thesis consists of seven chapters.

Chapter 1 comprises an introduction, overview and theme of the thesis. It outlines the scope of the thesis, setting out the parameters within which the topic will be explored.

Chapter 2 examines the nature and characteristics of a demand guarantee, focusing on the autonomy principle and documentary nature of demand guarantees. Applicable international ICC rules and the applicable convention relating to demand guarantees are examined in regard to only aspects specifically relevant to the theme of the thesis.

Chapter 3 comprises a South African law discussion of the unconscionability and the breach of negative stipulation exceptions. As evidenced by judicial analysis, the current South African law position, including these exceptions' application and parameters, is considered under separate headings. Where appropriate, a comparative reference will be made to the USA's UCC,[97] a prime example of statutory codification of the law of documentary credits. Arguments for and criticisms levelled against elements of the two exceptions will also be evaluated from a South African perspective under the relevant headings.

Chapter 4 consists of an English law discussion of the unconscionability exception and the breach of a negative stipulation exception. The application and parameters of the unconscionability and breach of a negative stipulation exceptions under English law and arguments for and criticisms levelled against aspects thereof are evaluated under separate headings with reference to applicable

[97] Uniform Commercial Code (1995).

case law.

Chapter 5 comprises an Australian law discussion of the unconscionability exception and the breach of negative stipulation exception under separate headings. The application and parameters of the unconscionability exception and breach of a negative stipulation exception under Australian law and arguments for and criticisms levelled against aspects thereof are assessed with reference to applicable case law. Statutory, as well as common law, will also be considered in respect of the unconscionability exception.

Chapter 6 deals with relevant provisions, particularly in respect of the autonomy principle, of the URDG 758, UCP 600, ISP98, Uniform Rules for Contract Guarantees ("URCG")[98] and the UNCITRAL Convention, which are discussed with a focus on interpretive guidance that may be garnered from these international standards with respect to the unconscionability and breach of negative stipulation exceptions.

Chapter 7 contains the summaries, conclusions, and recommendations based on the research conducted. The conclusions reached and recommendations proposed pursuant to the thesis, including how the South African law of demand guarantees can develop its law regarding unconscionability and breach of a negative stipulation as exceptions to the autonomy principle, are drawn in Chapter 7. The guidance that may be extrapolated from the English law, and Australian law jurisdictions, respectively, as well as international practice rules and the UNCITRAL Convention on the unconscionability exception and the breach of negative stipulation exceptions, are also provided.

1.6 METHODOLOGY FOLLOWED

The research was conducted through a literature examination of all available information relevant to the theme of the thesis and includes books, articles, published research papers, theses, dissertations, reports, ICC rules, Conventions and local and international case law from the identified jurisdictions. The research is a desk-based study and not of an empirical nature.

It has been asserted that it is a traditional practice in writing a South African thesis to undertake comparative legal research in countries that are representative of different legal families, typically one from the Anglo-American family (e.g., England and the USA) and another from the Romance

[98] ICC Uniform Rules for Contract Guarantees (ICC Publication No 325 (1978)) (hereinafter, "URCG").

and the Germanic legal families (e.g., France and Germany).[99] By focusing on Australia, the proposed thesis will not conform to this traditional South African approach because Australia is a leading jurisdiction regarding the recognition of unconscionability and a breach of negative stipulation in a contract as exceptions to the autonomy principle of demand guarantees. England is considered a pertinent jurisdiction due to the close ties between English law and South African law and the influence of English law on South African law. Therefore, it is essential to also consider English law in this thesis.

Based on the research methodology set out above, an analysis of various approaches to unconscionability and breach of negative stipulation exceptions is undertaken with reference to the positions in Australia and England.

1.7 THE PERIOD OF THE LAW COVERED

Case law, legal writings, legislation, international practice rules and conventions up to 30 April 2022 were considered for writing this thesis.

[99] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 14.

CHAPTER 2: THE NATURE, BASIC CHARACTERISTICS AND BROAD OVERVIEW OF DEMAND GUARANTEES

2.1 THE PARTIES AND RELATIONSHIPS IN A DEMAND GUARANTEE ARRANGEMENT

2.1.1 Three-Party or Direct Demand Guarantee

In its simpler form, a demand guarantee arrangement typically comprises three separate legal relationships[1]involving the following contracts/agreements or arrangements[2]and parties:[3]

1. an underlying contractual agreement (for instance, a construction contract or sale-of-goods contract) between a beneficiary and a principal for performance by the principal pursuant to the contract (agreement);

2. an indemnity (or reimbursement) contract (agreement) between the principal (as applicant) and the financial institution issuing the demand guarantee (i.e., the guarantor or issuer) at the principal/applicant's behest, providing for, *inter alia*, reimbursement of the guarantor by the applicant in the event of a valid payment pursuant to the demand guarantee; and

3. a demand guarantee issued by the guarantor (or issuer) to the beneficiary as an instrument independent[4] from the underlying contract.

The relationships outlined above, which are typical of a simple demand guarantee (often referred to as a direct guarantee) arrangement, are illustrated in figure 1 below.

---

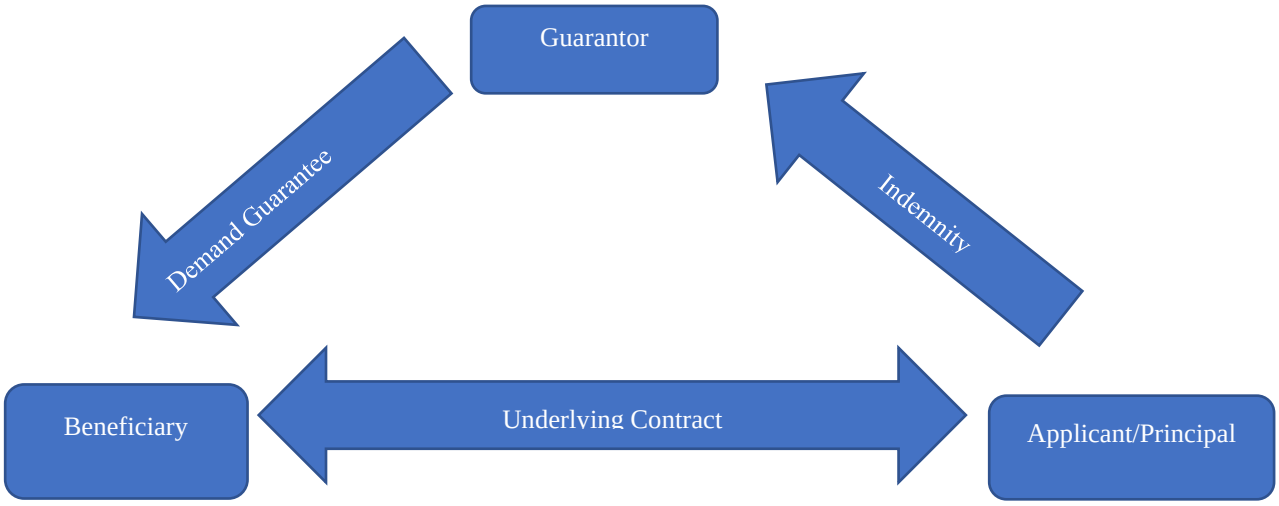
[1] *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), para 61.

[2] See the discussion in section 2.2.2 below regarding the issue as to why documentary credits, including demand guarantees, are not necessarily considered to be contracts in the context of the traditional definition of a contract.

[3] See Kelly-Louw, M "*Selective Legal Aspects of Bank Demand Guarantees: The Main Exceptions to the Autonomy Principle*", LLD thesis, University of South Africa, 2008 (hereinafter "Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*"), at 22-26 for a detailed consideration of the respective parties and agreements involved in respect of direct/three-party or indirect/four-party demand guarantees. See also Marxen, K *Demand Guarantees in the Construction Industry: A Comparative Legal Study of their Use and Abuse from a South African, English and German Perspective*, 1 ed, Juta & Co (Pty) Ltd, 2018 (hereinafter, "Marxen, K *Demand Guarantees in the Construction Industry"*), at 66-69 for a summary of the roles of the respective parties to a direct guarantee; Hsu, C "The Independence of Demand Guarantees, Performance Bonds and Standby Letters of Credit" (2006), 1(2), *National Taiwan University Law Review*, 3, at 15-16 and 28-29 and Sifri, J E, *Standby Letters of Credit, A Comprehensive Guide*, eds, Palgrave Macmillan, 2008 (hereinafter, "Sifri, *Standby Letters of Credits*"), at 138-141, for consideration of the mechanisms and roles and responsibilities of parties to standby letters of credits.

[4] See section 2.3 below for elucidation of the independent nature of documentary credits, particularly demand guarantees.

Figure 1: Illustration of a simple three-party demand guarantee arrangement.



2.1.2 Four-Party or Indirect Demand Guarantee

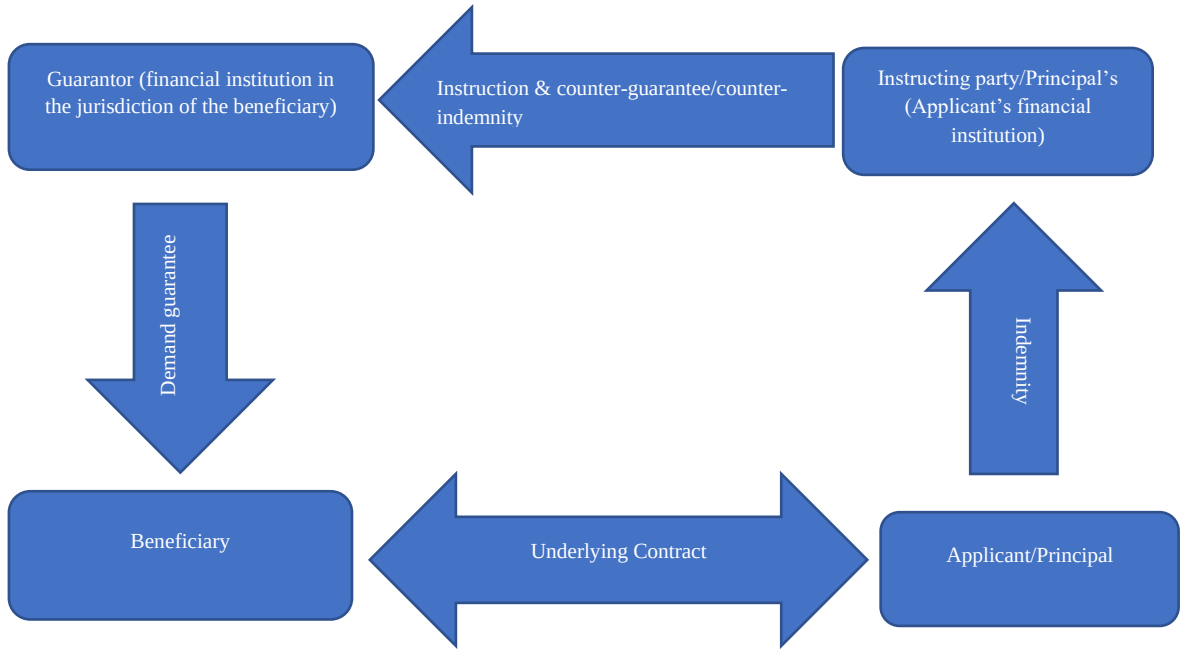
In certain cases, for example, where the principal (applicant) and the beneficiary are in different jurisdictions, the beneficiary may require a demand guarantee to be issued in their own jurisdiction by a financial institution there rather than the principal's (applicant's) financial institution in the principal's jurisdiction.[5] This is typically insisted upon by beneficiaries so that they enjoy the convenience and advantages associated with a demand guarantee that can be enforced locally under local law instead of unfamiliar foreign law under which the demand guarantee could otherwise be issued, and also for the added assurance of being issued a demand guarantee by a locally well-known, and usually reputable financial institution. In such cases, step one outlined above for a three-party demand guarantee remains the same.[6] Step two also remains the same between a principal and the principal's financial institution. Still, a key difference is that the principal's financial institution is not itself the guarantor and does not issue a guarantee directly to the issuer. Rather, the principal's financial institution (usually referred to as the instructing party) issues instructions to issue a demand guarantee in favour of the beneficiary, together with a counter-indemnity (also known as a counter-guarantee) to the preferred financial institution of the beneficiary in the beneficiary's jurisdiction. The instructions and counter-guarantee constitute the instructing financial institution's (party's) mandate to the guarantor, instructing and authorising it (the guarantor) to issue a demand guarantee in favour of the beneficiary and the instructing financial institution's agreement to reimburse the guarantor for any payment made pursuant to a

[5] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 24.

[6] See section 2 above.

claim on the demand guarantee. A demand guarantee is then issued by the guarantor (usually a bank in the beneficiary's jurisdiction) to the beneficiary as an independent undertaking to make payment to honour any demand made that is compliant with the terms of the demand guarantee.[7] Due to the indirect relationship created by the interposition of a second financial institution (the guarantor) between the principal and the principal's bank on the one hand, and the beneficiary on the other hand in demand guarantee arrangements of this nature, they are often referred to as indirect demand guarantees.[8] Following similar logical lines, the fact that such arrangements usually involve at least four parties (i.e., the principal, the principal's financial institution (instructing financial institution), the financial institution issuing the guarantee (guarantor) in the beneficiary's jurisdiction, and the beneficiary) they are also known as four-party demand guarantees.

Figure 2: Illustration of a four-party demand guarantee arrangement.



[7] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 24 – 25; Marxen, K *Demand Guarantees in the Construction Industry*, at 66-69 for a summary of the roles of the respective parties to an indirect/four-party demand guarantee; Hsu, C "The Independence of Demand Guarantees, Performance Bonds and Standby Letters of Credit" (2006), 1(2), *National Taiwan University Law Review*,3, at 15-16 and 28-29 and Sifri, *Standby Letters of Credits*, at 138-141, for consideration of the mechanisms and roles and responsibilities of parties to standby letters of credits. See also Hugo, CF, "*The Law Relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks*", LLD thesis, The University of Stellenbosch, 1996 (hereinafter, "Hugo, *The Law Relating to Documentary Credits"*), at 20-37 for a detailed and thorough analysis of the relationships between the various parties to a documentary credit transaction.

[8] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 24.

2.2 NATURE OF A DEMAND GUARANTEE

Further to the above outline of the main parties involved in a demand-guarantee arrangement, the definition, nature and key characteristics of the demand guarantee are explained below to enable a sufficient understanding of the basics of the demand guarantee that are fundamental to the scope of this thesis.

2.2.1 Definitions

As a selective sample, some definitions of a demand guarantee and similar documentary credits are outlined below to clearly carve out the core elements of demand guarantees. Without these elements, it is submitted that the question of whether an instrument is indeed a demand guarantee would become debatable.

The ICC Uniform Rules for Demand Guarantees ("URDG 758")[9]defines a demand guarantee as simply "any signed undertaking, however, named and described, providing or payment upon presentation of a complying demand".[10] Furthermore, the URDG 758 in Article 2 describes a "complying demand" as a "demand that meets the requirements of a complying presentation". According to Article 2, a "complying presentation" is,

> "a presentation that is in accordance with, first, the terms and conditions of that guarantee, second, these rules [i.e., URDG 758] so far as consistent with those terms and conditions and, third, in the absence of a relevant provision in the guarantee or these rules, international standard demand guarantee practice."[11]

The predecessor of the URDG 758, the 1992 ICC Uniform Rules for Demand ("URDG 458"),[12] defined a demand guarantee as:

> "any guarantee, bond or other payment undertaking, however, named or described, by a bank, insurance company or other body or person (hereinafter called "the Guarantor") given in writing for the payment of money on presentation in conformity with the terms of the undertaking of a written demand for payment and such other document(s) (for example, a certificate by an architect

[9] ICC Publication No 758, Paris (2010) (hereinafter "URDG 758").

[10] URDG 758, Article 2.

[11] Ibid.

[12] ICC Publication No 458, Paris (April 1992) (hereinafter "URDG 458").

or engineer, a judgment or an arbitral award) as may be specified in the Guarantee, such undertaking being give[n]

i) at the request or on the instructions and under the liability of a party (hereinafter called the "**Principal**" or the "**Applicant**"); or

ii) at the request or on the instructions and under the liability of a bank, insurance company or any other body or person (hereinafter "the instructing Party") acting on the instructions of a Principal."[13]

Another proffered definition, which is more descriptive in respect of practical aspects of a demand guarantee, describes a demand guarantee as,

> "typically a short and straightforward instrument issued by a bank, other financial institution or insurance company under which the obligation to pay a beneficiary a fixed or maximum sum of money arises merely upon the making of a demand for payment in the prescribed form and occasionally also the presentation of documents as specified in the guarantee within the period of validity of the guarantee."[14]

Another description of a demand guarantee, provided by Lukic,[15] slightly more focused on the common form and style it takes in banking practice, is that it is,

> "generally a short and simple instrument issued by a bank (or other financial institution) under which the obligation to pay a stated or maximum sum of money arises merely upon the making of a demand for payment in the prescribed form and sometimes also the presentation of documents as stipulated in the guarantee within the period of validity of the guarantee."[16]

Given the close similarity in nature and purpose between standby letters of credit and demand guarantees, it is perhaps worth considering the definition of standby letter of credit, which is codified in the International Standby Practices ("ISP 98").[17] ISP 98 encapsulates the essence of a

[13] Article 2 of the URDG 458.

[14] Kelly-Louw, M "General Update on The Law of Demand Guarantees and Letters of Credit", a paper delivered at the 2016 Annual Banking Law Update (hereinafter "Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*"), at 43.

[15] Lukic, A "Bank Demand Guarantee and Standby Letter of Credit as collaterals in International Trading Operations" (2014), 4(1), *International Journal of Management Excellence*, 508 (hereinafter, "Lukic, *Bank Demand Guarantee and Standby Letter of Credit*").

[16] Idem, at 508.

[17] ICC Publication No 590, Paris (1998) (hereinafter "ISP 98").

standby letter of credit, referred to therein as "standby",[18] by outlining and explaining its key features, being that it is an, "irrevocable, independent, documentary and binding undertaking when issued and need not so state."[19]

The irrevocability of a standby letter of credit is explained in the ISP 98. This means that the issuer's obligations thereunder cannot be amended or cancelled save as provided for in the standby letter of credit itself or with the consent of the person against whom the cancellation or amendment is asserted.[20] With regard to the independent nature of a standby letter of credit, the ISP 98 explains this to mean that the enforceability of payment obligation pursuant thereto is not dependent on extraneous factors, such as the issuer's reimbursement, a beneficiary's rights *vis a vis* the applicant, reference to any underlying transaction or reimbursement agreement or the issuer's knowledge of a breach of such underlying agreement or transaction.[21] The documentary character and binding nature of standby letters of credit are explained with reference to their dependence on the presentation and examination of documents and their enforceability regardless of whether the applicant authorised it, the issuer received a fee or the beneficiary received/relied on the standby letter of credit.[22]

The Uniform Customs and Practice for Documentary Credits ("UCP 600"),[23] which mainly cater for letters of credit, but do not expressly exclude other types of documentary credit, for instance, demand guarantees, define a credit as "any arrangement, however, named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation".[24] For a complete contextual understanding of this definition, a complying presentation is essentially one which is "in accordance with the terms and conditions

[18] Some authorities have construed the term "standby" as used in the ISP 98 to encompass not only standby letters of credit, but also demand guarantees. See Walter, WB, Dolan, JF and Smith, DR, *Users' Handbook for Documentary Credits under UCP 600*, eds, ICC Services Publications, 2008 (hereinafter, "Walter, Dolan and Smith, *Handbook for Documentary Credits*"), at 144.

[19] ISP 98, Article 1.06(a).

[20] ISP 98, Article 1.06(b).

[21] ISP 98, Article 1.06(c).

[22] ISP 98, Article 1.06(d)-(e).

[23] ICC Uniform Customs and Practice for Documentary Credits (ICC Publication No 600, Paris (2006), (hereinafter "UCP 600").

[24] UCP 600, Article 2.

of the credit…".[25] The potential versatility of the UCP 600 is supported by Article 1 thereof, which provides that they apply to any documentary credit expressly made subject to it, "including, to the extent to which they may be applicable, any standby letter of credit".[26] By token of this provision, the UCP 600 could be construed as open to embracing all types of undertakings to which the UCP 600 is explicitly made subject, including, potentially, demand guarantees. Goode provides the following more concise definition of a documentary credit, describing it as "a banker's assurance of payment against presentation of specified documents."[27]

While some differences exist between the definitions outlined above as well as other definitions proffered by various scholars and authorities,[28] the two key elements, being the autonomy principle and the documentary nature of the demand guarantee and other documentary credits (i.e., commercial and standby letters of credit) are consistently entrenched and envisaged therein.

An aspect that contributes to differences in the definition of what is essentially the same instrument is the varying levels of granularity or prescriptiveness when describing the elements that together form a demand guarantee, standby letter of credit, letter of credit or documentary credit. Depending on the perspective and focus informing a relevant definition, a definition tends to "zoom in" on selective characteristics, out of perhaps a handful to choose from, that are considered the essence of the instrument the definition seeks to encapsulate. In addition to other elements considered to form the instrument being defined, some definitions incorporate a reference to the type of issuer to illustrate this with reference to the definitions considered above. In this regard, Kelly-Louw's definition refers to a "bank, other financial institution or insurance company"[29]. In contrast, Lukic

[25] Ibid.

[26] UCP 600, Article 1.

[27] Goode, R *Commercial Law*, 2 ed, Penguin Harmondsworth, 1995, at 964 concisely defined a documentary credit as, "a banker's assurance of payment against presentation of specified documents".

[28] See Marxen, *Demand Guarantees in the Construction Industry*, at 49; Wood, PR *International Loans, Bonds, Guarantees, Legal Opinions*, 2 ed, Sweet and Maxwell, 2007, at 370; Bertrams, RF *Bank Guarantees in International Trade: The Law and Practice of Independent (First Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions*, 4 ed, Kluwer Law International, 2013 (hereinafter "Bertrams, *Bank Demand Guarantees in International Trade*"), at 8 and 46; and Enonchong, N *The Independence Principle of Letters of Credit and Demand Guarantees*, 1 ed, Oxford University Press, 2011 (hereinafter, "Enonchong, *The Independence Principle of Letters of Credit")*, at 29-30. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 3 for a summary of descriptive features defining a demand guarantee and Sifri, *Standby Letters of Credits*, at 6-7 and Walter, Dolan and Smith, *Handbook for Documentary Credits*, at 148 for further consideration of the definition of standby letters of credit.

[29] Kelly-Louw, M "General Update on the Law of Demand Guarantees and Letters of Credit", a paper delivered at the 2016 Annual Banking Law Update (hereinafter "Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*"), at 43.

refers to "by a bank or other financial institution".[30] Both Kelly-Louw and Lukic's definitions allude to detail regarding demand guarantees' general *prima facie* appearance, describing them as "typically a short and straightforward instrument" and "generally a short and simple instrument".

By referring to a documentary credit as a "banker's assurance[31]", Goode seemingly also considers the nature or type of the issuer as an element of the definition of documentary credit that is worth mentioning as part of the instrument's definition. The reference to an "issuing bank" in the UCP 600 denotes a similar stance.[32] Exemplifying a different approach, the URDG 458 sought to capture issuers on an "all and sundry" basis by referring to "a bank, insurance company or other body or person (hereinafter called "the guarantor")",[33] while the definition in its successor, the URDG 758, appears to have unfettered itself completely from referencing the issuer. Similar variances are notable in the level of specificity in definitions of independent instruments, for instance, specific reference to irrevocability,[34] the written or signed nature thereof,[35]and even the taxonomy used to name them.[36] In pointing out these arguably inconsequential differences between the definitions, this thesis does not propose to delve further into these and similar comparisons and contrasts but to illustrate the varying approaches and perspectives to defining independent instruments like demand guarantees, which highlight the need to drill down to the "bare bones" of what constitutes a demand guarantee in line with the scope of this thesis.

In an attempt to navigate such nuances regarding terminology, the URDG 758, for instance, clarifies that its definition encompasses any instrument "however named and described"[37] so long as it satisfies the elements outlined in the definition. Similarly, this thesis will focus on what are considered to be the key elements of demand guarantees for the analysis to follow and will go no further in considering the varying definitions and semantics of demand guarantees.

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[30] Lukic, *Bank Demand Guarantee and Standby Letter of Credit*, at 508.

[31] See Goode, R *Commercial Law*, 2 ed, Penguin Harmondsworth, 1995, at 964.

[32] UCP 600, Article 2.

[33] Article 2 of the ICC Uniform Rules for Demand Guarantees (ICC Publication No 458).

[34] ISP 98, Article 1.06(b).

[35] URDG 758, Article 2; and Article 2 of the URDG 458.

[36] See section 1.2 in Chapter 1.

[37] URDG 758, Article 2. See also UCP 600, Article 2.

Despite the variances in the definition of demand guarantees noted above, two main elements that are submitted to be a "common denominator" are, firstly, the (independent) undertaking to pay and secondly, such payment only being upon presentation of documents compliant with the terms stipulated in the relevant demand guarantee or similar undertaking.[38] The common thread of these two elements also runs through the definitions of standby letter of credit and documentary credit as outlined above, respectively.[39]

In particular, the independent obligation to pay upon receipt of a complying presentation, which embodies the principle of autonomy, and the requirement for a complying demand or presentation, which also engrains the pertinence of the documentary nature of such instruments, are discussed below mainly in the context of demand guarantees, being the main subject of this thesis.

2.2.2 Documentary Credits (Particularly Demand Guarantees) versus Traditional Contracts

2.2.2.1 Note regarding Preferred Terminology

While it is acknowledged that some scholars draw a firm distinction between the terms demand guarantees and documentary credits, key similarities between them are acknowledged in equal measure.[40] Goode underscored a key distinction between the two as being their purpose or function. He explains that while documentary credits are designed to ensure the discharge of payment obligations, demand guarantees, in contrast, are almost exclusively security instruments.[41] Regarding their similarities, Goode summarises the key similarities as including that both documentary credits and demand guarantees are:

> "autonomous in character, so that in principle the bank's duty is to pay against conforming documents … [and] documentary in character, so that the obligation is triggered solely by

[38] URDG 758, Article 2; Article 2 of the ICC Uniform Rules for Demand Guarantees (ICC Publication No 458); Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 43; Lukic, *Bank Demand Guarantee and Standby Letter of Credit*, at 508; and Van Niekerk, JP and Schulze, WG, *The South African Law of International Trade: Selected Topics,* 4 ed, SAGA legal Publications CC, 2016 (hereinafter, "Van Niekerk and Schulze, *The South African Law of International Trade*"), at 278.

[39] ISP 98, Article 1.06(a) and 1.06(c) and UCP 600, Article 2.

[40] See Goode, R. "Abstract Payment Undertakings in International Transactions" (1996), *22*(1) *Brook J Int'L L,* 1 (hereinafter *"*Goode, *Abstract Payment Undertakings in International Transactions"*), at 14-16 for a more detailed comparative analysis of the similarities and differences between documentary credits and demand guarantees.

[41] Idem, at 14.

presentation of documents within the time and on the terms specified in the undertaking without regard to external facts or events."[42]

The term "credit" in relation to a letter of credit can be explained as denoting the debt owed by the applicant in terms of the underlying contract (i.e., the debtor in terms of the underlying contract), which debt the issuer of the letter of credit undertakes to pay on behalf of the applicant. This can be conceptualised as a credit vis-à-vis a debt or debit pursuant to the underlying contract. In the case of a demand guarantee, which is not a primary payment instrument but rather a security instrument, there is generally neither a debt nor a credit. As Goode correctly points out, payment under a demand guarantee serves to secure performance by the applicant or principal, which function can be distinct from mere payment of a monetary debt.[43] The parallels between letters of credit on the one hand, and demand guarantees, on the other hand, are considered in section 2.6.2 of this thesis further below.

The UCP 600, which are versatile to the extent that they attempt to accommodate commercial letters of credit and standby letters of credit,[44] are broadly recognised and accepted.[45] The rules also use the term "documentary credit" to include any instrument, however, such instrument is named or described, which constitutes an undertaking to pay upon presentation of compliant documents.[46] This highlights the two main elements of demand guarantees as well: the payment obligation, which arises only upon presentation of the compliant demand without reference to extraneous factors (known as the autonomy principle), and the reliance solely on the documents presented to determine whether such a payment obligation arises.[47]

The broad non-specificity of the definition of a documentary credit in the UCP 600 while still highlighting the autonomy principle and documentary nature thereof, which elements are common across standby/commercial letters of credits and demand guarantees, have made documentary credit the preferred "neutral" term used in this thesis to cover not just letters of credit but also

[42] Idem, at 4.

[43] Idem, at 14.

[44] UCP 600, Article 1.

[45] Byrne, JE, *LC Rules & Laws: Critical Texts for Independent Undertakings*, 7th ed, The institute of International Banking Law 7 Practice, Inc, 2018, at 1.

[46] UCP 600, Article 2.

[47] URDG 758, Article 2; Article 2 of the URDG 458; Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 43; Lukic, *Bank Demand Guarantee and Standby Letter of Credit*, at 508; and Van Niekerk and Schulze, *The South African Law of International Trade*, at 278.

demand guarantees. Perhaps acknowledging the breadth of the instruments that can be encompassed by the term "documentary credit", Hugo opines that "[a]n accurate definition is very difficult due to the many different varieties in use, [and they] are accordingly best described in general terms". For the reasons summed up above, references to documentary credits as used in this thesis are intended to encompass standby letters of credit, commercial letters of credit, and demand guarantees, as explained in Chapter 1 of this thesis.[48]

2.2.2.2 The (Quasi) Contractual Status of Documentary Credits

The terms "agreement" and "contract" are often used synonymously, although it is noted that the former may simply reference the reaching of consensus whereas the latter captures an agreement of more formality with certain essential criteria, such as an offer, acceptance of the offer and the exchange of consideration. A contract may or may not be reduced to writing or incorporated into a document. An inevitable aspect of examining the true nature of documentary credits, such as demand guarantees, is the discourse around whether or not they constitute traditional (or true) contracts. The characteristics of documentary credits that give rise to debate in this regard include the fact that they are considered to be binding at the time of issue by a guarantor (e.g., a bank) without the need for acceptance as contemplated in the context of contracts and in the absence of consideration between the actual parties to it since the beneficiary typically furnishes no consideration for the benefit they receive from the guarantor under a documentary credit.[49] In addition to these, the absence of strict application of the doctrine of privity of contract has also been noted to distinguish documentary credits from traditional contracts.[50] The following description of a documentary credit by Goode encapsulates the quasi-contractual nature thereof: "a money promise which is independent of the transaction that gives it birth and which is considered binding when received by the beneficiary without acceptance, consideration, reliance, or execution in solemn form."[51]

[48] See section 1.2 in Chapter 1.

[49] Goode, *Abstract Payment Undertakings in International Transactions,* at 3 and Goode, R, Kronke, H and McKendrick, E, *Transnational Commercial Law: Texts, Cases and Materials,* 2 ed, Oxford University Press, 2015 at 326.

[50] Kozolchyk, B "The Legal Nature of the Irrevocable Letter of Credit" (1965), 14, *American Journal of Comparative Law,* 395 (hereinafter "Kozolchyk, *The Legal Nature of the Irrevocable Letter of Credit*"), at 400.

[51] Roy Goode, "Abstract Payment Undertakings", in Peter Cane & Jane Stapelton, eds, *Essays for*

Patrick Atiyah 209, 209 (Oxford University Press, 1991).

Some commentators have propounded the view that, despite its popularity, the tendency of courts to refer to documentary credits as "contracts" is, strictly speaking, inaccurate[52]based on their non-conformity with trite rules of contracts such as the requirement for consideration to be exchanged and for acceptance of an offer but are nevertheless binding.[53] This, as noted by scholars such as Kelly-Louw, has not deterred courts and other commentators from deeming documentary credits to be contractual in nature and governed by the principles of contract.[54] Similarly to the decidedly loose usage of various and sometimes confusing terminology to refer to documentary credits, the binding nature of such instruments, despite their noncompliance with ordinary rules of contract law, has been attributed by some scholars to mercantile usage.[55] Although the quasi-contractual nature of documentary credits is a general contract law issue, it was also noted to cause theoretical issues under English documentary credit law.[56] Given this quasi-contractual nature, Goode sums up documentary credits as "mercantile specialties, undertakings which, by the usage of merchants, have effect by virtue of their issue without any additional requirements".[57]

2.2.2.3 Similarities between Documentary Credits and Traditional Contracts

Notwithstanding the divergences between contracts and documentary credits outlined above, it has been acknowledged that several contract law principles are routinely applied in respect of documentary credits.[58] Wooler notes the construction of ambiguity against the issuer; interpretation in a manner which is fair, customary and consistent with what prudent parties would enter into; an interpretation which favours making an instrument operable if possible; a preference for typed/handwritten provisions over printed ones, where there is a discrepancy and the duty of

[52] Wooler, GC "*Lifting the Veil of Autonomy: Unconscionable Conduct as Grounds for Injunctive Relief in Australia and Singapore-A Study in the Context of Independent Trade Finance Instruments*", PhD thesis, The University of Queensland, 2017 (hereinafter "Wooler, *Lifting the Veil of Autonomy*"), at 20.

[53] UCP 600, Article 7(b) states: "An issuing bank is irrevocably bound to honour as of the time it issues the credit". See also, Goode, *Abstract Payment Undertakings in International Transactions,* at 3, where Goode opines that payment undertakings such a demand guarantees do not fall within ordinary contract principles or involve offer, acceptance, dependence of consideration or reliance by the promissee or any special formal requirements and are neither bi-lateral or unilateral contracts.

[54] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 43.

[55] Clark, J, Shattock, A and Tekin, S "Demand Guarantees: The Consideration Dilemma" (2015), 6, *Butterworths Journal of International Banking and Financial Law*, 340 at 341 and Goode, *Abstract Payment Undertakings in International Transactions,* at 3.

[56] Rowe, M *Letters of Credit*, Euromoney Books, 2 ed, 1997 (hereinafter, "Rowe, *Letters of Credit")*, at 58-59.

[57] Goode, *Abstract Payment Undertakings in International Transactions,* at 3.

[58] Wooler, *Lifting the Veil of Autonomy,* at 20 citing Wunnicke, B, Wunnicke, D and Turner, P *Standby and Commercial Letters of Credit,* 2 ed, Wiley Law Publications, 1996, at 5-6.

good faith, as examples of common-law contract principles that the United States of America's ("USA's'') courts have applied in the context of letters of credit.[59] This depicts that some, though not all, elements of contract law apply to documentary credits.[60] Perhaps due to these similarities with contracts, an alternative approach suggested in response to the controversy of whether documentary credits are contracts has been to deem them as binding contracts, albeit of a variety that does not conform to the ordinary rules of contract law.[61] The postulation that documentary credits, contrary to ordinary contracts, constitute "specialty contracts" also supports this line of thinking.[62]

2.2.2.4 Valid/Binding Nature Despite No Consideration

While it is arguable that the guarantor receives consideration pursuant to the indemnity provided by an applicant (principal) for the issuance of a demand guarantee, this stance appears to flout the privity of contract doctrine by enabling a third party (i.e., the beneficiary) to benefit from an agreement to which they are not a party (i.e., the indemnity agreement between the applicant and the guarantor).[63] Sarna raises further reasons why this argument would likely not hold, including that consideration relied upon to give effect to an agreement cannot be relied upon a second time as the basis of the demand guarantee issued by the guarantor (e.g., a bank) to the beneficiary[64] and also that consideration, "must not be past consideration, that is, arising from a previous bargain" to be valid for the purposes of constituting a contract.[65]

The case of *Dexters, Ltd v Schenker & Co*[66] exemplifies the potential of lack of consideration being raised as a possible defence against honouring a documentary credit. Although a conclusive decision was not made on the matter in this case, the general consensus based on the *dicta* supports

[59] Ibid.

[60] Wooler, *Lifting the Veil of Autonomy*, at 20.

[61] UCP 600, Article 7(b) states that "[a]n issuing bank is irrevocably bound to honour as of the time it issues the credit".

[62] McLaughlin, G "Exploring Boundaries: A Legal and Structural Analysis of the Independence Principle of Letter of Credit Law" (2002), 119, *Banking Law Journal,* 501 (hereinafter "McLaughlin, *Exploring Boundaries: A Legal and Structural Analysis*"), at 501-504 and McLaughlin, G, "Letters of Credit and Illegal Contracts: The Limits of the Independence Principle" (1989), 49, *Ohio State Law Journal*, 1197, at 1197.

[63] Kozolchyk, *The Legal Nature of the Irrevocable Letter of Credit*, at 400.

[64] Sarna, L *Letters of Credit: The Law and Current Practice,* 2 ed, Carswell Legal Publishers, 1986 (hereinafter "Sarna, *Letters of Credit: The Law and Current Practice"*), at 30.

[65] Sarna, *Letters of Credit: The Law and Current Practice* at 29.

[66] (1923) 14 LI.L.R. 586, para 588.

the binding nature of documentary credits, notwithstanding lack of consideration.[67] Goode summed this position up as a struggle to "reconcile the binding nature of the bank's undertaking with traditional concepts of general law, which deny legal effect to a simple promise unless consideration is furnished…".[68] The USA's Uniform Commercial Code ("UCC")[69] rationalises the issue of consideration in respect of letters of credit by stating that while it is not expected for issuers to issue letters of credit without some consideration, it is not expected that a beneficiary would know what the consideration was or whether in fact there was any consideration at all.[70] The commentary to the UCC appears to dismiss any need to establish consideration with reference to case law, which is considered to render the matter of consideration irrelevant.[71]

A stipulation in favour of a third is a possible explanation for the relationship of an issuing bank and a beneficiary, and one might even rationalise that mere consensus could make it binding. Van Niekerk and Schulze note the explanations proffered for the basis of the guarantor-beneficiary relationship, including cession, suretyship, agency and the stipulation in favour of a third party, but ultimately acknowledge that none of these explanations are satisfactory.[72]

Despite the latter falling short on certain technical aspects required to form a valid contract, Van Niekerk and Schulze further proffered an alternative justification for an equal footing between contracts and documentary credits in the form of the concept of non-novatory delegation.[73] The non-novatory delegation, according to Van Niekerk and Schulze, occurs where the obligation of the applicant (delegator) to pay a debt to the beneficiary (delegatory) according to the underlying contract is delegated (via an instruction to issue a guarantee) to the guarantor (delegate), who accepts the delegation by issuing the guarantee, all without the underlying contract between the applicant and the beneficiary being novated.[74] In further explanation of this notion, the absence of

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[67] Bradgate, R, White, F and Fennell, S *Commercial Law*, 9th ed, Oxford University Press, 2002, at 273. See also Rowe, *Letters of Credit,* at 58 - 59 citing *Bank of Nova Scotia v Angelica-Whitewear Ltd* [1987] 1 SCR 59, para 82.3.

[68] Goode, R and McKendrick, E *Goode on Commercial Law,* 4 ed, Penguin UK, 2010 (hereinafter, "Goode and McKendrick, *Goode on Commercial Law"*), at 1078.

[69] Uniform Commercial Code, Revised UCC Article 5, Letters of Credit, 1995 (hereinafter, the "UCC").

[70] UCC, Section 5-105 and official comment thereon.

[71] *Pillans v Van Mierop* 97 Eng Rep. 1035 (KB 1765).

[72] Van Niekerk and Schulze, *The South African Law of International Trade*, at 275.

[73] Van Niekerk and Schulze, *The South African Law of International Trade*, at 275-276.

[74] Van Niekerk and Schulze, *The South African Law of International Trade*, at 276.

clear formalities bringing about a delegation has been attributed to its inception under Roman law based on informal verbal stipulations, which has enabled its development with no common law *naturalia*.[75]

Another ground on which the binding nature of documentary credits has been questioned is the lack of just cause/*iusta causa.* This ground has been refuted firstly on the basis that rather than focusing on the imprecise principle of just cause, the focus should be placed on the concept of *animus contrahendi*, which requires merely that there is seriousness, deliberation and intention between the relevant parties for a legally binding obligation to be created, all of which are indubitably present in the context of documentary credits.[76] Secondly, it is argued that the binding nature of documentary credits as between the issuer and the beneficiary is a well-established tenet of customary law.[77]

2.2.2.5 Valid/Binding Nature Despite Offer Without Acceptance

Another pertinent area of contention regarding the abstract nature of/purported contractual relationship between a guarantor and a beneficiary is the absence and/or unsettled timing of offer and acceptance, both of which are essential to forming a contract.[78] It has been submitted that an issuer's undertaking under a letter of credit constitutes an offer, which the beneficiary accepts by the presentation of complying documents to claim payment.[79] Based on this view, a contract between an issuer and a beneficiary is argued to come into effect only upon the presentation of a demand by the latter, being the time that the requirement for offer and acceptance, a two key *essentialia* of a contract, is satisfied. A quirk arising from this construction, as noted by Schulze and Niekerk, is that it envisages a revocable letter of credit since the offer (letter of credit) can conceivably be withdrawn before acceptance (a demand), thereby begging the question of what the position is regarding irrevocable letters of credit.[80] Articles 7 and 8, 7(b) of the UCP, which emphasise that a letter of credit is a definite undertaking provided that compliant documents are provided to the issuer and that it is binding from the time it is issued, respectively, have been cited

[75] Idem, at 276.

[76] Van Niekerk and Schulze, *The South African Law of International Trade*, at 277.

[77] Idem, at 277.

[78] Van Niekerk and Schulze, *The South African Law of International Trade*, at 275.

[79] Van Niekerk and Schulze, *The South African Law of International Trade*, at 276.

[80] Van Niekerk and Schulze, *The South African Law of International Trade*, at 277.

as being at odds with the perception that offer and acceptance are satisfied upon a compliant demand being presented to an issuer.[81] A similar stance seems to be supported by prominent scholars such as Goode, who declares that payment undertakings such as demand guarantees come into effect merely by virtue of their issue with no other formalities required.[82] It thus seems widely accepted that a binding legal obligation comes into being when an issuer issues the undertaking.

With reference to what is known as the information theory of a contract pursuant to which a contract is created upon acceptance of an offer, it has been noted that an exception to such theory is where an offeror tacitly waives their right to be notified of acceptance of their offer.[83] Following this line of thought, it is argued to be customary for beneficiaries in respect of letters of credit not to notify the issuer of their acceptance.[84] It has also been argued, perhaps alternatively, that receipt of a letter of credit and/or dispatch of goods (or equivalent action under an underlying contract) can be deemed to be conducted by the beneficiary, which is tantamount to acceptance of an offer.[85]

Some English cases, such as *Urquhart Lindsay & Co, Ltd v Eastern Bank Ltd*,[86] and *Elder Dempster Lines Ltd v Ionic Shipping Agency Inc*,[87] have endeavoured to rationalise the validity of documentary credits despite lack of acceptance by adopting the view that a documentary credit is an offer made by an issuer (guarantor), the acceptance of which is effected by the beneficiary (e.g., a seller) acting upon it and which only becomes binding upon such acceptance. However, it has been pointed out that this view is inconsistent with the irrevocable nature of documentary credits,[88] which arguably creates a binding effect when a documentary credit is issued rather than when a beneficiary accepts it by acting on it. Other cases, however, such as *Dexters, Ltd v Schenker & Co*,[89] endorse an alternative view, namely that documentary credits only become binding upon

[81] Idem, at 277.

[82] Goode, *Abstract Payment Undertakings in International Transactions* at 3.

[83] Van Niekerk and Schulze, *The South African Law of International Trade*, at 277.

[84] Ibid.

[85] Ibid.

[86] [1922] 1 KB 318. See also Devlin J. in *Midland Bank, Ltd v Seymour* [1955] 2 Lloyd's Rep. 147, para 166.

[87] [1968] 1 Lloyd's Rep. 529, para 535.

[88] Alawamleh, KJA "*Documentary Credits and Independent Guarantees: A Critique of the 'Fraud Exception' Position in English and Jordanian Law*", PhD thesis, University of Central Lancashire, 2013 (hereinafter "Alawamleh, *Documentary Credits and Independent Guarantees*"), at 36.

[89] (1923) 14 LI.L.R. 586 at 588.

reaching the beneficiary's hands.

2.2.2.6 Conclusion and Approach Taken for the Purposes of this Thesis

With limited levels of success,[90] some scholars[91] have attempted to establish a solid legal rationale for the binding effect of documentary credits, notwithstanding their non-compliance with contract law conventions such as the requirement for consideration and acceptance. Others[92] have, broadly speaking, shunned such attempts in favour of conceding the "*sui generis*" [93] or "special"[94] nature of documentary credits in this regard. To this end, Goode referring to endeavours to establish a theoretical solution to the binding nature of documentary credits despite their derogation from contract law asserted that such endeavours "distort the character of the transaction and predict facts and intentions at variance with what is in practice done and intended by the parties [and] show the undesirability of trying to force all commercial instruments and devices into a straight-jacket of traditional rules of law".[95] Rowe also opines that such endeavours are generally at odds with commercial realities.[96] In line with this view, attempts to find a solution are seen as a largely academic exercise[97] which is of little practical use.[98] It is also not the objective of this thesis to

[90] Mugasha, in considering the various arguments and explanations offered for this phenomenon, renders the verdict that they remain "peculiarly unsatisfactory" (Mugasha, A *The Law of Letters of Credit and Bank Guarantees,* Federation Press, 2003 (hereinafter "Mugasha, *The Law of Letters of Credit and Bank Guarantees*"), at 31). See also, generally, the discussion in Thayer, P "Irrevocable Credits in International Commerce: Their Legal Nature" (1936), 36, *Colum L Rev,* 1031.

[91] See Van Niekerk and Schulze, *The South African Law of International Trade*, at 277. Also see, generally Ellinger, PE *Documentary Letters of Credit: A Comparative Study*, University of Singapore Press, 1970 (hereinafter, "Ellinger, *Documentary Letters of Credit"*) and Thayer, P "Irrevocable Credits in International Commerce: Their Legal Nature" (1936), 36, *Colum L Rev,* 1031.

[92] Goode and McKendrick, *Goode on Commercial Law*, at 1078; Rowe, *Letters of Credit,* at 58 -59); Malek, A & Quest, D *Jack: Documentary Credits,* 4 ed, Tottel Publishing, 2009 (hereinafter "Malek and Quest, *Jack: Documentary Credits"*), at 7; Rooy, F *Documentary Credits,* Kluwer Law and Taxation Publishers, 1984 (hereinafter "Rooy, *Documentary Credits*"), at 99; and Ellinger, P and Neo, D *The Law and Practice of Documentary Letters of Credit*, Hart Publishing, 2010 (hereinafter "Ellinger and Neo, *The Law and Practice of Documentary Letters of Credit")*, at 111.

[93] Leacock, S "Fraud in the International Transaction: Enjoining Payment of Letters of Credit in International Transactions" (1984), 17(4), *Vand J Transnat'l L,* 885, (hereinafter "Leacock, *Fraud in the International Transaction*"), at 891; Rooy, *Documentary Credits* at 99, and Ellinger, *Documentary Letters of Credit,* at 22.

[94] See also Malek and Quest, *Jack: Documentary Credits,* at 7.

[95] Goode and McKendrick, *Goode on Commercial Law*, at 1078.

[96] Rowe, M. "Letters of Credit" (Euromoney Books, 2 ed., London, 1997) at 58-59

[97] Alawamleh, *Documentary Credits and Independent Guarantees*, at 39.

[98] Sarna, *Letters of Credit: The Law and Current Practice* at 54 and Goode, *Abstract Payment Undertakings in International Transactions* at 3. See also the discussion of the abstract nature of payment undertakings in Kelly-Louw,

settle this theoretical debate here but merely to allude to the divergent views on the matter.

Notwithstanding the controversy surrounding the rationale thereof, the binding and enforceable nature of documentary credits is widely accepted[99] and not in question.[100] In other words, while the exact nature of documentary credits may be considered a "matter of some conjecture",[101] their binding nature is not. As noted by Mugasha, the increasing use of documentary credits could be construed as evidence that the lack of a satisfactory justification for their legal operation has not detracted from the practical value of documentary credits.[102]

Possibly due to an awareness of the above-mentioned qualities that render a documentary credit something less than a contract in the true sense, commentators have pointed out that rather than referring to documentary credits as contracts, popular monikers that can be used to describe documentary credits include "arrangement",[103] "binding undertaking"[104] or "definite undertaking".[105] Similarly, in light of the divergent aspects between documentary credits and contracts as they are traditionally known and as discussed above, it is not proposed to confer any contractual status (partial, deemed or otherwise) on documentary credits for the purposes of this thesis and either the terms discussed in Chapter 1 above or flexible terminology such as "arrangement" or "instrument", will be used instead.

2.2.3 Various Terminology by which Demand Guarantees and Similar Documentary Credits are Known

As noted in Chapter 1, documentary credits go by different names around the world, including, to reiterate, "performance bonds/guarantees", "construction bonds/guarantees", "tender bonds/

Selective Legal Aspects of Bank Demand Guarantees, at 41-43, which culminates in a similar conclusion (i.e., that belabouring the different approaches/rationales to explain the binding force of payment undertakings despite the fact that they do not meet all the technical requirements of contracts is a moot exercise given that the binding nature of such undertakings is accepted).

[99] Goode, *Abstract Payment Undertakings in International Transactions* at 3; Ellinger, *Standby Letters of Credit*, at 615 and Van Niekerk and Schulze, *The South African Law of International Trade*, at 277.

[100] See also Rowe, *Letters of Credit*, at 58-59 citing *Bank of Nova Scotia v Angelica-Whitewear Ltd* [1987] 1 SCR 59, para 82.3.

[101] See Van Niekerk and Schulze, *The South African Law of International Trade*, at 275.

[102] Mugasha, *The Law of Letters of Credit and Bank Guarantees*, at 32.

[103] UCP600, Article 2.

[104] ISP 98, Article 1.06(a).

[105] Uniform Commercial Code (1995) (hereinafter "UCC"), Article 5-102(a)(10).

guarantees"', "independent (bank) guarantees", "independent undertakings', "payment undertakings" "demand guarantees", "bank guarantees", "first demand guarantees", "default undertakings" and "standby letters of credit"[106] The development of this inconsistent and sometimes confusing panoply of terms to denote documentary credits has been explained as being due to the existence and use of several different instruments on various local and international commercial platforms.[107] It has also been posited that as part of the international use of documentary credits, prescribed templates of forms common to relevant jurisdictions may be insisted upon by contracting parties, which forms, though well understood by such parties, may contain terminology which is inaccurate from a legal perspective.[108]

The use of various terminology to denote demand guarantees and/or documentary credits has been attributed to the origination of such terminology from various trade finance industry patrons, including bankers, exporters and insurers, rather than lawyers, who would have perhaps established more uniform terminology based on more common legal drafting conventions.[109] Wooler expresses a similar view regarding the language used in relation to documentary credits, stating that it is "the language of the user community and not the product of any particular court, jurisdiction, or organ of state".[110] Notwithstanding the confusion surrounding the various terms used to denote independent instruments, it is widely considered that materially, the legal characteristics of such instruments are synonymous.[111]

[106] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 7-8 and 19.

[107] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit,* at 44 and Kelly-Louw, M "Construction of Demand Guarantees Gone Awry: *Minister of Transport and Public Works v Zanbuild Construction*", (2013), 25, *SA Merc LJ* 404 (hereinafter "Kelly-Louw, *Construction of Demand Guarantees Gone Awry*"), at 408.

[108] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 408.

[109] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit,* at 44 and Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 408.

[110] Wooler, *Lifting the Veil of Autonomy*, at 31.

[111] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 408. See also Guest, A *Benjamin's Sale of Goods,* 7 ed, Sweet & Maxwell, 2006, at 2068.

2.3 THE AUTONOMY PRINCIPLE OF DEMAND GUARANTEES

2.3.1 Meaning of the Autonomy Principle

The autonomy principle, also referred to as the independence principle or the doctrine of independence,[112]is considered a cardinal principle[113] and a key bulwark of documentary credits, including demand guarantees, which are at the centre of this study. In the context of the principle of autonomy, autonomy refers to the independence of the obligations of an issuer of a documentary credit from all other contractual relationships or transactions that may be related to that documentary credit, including those that gave rise to it.[114] The nature of this independence has also been described as an "intra-transactional" delineation between the obligation created by a documentary credit and all other contracts forming part of that one overall transaction.[115] Simply put, the autonomy principle separates the obligation of an issuer/guarantor to pay under the letter of credit/demand guarantee from the obligations of the parties (i.e., principal/applicant and the beneficiary) to the underlying contract (e.g., construction contract or sale-of-goods contract).[116]

Perhaps due to the very limited scope that the autonomy principle allows issuers/guarantors to legally defend or resist a compliant demand for payment,[117] it has been likened to a legal shield

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[112] Wooler, *Lifting the Veil of Autonomy* at 30.

[113] *Boral Formwork and Scaffolding v Action Makers Ltd* [2003] NSWSC 713, para 22.

[114] Byrne, J et al. *UCP600 - An Analytical Commentary*, Institute of International Banking Law and Practice, 2010, at 296.

[115] McLaughlin, *Exploring Boundaries: A Legal and Structural Analysis*, at 503.

[116] Horowitz, D *Letters of Credit and Demand Guarantees: Defences to Payment*, Oxford University Press, 2010 (hereinafter "Horowitz, *Letters of Credit and Demand Guarantees: Defences to Payment*").

[117] Most pertinent is proven fraud (see Kelly-Louw, M "Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit", in Visser, C & Pretorius, JT (eds) *Essays in honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, Juta, 2014, at 197 (hereinafter "Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*"), at 200 and Dolan, J "Tethering the Fraud Inquiry in Letter of Credit Law" (2006), 21(3), *Banking and Finance Law Review*, 479, at 480 and 485. For a comprehensive consideration and analysis of the fraud exception to the autonomy principle, including from a South African law perspective, see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 161-255). However, other exceptions have also been noted as recognised exceptions in some jurisdictions to one extent or another, for instance, illegality in the underlying contract (see also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 257-286; Kelly-Louw, M "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees" (2009), 42(3), *CILSA*, 339 and Alavi, H "Illegality as an Exception to Principle of Autonomy in Documentary Letters of Credit; A Comparative Approach" (2016), 20(3), *Korea University Law Review*, 3 (hereinafter, "Alavi, *Illegality as an Exception to Principle of Autonomy*") for a discussion of the acceptance of illegality in the underlying contract, including in South Africa, England and the USA. In the recent South African case of *Mattress House (Proprietary) Ltd v Investec Property Fund Ltd* [2017] ZAGPHC 298, the court seemingly accepted illegality in the underlying contract as a possible exception to the autonomy principle). In Australia, for example, unconscionable conduct seems to be an acceptable exception (see Section 51AA of the Australian Trade Practices Act 1974 (Cth) and the cases of *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27; *Boral Formwork v Actionmakers* [2003] NSWSC 713, *Australian Competition and Consumer Commission v Samton*

from potential defences against payment that reassures a beneficiary of the payment.[118] In line with this view, the autonomy principle is regarded as conferring a high level of immunity from attacks based on a beneficiary's (e.g., seller's) breach of duty to the principal/applicant (e.g., buyer), albeit subject to the caveat that such immunity is not absolute.[119] To further emphasise the independence of a documentary credit pursuant to the autonomy principle, it has been asserted that a payment obligation under a documentary credit would still be enforceable regardless of whether the underlying contract is enforceable.[120]

Some authorities, particularly courts, have sometimes referred to a documentary credit as "unconditional" to denote its independent nature.[121] This has been criticised as an inaccurate depiction based on the contention that the requirement for a complying demand to be presented before payment may itself constitute conditionality.[122] It is submitted that the term "irrevocable", which has sometimes also been used to explain the autonomy principle,[123] could be argued to be inaccurate for similar reasons.

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*Holdings Pty Ltd (*2002] FCAFC 4; 117 FCR 301; 189 ALR 76 and *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136). For cases in Singapore where other exceptions, besides fraud were accepted see *Design Studio Pte Ltd v Chang Development Pte Ltd* [1991] 2 MLJ 229 (HC); *Kvaerner Singapore Pte Ltd v UDL Shipbuilding (Singapore) Pte Ltd* [1993] 3 SLR 350 (HC); and *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352). Regarding cases in England see, e.g., the *TTI Team Telecom International Ltd v Hutchison* 3G UK Ltd [2003] EWHC 762; *Potton Homes Ltd v Coleman Contractors* (1984) 28 BLR 19 (CA); *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC) and *Elian and Rabath v Matsas and Matsas* [1966] 2 Lloyd's Rep 495 (CA) where it was, *inter alia*, argued that unconscionability as an exception to the autonomy principle was accepted, albeit implicitly). See also Wells, G "The Doctrine of Unconscionability: A Sword as Well as a Shield" (1977), 29, *Baylor Law Review,* 309, at 309: "The courts of equity have long recognised the doctrine of unconscionability as a 'shield' to prevent enforcement of a grossly unfair and unreasonable contract."

[118] Ellinger and Neo, *The Law and Practice of Documentary Letters of Credit,* at 138.

[119] Goode, R. "Abstract Payment Undertakings in International Transactions" (1996), *22*(1) *Brook J Int'L L,* 1 (hereinafter *"*Goode, *Abstract Payment Undertakings in International Transactions"*), at 3; Goode, R, Kronke, H and McKendrick, E, *Transnational Commercial Law: Texts, Cases and Materials,* 2 ed, Oxford University Press, 2015 at 326 and Leacock, *Fraud in the International Transaction*, at 891, which expound the enforceability of documentary credits despite the absence of consideration.

[120] Hapgood, M *Paget's Law of Banking, 12th ed,* Butterworths Law, 2003 (hereinafter "Hapgood, *Paget's Law of Banking*") and Bennett, HN "Performance bonds and the principle of autonomy" (1994), *Journal of Business Law,* 574 (hereinafter "Bennet, *Performance bonds and the principle of autonomy*"), at 575.

[121] See, e.g., *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 13; *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 20-21; *Investec Bank Ltd v Lombard Insurance Company Ltd and Another* [2019] ZAGPPHC 251, para 7; and see also Peter S. O'Driscoll, P S "Performance Bonds, Bankers' Guarantees, and the Mareva Injunction" (1985-1986), 7, *Nw J Int'l L and Bus*, 380, at 384-385.

[122] Kozolchyk, *The Legal Nature of the Irrevocable Letter of Credit*, at 414.

[123] See generally *RD Harbottle (Mercantile) v National Westminster Bank* [1977] 2 All ER 862.

The sanctity of the autonomy principle has also been explained by reference to the principles underpinning it,[124] including public policy considerations, such as the rules of privity of contract, pursuant to which an issuer of a documentary credit cannot assume liability for the performance of a contract that it is not a party to (i.e., the underlying contract). Privity of contract has, therefore, been invoked effectively to support the independence of documentary credits and why such instruments cannot be viewed as being linked in any way to obligations pursuant to an underlying contract. A further argument advanced by proponents of this argument in favour of the autonomy principle is that miring documentary credits in "underlying contractual controversy"[125] would handicap the trade facilitation function they serve.[126] Therefore, the autonomy principle constitutes the dual independence of the documentary credit from the underlying contract between the applicant (principal) and the beneficiary and the contract (agreement) between the applicant and the issuer.[127]

2.3.2 Rationale and Purpose of the Autonomy Principle

2.3.2.1 Overall Importance to Commercial Transactions and Trade

The autonomy principle has been credited as the feature that makes documentary credits functional and imbues them with their unique commercial character in international trade finance.[128] Depicting the South African and English law recognition of the autonomy principle, the South African case of *Loomcraft Fabrics v Nedbank,*[129] Scott JA, quoting a statement from the seminal English case of *RD Harbottle v National Westminster Bank,*[130] underscored the importance of the autonomy principle as the "lifeblood of commerce" without which "trust in international

[124] Wooler, *Lifting the Veil of Autonomy* at 29.

[125] Ortego, J and Krinick, E "Letters of Credit: Benefits and Drawbacks of the Independence Principle" (1998), 115(5), *Banking Law Journal,* 487, at 488.

[126] Ortego, J and Krinick, E "Letters of Credit: Benefits and Drawbacks of the Independence Principle" (1998), 115(5), *Banking Law Journal,* 487, at 488.

[127] Goode, *Abstract Payment Undertakings in International Transactions,* at 12; Malan, FR "Letters of Credit and attachment Ad Fundandam Jurisdictionem" (1994) *TSAR* 150 (hereinafter "Malan, *Letters of Credit and Attachment Ad Fundandam Jurisdictionem*"), at 150'-151.See also *Bolivinter Oil SA v Chase Manhattan Bank, Commercial Bank of Syria and General Company of Homs Refinery* 1984 1 Lloyd's Rep 251 (CA) 256-257; *Royal Design Studio Pte Ltd v Chang Development Pte Ltd* [1990] SLR 1116]*; Bocotra Construction v Attorney-General* [1995] 2 SLR 733, at 737-738; and *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976, at 981.

[128] Wooler, *Lifting the Veil of Autonomy,* at 41.

[129] 1996 (1) SA 812 (SCA).

[130] [1977] 2 All ER 862.

commerce could be irreparably damaged" and also emphasised the reluctance of courts to interfere with the issuers'/guarantors' payment obligations in the context of documentary credits, except in exceptional circumstances, such as clear cases of fraud.[131] The indispensable nature of the autonomy principle is also well articulated in the following statement made in the USA case of *Frey Son, Inc v Sherburne Co:*[132]

> "It would be a calamity to the business world if for every breach of a contract between buyer and seller a party may come into a court of equity and enjoin payment on drafts drawn upon a letter of credit issued by a bank which owed no duty to the buyer in respect of the breach".[133]

2.3.2.2 The Role of the Autonomy Principle: Security for the Beneficiary

The fast and simple realisation of demand guarantees attributed to the autonomy they embody has been plugged as a feature that makes them "one of the most important instruments of security payments in international trading operations".[134] In line with this view, the overriding purpose of demand guarantees is considered to be the provision of a "speedy monetary remedy" for the beneficiary against the principal to the underlying contract.[135] A critical distinction between demand guarantees and commercial letters of credit worth clarifying here is that while letters of credit are used to facilitate normal payments in a transactional context, with demand guarantees, payment does not constitute the norm *per se* but would only occur upon the crystallisation of the risk of default that it secures against.[136] Payment pursuant to a demand guarantee, in line with its security function, thus only happens where there has been a default, whereby payment under a letter of credit is a matter of course in relation to a transaction such as a sale of goods pursuant to which a commercial letter of credit is issued. The fact that demand guarantees serve a security function does not, however, derogate from the need for quick monetary recourse as this remains of critical importance to a beneficiary when or if a default occurs and a demand for payment is made under a demand guarantee, which the autonomy principle plays a key role in ensuring. For

[131] *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (SCA), at 7- 8.

[132] *Frey Son, Inc v Sherburne Co* 193 App Div 849 (N Y App Div. 1920) and *Sztejn v J Henry Schroder Banking Corporation* (1941) 31 NYS 2d 631.

[133] Ibid.

[134] Lukic, A "The Role and Importance of Bank Demand Guarantees in International Trade" *Int J Eco Res*, (2014), 5(3), 6 (hereinafter "Lukic, *The Role and Importance of Bank Demand Guarantees*), at 9.

[135] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees,* at 3, 109 and 142.

[136] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 75.

this reason, the autonomy principle is widely regarded as the key attraction of documentary credits for rational users, which, some assert, is the basis for its sanctity and the reluctance of courts to tamper with it in any way.[137]

Commentators have noted, in respect of the purpose of letters of credit, that the "raison d'etre is to provide absolute assurance of payment".[138] In line with this, others aver that the autonomy principle is the very basis of the letter of credit system, permitting both assurance and immediacy of payment"[139]for the beneficiary. As stated by Lord Diplock in the case of *United City Merchant (Investment) Ltd v Royal Bank of Canada*[140] the autonomy principle of a letter of credit provides, (sic) "an assured right to be paid … that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment".[141] It has also been asserted that "the whole commercial purpose of a performance bond [which applies similarly in the case of a demand guarantee] is to provide a security which is to be readily, promptly and assuredly realisable".[142] A key aspect of the role of the autonomy principle has, therefore, been noted as the facilitation of quick monetary recourse, both in a security context in relation to demand guarantees[143] and for payment purposes in the context of letters of credit.[144] Therefore, the autonomy principle is integral to the ability of documentary credits to fulfil their commercial purpose.

2.3.2.3 The Role of the Autonomy Principle: Provision of Clarity Regarding the Role of Guarantors

Another pertinent function fulfilled by the autonomy principle is a clarification of the role of issuers/guarantors in relation to documentary credits. The autonomy principle makes it clear that an issuer's or guarantor's mandate pursuant to a demand guarantee is to honour it in accordance

[137] Wooler, *Lifting the Veil of Autonomy,* at 29.

[138] Xiang, G and Buckley, RP "A Comparative Analysis of The Standard of Fraud Required Under the Fraud Rule in Letter of Credit Law" (2003), 13, *Duke Journal of Comparative & International Law*, 293 (hereinafter "Xiang and Buckley, *A Comparative Analysis of the Standard of Fraud*"), at 293.

[139] Sarna, *Letters of Credit: The Law and Current Practice* at 125.

[140] [1983] 1 AC 168.

[141] *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168, at 183.

[142] *Siporex Trade SA v* Banque *Indosuez* [1986] 2 Lloyd's Rep 146.

[143] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees,* at 3, 109 and 142.

[144] McLaughlin, *Exploring Boundaries: A Legal and Structural Analysis*, at 502-503.

with its terms, giving no regard to the relationship of the applicant/principal and the beneficiary or to whether there has been the performance or lack thereof or default in terms of their underlying contract.[145] Given the inherent "middleman" position of guarantors of demand guarantees, the autonomy principle helps to ensure that they are clear on their remit and insulated from potential disputes between the applicant/principal and the beneficiary and the costly (potentially for all parties) legal wrangling which could ensue relating to disputes regarding the underlying contract.

2.3.2.4 The Role of the Autonomy Principle: Neutralising Competing Interests of Parties

A salient aspect of a documentary-credit arrangement, which has also been argued to have contributed to documentary credits'/demand guarantees' development in the commercial arena, is the interposition of the issuer/guarantor between the applicant/principal and the beneficiary to resolve issues associated with their competing interests in a transaction.[146] The position of a guarantor regarding a demand guarantee arrangement and the inherent conflict of interest associated with such a position has also been likened to that of an "unenviable meat in the sandwich.[147] With this analogy in mind, the contribution of the autonomy principle towards balancing and managing the competing interests of the parties involved in a demand-guarantee arrangement, which, even in the simplest of forms, would involve three parties, can be appreciated.

The management of parties' conflicting interests is achieved, in part, by the autonomy principle's demarcation of the underlying contract from the documentary credit itself.[148] In this regard, the autonomy principle has been argued to kick in as soon as the obligation under the letter of credit (and by implication also a demand guarantee) becomes enforceable, after which it is seen as having the effect of "cutting the credit loose" from underlying agreements or contracts that give rise to its existence per its traditional form as "an instrument of commerce that travels with no baggage except that which is acquired by its terms".[149] However, other commentators believe that the

[145] *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976, at 981. See also *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 10 and 11.

[146] Malek and Quest, *Jack: Documentary Credits* at 177.

[147] Whitten, M "Calling on a Performance Security: As Good as Cash?" presented on 18 June 2013 to the Victorian Bar, Commercial Bar Association, Construction Law Section, Neil McPhee Room, Owen Dixon Chambers East, 205 William Street, Melbourne (hereinafter "Whitten, *Calling on a Performance Security*"), at 12.

[148] Wooler, *Lifting the Veil of Autonomy*, at 33.

[149] McLaughlin, *Exploring Boundaries: A Legal and Structural Analysis*, at 505 and the case referred to: *In Re Air Conditioning* 72 BR 657 (S D Fla 1987). UCP 600, Article 7(b) also provides that the obligation to honour is binding as of the time of issue of a credit.

autonomy principle applies upon the issuance of a documentary credit, immediately following which the issuer is obliged to comply with the terms of the letter of credit, and the underlying contract ceases to impinge on that obligation.[150] Notwithstanding differing views regarding the point at which the autonomy principle comes into effect, what is important is that the autonomy principle is inevitably operative at the point which matters most. This is when parties seek to enforce their rights and obligations under a demand-guarantee arrangement and would typically be triggered by a demand made by the beneficiary.

2.3.3 Potential for Exploitation and Absolute Nature of the Autonomy Principle, Barring Exceptions

The guarantor's obligation to pay a beneficiary upon presentation of a demand which is compliant with the terms of a demand guarantee is relatively absolute,[151]subject only to recognised "exceptions" to it. Sarnia notes, in particular, that "the rule of autonomy is multi-edged,"[152] as it is not absolute and leaves the door open for some exceptions.[153] Other than the fraud exception, which is largely accepted internationally as giving rise to an exception to the autonomy principle, there is no uniform global position regarding the acceptable exceptions to the autonomy principle. In addition to fraud,[154]other possible exceptions that have been put forward and accepted or rejected to various degrees in different jurisdictions include illegality in the underlying contract,[155] nullity of a document that is presented under a demand guarantee or letter of credit (e.g., due to

[150] Wooler, *Lifting the Veil of Autonomy,* at 37.

[151] Bennet, *Performance bonds and the principle of autonomy,* at 575.

[152] Sarna, *Letters of Credit: The Law and Current Practice,* at 127.

[153] Sarna, *Letters of Credit: The Law and Current Practice* at 127.

[154] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 200; Dolan, J "Tethering the Fraud Inquiry in Letter of Credit Law" (2006), 21(3), *Banking and Finance Law Review,* 479, at 480 and 485. For a comprehensive consideration and analysis of the fraud exception to the autonomy principle, including from a South African law perspective, see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 161-255.

[155] For a comprehensive consideration and analysis of the illegality in the underlying contract exception to the autonomy principle, including from a South African law perspective, see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 257-286 and Kelly-Louw, M "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees" (2009), 42(3) *CILSA,* 339. In the recent South African case of *Mattress House (Proprietary) Ltd v Investec Property Fund Ltd* [2017] *ZAGPHC* 298, the court seemingly accepted illegality in the underlying contract as a possible exception to the autonomy principle. See also N Enonchong, "The Autonomy Principle of Letters of Credit: An Illegality Exception?" (2006), 1(M), *Lloyd's Maritime and Commercial Law Quarterly* 404; Alavi, *Illegality as an Exception to Principle of Autonomy*, 3; McLaughlin, G, "Letters of Credit and Illegal Contracts: The Limits of the Independence Principle" (1989), 49, *Ohio State Law Journal*, 1197; Malek and Quest, *Jack: Documentary Credits,* at 412-429 and Horowitz, D *Letter of Credit and Demand Guarantees Defences to Payment,* eds, Oxford University Press, 2010 (hereinafter, "Horowitz, *Letter of Credit and Demand Guarantees")*, at 173-226 for further and more detailed consideration of the acceptance of illegality in the underlying contract.

forgery, which would render it null by stripping it of any commercial value),[156] breach of a negative stipulation[157] and unconscionability,[158] the last two of which will be considered comprehensively as the focus of this thesis.

The general inclination of courts to reinforce the incorruptibility of the autonomy principle and corollary hesitance to uphold exceptions to it is exemplified in the English case of *Hamzeh Malas and Sons v British Imex Industries Ltd*,[159] where the court held that the autonomy principle gave rise to an *"*absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to the contract or not".[160] Depicting the limited grounds upon which exemption to the autonomy principle may be entertained, in the Australian case of *Olex Focas Pty Ltd v Skodaexport Co Ltd*,[161] the court stated that courts would only intervene with the autonomy principle in very limited and exceptional circumstances such as fraud as to do otherwise would destroy the whole purpose of demand guarantees.[162] This reluctance was further portrayed in *Olex Focas*, where it was observed whether a demand pursuant to a demand guarantee was unconscionable under the Australian Trade Practices Act,[163] according to which recognising

[156] See generally Malek and Quest, *Jack: Documentary Credits*, at 256; Hooley R "Fraud and Letters of Credit: Is there a *nullity Exception*?"' (2002), 61, *Cambridge Law Journal*, 279; Horowitz, *Letter of Credit and Demand Guarantees*, at 37-61; Neo, D, "A Nullity Exception in Letter of Credit Transactions?" (2004), 1, *Singapore Journal of Legal Studies*, 46, Enonchong, *The Independence Principle of Letters of Credit*, at 146–151 and Donnelly, K. "Nothing for Nothing: A Nullity Exception in Letters of Credit" (2008), 4, *JBL*, 316. Different jurisdictions have adopted different stances on the nullity exception, as exemplified by the Singaporean case of *Beam Technologies v Standard Chartered Bank* [2003] 1 SLR 597 which supported the recognition of nullity as an exception to the autonomy principle, and conversely the English law case of *Montrod Ltd v Grundkötter Fleischvertriebs GmbH* [2001] 1 All ER (Comm) 368 (QBD), where nullity was rejected as a standalone exception to the autonomy principle.

[157] This is considered in this thesis (see Chapter 1, and the relevant sections considering breach of a negative stipulation as an exception to the autonomy principle in Chapters 2-9).

[158] This is considered in this thesis (see Chapter 1, and the relevant sections considering unconscionability as an exception to the autonomy principle in Chapters 2-9).

[159] [1958] 2 QB, 703.

[160] *Hamzeh Malas and Sons v British Imex Industries Ltd* [1958] 2 QB, 703.

[161] [1998] 3 VR 380.

[162] Idem, at 400-404. For other seminal case law upholding the autonomy principle under Australian law, see *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158; *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420, paras 17 and 23 and *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812. See also *Vos Construction & Joinery Qld Pty Ltd v Sanctuary Properties Pty Ltd & Anor* [2007 QSC 332, para 8] and *Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd* [2003] NSWSC 713, paras 32 and 39.

[163] Section 51AA of the *Australian Trade Practices Act* 1974.

statutory unconscionability as an exception could make substantial inroads into the common law autonomy principle.[164]

Despite its all-important function in the commerciality and utility of documentary credits, the autonomy principle can be exploited to facilitate abusive demands for payment.[165] The autonomy principle may thus lend itself to abuse by unscrupulous beneficiaries. However, such risk has been argued to be one that principals/applicants accept when they contract with a counterparty with full knowledge of the requirement for a demand guarantee to be issued in such counterparty's (beneficiary's) favour.[166] Also, the very existence of the fraud exception, other exceptions recognised in various jurisdictions (as mentioned above), the unconscionability exception and breach of negative stipulation exception (considered as a possible exception in detail in the next chapters) have arguably come about to balance out the potential adverse effects arising from the autonomy principle such as abusive or unjust demands by beneficiaries with no qualms about leveraging the balance of power in their favour for fraudulent or illicit purposes. Therefore, the very existence of exceptions to the autonomy principle is arguably an acknowledgement that for all its benefits, purposes and rationale, the autonomy principle in its absolute form has an underbelly which can, *inter alia*, manifest itself in the form of or facilitate exploitation or abuse by the beneficiary.

2.4 CASE LAW AND PARAMETERS OF THE AUTONOMY PRINCIPLE

2.4.1 Introduction

The autonomy principle has been articulated, applied, and endorsed internationally in numerous cases. A strong precedent exists in the jurisdictions under consideration for this thesis, particularly England, Australia, and South Africa. A number of cases will be referenced to bolster the context and parameters of the autonomy principle as understood and intended to be conveyed within this thesis.

While the autonomy principle represents independence from all associated contracts in a documentary-credit transaction, the underlying contract between the applicant/principal and the beneficiary, which typically gives rise to the documentary credit, is the most popular avenue by

[164] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, at 404.

[165] Wooler, *Lifting the Veil of Autonomy*, at 28.

[166] Bennet, *Performance bonds and the principle of autonomy*, at 575.

which parties attempt to dispute or compromise the autonomy principle. For this reason, the autonomy principle is typically explained by reference to the independence of a documentary credit from (mainly) the underlying contract. In the South African case of *Phillips v Standard Bank of South Africa,*[167] with reference to the American case of *Sztejn v J. Henry Schroder Banking Corporation,*[168] and the English case of *United City Merchants v Royal Bank of Canada*[169]*,* the autonomy principle was expressed in terms of a letter of credit being independent of the primary contract between the buyer and the seller.[170]

In *Sztejn v J Henry Schroder Banking Corporation,*[171]which is considered to be the *locus classicus* for the autonomy principle and the parameters thereof in relation to the fraud exception,[172] noted that the autonomy principle is a well-established tenet which is essential to preserve the efficacy of letters of credit as instruments for the financing of trade.[173] Any consideration of controversies or matters outside of a documentary credit in a manner contrary to the autonomy principle was held by the court to constitute "a most unfortunate interference with business transactions".[174] Therefore, payment under a demand guarantee should be determined solely by reference to the demand guarantee itself, without reference to the underlying contract.[175] As pointed out by the court in *Sztejn v J Henry Schroder Banking Corporation,*[176]where parties intend for an issuer to enquire into matters pertaining to an underlying contract, such intention can be expressly provided for in the documentary credit itself.[177] However, it is submitted that such a provision would undoubtedly question whether an instrument is indeed a documentary credit or some other accessory agreement of a similar nature to a suretyship agreement.

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[167] 1985 (3) 301 (W) at 67.

[168] See *Sztejn v J. Henry Schroder Banking Corporation* (1941) 31 NYS 2d 631, at 633-634.

[169] See *United City Merchants v Royal Bank of Canada* [1983] 1 AC 168, at 183.

[170] *Phillips v Standard Bank of South Africa Ltd* [1985] 4 All SA 66 (W), at 67 to 68.

[171] (1941) 31 NYS 2d 631.

[172] Ibid. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 179 and Xiang and Buckley, *A Comparative Analysis of the Standard of Fraud*, at 295.

[173] (1941) 31 NYS 2d 631.

[174] Ibid.

[175] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 49.

[176] (1941) 31 NYS 2d 631.

[177] Idem, at 633-634.

The United States of America, being a country with statutory rules governing letters of credit, in the form of Article 5 of the UCC, provides unique insight into the governance of documentary credit law from a statutory perspective. The autonomy principle is recognised in the UCC, which categorically provides that the obligations of an issuer to a beneficiary are independent of "the existence, performance, or non-performance of the contract or arrangement out of which the letter of credit arises or which underlie it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary".[178] It is further underscored that an issuer of a letter of credit is in no way responsible for, *inter alia*, performance (or lack thereof) under an underlying contract, transaction or arrangement.[179] The UCC also makes the documentary nature/focus on documents clear in respect of letters of credit by defining "letter of credit" by reference to a "definite undertaking… [and] a documentary presentation,"[180] and expressly providing that where such instrument contains non-documentary conditions an issuer must disregard such non-documentary conditions as though they were not there.[181]

2.4.2 Selective South African Case Law Relating to the Autonomy Principle

Several cases have endorsed and demonstrated the importance of the autonomy principle to documentary credits and its recognition under South African law.[182] While South Africa has steadfastly recognised the autonomy principle and unequivocally acknowledged only fraud as an exception to the autonomy principle, several fairly recent cases have underscored the urgent need for an answer to the question of whether other exceptions can be recognised in a South African context. The Supreme Court of Appeal case of *Dormell Properties 282 CC v Renasa Insurance*

[178] Article 5-103(d).

[179] Article 5-108(f)(1).

[180] UCC, Section 5-102(a)(10).

[181] UCC, Section 5-108(g).

[182] See the following cases before South African Supreme Court of Appeal or, as applicable, the Appellate Division (which is what the Supreme Court of Appeal was known as prior to the creation of the Constitutional Court of South Africa and the enactment of s 166 of the Constitution of the Republic of South Africa, Act 108 of 1996) reinforcing recognition of the autonomy principle: *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (SCA), at 8; *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & Others* 2010 (2) SA 86 (SCA) paras 19 and 20; *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA), para 14; *FirstRand Bank Ltd v Brera Investments CC* 2013 (5) SA 556 (SCA), paras 2 and 11*; Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 12-13; *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), paras 14 and 28; *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), paras 38, 39, and 61; and *Eskom Holdings v Hitachi Power Africa* [2013] ZASCA 101, para 15.

Co Ltd & Others NNO[183] is one such case where the court, for a short period of time, accepted another ground, besides clear fraud, as an exception to the autonomy principle.

In *Dormell*, following a dispute between the principal and the beneficiary, the beneficiary cancelled the underlying contract and presented a demand for payment per the demand guarantee. The guarantor refused to honour the guarantee and sued, which refusal was upheld by the court *a quo*, albeit with leave to appeal. Pending the appeal, the dispute between the principal and the beneficiary was settled by an arbitration award which found that there had been no breach of the underlying contract by the principal and, consequently, the cancellation of the contract by the beneficiary based on an alleged breach was tantamount to a repudiation of the contract by the beneficiary.

On appeal in the *Dormell* case, the guarantor sought and was granted leave to use the outcome of the arbitration as evidence because the arbitration established that the beneficiary had no grounds upon which to enforce the guarantee. The court found no "legitimate purpose to which the guaranteed sum could be applied"[184]. The principal would thus be immediately entitled to reimbursement of any payment made to the beneficiary by the guarantor. It was held that there would be no practicality in upholding payment under the guarantee. In effect, therefore, the *Dormell* majority judgment found that a final arbitration decision against a beneficiary could form the basis of a defence to payment pursuant to a demand guarantee. This appeared to accept consideration of extraneous factors to a documentary credit, a stance that is starkly at odds with the autonomy principle.

The controversial position established by *Dormell* is that the resolution of a dispute under an underlying contract in favour of a principal/applicant can oust the autonomy principle by providing a defence against payment under the documentary credit. This potential opening of the proverbial floodgates against any defences to payment under documentary credits based on the underlying contract was widely considered an unacceptable direction to take.[185] This floodgate-opening effect

[183] 2011 (1) SA 70 (SCA).

[184] *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), para 41.

[185] Hugo, C "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal Relating to Demand Guarantees" (2014), 4, *TSAR*, 661 (hereinafter "Hugo, *Protecting the Lifeblood of Commerce*"), at 665.

was noted in the following statement delivered in the later Supreme Court case of *Coface South Africa Insurance v East London Own Haven*:[186]

> "Since the decision in *Dormell*, and perhaps predictably, there has been an increasing number of cases in which guaranteeing banks have sought to introduce contractual disputes in order to avoid meeting the guarantee. In some cases the allegedly defaulting contractor sought to join the fray. It is the very consequence that the line of cases prior to *Dormell* sought to avoid".[187]

Given the neutering effect that an interdict/injunction on such grounds would have on the effectiveness of documentary credits, some commentators have suggested applying certain parameters around it. One such parameter is that a court order or arbitration award pursuant to which an interdict to prevent a beneficiary from making a demand is sought must be a final arbitration or court order and not subject to appeal.[188]

The *Dormell* majority ruling has been subjected to overwhelming criticism, which has made the minority judgment all the more noteworthy. Cloete JA (Mpati P concurring) in *Dormell* took the view, in line with the autonomy principle, that evidence extraneous to the demand guarantee in question should not have been led. Cloete JA maintained that fraud is the only exception to the autonomy principle. Apart from that, any dispute between the principal and the beneficiary had no bearing on the obligations of the guarantor under the demand guarantees, which view was supported by a number of subsequent cases.[189]

Dissenting views against the majority judgment in *Dormell* culminated in the Supreme Court of Appeal essentially retracting its *Dormell* position in the case of *Coface.*[190] In *Coface,* payment under a demand guarantee was disputed based on similar reliance on alleged circumstances relating to the underlying contract, in the form of a certificate and statement confirming that the principal did not owe the beneficiary any funds. The court held that an arbitrator's decision was regarded as having no bearing on a guarantor's obligation to pay pursuant to a compliant demand under a

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[186] 2014 (2) SA 382 (SCA).

[187] Idem, para 24.

[188] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 218.

[189] *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), para 63 and also para 38.

[190] *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA). See the discussion of *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA) and other subsequent cases and the ultimate debunking of the approach in the *Dormell* majority ruling in paras 5-25.

guarantee being presented.[191] The Supreme Court of Appeal, with reference to cases that had snubbed the majority judgment in *Dormell* in favour of the minority judgment,[192] overruled the *Dormell* case and held that the contents of documents extraneous to the demand guarantee itself, particularly the payment certificate, in this case, did not constitute a defence against payment in terms of the demand guarantee or have any bearing on a guarantor's obligation to pay pursuant to a compliant demand.

The *Coface* decision effectively conceded that the *Dormell* ruling had been incorrect to the extent that the arbitration award in favour of an applicant sought to be insinuated in respect of the obligation of the guarantor to the beneficiary.[193] The minority judgment in *Dormell* and the ruling in *Coface* can thus be credited with reinstating the equilibrium and certainty of the autonomy principle. The position of the guarantor in relation to it under South African law is that guarantors must pay upon presentation of a complying demand regardless of whether an underlying contract has, in fact, been breached or any consequent loss actually suffered by a beneficiary.[194] However, it is worth noting that in the minority decision of *Dormell*, it was acknowledged that an arbitration award to the effect that the beneficiary had not been entitled to cancel the underlying contract was relevant visa vis the applicant and the beneficiary.[195] It is noteworthy that despite inconsistencies in respect of some exceptions, as illustrated by the *Dormell* and *Coface* cases, the Supreme Court of Appeal has, with staunch consistency, acknowledged what is perceived to be a universally

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[191] *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 10, 13, 15 and 21.

[192] *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 25 and *FirstRand Bank Ltd v Brera Investments CC* 2013 (5) SA 556 (SCA), para 10.

[193] See *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), particularly the discussion of *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA) in paras 5-25.

[193] *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 10, 13, 15 and 21.

[194] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 214.

[195] *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), para 64. See also the recent High Court case of *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited and Another* [2020] ZAGPPHC 554 in which the minority judgment in *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA) was endorsed and the High Court, with reference to the autonomy principle, found that a final arbitration ruling against a beneficiary does not affect the beneficiary's entitlement to make a demand under the terms of a demand guarantee and that such an arbitration ruling does not render a demand for payment pursued thereafter by a beneficiary fraudulent or in bad faith. This position was summed up in the statement that, "… the fact that an arbitrator's award is final as between [the applicant] and [the beneficiary] does not mean that it is correct, or that [the beneficiary] would have to set it aside before calling up the guarantee, much less that [the beneficiary] is acting in bad faith in seeking to enforce payment under the guarantee against [the guarantor]", para 28.

accepted exception to the autonomy principle: fraud.[196] Other exceptions, such as illegality, have been touched upon by South African courts. The High Court case of *Mattress House (Proprietary) Ltd v Investec Property Fund* appears to recognise illegality in the underlying contract as a possible exception to the autonomy principle. The case of *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture*[197] also alludes to the other exceptions to the autonomy principle in addition to fraud, particularly unconscionability and breach of a negative stipulation in the underlying contract,[198] both of which are considered in more detail in this thesis.[199]

An avenue available to the principal/applicant in instances of clear fraud to prevent the payment from being made in terms of a demand guarantee may include obtaining an interdict (or injunction as it is known in other jurisdictions) preventing the beneficiary from making a demand under the documentary credit. This, however, is contrary to the situation where a guarantor refuses to make payment under the guarantee due to the beneficiary having rendered a non-compliant demand.[200]

2.4.3 Selective English Case Law relating to the Autonomy Principle

The autonomy principle is trite under English law.[201] One of the rules English courts have constantly reiterated that they abide by is non-interference with the operation of the autonomy principle, particularly because they are immaterial to the relevant documentary credit itself.[202] The English law case of *Edward Owen Engineering Ltd v Barclays Bank International Ltd and*

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[196] *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 9-13 and *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), paras 38 and 63. See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 161-255 for a comprehensive analysis of the fraud exception across selected jurisdictions, including South African, American and English law and Marxen, *Demand guarantees in the construction industry*, at 61-64. See also *Kelly-Louw "Limiting Exceptions to the Autonomy principle of demand guarantees and letters of credit*" in Visser and Pretorius (eds) *Essays in Honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, LexisNexis, 2014 at 197-218*;* Van Niekerk and Schulze, *The South African Law of International Trade*, at 291-298*;* Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 51 and Kelly-Louw, "Construing Whether A Guarantee is Accessory or Independent is Key" at 115 in Hugo, C and Kelly-Louw, M, (eds) *Jopie: Jurist, Mentor, Supervisor and Friend-Essays on the Law of Banking, Companies and Suretyship*, Juta, 2017.

[197] *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695, para 41.

[198] *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695, para 41.

[199] See Chapter 1, and the relevant sections considering breach of a negative stipulation as an exception to the autonomy principle in Chapters 2-9.

[200] See the discussion in section 0 further below.

[201] Enonchong, *The Independence Principle of Letters of Credit*, at 69.

[202] *Themehelp Ltd v West and Others* [1995] 4 All ER 215, at 218; Malek and Quest, *Jack: Documentary Credits*, at 17. See also Bertrams, *Bank Guarantees in International Trade*, at 2-3.

Another,[203] which is considered to be seminal for its reinforcement of the autonomy principle, summed up the autonomy principle as follows:

> "A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question of whether the supplier has performed his contracted obligation or not; nor with the question of whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is clear fraud of which the bank has notice."[204]

In the case of *Power Curber International Ltd v National Bank of Kuwait SAK*,[205] the court noted a deterrent against interfering with the autonomy principle. The following dire consequences may result from such interference by courts:

> "If the court of any of the countries should interfere with one of the obligations of its banks (by ordering it not to pay under a letter of credit), it would strike at the very heart of that country's trade. No foreign seller would supply goods to that country on letters of credit because he could no longer be confident of being paid. No trader would accept a letter of credit issued by a bank of that country if it might be ordered by its courts not to pay. So it is part of the law of international trade that letters of credit should be honoured and not nullified by an attachment order at the suit of the buyer."[206]

The recognition of fraud as an exception to the autonomy principle is also largely unanimous in English courts, as entrenched by several prominent cases.[207] Illegality in the underlying contract, albeit to a lesser extent, has also gained traction as an exception to the autonomy principle under

[203] [1978] 1 All ER 976.

[204] Idem, at 983.

[205] [1981] 3 All ER 607.

[206] Idem, at 613.

[207] See, e.g., *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd and Others* 1978] 1 QB 146 (CA), paras 155G-156A; *Edward Owen Engineering Ltd v Barclays Bank International Ltd and Another* [1978] 1 QB 159 (CA) at para 169A-D; *United City Merchants (Investments) Ltd and Glass Fibres and Equipments Ltd v Royal Bank of Canada (incorporated in Canada); Vitrorefuerzos SA and Banco Continental SA* [1981] 1 Lloyd's Rep 604 (CA) and [1983] AC 168 (HL), at para 183D-F; *Intraco Ltd v Notis Shipping Corporation (The 'Bhoja Trader')*, [1981] 2 Lloyd's Rep 256 (CA) at 257 and *Bolivinter Oil SA v Chase Manhattan Bank, Commercial Bank of Syria and General Company of Homes Refinery*, [1984] 1 Lloyd's Rep 251 (CA) at 257.

English law as supported by certain cases.[208] Unconscionability, which is one of the exceptions considered in this thesis, is on an uncertain footing under English law, although alluded to in cases such as *TTI Team Telecom International Ltd v Hutchison*.[209] Breach of a negative stipulation, another potential exception to the autonomy principle examined in this thesis, has been endorsed by English case law,[210] with the case of *Simon Carves Ltd v Ensus UK* Ltd,[211] exemplifying the granting of an injunction preventing a beneficiary from making a call a demand guarantee due to an express prohibition from doing so under the underlying contract (referred to as a breach of a negative stipulation). The position of unconscionability and breach of negative stipulation as potential exceptions to the autonomy principle under English law are considered further in this thesis.[212]

From the cases sampled above, it is evident that recognition of the autonomy principle is well settled under English law, subject to certain exceptions as recognised to various extents.[213]

2.4.4 Selective Australian Case Law relating to the Autonomy Principle

The autonomy principle is well established under Australian law, as depicted in the early case of *Wood Hall Ltd v The Pipeline Authority,*[214] where the matter before the courts concerned performance guarantees which had been issued by a contractor in favour of the employer for due and faithful performance in relation to an underlying construction contract for a pipeline. Before completing the contract, there was a dispute regarding the underlying contract. The employer alleged that there had not been due and faithful performance and presented a demand under the guarantees. The demand was sought to be defended because there had indeed been due performance under the underlying contract. The court held that whether or not due performance

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[208] See generally the cases of *Deutsche Ruckvershcherung A.G. v Walbrook Insr Co Ltd* [1995] 1 WLR 1017; *Group Josi Re v Walbrook Insurance Co Ltd and Others* [1996] 1 Lloyd's Rep 345 (CA) and *Mahonia Ltd v JP Morgan Chase Bank and Another* [2003] 2 Lloyd's Rep 911 (QB (Com Ct)) and *Mahonia Ltd v West LB AG* [2004] EWHC 1938.

[209] [2003] EWHC 762 (TCC).

[210] See *Lumely v Wagner* 1852 1 De GM & G 604; *Doherty v Allman* (1878) 3 App Cas 709 and *Sirius International Insurance Company v FAI Insurance Ltd* [2002] EWHC 1611 (Ch).

[211] [2011] EWHC 657 (TCC).

[212] See Chapter 4 of this thesis.

[213] See also Bennett, HN "Performance bonds and the principle of autonomy" (1994), *Journal of Business Law,* 574 and Malek and Quest, *Jack: Documentary Credits,* at 17-18 and and all the case law cited therein.

[214] *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443.

had been undertaken per the underlying contract did not affect the beneficiary's entitlement to make a demand under the demand guarantees, in line with the unconditionality of the demand guarantees. The nature of the autonomy principle was reiterated, with the court emphasising the position that there is no basis for any qualification on the unconditional nature of a documentary credit or a beneficiary's right to demand payment thereunder by reference to the terms of an underlying contract.

The court in *Wood Hall* also underscored the importance of not undermining the perception that demand guarantees are "as good as cash" as it is integral to their utility and purpose.[215] In this regard, Stephen, J emphasising the indispensability of the autonomy principle, declared:

> "Once a document of this character ceases to be the equivalent of a cash payment, being instantly and unconditionally convertible to cash, it necessarily loses acceptability. Only so long as it is 'as good as cash' can it fulfil its useful purpose of affording to those to whom it is issued the advantages of cash while involving for those who procure its issue neither the loss of use of an equivalent money sum nor the interest charges which would be incurred if such a sum were to be borrowed for the purpose. Being "as good as cash" in the eyes of those to whom it is issued is essential to this function."[216]

In addition, the fact that the beneficiary in the *Wood Hall* case had accepted the demand guarantees *in lieu* of cash security reaffirmed the commercial utility and security function that demand guarantees were also illustrated to fulfil.

Another Australian case, *Clough Engineering Limited v Oil and Natural Gas Corporation Limited*,[217] supported the autonomy principle and endorsed a "pay now and argue later" approach, noting that a guarantor has no obligation to inquire into a principa"s rights pursuant to the underlying contract.[218] The court in *Clough Engineering* also stressed that demand guarantees are equivalent to cash, and depriving them of such status by making them conditional or subject to extraneous factors would effectively rob them of their commercial utility.[219] Consistent with this, Australian law analysts of the autonomy principle have opined that a guarantor's concern must be

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[215] Idem, para 7.

[216] *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443, para 7.

[217] [2008] FCAFC 136.

[218] *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136, paras 76 and 109.

[219] Ibid.

confined to whether a compliant demand has been made and not the merits or otherwise of a beneficiary's motivation or entitlement for making a demand under the terms of the underlying contract.[220]

As in several other jurisdictions, the fraud exception to the autonomy principle is trite under Australian law.[221] However, case law directly evidencing recognition of less common exceptions to the autonomy principle, such as illegality in the underlying contract, is scarce. The recognition of such exceptions under Australian law has been argued to be weakly supported at best.[222] However, cases such as *Fletcher Construction Australia Ltd v Vransdorf Pty Ltd*[223] in which it is remarked that a beneficiary cannot be restrained from conforming with a contract in the absence of "fraud or illegality",[224] have been construed as indicative of a positive attitude towards accepting illegality in the underlying contract as a possible exception to the autonomy principle.[225]

Unconscionability under Australian law was entrenched into statute[226] and is recognised as a statutory exception[227] to the autonomy principle and payment obligations thereunder, as depicted in a number of cases where injunctions preventing payment under demand guarantees were granted based on unconscionability.[228] There is also precedent for recognising the breach of negative covenant overriding the autonomy principle under Australian law, with the case of *Pearson Bridge*

[220] Whitten, *Calling on a Performance Security*, at 12.

[221] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27; *Fletcher Construction Australia Ltd v Vransdorf Pty Ltd [1998] 3 VR 812;*

[222] Liao, Z "Illegality in the Underlying Transaction: A Defence to Dishonouring Letters of Credit?" (2015), 23, Waikato Law Review, 34, at 43-46.

[223] [1998] 3 VR 812.

[224] Idem, at 839

[225] Alavi, *Illegality as an Exception to Principle of Autonomy*, at 18.

[226] Section 51AA of the Australian Trade Practices Act 1974 (Cth) which is now the Competition and Consumer Act 2010 (Cth) (Schedule 2 of the Competition and Consumer Act 2010 being the Australian Consumer Law).

[227] Section 51AA of the Australian Trade Practices Act 1974 (Cth) which is now the Competition and Consumer Act 2010 (Cth) (Schedule 2 of the Competition and Consumer Act 2010 being the Australian Consumer Law), has adopted the equitable concept of unconscionability as a separate ground from that of fraud restraining the enforcement of on-demand guarantees and states that, "*A person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law, from time to time*".

[228] See *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27; *Boral Formwork v Actionmakers* [2003] NSWSC 713, *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd* (2002] FCAFC 4; 117 FCR 301; 189 ALR 76 and *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2005] FCAFC 136.

Pty Ltd v State Rail Authority of New South Wales[229] serving as an example in this regard. This thesis will explore both the unconscionability and breach of negative stipulation exceptions in more detail.[230]

2.4.5 Incorporation of the Autonomy Principle of Documentary Credits in International Rules and Standards and the UNCITRAL Convention

The autonomy principle is internationally recognised as one of the essential principles underpinning documentary credits. Its incorporation in all key international rules and standards relating to documentary credits is emblematic of the vital role it plays in the arena of international commerce. The autonomy principle is incorporated in the main international rules governing various documentary credits by agreement between the involved parties, namely the UCP 600,[231] URDG 758,[232] and the ISP 98.[233] The principle is also accentuated in the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit ("UNCITRAL Convention").[234] Although the UNCITRAL Convention will automatically apply to the states (jurisdictions) that have accepted the Convention, parties are free to decide to make it applicable to their instrument. Notably, none of the key jurisdictions to be considered in this thesis (i.e., South Africa, England and Australia) have accepted or acceded to the UNCITRAL Convention.

Article 5(a) of the URDG 758, being the current iteration of international rules specifically tailored for demand guarantees, entrenches the independence of a demand guarantee from both the underlying contract (between the applicant and the beneficiary) and the application of the guarantee (i.e., the relationship between the applicant and the guarantor).[235] It is further stated in

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[229] [1982] 1 ACLR 81 (NSWSC). See also *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 ((1986) 2 BCL 366 (Sup Ct)) and, (although on a different basis) *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451 Sup Ct NSW and *ADI Ltd v State Electricity Commission of Victoria* a (1997) 13 BCL 337 Sup Ct Vic.

[230] See Chapter 5 of this thesis.

[231] UCP 600, Articles 4(a), 4(b) and 5.

[232] URDG 758, 5(a).

[233] ISP 98, Rule 1.06(a) and 1.06(c).

[234] United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) (hereinafter "UNCITRAL Convention"), Articles 2 and 3.

[235] The independence of demand guarantees was also entrenched in Article 2(b) of the URDG 458, which stated that, "Guarantees by their nature are separate transactions from the contract(s) or tender conditions on which they may be based, and Guarantors are in no way concerned with or bound by such contract(s), or tender conditions, despite the

the URDG 758 that the independence of a demand guarantee would still hold even where the underlying relationship is specifically mentioned in the demand guarantee. Moreover, the URDG 758 explicitly provide that a demand guarantee is not subject to any claims or defences extraneous to the relationship between the guarantor and the beneficiary under the demand guarantee itself.[236] The narrow scope of a guarantor's duties or powers pursuant to the autonomy principle of demand guarantees is also ensconced in Article 6 of the URDG 758 (confirming the documentary nature of the demand guarantee), which stipulates that guarantors deal with documents alone and need not concern themselves with goods, services or any performance to which the documents may relate.[237]

In relation to standby letters of credit, the ISP 98 incorporates applying the autonomy principle to standby letters of credit. It unequivocally stipulates that an issuer's obligation to pay thereunder is in no way dependent on extraneous factors such as the ability of the issuer to obtain reimbursement from the applicant, any rights of the beneficiary to obtain payment from the applicant, reference to the underlying contract in the standby letter of credit, or any knowledge relating to, performance, breach or any reimbursement agreement or underlying agreement or transaction.[238]

The UCP 600, which generally seek to cater to documentary credits, expressly incorporate the autonomy principle in similar terms as those in the URDG 758 and ISP 98.[239] The UCP 600 stipulate that a bank's obligation to fulfil an obligation under a documentary credit is not subject to any defences or claims related to underlying or extraneous contracts, including those between the applicant and the beneficiary, the applicant and the issuing bank or between two banks (e.g., the instructing bank and the guaranteeing bank).[240] To reinforce this principle, the UCP 600 require

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inclusion of a reference to them in the Guarantee. The duty of a Guarantor under a Guarantee is to pay the sum or sums therein stated on the presentation of a written demand for payment and other documents specified in the Guarantee which appear on their face to be in accordance with the terms of the Guarantee".

[236] Article 5(a). See also Article 5(b) in respect of the independence of counter-guarantees.

[237] URDG 758, Article 6.

[238] ISP 98, Rule 106(c). See also Rule 107 which reiterates the immunity of the obligations of the issuer of a standby letter of credit from any rights or obligations between the issuer and the applicant pursuant to any agreement, practice or law.

[239] Article 4(a) of the UCP 600 explains the principle of autonomy as follows: "A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary."

[240] UCP 600, Article 4(a).

issuing banks to discourage attempts by applicants to include copies of the underlying contract as an integral component of documentary credit and, in any event, provide for the application of the autonomy principle even where an underlying contract is referenced in the documentary credit.[241]

In further explaining the effect of the autonomy principle, the UCP 600 stipulate that issuers of documentary credits must deal only with documents in respect thereof and need not concern themselves with goods, services or any related performance (also confirming the instrument's documentary nature).[242] The UCP 600 also confirm the autonomy principle's effect in separating the obligations of a confirming bank to reimburse another nominated bank from the confirming bank's obligations to the beneficiary.[243]

The UNCITRAL Convention incorporates the autonomy principle by providing that a guarantor/issuer's obligation to a beneficiary is not dependent even upon the existence or validity of an underlying transaction or any other undertaking, nor is it subject to any terms or conditions outside the undertaking itself, including any future or uncertain acts or events.[244]

2.5 THE DOCUMENTARY NATURE OF DEMAND GUARANTEES

2.5.1 Requirement for Demand Guarantees to be in Writing

Unlike a typical contract that may or may not be reduced to writing (i.e., contained in a document),[245] the URDG 758 definition of a demand guarantee, which is a central reference point in this thesis, clearly seems to envisage a written instrument by describing a demand guarantee as a "signed undertaking". Not all definitions of demand guarantees are however strictly prescriptive regarding the requirement to be in writing. For instance, one such definition, proffered by Goode,[246] describes a demand guarantee as an undertaking to pay a fixed or maximum sum of money on presentation to the party giving the undertaking of a demand for payment (nearly always required to be in writing) and such other documents (if any) as may be specified in the guarantee within the period and in conformity with the other conditions of the demand guarantee.

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[241] UCP 600, Article 4(b).

[242] UCP 600, Article 5.

[243] UCP 600, Article 8(c).

[244] UNCITRAL Convention Article 3.

[245] See the discussion of the quasi-contractual nature of documentary credits in section 2.2.2.2 of this thesis.

[246] Roy Goode *Guide to the ICC Uniform Rules for Demand Guarantees* (1992) ICC Publication 510, at 9-10.

A key distinction between Goode's definition and the URDG 758 definition is that the former caters for the possibility of demand guarantees and demands thereunder, which may not necessarily be in writing. In contrast, the latter definition prescribes written form for both the demand guarantee and a demand under it. The absence of a requirement for a written demand may lend itself to flexibility and more practical terms between parties and potentially enhance the ease with which a demand guarantee can be utilised as a substitute for cash.[247] This option has also been attributed to the origins of demand guarantees as instruments intended to substitute cash deposits and the superior negotiating power of beneficiaries,[248] enabling them to secure payment upon the most unencumbered form of demand.

An unwritten demand guarantee, pursuant to which a demand can be made orally, has been observed to be the epitome of a demand guarantee "in its simplest form".[249] Given the disputes commonly arising in respect of demand guarantees and demands issued pursuant to it, it is submitted that oral arrangements provide less certainty than a documented form of demand guarantee, particularly from an evidentiary perspective in the event of a dispute, which may be one of the reasons why documented demand guarantees seem to be the overwhelmingly dominant form of demand guarantee used universally. This thesis will be focused on documented demand guarantees and other documentary credits as appropriate, with the documentary nature thereof being considered a central feature of such instruments.

2.5.2 Demands: Statement of Breach and Supporting Documents

The obligation to render payment to a beneficiary pursuant to a demand guarantee is triggered by a demand for payment. As envisaged in both the URDG 758 and Goode's definition of a demand guarantee, additional documents may (or may not) be required to be delivered together with a demand for payment under the terms of the demand guarantee. Several demand guarantees and other documentary credits stipulate that such payment is triggered on first demand without the requirement for any additional documents.[250] In such cases, demand guarantees are thus payable on "first written demand" or "simple demand" without any specific supporting documents

[247] *Intraco Ltd v Notis Shipping Corporation (The 'Bhoja Trader')* [1981] 2 Lloyd's Rep 256 (CA), at 257.

[248] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 17.

[249] Ibid.

[250] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 55.

required.[251] Some analysts have linked this simplicity of the demand process to the historical origins of demand guarantees as a replacement for cash deposits and the traditionally superior bargaining power of beneficiaries.[252]

Increasingly, however, demand guarantees are required to be accompanied by supporting documents, which requirement is typically incorporated in the demand guarantee itself.[253] Such supporting documents can include, *inter alia*, a statement indicating that a breach has occurred, which is provided for in the URDG 758.[254] Where this is the case, the relevant demand guarantee would explicitly require supporting documents to accompany a demand, with the bare minimum of these typically being a written statement stating that a principal is in default[255] or a copy of the liquidation order of the principal/applicant.[256]

Where a demand guarantee or other documentary credit is electively governed by a set of international rules such as URDG 758 or ISP 98, the requirements for a valid demand are generally much clearer[257] as interpretation is guided by the relevant rules. For instance, the demand provisions in URDG 758 make clear the position that a demand "shall be supported by such other documents as the guarantee specifies, and in any event by a statement, by the beneficiary, indicating in what respect the applicant is in breach of its obligations under the underlying relationship".[258] The URDG 758 also clarify that the statement alleging breach may be housed in the demand itself or a separate document accompanying the demand or identifying it. Despite the optional nature of the requirement for supporting documents to accompany a demand, the theme of documentary conformity with the terms of a demand guarantee is echoed in both. Therefore, it

[251] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 18.

[252] Idem, at 17 and 18.

[253] See Goode, R, and Affaki G *Guide to the ICC Uniform Rules for Demand Guarantees URDG758* (2011) International Chamber of Commerce, at 92 and 102.

[254] URDG, Article 15(a).

[255] Hapgood, *Paget's Law of Banking,* at 730 and O'Brien "Letters of intent and demand guarantees", a paper delivered at the 1993 Annual Banking Law Update, at 159.

[256] See, e.g., *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA).

[257] Hapgood, *Paget's Law of Banking*, at 732.

[258] URDG, Article 15(a). Article 20(a) of the URDG 458 also contained similar provisions in respect of demand for payment pursuant to a demand guarantee.

is universally accepted that all demands must comply with the terms of the demand guarantee to which they relate.

2.5.3 Documentary Focus of Demand Guarantees

The documentary nature of demand guarantees means that a guarantor is bound to make payment where the documents presented with the demand for payment are compliant with the documents called for in the demand guarantee. This reliance solely on complying documentation is a vital cog of autonomy principle machinery, which renders the guarantor's obligation to pay absolute, without the need to establish the occurrence of a default, where a complying demand and supporting documents (as applicable) are presented. The level of compliance required regarding a demand for payment or any supporting documentation pursuant to a demand guarantee is, in essence, determined or outlined by the terms of the relevant demand guarantee.[259] Given that compliance of a demand with the requirements set out in a documentary credit is an integral aspect of the documentary nature of such an instrument, the doctrine of strict compliance is considered to complement the documentary nature of demand guarantees.[260]

Kelly-Louw has articulately explained the documentary nature of documentary credits as referring to the fact that "the amount and duration of the duty to pay, the conditions of payment and the termination of the payment obligation depend entirely on the terms of the guarantee or credit itself and on the presentation of a demand and such other documents, if any, as may be specified in the guarantee or credit itself".[261] This has also been described as the principle that documentary credit transactions are transactions, "in documents and in documents alone."[262]

Several South African cases evidence the application of the documentary nature of documentary credits in practice, as they endorse the view that issuers/guarantors of documentary credits are not

[259] See sections 2.8.1 and 2.8.2 of this thesis below for a more detailed discussion in respect of the level of compliance required, and particularly the doctrine of strict compliance in relation to demand guarantees.

[260] Chuah, J *Law of International Trade: Cross-border Commercial Transactions*, 5 ed, Sweet & Maxwell, 2013 (hereinafter "Chuah, *Law of International Trade"*), at 600. See sections 2.8.1 and 2.8.2 of this thesis below for more detailed discussion in respect of the level of compliance required, and particularly the doctrine of strict compliance in relation to demand guarantees.

[261] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 199.

[262] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit,* at 45.

obliged to investigate whether there has been actual default or the extent of any loss suffered.[263] This limitation on the role of issuers is exemplified by the case of *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd*,[264] where the court observed that an issuer's interest in this regard should be confined to ensuring that documents presented with a demand are compliant with the documentary credit before making payment and that in the absence of such, an issuer is neither obliged nor entitled to make payment.[265]

The documentary nature of documentary credit is also depicted in the South African case of *Phillips v Standard Bank of South Africa*,[266] where the court, against the backdrop of the autonomy principle, emphatically reiterated that an issuer assumes a payment obligation upon the presentation of complying documents and not goods.[267]

2.5.4 The Entrenchment of the Documentary Nature of Documentary Credits in International Rules and Standards and the UNCITRAL Convention

Article 6 of the URDG 758[268] entrenches the documentary nature of demand guarantees by requiring guarantors to deal only with documents and not goods, services or any performance to which the documents may relate. The ISP 98 also incorporate the documentary nature of standby letters of credit.[269] Article 5 of the UCP 600 clarifies that banks that issue documentary credits must focus on documents only as they are not expected to deal with any other aspects such as

[263] *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), para 10. See also Eitelberg, E "Autonomy of Documentary Credit Undertakings in South African Law" (2002), 119, *SALJ*, 120, at 122 and Malan, *Letters of Credit and Attachment Ad Fundandam Jurisdictionem*, at 151.

[264] 2002 (3) SA 688 (SCA). See also *Denel Soc Limited v ABSA Bank Limited* [2013] ZAGPJHC 102, paras, 36 and 51-52 and *Casey and Another v First National Bank Ltd* 2013 4 SA 370 (GSJ), paras 14 and 16.

[265] 2002 (3) SA 688 (SCA), paras 5, 28 and 33. See also Malek and Quest, *Jack: Documentary Credits*, at 17 and Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 199.

[266] [1985] 4 All SA 66 (W).

[267]Idem, at 67. See also *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168, at 183.

[268] See also Article 19(a), which requires guarantors, when determining whether a presentation appears on the face of it to be compliant, to make such determination "on the basis of a presentation alone". In addition to emphasis on the need for a demand and any supporting documents to conform with the requirements of a guarantee in Article 2 of the URDG 458, Article 9 thereof specifically provided that, "[a]ll documents specified and presented under a Guarantee, including the demand, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such documents do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused" all underscoring the documentary nature of demand guarantees.

[269] ISP 98, Article 1.06(d).

goods, services or performance.[270] The UCP 600 further reinforce the documentary nature of documentary credits by stating that issuing banks must make a determination relating to payment based on documents alone when considering a demand for payment.[271] The UNCITRAL Convention also clarifies, in the context of the independence of documentary credits, that such independence means that such instruments are not subject to any term, condition, future or uncertain act or event except, *inter alia*, "presentation of documents".[272]

2.5.5 Overall Contribution of the Documentary Nature of Demand Guarantees to Clarifying the Role of Issuers/Guarantors of Documentary Credits

The guarantor of a demand guarantee is considered to have a singular duty: the payment of a beneficiary upon being presented with a compliant demand.[273] Therefore, the guarantor is neither obliged to carry out any further investigation save to check that a demand and any accompanying documents are compliant with the terms of the documentary credit nor to authenticate the presented documents.[274]

This interplay between the documentary nature of documentary credits and the doctrine of strict compliance has also been highlighted to be important because a guarantor or issuer is typically not in a position to decide as to whether a beneficiary is genuinely entitled to payment under a documentary credit but can check whether documents presented strictly comply with the requirements of the documentary credit.[275] Due to the limitation in most guarantors' or issuers' knowledge and expertise in respect of goods or other substantive considerations outside of a documentary credit, it is considered very rare for any guarantor or issuer (e.g., a bank) to include in its repertoire any involvement "beyond the level of payment against documents".[276] It is

[270] UCP 600, Article 5. See also Articles 7 of URDG 758, ISP 98 Rule 4.11 and UCP 600 Article 14(h) which make it clear that non-documentary conditions are to be disregarded.

[271] Article 14(a).

[272] Article 3(b).

[273] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 56. See also sections 2.8.1 and 2.8.2 of this thesis below for more detailed discussion in respect of the level of compliance required, and particularly the doctrine of strict compliance in relation to demand guarantees.

[274] Furmston and Chuah, *Commercial Law*, at 380.

[275] Ibid. See also sections 2.8.1 and 2.8.2 of this thesis below for more detailed discussion in respect of the level of compliance required, and particularly the doctrine of strict compliance in relation to demand guarantees.

[276] See Carr, I *International Trade Law*, 4 ed, Routledge-Cavendish, 2010 (hereinafter "Carr, *International Trade Law*"), at 464.

considered reasonable to infer that guarantors or issuers (banks) will, in practice, find it challenging to verify the contracts pursuant to which they provide finance or issue demand guarantees.[277]

2.6 THE DISTINCT NATURE OF DEMAND GUARANTEES COMPARED TO SELECTIVE INSTRUMENTS

2.6.1 Documentary Credits (particularly Demand Guarantees) versus Suretyship Agreement and/or Traditional Guarantees (Suretyship Guarantees)

The synonymous use of the terms "guarantee" and "suretyship" in South African legal writing and court cases has been criticised,[278] and rightly so, it is submitted, for exacerbating the interpretation quandary usually at the centre of disputes regarding whether or not an instrument is independent or accessory in nature. It could, however, be argued that if the term guarantee is ordinarily understood to refer exclusively to a guarantee of an accessory nature, akin to a suretyship, the interchangeable use of the terms "guarantee" and "suretyship" could be rationalised based on their common accessory nature, in a manner not dissimilar to how demand guarantees and standby letters of credit are sometimes considered interchangeable due to their similarity of nature and function.[279] In support of this inference, suretyship agreements have also been considered similar to and sometimes referred to as suretyship guarantees[280] or surety bonds.[281] Ambiguously drafted instruments that are unclear as to whether they are independent or accessory in nature have also been said to contribute to lack of clarity.[282]

While there is no statutory definition for a contract of suretyship under South African law, one established definition, proffered by Forsyth and Pretorius, describes it as an accessory contract by which a surety undertakes to the creditor of the principal debtor primarily that the principal debtor, who remains bound, will perform their obligation to the creditor and if and so far as the principal

[277] Alawamleh, *Documentary Credits and Independent Guarantees,* at 42.

[278] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 404-405.

[279] See the discussion in Chapter 1.

[280] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 214 - 215.

[281] Whitten, *Calling on a Performance Security*, at 4.

[282] See Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 405, particularly the example of *Neuhoff v York Timbers Ltd* 1981 (4) SA 666 (T) 675 cited therein, where the surety's obligations were drafted loosely and included the words "payment upon demand" which were considered typical of an independent undertaking as opposed to a suretyship, at 684.

debtor fails to do so, the surety will perform the obligation or, failing that, will indemnify the creditor.[283] This definition was endorsed in appellate division cases[284] but was also criticised on a number of grounds. One criticism is that it purports to place an obligation on the surety to ensure, in the first instance, that the principal debtor fulfils their obligation, which, it has been argued, does not create a primary obligation.[285]

It is further argued that even if a primary obligation were indeed created, this would have the absurd consequence that a creditor could only enforce the suretyship by calling on the surety to procure performance by the principal debtor.[286] The following definition of suretyship was asserted to be more appropriate:

> "Suretyship is a contract in terms of which one person (the surety) binds himself as debtor to the creditor of another person (the principal debtor) to render the whole or part of the performance due to the creditor by the principal debtor if and to the extent that the principal debtor fails, without lawful excuse, to render the performance himself."[287]

However, it was noted that the initial definition of Forsyth and Pretorius has since been amended to address the criticism[288] by removal of the reference to the primary and secondary obligations,[289] on the assertion that, *sans* the removed words, the surety's obligation becomes crystal clear: performance upon failure by the principal debtor to perform.[290]

While a comprehensive analysis of suretyship agreements and the *essentialia* or nature thereof

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[283] See Forsyth, CF and Pretorius, JT *Caney's Law of Suretyship in South Africa,* 6th ed, Juta, 2010 (hereinafter "Forsyth and Pretorius, *Caney's Law of Suretyship*").

[284] See *Trust Bank of Africa Ltd v Frysch* [1977] 4 All SA 114 (A), at 125; *Sapirstein and Others v Anglo African Shipping Co (SA) Ltd* 1978 (4) SA 1 (A), at 477; and *Nedbank Ltd v Van Zyl* 1990 (2) SA 469 (A), para 5.

[285] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 406-407 and the reference therein to Lotz, JG "Suretyship" in Joubert, WA *The Law of South Africa*, vol 26, Butterworths, 1997, at 193 and generally 191-222. See also Forsyth, C and Du Plessis, M "Suretyship, Guarantee and Islamic Banking" (2002), 119(4), *South African Law Journal*, 671, at 671.

[286] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 406.

[209] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 407.

[288] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 406-407.

[289] Forsyth and Pretorius, *Caney's Law of Suretyship*, at 29.

[290] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 406-407.

falls outside the scope of this thesis,[291] the definitions of suretyship outlined above demonstrate that the accessory nature of a suretyship (i.e., contingency of surety's performance obligation on the existence of a valid principal debt and failure by the principal debtor to discharge same), as opposed to a demand guarantee, is indisputable. In the context of demand guarantees, the guarantor's obligation to pay arises upon presentation of a complying demand (and supporting documents as applicable) without the need to establish that a default has occurred or even that there is a valid underlying agreement.[292] This distinguishes demand guarantees from suretyship agreements, which require actual default by the principal party (equivalent to an applicant) to have occurred for a payment obligation to arise.[293] Another widely agreed distinction between suretyships and demand guarantees which is notable at this juncture is that while the former encompasses an obligation to perform, which may include non-monetary obligations, the latter instrument, which is a primary payment undertaking tailored to provide a speedy monetary remedy, envisages an obligation to pay.[294]

In addition to the numerous names by which documentary credits are known, the use of the term "guarantee" on its own can be confusing due to its lack of clarity on the true nature of a particular instrument.[295] The use of the broad term "guarantee" can sometimes cause confusion because, in the absence of clarification, it could relate to either of or both a primary/independent guarantee (e.g., a demand guarantee) and/or an accessory/secondary guarantee (often referred to as a true guarantee, for instance, a suretyship). The two types of guarantee are very distinct in both form and substance.

Certain key elements of a demand guarantee will be contrasted against the key characteristics of a suretyship agreement to highlight the differences between a demand guarantee and a true guarantee or a suretyship agreement. In line with the definition of suretyship advanced by Forsyth and

[291] For a fuller discussion of the definition of suretyship under South African law, refer to Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 406-407 and further sources cited therein. See also Musesengwa, T "Obligations of a Surety" (2015), 15(1), *Without Prejudice*, at 20.

[292] Magolego, N "Weighing the risk-Revisiting various risk-mitigating mechanisms" (2013), 30, *De Rebus*, 173, at 173.

[293] See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 19.

[294] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 45-46. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 30-40 for a comparative analysis of documentary credits and suretyship instruments.

[295] See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 30-31 and Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 404-405.

Pretorius, a suretyship envisages an accessory contract by which a surety undertakes to the creditor of a principal debtor primarily that the principal debtor, who remains bound by their obligation, will perform it and that secondarily, failing such performance by the principal debtor, that the surety will perform the obligation or indemnify the creditor.[296] Although this definition has been noted to have been criticised in some cases,[297] it is largely accepted as depicted in a number of South African cases.[298]

Referring to only a guarantee (i.e., as opposed to a demand guarantee) has generally been taken to denote a traditional or true guarantee. Both are terms perhaps intended to clarify the distinct nature of such a guarantee. While acknowledging that both demand guarantees and traditional/true guarantees, being guarantees despite their critical differences, are equally entitled to sit under the umbrella heading "guarantee", this approach highlights that these are different types of guarantees and should not be confused for the same thing. True/traditional guarantees are widely viewed to be akin to, or even to encompass suretyships is a traditional guarantee, also referred to by some scholars as a true guarantee. This similarity is clearly depicted in the description of a true guarantee as entailing an undertaking by a guarantor that the principal debtor will perform their obligations but that if they do not, then the guarantor will be liable for such obligations, and it is envisaged to include suretyships.[299] Any obligation pursuant to a true guarantee or suretyship is thus a co-extensive one and would simultaneously fall away for any reason causing the principal obligation to fall away (e.g., voidness, discharge or diminishment).[300]

Critical differences that stand out in the comparison between a suretyship agreement/true guarantee and a demand guarantee include that the former is an accessory obligation. In contrast, the latter is an independent and standalone obligation, as explained further below.[301] The accessory

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[296] See C F Forsyth and J T Pretorius *Caney's Law of Suretyship in South Africa* 5 ed (2002), at 27 -28.

[297] Lotz JG "Suretyship" in Joubert WA *The Law of South Africa*, vol 26, Butterworths, 1997, at 192,

[298] See, e.g., *Trust Bank of Africa Ltd v Frysch* 1977 (3) SA 562 (A), para 584F and *Sapirstein and Others v AngloAfrican Shipping Co (SA) Ltd* 1978 (4) SA 1 (A), para 11H and *Nedbank Ltd v Van Zyl* 1990 (2) SA 469 (A), para 473I. See also *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd and Others* 2001 (2) SA 760 (C), para 766F, in which this was also endorsed.

[299] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 30-36, where the terminology "suretyship guarantee" is also used, thereby denoting the commonality of character or overlap between true guarantees and suretyship agreements.

[300] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 35.

[301] See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 31-38 for a more comprehensive comparative discussion of demand guarantees and suretyship agreements and/or traditional guarantees, which also considers broader scope instruments such as surety bonds or contract bonds.

nature of a suretyship agreement means that it is reliant upon the existence of a valid principal obligation and cannot independently exist without it. Where there is no valid principal obligation and a principal is not bound by any obligation, the surety likewise has the same defence for non-performance (i.e., absence of a binding agreement) as the principal debtor at their disposal.[302]

In accordance with its character as described above, a suretyship agreement has been described as creating a liability which is in addition to, rather than in substitution for, that of the principal debtor.[303] The accessory and secondary nature of suretyship agreements had caused them to be understood as "secondary both in intent and in form",[304] with the intent being for a surety to only become liable upon the principal debtor's default and such intent being captured in the requirements to perform the obligation again only upon default by the principal debtor, which terms are expressed in the form of the agreement.[305] Some commentators have expressed that default in the context of a suretyship would need to be established or proved, a stance which stands in stark contrast with demand guarantees, as a mere allegation of default is sufficient for the latter.[306]

The secondary nature of a true guarantee or a suretyship agreement lies in that it only kicks in as a second option, that is, after the first option, being the principal obligor's performance of their obligation has failed. Performance or payment by a surety or guarantor under a true guarantee will only be called upon if, and only to the extent that the principal debtor is in default.[307] A primary undertaking (e.g., demand guarantees as discussed in this thesis) instead is direct and independent of the principal obligation. It would remain enforceable regardless of whether the principal obligation is enforceable or not.[308] In stark contrast to the autonomy principle of demand guarantees, obligations of a secondary and accessory nature, such as those under a suretyship or

[302] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 33.

[303] Idem, at 36.

[304] Ibid.

[305] Ibid.

[306] See Kelly-Louw's discussion of the views of Kurkela (citing, Kurkela, MS *Letters of Credit and Bank Guarantees Under International Trade Law,* 2 ed, 2008, Oxford University Press, at 11-13) in Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 37.

[307] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 36.

[308] Ibid. See also the discussion of the independence of demand guarantees and the independent enforceability thereof in section 2.3 of this thesis.

traditional guarantee, are inextricably tied to the status of the principal obligation and the agreement giving rise to the principal obligation.

Due to the independence of demand guarantees from the underlying contract, guarantors are categorically not required to delve into substantive enquiries such as whether a default has, in fact, occurred or been established, and must meet their obligations upon receipt of compliant documentation (usually including a statement that there has been a default). Demand guarantees, in contrast to suretyships and true/traditional guarantees, can thus be described as independently primary both in their intent (that a primary obligation is created and the guarantor will be obliged to pay upon presentation of a compliant demand per the terms of the demand guarantee regardless of the status of the underlying contract) and form (being the terms reflecting that a guarantor's payment obligation arises upon compliant presentation of a demand and any supporting documents in the form specified in the guarantee).

The quagmire often surrounding instruments that are simply labelled "guarantee" but lack sufficient clarity regarding whether they are accessory or autonomous in nature is well illustrated by the South African case of *Minister of Transport and Public Works v Zanbuild Construction.*[309] In *Zanbuild*, the applicant argued a set of guarantees to be accessory in a manner similar to suretyships. In contrast, the beneficiary contended that the same guarantees were independent, akin to irrevocable letters of credit.[310] The Supreme Court of Appeal, re-affirming the decision of the court *a quo*, held that the guarantees contained characteristics resembling a suretyship, particularly a provision enabling termination of the guarantee on 30 days' notice, and granted the interdicts preventing payment by the guarantor on the basis that the 30-day notice provisions in the guarantees were so commonly found in suretyship agreements that a corresponding interpretation was warranted.[311] The appeal court, notably with reference to the terms of the underlying contract, held that the beneficiary had failed to establish any amount owed to it before the expiry of such notice period and, as such, was not entitled to make a demand under the guarantee.[312]

[309] 2011 (5) SA 528 SCA. For a full discussion of the case, see Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 404-417.

[310] 2011 (5) SA 528 SCA, para 12.

[311] Idem, para 24.

[312] Ibid.

The *Zanbuild* case has been invoked to support the view that courts will not casually construe a guarantee as being independent in nature but will only do so where such intention is clear from a holistic interpretation of the demand guarantee.[313] The importance of clear, unambiguous language has been reiterated by commentators following the *Zanbuild* case, with beneficiaries of demand guarantees being cautioned to accept nothing less. Kelly-Louw sounds the following warding in this regard:

> "One cannot simply accept that guarantees issued by reputable banks with the correct name, label or title will necessarily constitute an independent guarantee or demand guarantee, because the rights and duties of the different parties to any guarantee will always be determined by the wording of the guarantee".[314]

2.6.2 Similarities and Distinctions between Demand Guarantees, Standby Letters of Credit and Commercial Letters of Credit

Notwithstanding their similarities, as discussed below, demand guarantees and standby letters of credit are noted to have markedly different historical development, with the use of the latter widely believed to have grown as an appendage of the traditional commercial letter of credit stemming from restrictions on banks issuing guarantees as part of their business under the United States' National Bank Act.[315] Such restrictions are attributed to the development of the term "standby letters of credit"[316] by leading enterprising banks, which approach was adopted in other places around the world by institutions which were subject to similar restrictions.[317]

Many similarities are noted to exist between demand guarantees and letters of credit. Both types of instruments are considered so important to international commerce that they are considered to be as essential as "the lifeblood of commerce".[318] The common law applicable to these instruments

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[313] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 415.

[314] Ibid.

[315] National Bank Act of 3 June 1864 (as amended).

[316] Kelly-Louw, M "Initiatives of the International Chamber of Commerce to Prevent Fraudulent Calls on Demand Guarantees and Standby Letters of Credit" (2009) *South African Mercantile Law Journal* 710 (hereinafter "Kelly-Louw, *Initiatives of the International Chamber of Commerce*"), at 711. See also Ellinger, E "Standby Letters of Credit" (1978), 6, *Int'l Bus Lawyer* 604 (hereinafter, "Ellinger, *Standby Letters of Credit*"), at 610-612 for a discussion of the origins of standby letters of credit.

[317] Kelly-Louw, *Initiatives of the International Chamber of Commerce*, at 711- 712.

[318] See *RD Harbottle (Mercantile) v National Westminster Bank* [1977] 2 All ER 862, at 870; *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976, at 983 and *Intraco Ltd v Notis Shipping*

has been noted to be similar.[319] Another essential characteristic shared by these instruments is their independent or autonomous nature.[320] The UNCITRAL Convention, which incorporates standards applicable to both demand guarantees and standby letters of credits, also pays homage to this similarity by explaining that the entrenchment of the independence principle therein seeks to "[solidify] recognition of common basic principles and characteristics shared by the two [including] the independence principle".[321]

Continuing with the "lifeblood" analogy, the *Intraco Ltd v Notis Shipping Corporation (The 'Bhoja Trader')*[322]case emphasised the importance of the autonomy principle as a key feature of documentary credits,[323]with Donaldson LJ declaring that a "thrombosis will occur"[324]if the autonomy principle is sullied by the intervention of the courts. In light of their similarity, grounds justifying non-payment under a commercial or standby letter of credit are considered to be equally cogent reasons for non-payment under a demand guarantee.[325]

The main distinction between commercial letters of credit and demand guarantees is a functional one. While commercial letters of credit are considered to be effective payment instruments, demand guarantees are security instruments by design.[326] The term "credit", in relation to a letter of credit, relates to the corresponding monetary debit or debt owed by the applicant under the underlying contract whereas a demand guarantee relates to security for the performance of an obligation and need not involve a debt nor a credit in the manner of a letter of credit.[327]

Corporation (The Bhoja Trader) 1981 2 Lloyd's Rep 256 CA, at 257. The earliest use of this imagery by South African courts was in *Ex parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W), para 224H, and after that in *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (SCA), at 7.

[319] Buckley, RP "Potential Pitfalls with Letters of Credit" (1996) 70, *Australian Law Journal,* 217 (hereinafter "Buckley, *Potential Pitfalls with Letters of Credit"*), at 229.

[320] Malek and Quest, *Jack: Documentary Credits,* at 17. and see also Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 197. See also *Coface South Africa Insurance Co Limited v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), para 11.

[321] Explanatory Note to Article 3.

[322] [1981] 2 Lloyd's Rep 256 (CA), at 257.

[323] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 197.

[324] [1981] 2 Lloyd's Rep 256 (CA), at 257.

[325] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 199.

[326] Hugo, *Protecting the Lifeblood of Commerce,* at 661.

[327] Goode, *Abstract Payment Undertakings in International Transactions,* at 14.

Despite the widely recognised similarity between demand guarantees and standby letters of credit, such as their commercial purpose[328] and legal nature, the latter remains different from a demand guarantee in some notable respects. One area of such difference is commercial use, particularly that standby letters of credit typically secure non-monetary performance such as performance under a construction contract or a sale of goods. In contrast, demand guarantees commonly secure payment obligations.[329] Compared to demand guarantees, standby letters of credit are generally considered more multipurpose and malleable for a wide range of commercial uses.[330] However, in the USA, this distinction is noted to have been diluted somewhat by the fact that historical use of standby letters of credit as substitutes for demand guarantees has established common use of standby letters of credit to secure monetary obligations.[331] In addition, Kelly-Louw emphasises that a major difference between the two instruments is the fact that standby letters of credit are, in practice, drafted on a letter of credit form and put to use in ways more conventional for a commercial letter of credit.[332]

Due to the similarity between demand guarantees and letters of credit, legal precedents relating to demand guarantees generally apply to letters of credit and *vice versa*.[333] So belaboured is the similarity between demand guarantees and standby letters of credit that they are considered to be essentially the same type of instrument. Some commentators have even averred that standby letters of credit are nothing but a "special type of independent guarantee".[334]

The main documentary and functional distinctions between commercial letters of credit and standby letters of credit and corresponding similarities between standby letters of credit and demand guarantees were encapsulated in the case of *ALYK (H.K.) Limited v Caprock Commodities*

[328] *Boral Formwork v Action Makers* [2003] NSWSC 713, para 36. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 83.

[329] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 82-83.

[330] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 82.

[331] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 83.

[332] Ibid.

[333] Hugo, *Protecting the Lifeblood of Commerce,* at 661.

[334] Hedley, W and Hedley, R *Bills of Exchange and Bankers' Documentary Credits,* 4 ed, LLP Professional Publishing, 2001 (hereinafter "Hedley and Hedley, *Bills of Exchange and Bankers' Documentary Credits*"), at 293.

Trading Pty Limited and Anor.[335] Regarding the two types of letters of credit, it was noted that while both instruments are

> "activated by the tender of documents in accordance with the requirements of the credit…The ordinary letter of credit is a payment instrument which normally obliges the beneficiary to tender, together with other specified documents, the transport documents. The standby credit is intended to protect the beneficiary in case of default of the other party to the (underlying) contract. In a standby credit the required documents need not include the transport documents; this type of credit may be activated by a document of any description, e.g. a demand by the beneficiary or a statement from him that the other party is in default."[336]

The court concluded that the standby letter of credit is nearer in relation to a demand guarantee, making the undisputed declaration that "[t]he standby letter of credit is thus often functionally similar in effect to a bank guarantee or performance bond".[337]

Based on the established substantive similarity between demand guarantees and standby letters of credit, attempts to distinguish between the two types of instruments have been ruled to be illusory or simply an exercise in semantics.[338] As distinct from commercial letters of credit, a key similarity shared by demand guarantees and standby letters of credit is that they fulfil the same commercial purpose: the provision of security against default pursuant to an underlying contract.[339] To try and explain the conceptual difference between demand guarantees and standby letters of credit, Goode has advanced the view that the two terms are used to distinguish transactions that are indeed distinct in a business sense but are similar in a legal sense, rationalising this view on the basis that the terms are founded on business practice and not in law.[340] To further illustrate the point, Goode refers to how terms such as "rent", "lease" and "contract hire" may be used for example, by leasing companies, to denote different things in a business sense. In contrast, legally, they bear similar

[335] [2012] NSWSC 1558.

[336] [2012] NSWSC 1558 (13 December 2012), para 78.

[337] Ibid.

[338] Ellinger, *Standby Letters of Credit,* at 622; Ellinger and Neo, *The Law and Practice of Documentary Letters of Credit,* at 5; Hedley and Hedley, *Bills of Exchange and Bankers' Documentary Credits,* at 293.

[339] *Boral Formwork and Scaffolding v Action Makers Ltd* [2003] NSWSC 713, para 36. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 82.

[340] Goode, R *Commercial Law*, 3 ed, Penguin Books, 2004 (hereinafter "Goode, *Commercial Law*"), at 1017-1018. The same has been expressed by Bertrams who stated in respect of standby letters of credits and demand guarantees that they, "represent conceptually and legally the same device [and merely have] some minor differences which relate to practice and terminology" (Bertrams, *Bank Guarantees in International Trade*, at 7).

consequences.[341] Bertram proffers, regarding the distinction between demand guarantees and standby letters of credit, that they "represent conceptually and legally the same device. All one could say is that there are some minor differences in practice, uses and terminology".[342]

Both Goode's and Bertram's analyses provide a helpfully simple explanation of the relationship between demand guarantees and standby letters of credit, arguably rendering unnecessary any further discourse on the subject within the scope of this thesis. Therefore, the substantive similarity of these instruments is the key reason why consideration of standby letters of credit and case law relating to them has been underlined as an inevitable aspect of this thesis, which is focused on demand guarantees.

2.6.3 Proper Construction of Demand Guarantees on the basis of Substance

There seems to be a general consensus that the correct characterisation of an instrument as either a documentary credit such as a demand guarantee or a suretyship agreement must be determined on the construction of the instrument in question.[343] South African courts have also seemed to lean towards this approach, with precedent indicating that a guarantee would only be interpreted as an independent guarantee where the intention for it to be so is evident on a proper interpretation of the instrument as a whole.[344] The determination of whether a payment obligation is accessory or independent in nature by reference to construction also has a firm foothold in English law, as exemplified by the case of *Marubeni Hong Kong and South China Ltd v The Mongolian Government*.[345]

[341] Goode, *Commercial Law*, at 1017-1018.

[342] See Bertrams, *Bank Guarantees in International Trade*, at 7. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 82.

[343] Enonchong, N *The Independence Principle of Letters of Credits and Demand Guarantees*, Oxford University Press, 2011, at 53. See also *Marubeni Hong Kong and South China Ltd v Government of Mongolia* [2005] 2 All ER (Comm) 289 where construction was applied to determine whether an instrument was an unconditional independent promise by the government to pay on demand all amounts payable under a sales contract or whether it was a secondary or conditional promise to act akin to suretyship agreement.

[344] See *Minister of Transport and Public Works, Western Cape, and Another v Zanbuild Construction (Pty) Ltd and Another* 2011 (5) SA 528 SCA, para 14.

[345] [2004] 2 Lloyd's Rep 198 (QB) (Com Ct).

The case of *Minister of Transport and Public Works, Western Cape, and Another v Zanbuild Construction (Pty) Ltd and Another*,[346] referred to above,[347] also underscores the fact that whether an instrument is accessory or independent in nature is not dependent on extraneous aspects such as the title given to the instrument in question, but its substance on a proper construction.[348] Similarly, the pitfalls of overreliance on mere words and the importance of due regard to surrounding circumstances and context were highlighted in *List v Jungers,*[349] another South African case. In *List v Jungers,*[350] Diemont JA opined in relation to the word "guarantee" that latching on a word and seeking to interpret a document in view of the ordinary meaning ascribed to that word was an unrewarding and misleading exercise further challenged by the fact that determining the more usual or ordinary meaning of a word is "a delicate task" and proceeded to point out that context within which a word is used is of "prime importance".[351] Various commentators have invoked these remarks to support due consideration of context as an approach to interpretation under the South African law.[352]

2.6.4 Language of a Demand Guarantee as an Interpretive Aide

The importance of clear language as an interpretive cue was emphasised in the English case of *Vossloh AG v Alpha Trains* (UK) Ltd,[353] where it was noted that courts are reluctant to construe a guarantee as a demand guarantee without clear words to that effect. A relevant and well-touted interpretation rule of thumb is that words are interpreted per their ordinary grammatical meaning. Still, a rigidly literal approach need not be adhered to where an interpretation based on ordinary meaning would cause absurdity or is inconsistent with the parties' intention and where a less literal interpretation would clarify such intention. While construction is centred on the substance of an instrument, express language on the face of the document itself may go some way in demonstrating the intention of the parties, particularly whether an instrument should be treated as an independent

[346] 2011 (5) SA 528 (SCA).

[347] See section 2.6.1 above.

[348] 2011 (5) SA 528 (SCA), para 14.

[349] 1979 (3) SA 106 (A), at 127.

[350] 1979 (3) SA 106 (A), at 127.

[351] Idem, para 118C-E.

[352] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 404.

[353] Furmston and Chuah, *Commercial Law*, 381. See also *Vossloh AG v Alpha Trains* (UK) Ltd 2010 EWHC 2443 (Ch).

guarantee. Generally, a "commercially sensible" interpretation adopted with due regard to the full context of the relevant contract as a whole appears to be preferred over any other, particularly by South African courts.[354]

2.6.5 Consideration of the "Matrix of Facts" as a Construction Tool

A contract law tenet that has been suggested for determination of compliance in relation to documentary credits is that where there are two possible interpretations for a contract, deference must be given to the one which makes business common sense over one which would undoubtedly lead to commercially absurd results. This approach is also known as the "matrix of facts" method and has been adopted in both English and South African courts.[355]

Under English law, consideration of the surrounding circumstances or "matrix of facts" has been the adopted approach for the construction of commercial instruments.[356] Such an approach has been noted to be particularly useful when a commercial instrument is vague or there is a drafting error. The literal interpretation thereof would yield an "uncommercial result".[357] While an interpretation favouring business common sense has been observed to be favourable,[358] courts have also been cautioned to avoid substituting their "own judgment of the commerciality of the transaction for that of the parties or, indeed, the industry."[359]

South African law favours a similar "matrix of facts" methodology to decipher the intention of the parties to commercial instruments where clarity is lacking[360] and precedent is established for applying this approach in the context of demand guarantees.[361] The utility of considering the "matrix of facts" to decipher the intention of parties to an agreement or similar arrangement is

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[354] Van der Merwe, CG, Du Plessis, JE and Zimmermann, R *Introduction to the Law of South Africa*, Kluwer Law International, 2004 (hereinafter "Van der Merwe, *Introduction to the Law of South Africa*"), at 264-265.

[355] Furmston and Chuah, *Commercial Law*, at 382.

[356] *Rainy Sky SA v Kookmin Bank* [2012] 1 All ER 1137, at 1137.

[357] *Rainy Sky SA v Kookmin Bank*, at 1138 and 1144.

[358] Furmston and Chuah, *Commercial Law*, at 382.

[359] *Rainy Sky SA v Kookmin Bank* [2012] 1 All ER 1137, at 1153.

[360] See Christie, RH and Bradfield, G *Christie's Law of Contract in South Africa*, 7 ed, LexisNexis, 2016, at 199-234.

[361] See generally *Minister of Transport and Public Works, Western Cape, and Another v Zanbuild Construction (Pty) Ltd and Another* 2011 (5) SA 528 SCA and *First National Bank-A Division of Firstrand Bank Limited v Clear Creek Trading 12 (Pty) Ltd* 2018 (5) SA 300 (SCA) which also endorse application of the "matrix of facts" method of construction.

explained by the following dicta in the South African Supreme Court of Appeal case of *Novartis SA v Maphil Trading*:[362]

> ". . . the interpretative process is one of ascertaining the intention of the parties – what they meant to achieve. And in doing that, the court must consider all the circumstances surrounding the contract to determine what their intention was in concluding it. . . and the court should always consider the factual matrix in which the contract is concluded – the context – to determine the parties' intention."[363]

In another example of the "matrix of facts" methodology, the South African Supreme Court of Appeal case of *Mutual and Federal Insurance Company Limited v KNS Construction (Pty) Limited*[364] endorsed and adopted an interpretation based on the "matrix of facts" when determining whether a performance guarantee was a suretyship or an independent guarantee. It was concluded that the parties had intended to create an accessory obligation akin to a suretyship.

The following four-step interpretation technique, which can be extrapolated as a useful reference point for demand-guarantee-related case law, has been proposed before South African courts: Firstly, there is the ordinary grammatical meaning of words in a contract. Secondly, the context within which they are used per the contract as a whole, thirdly, the background context that would assist in determining the purpose of the contract and, lastly, consideration of the wider surrounding circumstances ("matrix of facts") where there is ambiguity in the language of the contract.[365] The caveat to this seemingly liberal approach to interpretation could perhaps be that the four steps outlined above work successively (i.e., each preceding stage must be applied first to no avail before the following one), resulting in the normal grammatical meaning of words retaining first fiddle in the interpretation process. This is supported by the view expressed by Van de Merwe *et al*[366] that

[362] [2015] 4 All SA 417 (SCA).

[363] Idem, para 27.

[364] [2016] ZASCA 87, para 9. For discission of this case, see Kelly-Louw, M "Must All the Required Documents for a Demand Guarantee be Presented at the Same Time?" (2017), 80, *Tydskrif vir Hedendaagse Romeins-Hollandse Reg*, 148 and Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit,* 43.

[365] *Coopers and Lybrand v Bryant* (1995) 3 SA 761 (A), paras 9-11.

[366] Van der Merwe, *Introduction to the Law of South Africa,* 265-266.

the ordinary grammatical meaning cannot easily be dispensed with as it remains *prima facie* the meaning intended by parties to a contract.[367]

2.7 RATIONALE AND PURPOSE OF DEMAND GUARANTEES

2.7.1 Security Function and Cash Equivalence of Demand Guarantees

Demand guarantees are utilised internationally for a targeted number of reasons by commercial parties. One key reason is to secure beneficiaries against default by counterparties pursuant to an underlying contract. Typically, the applicant/principal of the demand guarantee is the counterparty to an underlying contract. In affirmation of the security function of demand guarantees, it has been asserted that at their core lies "a promise to fix the default of others once they have defaulted".[368]

By way of example, and given the common perception that they are "as good as cash",[369] demand guarantees are sometimes issued in lieu of funds that a contracting party would have retained under a contract for the purposes of assurance of proper performance by a contractor for a period of time following completion of the relevant contract.[370] The perceived ease with which demand guarantees can be converted into cash fulfils an important security function by ensuring readily available funds that the beneficiary can have recourse to to defray the costs of a default by the principal/issuer under the underlying contract.[371] Other related factors incentivising the burgeoning use of demand guarantees include the broad protections afforded to beneficiaries, including prevention of or failing prevention, penalisation of bad faith, poor performance or non-performance by contracting parties.[372]

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[367] Van der Merwe, *Introduction to the Law of South Africa,* 265-266.

[368] *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] AC 199 at 205.

[369] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 161.

[370] Whitten, *Calling on a Performance Security,* at 2. See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 28 and Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 214. See further the discussion of the different types of demand guarantees in section 2.9 of this thesis.

[371] Pierce, A *Demand Guarantees in International Trade* (1993) 1.

[372] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 214.

2.7.2 Risk Allocation Function of Demand Guarantees

Another reason, which is considered to be of fundamental influence[373] in the use of demand guarantees, is their risk allocation function. The autonomy principle is argued to be founded on a "pay now, argue later" basis in the case of a dispute between the parties to the underlying contract,[374] giving effect to the risk allocation agreed by the parties and insulating such risk allocation from any allegations raised by disputing parties.[375] This function of demand guarantees is manifest in the beneficiary's ability to give rise to a payment obligation without proof of default should there be a dispute between the beneficiary and the applicant/principal pursuant to the underlying contract, thereby buffering the beneficiary from incurring any credit risk pending final resolution of the dispute.[376] An example of this effect is where a demand guarantee serves to avoid interruption of a performance project (e.g., a construction project) during a dispute, which interruption could materially prejudice the position of the employer or a beneficiary.[377]

This risk allocation function of documentary credits was alluded to in the case of *RD Harbottle v National Westminster Bank*[378] where Kerr J opined the following in justification of the court's non-interference with the autonomy principle, "the courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take". The risk allocation function of demand guarantees can be summed up from the *dictum* in the Australian case of *Boral Formwork and Scaffolding v Action Makers Ltd,*[379] where it was stated in relation to independent instruments that they are "to protect the beneficiary from carrying credit risk during the course of a dispute".[380] In another case, *Otter Group Pty Ltd v Wylaars,*[381] the risk allocation function in relation to a

[373] Whitten, *Calling on a Performance Security,* at 2.

[374] Dolan, J "Tethering the Fraud Inquiry in Letter of Credit Law" (2006), 21(3), *Banking and Finance Law Review,* 479, at 480.

[375] See *In Re Originala Petroleum Corporation* (1984) 39 BR 1003, at 1007, where it was declared that "[t]he independence principle preserves the allocation of risk to the issuing bank by requiring the issuing bank to honour a draw request notwithstanding a dispute between the customer and the beneficiary as to an alleged breach of the underlying contract."

[376] Whitten, *Calling on a Performance Security,* at 2.

[377] Kelly-Louw, *Construction of Demand Guarantees Gone Awry*, at 417.

[378] [1977] 2 All ER 862.

[379] [2003] NSWSC 713. See also *In Re Originala Petroleum Corporation* (1984) 39 BR 1003, at 1007.

[380] Idem, para 36.

[381] [2013] VSC 98, para 17.

demand guarantee was acknowledged as inherently implying an agreement that "the party giving the security deposit [i.e. ultimately the applicant, on the basis of their reimbursement of the issuer after the latter satisfies a demand] shall be out of pocket pending resolution of the underlying dispute".[382]

Both the security and risk allocation functions of a demand guarantee mentioned above were highlighted in the English case of *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd*,[383] where it was opined that the two ends that a beneficiary sought to achieve, and indeed a principal should reasonably expect a demand guarantee to achieve, are, firstly, as security in the event of the principal's insolvency and secondly, to obtain prompt payment of any amounts claimed by the beneficiary notwithstanding that they may be disputed by the principal, as a risk allocation device.[384] The rationale has been proffered that since cash would fulfil both the security and risk allocation functions effectively, it follows that demand guarantees, by virtue of being a "cash equivalent",[385] should, in the absence of a clear contractual agreement to the contrary, reasonably be expected to fulfil both these functions.[386]

2.8 COMPLYING DEMAND

2.8.1 The Requirement for a Compliant Demand

An essential feature of documentary credits is that payment thereunder is triggered upon the presentation of documents (e.g., a demand), which complies with the terms of the documentary credit itself. Therefore, the issue of whether a demand is compliant has a direct bearing on the guarantor's obligation to pay. This was depicted in the South African cases of *OK Bazaars 1929 Limited v Standard Bank of South Africa Limited*[387] and *Loomcraft Fabrics CC v Nedbank Ltd & Another*[388]where the general principle was confirmed that issuers (or guarantors) are not required

[382] Idem, para 17.

[383] [2010] NSWCA 283.

[384] Idem, paras 39-40.

[385] Wooler, G *Unconscionable Conduct in Commercial Transactions: Global Perspectives and Applications*, Cambridge Scholars Publishing, 2018, at 43.

[386] Dixon, B "Bank Guarantees and the Reasonable Expectations of Beneficiaries*"* (2015), 43(6), *Australian Business Law Review*, 462, at 4. See also the discussion of the cash equivalent aspect of demand guarantees in section 2 of this thesis.

[387] See also *OK Bazaars 1929 Limited v Standard Bank of South Africa Limited* 2002 (3) SA 688 (SCA), para 25.

[388] 1996 (1) SA 812 (SCA), at 5-6.

to make payment under a documentary credit unless they are presented with documents (e.g., a demand) which is compliant with the terms of the documentary credit. This well-established position is typically ensconced in the terms of the indemnity agreement between the applicant and the guarantor, pursuant to which the latter's mandate is restricted to only honouring demand guarantees in respect of which a complying demand is presented.

Due to its role in determining whether a payment obligation is triggered, the question of whether a demand made by a beneficiary is compliant has come before the courts many a time.[389]

The UCP 600 define a complying presentation in relation to letters of credits as one which is "in accordance with the terms and conditions of the credit, the applicable provisions of this rule and international standard banking practice."[390] The UCP 600 encapsulate deference to the autonomy principle over any other approach by requiring an issuer to "examine a presentation … on the basis of the documents alone"[391] when determining whether or not documents appear, on their face, to be a complying presentation.[392]

The degree of compliance required for a demand to be considered compliant, particularly whether "strict" compliance (referred to and discussed below as the doctrine of strict compliance) is required or material compliance will suffice for the purposes of triggering a payment obligation under a documentary credit is dependent on the terms of the demand guarantee itself. However, this can still be and often is a contentious issue due to differences in construing/interpreting the terms of the demand guarantee.[393]

[389] See Malek and Quest, *Jack: Documentary Credits.*

[390] UCP 600, Article 2. It is worth noting that under the UCP 600 only irrevocable credits are considered to fall within the meaning of a documentary credit, in contrast to the position under the UCP 600's predecessor, the UCP 500 which catered for both revocable and irrevocable credits (see the ICC Uniform Customs and Practice for Documentary Credits (1993 Revision), Article 8).

[391] UCP 600, Article 14(a).

[392] UCP 600, Article 2 defines a "complying presentation" as "a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice".

[393] See the analysis in *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA), paras 7-13.

2.8.2 Degree of Compliance and the Doctrine of Strict Compliance

2.8.2.1 Origin and Background of the Doctrine of Strict Compliance

The doctrine of strict compliance has been averred to have originated in the context of commercial letters of credit.[394] The position taken in the *Equitable Trust Company of New York v Dawson Partners Ltd*[395] case was observed as echoing the earlier English case of *English, Scottish and Australian Bank Ltd v Bank of South Africa,*[396] which espoused "exact compliance" with the terms of a letter of credit on the basis that, "a bank is not bound or indeed entitled to honour drafts presented to it under a letter of credit unless those drafts with the accompanying documents are in strict accord with the credit".[397] The court in the *Equitable Trust Company of New York v Dawson Partners Ltd* case also stated:[398]

> "It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorised to accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines."[399]

The support for strict compliance in the *dicta* of these cases has been lauded as a clear and accurate articulation of the doctrine of strict compliance.[400]

The doctrine of strict compliance requires a demand and accompanying documents to "strictly comply" with what is required under the terms of the documentary credit and leaves no leeway for documents "which are almost the same, or which will do just as well".[401] In support of this view, the court in *Sztejn v J Henry Schroder Banking Corp*[402] stated in relation to the autonomy principle that it "presupposes that the documents accompanying the draft are genuine and conform in terms

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[394] Hugo, *Construction Guarantees,* at 163.

[395] (1927) 27 Lloyd's Rep 49, para 52.

[396] *English, Scottish and Australian Bank Ltd v Bank of South Africa* (1922) 13 LlLR 21.

[397] Idem, at 24.

[398] (1927) 27 Lloyd's Rep 49.

[399] *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Lloyd's Rep 49, para 52.

[400] See also *Kredietbank Antwerp v Midland Bank Plc* [1999] 1 All ER (Comm) 801, at 805.

[401] *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Lloyd's Rep 49, para 52.

[402] 31 NYS 2d 631 (1941), at 634.

to the requirements of the letter of credit", which statement also seems to acknowledge non-compliant documents as a possible defence against payment, albeit one which is consistent with and does not diverge from the application of the autonomy principle.[403] In this respect, non-payment, in line with both the autonomy principle and the documentary nature of demand guarantees, would be based on an analysis of the demand and any supporting documents provided (alone) and a finding of non-compliance.

2.8.2.2 Nature and Importance of the Doctrine of Strict Compliance in relation to Demand Guarantees

Due to the contentious nature of the question of how closely documents tendered in demand for payment must comply with the terms of a documentary credit, the doctrine of strict compliance has been proffered as potentially "the best legal rule which can be devised to govern" this.[404] The doctrine of strict compliance is considered an "ally of the principle of autonomy".[405] Given its emphasis on compliance as determined by looking only to the requirements for a demand in the independent documentary credit itself,[406] it is worth noting that similar to how the autonomy principle has been observed to be skewed in favour of beneficiaries,[407] the doctrine of strict compliance appears to protect the interests of applicants and perhaps guarantors by prescribing a narrower definition of compliance which a beneficiary would be required to satisfy (and correspondingly a wider opportunity to slip up).

Despite the important role played by the doctrine of strict compliance regarding documentary credits, caution has been advised against overinflating such importance to the point of effecting "manifestly unreasonable or absurd results", which the doctrine of strict compliance has the potential to cause.[408] According to Bertrams, while there are cogent reasons justifying the doctrine of strict compliance, exceptional instances exist where rigidity would be unjustifiable, and substantial compliance instead of strict compliance should be accepted.[409] This is, however,

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[403] Horowitz, *Letters of Credit and Demand Guarantees: Defences to Payment*, at 17.

[404] Buckley, *Potential Pitfalls with Letters of Credit*, at 223.

[405] Chuah, *Law of International Trade*, at 600.

[406] Ibid.

[407] See section 2.11.1 below.

[408] Bertrams, *Bank Guarantees in International Trade*, at 140.

[409] Idem, at 145.

caveated by the requirement that such an approach is permissible where it does not detrimentally affect any specific justifiable interests of the guarantor.[410]

An advantage often highlighted in support of the doctrine of strict compliance is certainty, particularly the argument that, like the autonomy principle, if it is disapplied, beneficiaries would be left with the rather hollow comfort of knowing that their recourse pursuant to a documentary credit was, "theoretically good but that payment could only be had after expensive lengthy litigation in a foreign jurisdiction".[411] However, some have argued against the doctrine of strict compliance because guarantors can abuse trivial discrepancies as a scapegoat by which they can escape payment.[412]

One of the key contributions to certainty, which is attributed to the doctrine of strict compliance, is that it clarifies the role of guarantors and parameters for consideration of whether a demand under a demand guarantee is compliant. Some commentators have shown a reluctance to accept anything falling short of strict compliance because such an approach would entail judgement of materiality by guarantors, typically banks, which they lack the expertise to make.[413] This lack of expertise was highlighted in the English case of *JH Rayner & Co Ltd v Hambro's Bank Ltd*,[414] in which it was considered "impossible to suggest that a banker is to be affected with knowledge of the customs and customary terms of every one of the thousands of trades for whose dealings he may issue a letter of credit".[415]

The case of *Equitable Trust Company of New York v Dawson Partners Ltd*[416] is a good reference point for the parameters of a guarantor's obligations in relation to strict compliance. This case makes it clear that it is not a guarantor's or issuer's role in the context of a documentary credit

[410] Idem, at 128-129.

[411] Ibid.

[412] Hooley and Sealy, *Commercial Law: Text, Cases, and Materials,* at 859.

[413] Todd P *Bills of Lading and Bankers' Documentary Credits*, 4 ed, Informa Law, 2007 at 275. See also Malek and Quest, *Jack: Documentary Credits* at 177.

[414] [1943] 1 KB 37, 40 (CA).

[415] *JH Rayner & Co Ltd v Hambro's Bank Ltd* [1943] 1 KB 37, 40 (CA), at 41.

[416] (1927) 27 Lloyd's Rep 49.

arrangement to assess the materiality of discrepancies or to make room for "documents which are almost the same, or which will do just as well."[417]

In the South African case of *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd,*[418] regarding the limited remit of issuers (guarantors), the court stated that *"*[t[he documents that are to be presented…are stipulated by the customer, and the issuing bank generally has no interest in their nature or in their terms".[419] The obligations of a guarantor in relation to strict compliance were further expounded in the English case of *Midland Bank Ltd v Seymour*[420] where the court stipulated that banks must conform strictly to the instructions received from their customer[421] (i.e., the applicant's instruction to pay only upon presentation of a complying presentation). The lack of discretion inherent in this requirement for strict compliance by a guarantor was further expressed thus by the court: [422]

> "It is not for the bank to reason why. It is not for it to say: 'This, that or the other does not seem to us very much matter.' It is not for it to say: 'What is on the bill of lading is just as good as what is in the letter of credit and means substantially the same thing.'"

Proceeding on this basis, a guarantor or issuer must, therefore, conform strictly with the requirements of a documentary credit when assessing a demand for payment thereunder, as the guarantor's entitlement to reimbursement by the applicant for any payment made is generally contingent upon such strict compliance.[423]

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[417] *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Lloyd's Rep 49 (HL), at 52.

[418] [2002] ZASCA 5.

[419] Idem, para 25. Similar views on the autonomy principle and the remit of issuers in relation thereto were expressed in the cases of *Commercial Banking Co of Sydney Ltd v Jalsard Pty Ltd* [1973] AC279 (PC), para 286C-D and *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (SCA), at 5-6.

[420] [1955] 2 Lloyd's Rep 147 at 151.

[421] Idem, at 151.

[422] [1955] 2 Lloyd's Rep 147 at 151.

[423] Fellinger, G "Letters of Credit: The Autonomy Principle and the Fraud Exception" (1990), 1, *JBFLP,* 4, at 9.

2.8.2.3 The Rule of Insignificance and Adopting a Non-Literal Approach in Applying the Doctrine of Strict Compliance

It has been noted that the doctrine of strict compliance applies regardless of materiality in instances where courts choose to disregard the *de minimis non curat lex*[424] maxim. A case which is emblematic of such an approach is *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran*[425], in which documents were rejected for the absence of the buyer's name on one document where it was required to be on all documents. In defence of this rejection for seemingly minor discrepancies, the court asserted that nothing could be considered trivial "because banks are not expected to test the materiality of the information or particulars required under the credit and contract between buyer and seller".[426] The *Seaconsar, therefore,* provides a prime example of the challenges to be found in distinguishing trivialities from significant non-compliance.

Rather interestingly, it would appear that even the triviality of a non-complying element can also be assessed in degrees, with some scholars firmly holding the view that immaterial inconsistencies such as a typographical error in a name would clearly not be regarded as non-compliance in the context of a demand made pursuant to a documentary credit.[427] To illustrate how the potentially harsh consequences of the doctrine of strict compliance must be ameliorated by pragmatism, scholars point out that the doctrine of strict compliance would not mean that a document will be regarded as nonconforming simply due to a typographical error or failure to dot every "i" and cross every "t".[428]

Some scholars on the subject of strict compliance opine that it need not entail a literal or mechanical comparison of documents and that guarantors must apply some degree of judgement when examining documents pursuant to a demand under a documentary credit.[429] In this vein,

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[424] "[Latin] The law does not take account of trifles. It will not, for example, award damages for a trifling nuisance." Law, J and Martin, EA *A Dictionary of Law*, 7 ed, Oxford University Press, 2014.

[425] [1994] 1 AC 438.

[426] Chuah, *Law of International Trade* at 601.

[427] Malek and Quest, *Jack: Documentary Credits,* at 186.

[428] Kelly-Louw, *The Doctrine of Strict Compliance*, at 94 and see also Sharrock R et al *The Law of Banking and Payment in South Africa*, 1 ed, Juta, 2016, at 416 regarding the tension between requiring strict compliance and trivial discrepancies.

[429] Malek and Quest, *Jack: Documentary Credits.*

Kelly-Louw[430] endorses the view that determining compliance is neither a simple matter of matching data in the documents presented with a demand guarantee nor literal replication of data. Byrne further avers that consideration of compliance must consider the nature and role of the relevant data in a document. A document must be considered part of an entire presentation rather than in isolation.[431] He acknowledges that where a literal interpretation is clearly expressed in a documentary credit, then the requirement for literalness must be honoured.[432]

2.8.2.4 General Consensus on the Doctrine of Strict Compliance in respect of Letters of Credit

English law has already been credited in this thesis for having a significant developmental contribution to South African law. One area where such a relationship is relevant is in respect of the doctrine of strict compliance. From an English law perspective, applying the doctrine of strict compliance to letters of credit is trite.[433] English courts have been observed to apply the doctrine of strict compliance regarding letters of credit,[434] albeit to a standard that is less than exact compliance.[435] One of the cases depicting the English position is *Scottish and Australian Bank v Bank of South Africa,*[436] where it was reiterated in support of strict compliance that an issuer is neither bound nor entitled to honour demands under documentary credit unless they were "in strict accord with the credit".[437]

Under South African law, the doctrine of strict compliance has been implicitly adopted for letters of credit.[438] However, scholars have noted the absence of a decisive South African judgment on

[430] Kelly-Louw, M "The Doctrine of Strict Compliance in the Context of Demand Guarantees" (2016), 49(1), *CILSA*, 85 (hereinafter "Kelly-Louw, *The Doctrine of Strict Compliance*"), at 110.

[431] Byrne, JE, Nelson, SR and Traisak, P *Standby & Demand Guarantee Practice: Understanding UCP600, ISP98 & URDG 758* (2014), at 122. See also, Kelly-Louw, *The Doctrine of Strict Compliance*, at 129.

[432] Byrne, *Standby & Demand Guarantee Practice: Understanding UCP600, ISP98 & URDG 758* (2014), at 122.

[433] Kelly-Louw, *The Doctrine of Strict Compliance*, at 91.

[434] *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Lloyd's Rep 49, para 52. See also Malek and Quest, *Jack: Documentary Credits,* at 184-189; Hugo, *The Law Relating to Documentary Credits*, at 296-298; Oelofse, *The Law of Documentary Letters of Credit,* at 282-288.

[435] *Kredietbank Antwerp v Midland Bank Plc* [1999] 1 All ER (Comm) 801, at 805-806.

[436] (1922) 13 LI L Rep 21.

[437] (1922) 13 LI L Rep 21, at 24.

[438] Kelly-Louw, *The Doctrine of Strict Compliance*, at 91. See also *OK Bazaars 1929 Limited v Standard Bank of South Africa Limited* 2002 (3) SA 688 (SCA), para 25 and *Casey and Another v First National Bank Ltd* 2013 4 SA 370 (GSJ), paras 24 and 26.

this matter.[439] Applying the doctrine of strict compliance to letters of credit under South African law has also been supported because following English precedent relating to letters of credit is a "long-standing tradition"[440] of South African courts.

2.8.2.5 Support for Application of the Doctrine of Strict Compliance to Demand Guarantees under South African Law

Prominent commentators on the topic of strict compliance, such as Kelly-Louw, have argued that strict compliance should be applied to demand guarantees in much the same way it does to letters of credit.[441] Kelly-Louw, however, concedes, with reference to the *Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd*[442] and *Denel Soc Limited v ABSA Bank Limited and Others*[443] cases, that this is a matter yet to be conclusively determined by the courts. In the meantime, a beneficiary must look to properly comply with the actual terms set out in a specific demand guarantee.[444] Despite the lack of an express ruling on the matter, it is worth noting that some commentators have construed the approach in *Denel Soc Limited v ABSA Bank Limited and Others*[445] and *Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd*[446] cases to nevertheless depict actual application and support of the doctrine of strict compliance to demand guarantees.[447] Other South African cases, including *Stefanutti & Bressan (Pty) Ltd v Nedbank Ltd*[448] and *Grinaker-LTA Rail Link Joint Venture v Absa Insurance Company Limited,*[449]

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[439] Kelly-Louw, *The Doctrine of Strict Compliance*, at 91.

[440] Ibid.

[441] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 68 and 90-91. See also Kelly-Louw, *The Doctrine of Strict Compliance*, at 128. See also Hapgood, *Paget's Law of Banking*, at 733.

[442] 2012 (2) SA 537 (SCA).

[443] [2013] ZAGPJHC 102.

[444] See also Kelly-Louw, *The Doctrine of Strict Compliance*, at 92.

[445] [2013] ZAGPJHC 102.

[446] 2012 (2) SA 537 (SCA).

[447] Kelly-Louw, *The Doctrine of Strict Compliance*, at 128 and Hugo, *Construction Guarantees*, at 171.

[448] [2008] ZAKZHC 50.

[449] (24110/2014) (2015) ZAGPJHC 302 (10 November 2015).

have also been cited as supporting the application of the doctrine of strict compliance to both letters of credit and demand guarantees.[450]

2.8.2.6 Absence of Clear Consensus regarding Degree of Strictness applicable to Compliance in respect of Demand Guarantees

The construction and application of the doctrine of strict compliance to demand guarantees under English law was not always a settled matter, with cases such as *Ermis Skai Radio and Television v Banque Indosuez Europa SRL*[451] supporting a stringent standard of compliance. In contrast, others, such as *Siporex Trade SA v* Banque *Indosuez*[452] appeared to oppose applying the same strictness to it in the context of demand guarantees. The rationale for applying a less strict standard of compliance in the context of demand guarantees in the *Siporex* case was that there was a "sound" distinction between the two instruments, with standby letters of credit requiring banks to deal with the documents themselves, whereas with demand guarantees a statement that a "certain event has occurred" would suffice. [453] This stance was endorsed in the case of *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank,*[454] where it was held that strict compliance plays a more vital role in respect of letters of credit than demand guarantees.[455] A similar approach was further elaborated on in the South African case of *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited*[456] because issuers rely more on the documents in respect of letters of credit. In contrast, with demand guarantees, the guarantors typically deal with only a mere statement or declaration alleging the occurrence of a default or a stipulated event.[457]

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[450] Furmston and Chuah, *Commercial Law*, at 382 and Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit,* at 58. See also the following cases: *Ermis Skai Radio and Television v Banque Indosuez Europa SRL* Unreported case, 26 February 1997; *Maridive & Oil Services (SAE) v CAN Insurance Co (Europe) Ltd* 2002 EWCA Civ 369; *Consolidated Oil Ltd v American Express Bank* (2002) CLC 488 (CA); *Sea-Cargo Skips AS v State Bank of India* 2013 1 Lloyds Rep 477 (QB (Com Ct)).

[451] Unreported case, 26 February 1997.

[452] [1986] 2 Lloyd's Rep 146, para 159. See also: *Frans Maas v Habib Bank* [2001] Lloyd's Rep Bank 14, where the dicta in *Siporex Trade SA v* Banque *Indosuez* [1986] 2 Lloyd's Rep 146 was supported.

[453] *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146 at 159.

[454] [1990] 2 Lloyd's Rep 496 (CA).

[455] Idem, at 501.

[456] [2015] ZAGPJHC 264, para 29-30.

[457] *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited,* [2015] ZAGPJHC 264, para 29-30. For a discussion of this case, see Kelly-Louw, M "Must All the Required Documents for a Demand Guarantee be Presented At the Same Time? *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance*

It is, however, worth noting that some commentators have construed cases such as the English case of *Frans Maas (UK) Ltd v Habib Bank AG*[458] as reflecting the English courts' inclination toward applying a stricter standard of compliance to demand guarantees. Despite expressly endorsing the dicta in the *Siporex* case, in *Frans Maas*, the court ruled that a demand alleging a failure to "meet … contractual obligations" was non-compliant with the terms of the relevant demand guarantee because the demand guarantee required a demand to allege failure to "pay … under their contractual obligation". This approach has been argued to reflect a progressive shift towards courts applying the same degree of strict compliance applied to letters of credit to demand guarantees.[459] Although various arguments have been raised in South African cases regarding the issue of whether the same standard of strict compliance as that applied to standby letters of credit also applies to demand guarantees, there remains no clear consensus on the South African or English law position in this regard.[460] Therefore, while there appears to be general acceptance of the doctrine of strict compliance itself, it is unclear whether that strict standard is exactly the same for letters of credit and demand guarantees

A somewhat halfway-house approach noted by scholars from some English cases is the notion that the doctrine of strict compliance applies to demand guarantees, albeit less stringently than it has been established to apply to letters of credit.[461] A number of South African cases have also been interpreted as favouring the view that demand guarantees require a lesser standard of compliance than that which applies to letters of credit.[462] This view has been argued in South African cases such as *Denel Soc Limited v ABSA Bank Limited and Others*[463] and *Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd*,[464] but, as has been observed rather critically by

Corporation of Africa Limited (23125/2014) [2015] ZAGPJHC 264 (20 October 2015)" (2017), 80, *THRHR*, 148. See also Furmston and Chuah, *Commercial Law*, at 382.

[458] [2001] Lloyd's Rep Bank 14.

[459] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 69 and Kelly-Louw, *The Doctrine of Strict Compliance*, at 103-104.

[460] See. e.g., Furmston and Chuah, *Commercial Law*, at 382.

[461] *Siporex Trade SA v* Banque *Indosuez* [1986] 2 Lloyd's Rep 146, at 159.

[462] See generally, *GLMB Joint Venture v Constatia Insurance Co Ltd* [2014] ZAGPJHC 440; *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* [2015] ZAGPJHC 264, paras 29-30 and *University of the Western Cape v Absa Insurance Company Ltd* [2015] ZAGPJHC 303, paras 7-12.

[463] [2013] ZAGPJHC 102.

[464] 2012 (2) SA 537 (SCA).

commentators, courts have yet to establish a firm stance on it.[465] In *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd,*[466] the court did not conclusively decide on the matter of whether the doctrine of strict compliance applies to demand guarantees, instead of holding that there had, in fact, not been any compliance, much less strict compliance based on the terms of the demand guarantee in question.[467]

The cases of *Kristabel*[468] and *University of the Western Cape v Absa Insurance Company Ltd*[469] are also invoked to support the view that a lesser standard than strict compliance is required for demand guarantees. In *Kristabel*, the court noted that strict compliance was required for letters of credit because guarantors are in a position to assess a demand by evaluating the presented documents and went on to mention that the degree of compliance in respect of demand guarantees had yet to be established.[470] In *University of the Western Cape,*[471] a guarantor argued that a demand made by a beneficiary's agent, rather than the beneficiary themselves, was not in strict compliance with the terms of the demand guarantee. The court upheld the demand because the demand guarantee did not expressly preclude the use of an agent by the beneficiary. It was common cause that the agent was acting in his capacity as the beneficiary's representative.[472] It has been observed that this approach, like that taken in the *Kristabel* case, alludes to a lesser standard of compliance than strict compliance.[473]

Rather than fixating on whether the doctrine of strict compliance applies to demand guarantees, it has been asserted that the important issue is whether there has, in fact, been compliance with the requirements stipulated in a demand guarantee or not.[474] In line with this approach, Kelly-Louw argues that the distinction between the *Kristabel* and *Compass* cases can also be considered to be

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[465] Kelly-Louw, *The Doctrine of Strict Compliance*, at 91-92.

[466] 2012 (2) SA 537 (SCA).

[467] 2012 (2) SA 537 (SCA), para 13.

[468] [2015] ZAGPJHC 264, paras 29-39.

[469] [2015] ZAGPJHC 303. See the discourse in paras 7-12 regarding the standard of compliance in relation to demand guarantees.

[470] [2015] ZAGPJHC 264, paras 29-30.

[471] [2015] ZAGPJHC 303, para 7.

[472] Idem, para 12.

[473] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 67.

[474] Idem, at 64.

rather moot due to the commonality of non-compliance with the requirements of the documentary credit which arose in both cases, namely, failure to present a document required to be presented with the guarantee at the same time as the guarantee.[475] In line with this observation, it has been suggested that the overriding factor in the context of a guarantor's obligations under a demand guarantee should simply be whether there has indeed been compliance with the terms of a demand guarantee.[476] Therefore, perhaps the correct question to be answered instead of whether strict compliance applies to demand guarantees is whether the documents required to be presented with the relevant demand in a given case have been presented in accordance with the terms of the demand guarantee.

2.8.2.7 Applying Contractual Rules of Construction as a Tool for Determining Application of Strict Compliance to Demand Guarantees

It has been asserted, in the context of the doctrine of strict compliance in relation to documentary credits, that the "matrix of facts" approach is best suited to determinations relating to types of commercial instruments, such as whether an instrument is a suretyship agreement or a demand guarantee, and not to determinations of what constitutes a compliant demand.[477] In this regard, Kelly-Louw urges courts not to take liberties with regard to the "matrix of facts" but instead to honour the autonomy principle by simply giving effect to what a demand guarantee calls for, in line with its terms, including where, in the court's perception, a commercial absurdity may arise.[478] Kelly-Louw further asserts that courts must give effect to the normal grammatical meaning of words, which is more likely to reflect the parties' intention, and only have recourse to the background "matrix of facts" in exceptional cases where this is justified.[479]

The reluctance to apply the matrix of facts approach in determinations relating to strict compliance may be due to the limitations of such an approach. These include the potential disjunction between avoiding commercial absurdity on the one hand and maintaining the autonomy of documentary

[475] Ibid. See Kelly-Louw, M "Must All the Required Documents for a Demand Guarantee be Presented At the Same Time? *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* (23125/2014) [2015] ZAGPJHC 264 (20 October 2015)", (2017), 80, *THRHR*, 148, for a detailed discussion of this issue.

[476] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 68.

[477] Ibid.

[478] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 68.

[479] Idem, at 68-69.

credits from underlying commercial contracts on the other.[480] In addition, commentators have observed the danger of courts imposing their own views of the commerciality of a transaction on the parties, over and above the intention of the parties.[481]

A middle ground to the two extremes of applying strict compliance dogmatically or taking a liberal or discretionary approach to interpreting compliance was suggested in the case of *IE Contractors Ltd v Lloyd's Bank Plc.*[482] In this case, the court held that whether or not strict compliance was applicable in respect of a performance bond was a matter of construction of the relevant bond. If a guarantor found this position unattractive, then "their remedy lies in their own hands".[483] This seems to imply that whether or not the doctrine of strict compliance is applicable in relation to a documentary credit is a decision for the parties to a documentary credit arrangement, with the onus on them (but more particularly on the issuer as the paying party), to make the agreed position clear. Following on from this submission, where guarantors seek to avoid having to make judgements on issues surrounding strict compliance, it is perhaps then up to them to ensure that this is provided for clearly in the relevant demand guarantee.

While the above-mentioned middle-ground approach seems sensible and pays due homage to the freedom of contract,[484] it is not without criticism. It has been critiqued as onerous for adding the requirement for an initial judgement regarding the degree of strictness of compliance required to be made.[485] While acknowledging the validity of this criticism, it is submitted that any encumbrance that has to make such a determination may pose on a guarantor is outweighed by the benefits of certainty that would result. Incorporating clear parameters of what would constitute a complying demand as agreed between the parties in a demand guarantee could, therefore, be beneficial for clarifying a guarantor's obligations and protecting their position in the context of a high-pressure situation of a demand being presented.

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[480] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 67.

[481] Idem, at 68 citing Furmston and Chuah, *Commercial Law,* at 382.

[482] [1990] 2 Lloyd's Rep 496 at 500-501.

[483] [1990] 2 Lloyd's Rep 496 at 500-501.

[484] Notwithstanding the *sui generis* nature of documentary credits and that they are in some ways distinct from contracts as referenced in section 2.2.2 of this thesis, it is submitted that such a distinction is irrelevant in the context of the contracting freedoms afforded to contracting parties, which freedoms, therefore, apply equally in respect of documentary credits.

[485] Hapgood, *Paget's Law of Banking*, at 868.

Despite various views, some divergent, regarding whether or not the doctrine of strict compliance is applicable to demand guarantees, and more specifically, what constitutes a compliant demand thereunder, two points of general consensus are that a demand must comply with the terms of a demand guarantee and that where such terms dictate a requirement for strict compliance, then the demand must so strictly comply.[486] This position is summed up aptly in the following words from the South African case of *Hollard Insurance Co Ltd v Jeany Industrial Holdings (Pty) Ltd and Others*:[487] "guarantees create a self-contained and primary obligation between the guarantor and the beneficiary and must be honoured by payment when a demand is made that complies with the formalities as recorded in the demand."[488]

2.9 OVERVIEW OF MAIN TYPES (BY USAGE) OF DEMAND GUARANTEES

2.9.1 Introduction

A number of documentary credits can be broken down by various classifications based on their usage. However, other types of documentary credits, such as standby letters of credit, are referenced in this thesis for reasons outlined in Chapter 1 above and only the main types of demand guarantees, being the focus of this thesis, will be considered further in this section based on their type or function.[489]

2.9.2 Performance Guarantee

Performance guarantees are a type of demand guarantee which is common in relation to construction and engineering contracts or international sale-of-goods transactions. They are evidently utilised across a wide range of transactions and sectors but have been noted on the basis of judicial decisions in some jurisdictions to be most commonly used in respect of construction contracts.[490] Performance guarantees are also sometimes referred to as performance or completion

[486] Kelly-Louw, *General Update on the Law of Demand Guarantees and Letters of Credit*, at 68.

[487] [2016] ZAGPJHC 175.

[488] Idem, para 27.

[489] See also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 27-29 for a summary of types of demand guarantees, which also includes (at 29), a brief overview regarding other types of demand guarantees not generated by the underlying contract.

[490] Whitten, *Calling on a Performance Security*, at 2.

bonds.[491]

As perhaps indicated by the broadness of the term "performance" in their name, performance guarantees are typically used to secure performance, usually contemplated in respect of the various stages of a contract, as opposed to an underlying payment obligation.[492] While it is not completely unheard of for a performance guarantee in the construction sector to also be used to provide security for the performance of an employer's payment obligations (i.e., a payment guarantee), this is considered unusual.[493] Performance guarantees can be likened to "performance standbys", the type of standby letters of credit correspondingly similar to performance guarantees. Performance standbys are largely regarded as instruments designed to support non-payment obligations and defray any costs incurred upon the default on performance under the terms of an underlying contract.[494]

Performance guarantees tend to be for a higher percentage of the contract value than, for instance, tender guarantees (e.g., between 5 per cent and 10 per cent).[495] Depending on the nature of the contract according to which the performance guarantee is issued, performance can range from project completion by a contractor to a specified quality standard and within a specific timeframe or export of goods of agreed quality and quantity and within an agreed time by a seller in an international trade transaction. In a manner which has been compared to cash security, the performance guarantee[496]provides the beneficiary with recourse in the event of non-performance or defective performance in accordance with its terms, which also has the punitive effect of a financial penalty being incurred by the principal. Despite the breadth of scope of a performance guarantee, in reality, a contract may be subdivided into separate performance obligations. These separate components of obligation have been explained alternatively as being "distinct parts of

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[491] See Hugo, C "Construction Guarantees and the Supreme Court of Appeal (2010-2013)" in Visser, C and Pretorius, JT (eds) *Essays in Honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, LexisNexis, 2014, at 159 (hereinafter "Hugo, *Construction Guarantees*").

[492] Hugo, *Construction Guarantees*, at 164.

[493] See Goode, *Abstract Payment Undertakings in International Transaction*), at 14, where Goode asserts that demand guarantees are, "used almost exclusively to secure the performance of a non-monetary obligation-typically the execution of construction."

[494] Byrne, JE, *LC Rules & Laws: Critical Texts for Independent Undertakings*, 7 ed, The institute of International Banking Law 7 Practice, Inc, 2018 (hereinafter, "Byrne, *LC Rules and Laws*"), at 33.

[495] Lukic, *The Role and Importance of Bank Demand Guarantees*, at 8 and see also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 28. See also the discussion of tender guarantees in section 2.9.3 below.

[496] Lukic, *The Role and Importance of Bank Demand Guarantees*, at 8 and see also Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 28.

liability to be covered within [a single] performance".[497] They are covered more specifically by other demand guarantees, some of which are discussed below.

2.9.3 Tender Guarantees

Invitations for tenders, for instance, regarding construction or engineering contracts, often require procurement of a performance or other demand guarantee, normally for a percentage of the project value (usually 0.5 per cent to 5 per cent),[498] as a prerequisite for consideration of the tender. The demand guarantee provided to satisfy this requirement is commonly known as a tender guarantee. However, it may also go by other names, such as a tender bond or bid bond. It is not uncommon for tender guarantees to be submitted together with the tender documents by the party tendering performance of the contract.

The purpose of a tender guarantee is to provide the beneficiary, in this context sometimes referred to as the employer (i.e., employer of the contractor), with partial security for performance of the contract tendered for by the contractor, such that if the contractor defaults on the performance of their obligations thereunder, the employer will have recourse to the amount of the guarantee, for the purpose of meeting costs associated with the default (e.g., costs of having processed the tender in anticipation of engagement and subsequent performance).

2.9.4 The Advance Payment Guarantee

In some cases, a contractor may require and be entitled to payment of specific amounts of money in advance of the performance of the relevant contract. The employer, in such instances, would typically require a guarantee to secure repayment of the advanced funds if the contractor fails to discharge their performance obligations after receiving advance payment. Such a guarantee, which normally amounts to between 10 per cent and 20 per cent of the value of the relevant contract, is known as an advance payment guarantee and has also been referred to by other names, including repayment guarantee or interim payment guarantee.[499]

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[497] Ibid.

[498] Ibid.

[499] Ibid.

2.9.5 Retention Guarantee

Construction projects are commonly completed in phases, with experts such as engineers issuing certificates to confirm adequate completion of a phase. Construction contracts can provide for an employer to retain a specific percentage of the value of the certified phase of a contract as security for the performance of the contract to a satisfactory standard as agreed by the parties. The purpose of the amount retained is to provide the employer with redress should the contractor fail to perform satisfactorily (e.g., if they render defective performance).[500] Due to contractors needing to maintain liquidity in relation to their project, it is usually agreed that the employer will release the retained amount against a demand guarantee, which will act as a substitute for the cash which would have been retained but is then released to the contractor. A demand guarantee issued for such purpose is usually known as a retention guarantee or retention bond and can be called upon by the employer if the contractor fails to fulfil the contract or where latent defects in relation to a contractor's performance emerge following completion of the contract. A retention guarantee is usually for a period of up to a year after completion of the contract by the contractor (also known as the maintenance period) and expires upon the issuance of a final completion certificate by an employer.

2.9.6 Maintenance Guarantee

As mentioned above, the premise of a retention guarantee is the provision of security for the employer against latent defects which could become apparent over an agreed period of time. It is provided in lieu of cash security.[501] However, an employer may agree to release any retention security, whether in the form of cash or a retention guarantee, in favour of another demand guarantee specifically to ensure that a contractor fulfils their obligations regarding any warranty or maintenance period.[502] A demand guarantee of such a nature is commonly referred to as a maintenance or warranty guarantee, in line with its purpose.[503]

2.10 ICC RULES, ISP 98 AND THE UNCITRAL CONVENTION

[500] Lukic, *The Role and Importance of Bank Demand Guarantees*, at 8-9.

[501] See Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 214, where in is stated, "The function of a demand guarantee is to replace cash retained by way of security".

[502] Lukic, *The Role and Importance of Bank Demand Guarantees*, at 9 and Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 29.

[503] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 29.

2.10.1 General

Various international rules and customs applicable to various types of documentary credits have been established for elective use by the parties to such instruments.[504] The International Chamber of Commerce ("ICC"), in particular, has been a prominent contributor to the body of rules governing demand guarantees and other documentary credits, namely the URDG, URCG, and UCP 600. The ISP 98 came about due to the contribution of several stakeholders in the area of standby letters of credit law, led and coordinated by the International Financial Services Association and the Institute of International Banking Law and Practice.[505]

The United Nations Commission on International Trade Law ("UNCITRAL")[506] was notably involved in the development of ISP 98. The ICC also endorsed the ISP 98 on 6 April 1998, after which it became operative on 1 January 1999. The UNCITRAL also contributed significantly to the governance of documentary credit by establishing the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit,[507] which has become commonly known as the "UNCITRAL Convention", as is used in this thesis. Unlike the rules mentioned above, which apply based on election by relevant transaction parties, the UNCITRAL Convention generally applies to countries that adopted the convention.[508]

While, broadly speaking, all documentary credits have certain essential features in common, such as the autonomy principle, a "one size fits all" approach when it comes to international rules governing them has proved to be unfeasible. For instance, although the Uniform Customs and Practice for Documentary Credits ("UCP")[509] appear to have been intended from its inception to cater for various types of documentary credits, including letters of credit and demand guarantees, analysts and industry experts quickly picked up that most of the provisions of the UCP were not

[504] URDG 758, ISP98, and UCP 600,

[505] See the introduction to Byrne, JE *The Official Commentary on the International Standby Practices*, 1 ed, The Institute of Banking Law and Practice, Inc, 1998, at xvi; United Nations, *United Nations Commission on International Trade Law Yearbook, Volume XXXI: 2000*, United Nations, 2001, at 579-580 and the discussion in Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 115.

[506] Hereinafter "the UNCITRAL".

[507] United Nations, *United Nations Commission on International Trade Law Yearbook*, Volume XXXI: 2000, United Nations, 2001, at 579-580 and Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 115.

[508] This is further explained in section 2.10.6 of this thesis below.

[509] When referring the to the Uniform Customs and Practice for Documentary Credits (without referring to any specific version of it), it will hereinafter be referred to as "UCP".

appropriate for demand guarantees specifically.[510] Issues such as this gave impetus to the development of separate sets of rules specifically tailored to the relevant documentary credit types for which they were targeted, such as the URDG 758 for demand guarantees and the ISP 98 for standby letters of credit. These are discussed further below.

In light of the fundamental similarities between the different commonly used documentary credits, as well as the varying needs and preferences of the users of such instruments, restricting the application of only a specific set of rules to a specific type of documentary credit or *vice versa* (e.g., requiring that a document must be a demand guarantee for the URDG 758 to apply to it and/or conversely allowing only the URDG 758 to be applicable to demand guarantees), is generally considered to be impractical.[511] It has, therefore, been generally accepted, and rightly so it seems, that the UCP 600, URDG 758 and ISP 98 can apply to any type of documentary credit at the election of the parties involved.[512] By way of example and as noted in further discussions below, the UCP 600 and the URDG 758 have been known to be used for standby letters of credit. Furthermore, the UCP 600 and, to some degree, the ISP 98 are similarly used regarding demand guarantees.[513]

2.10.2 Uniform Rules for Demand Guarantees (URDG 758)

The URDG 758 is arguably the most popular and prominent set of international standards to govern demand guarantees. The URDG 758 are specifically tailored to demand guarantees as a subset of documentary credits. The predecessor of the URDG 758 was the URDG 458 of 1992.[514] The URDG 458 followed in the wake of the Uniform Rules of Contract Guarantees of 1978 ("URCG"),[515] another set of rules still in place to electively govern certain types of guarantees.[516]

It has been emphasised that the URDG 758 did not only "update" URDG 458, the previously

[510] Goode and McKendrick, *Goode on Commercial Law*, at 1059. See also Sifri, J *Standby Letters of Credit: A Comprehensive Guide*, Palgrave Macmillan, 2008, at 3.

[511] Byrne, *LC Rules and Laws*, at 34.

[512] Byrne, *LC Rules and Laws*, at 34 and at 81.

[513] Byrne, *LC Rules and Laws*, at 34 and at 81.

[514] ICC Uniform Rules for Demand Guarantees (ICC Publication No 458, (1992).

[515] ICC Publication No 325 (1978) (hereinafter "URCG"). For a full discussion of the URCG, see Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 107-110 and 138-142.

[516] For more on the URCG, see the discussion under section 2.10.5 below.

existing rules, but went further by clarifying the rules significantly in a manner which has increased their popularity as the preferred governing rules for demand guarantees, much more so than their predecessor. While demand guarantees are not necessarily exclusively issued subject to the URDG 758,[517] the URDG 758 could arguably present a superior fit because it comprises a hybrid set of rules built from a plethora of sources such as provisions of the ISP 98 and UCP 600, which were considered to be optimum for demand guarantees. The URDG 758 also inserted new provisions where gaps were previously identified.[518]

Despite its noted improvements to documentary credit practice concerning demand guarantees, the URDG 758 has not escaped criticism. In particular, the URDG 758 have been argued to be largely biased in favour of applicants in demand guarantee arrangements in that it incorporates implicit rules and notification requirements that enable an applicant to obtain a court order or interdict or threaten to withhold reimbursement from a guarantor,[519] all of which aspects, it can be agreed, may undermine the effectiveness of the autonomy principle in practice. Specific areas have also been noted. The URDG 758 provides a somewhat narrower scope of scenarios than, for instance, the ISP 98.[520] For instance, Article 35 of the URDG 758 provides another example of this in that it rather prescriptively provides for exclusive jurisdiction for dispute resolution,[521] which provision and specificity seem to have no counterpart in the ISP 98 or UCP 600.

Of key significance for this thesis are the specific provisions of the URDG 758, which are pertinent to the autonomy principle and the documentary nature of demand guarantees, as has been discussed above,[522]in addition to provisions (or lack thereof) that provide clarity in respect of exceptions to the autonomy principle, which aspects will be considered further in this thesis.

2.10.3 International Standby Practices

The International Standby Practices ("ISP 98"), which first came into effect in 1999, are a set of rules designed to serve as a codification of "generally accepted practice, custom and usage of

[517] Anecdotal evidence has been noted to indicate the use of UCP 600 and limited use of ISP98 for demand guarantees still. See Byrne, *LC Rules and Laws*, at 81.

[518] Byrne, *LC Rules and Laws*, at 81.

[519] Byrne, *LC Rules and Laws*, at 81.

[520] Ibid.

[521] URDG 758, Article 35(a)-(b).

[522] See sections 2.5 and 2.5 of this thesis.

standby letters of credit."[523] One of the issues sought to be addressed by the ISP 98 was the absence of a specific set of rules tailored to standby letters of credit instead of commercial letters of credit.[524] Given the similarities between standby letters of credit and demand guarantees, it should come as no surprise that some use of ISP 98 for demand guarantees has been observed despite its focus on standby letters of credit.[525]

Previous versions of the UCP, particularly before the 1983 version ("UCP 400"),[526] were focused on commercial letters of credit and did not cater for standby letters of credit. The UCP 400 was the first version of the UCP to cater to standby letters of credit.[527] Subsequent versions of the UCP (i.e., "the UCP 500"[528] and the UCP 600) were credited with reinforcing some of the key principles which are applicable to standby letters of credit but ultimately were neither fully applicable nor sufficiently appropriate to standby letters of credit.[529] Given this background, several parallels can be drawn between the ISP98 and the UCP 600. Such a comparison when it comes to using standby letters of credit has largely favoured ISP 98 based on the view that it is "more precise, stating the intent implied in the UCP". Additional advantages highlighted by commentators in respect of ISP 98 include that it is drafted in neutral terms applicable to a broad range of scenarios and is designed to be compatible with the UNCITRAL Convention and applicable local law, with the proviso that if there are any conflicts with mandatory local law, such law will prevail.[530]

The ISP 98 has also been lauded for being crafted with input from several parties in the commercial arena, including not only bankers and merchants, as has been historically typical in the context of documentary credits,[531] but also treasurers, regulators, rating and government agencies, to name but a few. The factors highlighted above, coupled with the interpretation issues often arising in disputes related to documentary credits, have contributed to the ISP 98 is regarded as a useful

[523] Ibid.

[524] Byrne, *LC Rules and Laws*, at 33-34.

[525] Ibid.

[526] ICC Publication No 400, Paris (1983) (hereinafter the "UCP 400").

[527] See discussion in section 2.10.4 below relating to the background and development of the UCP.

[528] *ICC Publication* No 500, Paris (1993) (hereinafter UCP 500).

[529] Byrne, *LC Rules and Laws*, at 34. See also the discussion of the UCP under section 2.10.4 below.

[530] Byrne, *LC Rules and Laws*, at 34-35.

[531] Byrne, *LC Rules and Laws*, at 34.

source of guidance for lawyers and judges when interpreting standby letters of credit.[532] The ISP 98 is, therefore, a key bastion to standby letter of credit law and also a significant contributor to documentary credit law in general.

Specific ISP 98 provisions will be considered on the basis of their pertinence to the aspects explored in this thesis.

2.10.4 Uniform Customs and Practice for Documentary Credits

The first Uniform Customs and Practice for Documentary Credits UCP ("UCP"), which were introduced in 1933 ("UCP 82")[533] and revised several times, have over time been touted as "the most successful harmonising measure in the history of international commerce".[534] The UCP 600 were preceded by prior versions thereof,[535] starting with establishing the UCP 82, an early milestone aimed at harmonising letters of credit. The UCP 82 were adopted by some bankers in Europe and banks in the USA. Still, it was resisted by banks in the United Kingdom ("UK") and most Commonwealth countries.[536] A new version, which was fairly well-received in Europe, Asia, Africa and the USA, and similarly rejected by bankers in the UK but albeit adhered to by several "Commonwealth banking communities",[537] was issued in 1951 ("UCP 151").[538] The next iteration of the UCP was issued in 1962 ("UCP 222"),[539] won over, and was accepted by the UK and Commonwealth Nations and the participants that had already taken up previous versions. A further revised version of the UCP, with updates which were attributed, *inter alia*, to factors such as technological advances and the boom in the use of containers (also referred to as the container

[532] Ibid.

[533] *ICC Publication* No 82, Paris (1933) (hereinafter "UCP 82").

[534] Goode and McKendrick, *Goode on Commercial Law*, at 968.

[535] See Taylor, D *The Complete UCP - Texts, Rules and History 1920-2007*, eds, International Chamber of Commerce, 2008 and Hugo, C "The Development of Documentary Letters of Credit as Reflected in the Uniform Customs and Practice of Documentary Credits" (1993), 5(1), *SA Merc LJ*, 44, for a comprehensive consideration and review of the history and development of UCP 600 from its inception.

[536] See Ellinger, EP "The Uniform Customs–Their Nature and the 1983 Revision" (1984) *Lloyd's Maritime and Commercial Law Quarterly*, 578, at 579.

[537] Ibid.

[538] *ICC Publication* No 151, Paris (1951) (hereinafter "UCP 151").

[539] *ICC Publication* No 222, Paris (1962), which came into effect on 1 July 1963 (hereinafter the "UCP 222").

revolution) and new bank market entrants,[540] was issued in 1974 ("UCP 290").[541] In developing the UCP 290, the ICC was supported by contributions from broader sources, including UNCITRAL and banking organisations in socialist jurisdictions, whose contributions were channelled through an ad hoc working party.[542] The UCP 290 gained considerably more traction and approval from several quarters than their predecessor, assuming a key role in relation to the law of letters of credit.

As technology and other market-related elements continued to evolve, so did the UCP, with the next version issued in 1983, namely the UCP 400.[543] The UCP 400 are particularly noteworthy because they introduced a key change to the scope of the UCP, which until then expressly provided for commercial letters of credit only. The UCP 400 are credited with explicitly expanding the scope of the UCP to specifically cover standby letters of credit[544] and was generally well-received, as indicated by its acceptance in several countries. Due to further developments in transport and technology and incorporating other improvements, another iteration was issued in 1993, namely the UCP 500.[545] The UCP had largely been produced by bankers but the UCP 500 incorporated input from legal professionals and academics. In light of ongoing changes in the banking, transport and insurance sectors, further revisions of the UCP were proposed and considered through the ICC's working groups and processes, culminating in the current version of the UCP (i.e., UCP 600),[546]which came into operation on 1 July 2007.

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[540] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 97. Also see generally Lee, H, "Documentary Letters of Credit and the Uniform Customs and Practice for Documentary Credits (1974 Revision): A Selective Analysis" (1977), 3, *J Corp L*, 147, for analysis if the UCP 290.

[541] *ICC Publication* No 290, Paris (1974), which came into effect on 1 October 1975 (hereinafter, "UCP 290").

[542] See the introduction to the UCP 290.

[543] That came into force on 1 October 1984.

[544] Articles 1 of the UCP 400 stated, "These articles apply to all documentary credits, including, to the extent to which they may be applicable, standby letters of credit, and are binding on all parties thereto unless otherwise expressly agreed. They shall be incorporated into each documentary credit by wording in the credit indicating that such credit is issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication No 400."

[545] That came into effect on 1 January 1994.

[546] See Bergami, R "UCP 600 Rules-Changing Letter of Credit Business for International Traders?" (2009), 1(2), *International Journal of Economics and Business Research*, 191; Bergami, R "Will the UCP 600 "Provide Solutions to Letter of Credit Transactions?" (2007), 3(2), *International Review of Business Research Papers*, 41; Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 96-102 and Ulph, J "The UCP 600: documentary credits in the 21st century" (2007), 4, *Journal of Business Law, 355* for an overview of and commentary on the main changes introduced by the UCP 600. See also Baker, WB, Dolan, JF and Smith, DR *Users' Handbook for Documentary Credits under UCP 600, International Chamber of Commerce*, 2008 for a full and comprehensive commentary on the provisions of UCP 600.

Application of the UCP 600 to documentary credits, like the other rules such as the URDG 758 and the ISP 98, is based on election, meaning that parties must expressly agree to its application and document such agreement in the relevant documentary credit.[547] The UCP 600 are considered to be largely suited to commercial letters of credit, as opposed to standby letters of credit.[548] The autonomy principle said to have been developed through use by merchants is regarded as having been elevated to "modern *lex mercatoria*" because it is incorporated by reference in several international rules, including the UCP 600. Carr, although acknowledging that the UCP 600 are not law and cannot give life to the autonomy principle in the absence of law, states that "it does reflect the law merchant [as shown by the fact that] virtually all legal systems give effect to the independent character of the letter of credit".[549]

2.10.5 Uniform Rules of Contract Guarantees

Another set of rules that gained rather limited traction in the area of documentary credits is the Uniform Rules of Contract Guarantees ("URCG"),[550] issued in 1978.[551] The purpose of the rules was cited as clarifying ambiguities and inconsistencies in relation to guarantees issued by banks, insurance companies, and other guarantors in the form of, *inter alia*, tender bonds, performance guarantees and repayment guarantees.[552] One of the main reasons proffered for its lack of popularity and also the reason it is not proposed to be considered further or used as an authoritative reference source for the purposes of this thesis is that it is viewed to be "so far removed from market practice that never became popular". A popular example used to support this view is that the URCG required a beneficiary to obtain a judgment, arbitral award or principal's written approval before making a demand.[553] While the rationale for this was understood to be the deterrence of abusive demands, it was considered an unfeasible dispensation which effectively

[547] Byrne, *LC Rules and Laws*, at 34.

[548] Byrne, *LC Rules and Laws*, at 33.

[549] Carr, *International Trade Law*. See also UCP 600, Articles 4 and 5.

[550] ICC Publication No 325.

[551] Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*, Kluwer Law International, 2002, at 19.

[552] Ibid.

[553] Ibid; URCG, Article 9.

shrouded independent documentary credits with an accessory nature.[554] Rather ironically, given its perceived purpose of clarifying ambiguity, another criticism levelled against the URCG is that it was never clarified whether it applied only to independent documentary credits instead of accessory ones.[555] However, despite the criticism noted above and the arguably predictable preference for the URDG where demand guarantees are concerned, it is worth noting that the URCG does not have to be repealed/revoked and should remain available should parties to transactions elect to incorporate them.

2.10.6 UNCITRAL Convention

The UNCITRAL Convention came into force on 1 January 2000.[556] It was noted to be modelled on the UCP and the URDG 458, but a key distinguishing feature of the UNCITRAL Convention compared to the UCP and the URDG[557] is that the UNCITRAL Convention can have the effect of a uniform law or regulation for countries that adopt it and is generally mandatorily applicable in such countries.[558] The UNCITRAL Convention, therefore, applies as a general rule to those countries that have adopted it. However, technically, there is nothing *per se* preventing parties from making it applicable to their documentary credits (by expressly providing for it) despite the relevant jurisdiction involved not being party to the UNCITRAL Convention.[559] The UCP and URDG, in contrast, are published by a private body and incorporated by reference in documentary credits based on election by private parties.[560] There has been limited uptake of the UNCITRAL Convention as it seems that, to date, only eight countries are party to this Convention.[561] This could perhaps be seen as indicative of a marked preference for rules that are more specifically tailored to one specific type of documentary credit, as opposed to those which, like the UNCITRAL

[554] Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study,* Kluwer Law International, 2002, at 20.

[555] Ibid.

[556] Adopted by the United Nations General Assembly resolution 50/48 of 11 December 1995. See footnote 1 of the Explanatory Note prepared by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996).

[557] URDG 458 has since been superseded by URDG 758.

[558] Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study,* Kluwer Law International, 2002, at 21.

[559] Article 1(2) of the UNCITRAL Convention.

[560] Ibid.

[561] Available at https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-15&chapter=10&clang=_en, Accessed on 27 April 2020.S

Convention, cover both demand guarantees and standby letters of credits in a manner akin to the multi-instrument scope of the UCP 600. A broader scope may thus lend itself to the perception that UNCITRAL may carry the same flaws as the UCP600 (i.e., provisions that are considered to be more/only appropriate to one type of documentary credit and less or not at all appropriate to another). It is worth noting that none of the countries at the centre of the comparative analysis in this thesis (i.e., South Africa, England, Australia) are parties to the UNCITRAL Convention.

2.11 INTERDICTS/INJUNCTIONS

2.11.1 Potential for Exploitation of the Autonomy Principle: Abusive Demands

The purpose of demand guarantees, particularly their security and risk allocation function,[562] is normally deemed to reflect the intention of principals or applicants and the beneficiaries, with some commentators suggesting that such instruments were developed to "protect the position of both parties as far as practically possible".[563] However, popular opinion, which is arguably more accurate, is that they are skewed to the beneficiary's advantage.[564] In line with this view, the autonomy principle has been branded a double-edged sword in the sense that, by disregarding any disputes or extraneous facts existing between a beneficiary and an applicant (e.g., regarding whether there has in fact been a breach of the underlying contract), it can also be exploited by unscrupulous beneficiaries who make abusive demands.[565] This potential for the abuse of demand guarantees has been attributed to a risk asymmetry that the autonomy principle is deemed to create in favour of the beneficiary.[566] Consistent with this perception, a key purpose of the autonomy

[562] See 2.3.2 above.

[563] Oelofse, AN *The Law of Documentary Letters of Credit in Comparative Perspective*, Interlegal, 1997 (hereinafter, "Oelofse, *The Law of Documentary Letters of Credit*"), at 5.

[564] The uneven balance of power in favour of beneficiaries is depicted in Cowan, K, Paswan, A and Steenburg, E "When Inter-firm Relationship Benefits Mitigate Power Asymmetry" (2015), 48, *Industrial Marketing Management* 140, at 140 and 143. See also *Sumatec Engineering and Construction v Malaysian Refining Company* [2012] 3 CLJ, 401.

[565] *In Re Originala Petroleum Corporation* (1984) 39 BR 1003, at 1007. See also Y Zhang, "Documentary Letter of Credit Fraud Risk Management" (2012), 19(4), *Journal of Financial Crime* 343, at 344, where it is stated, with reference to the autonomy principle and the doctrine of strict compliance, that, "[s]uch principles intending to facilitate international transactions make L/C easy to be abused by fraudsters."

[566] Cowan, K, Paswan, A and Steenburg, E "When Inter-firm Relationship Benefits Mitigate Power Asymmetry" (2015), 48, *Industrial Marketing Management* 140, at 140 and 143.

principle is said to be the protection of the beneficiary from being out of pocket pending the resolution of any disputes relating to the underlying contract.[567]

This potential abuse of the autonomy principle was highlighted in the Singaporean case of *GHL Pte Ltd v Unitrack Building Construction Pte Ltd*,[568] where the following reminder was given: "it should not be forgotten that a performance bond can be used as an oppressive instrument".[569] The prejudicial consequences that could arise from abusive demands have been invoked to support the argument for additional exceptions to the autonomy principle because such exceptions serve to counteract such consequences.[570] Similar concerns were expressed in the case of *Sumatec Engineering and Construction v Malaysian Refining Company*[571] in which it was noted that:

> "certainty of payment to the beneficiary under the autonomy principle has tipped the balance of risk heavily in favour of the beneficiary, sometimes resulting in inequitable result to the account party while achieving the desired commercial result."[572]

Despite some commentators holding the view that the autonomy principle is designed to serve the expectations and needs of all the parties to a demand-guarantee arrangement,[573] a common assertion is that the autonomy principle is skewed mainly in favour of beneficiaries, who are absolved from having to prove any actual default when presenting a demand for payment, and sometimes guarantors or issuers, who are absolved of any investigative duties beyond considering what is stated in the demand guarantee when determining whether to make payment pursuant to a demand. The risk is then seen as falling squarely and solely on the shoulders of the applicant (e.g.,

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[567] *Boral Formwork and Scaffolding v Action Makers Ltd* [2003] NSWSC 713, para 36.

[568] [1999] 4 SLR 604.

[569] Idem, para 20. See also *In Re Originala Petroleum Corporation* (1984) 39 BR 1003, at 1007.

[570] See *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] SGCA 28, paras 11-13, 23, 27 and 38. See also *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604, para 20 wherein it was stated:

> "It should not be forgotten that a performance bond can be used as an oppressive instrument … . It is in part to offset the risk of such oppressive behaviour that the Court in that jurisdiction developed the unconscionability exception to independence."

[571] [2012] 3 CLJ, 401, at 414.

[572] Ibid.

[573] Alawamleh, *Documentary Credits and Independent Guarantees*, at 44.

buyer), who is unable, by virtue of the autonomy principle, to require a guarantor to evaluate any beneficiary activities (e.g., seller).[574]

In defence of the *status quo* attributed to demand guarantees, it has been observed that the power asymmetry and the unequal distribution of power associated with the autonomy principle in the context of demand guarantees is an inherent aspect of commercial transactions and "a fact of ongoing inter-firm relationships".[575] Therefore, a dominant party leveraging their "leadership role to manage and distribute risks and benefits, either equitably or opportunistically"[576] is an arguably normal aspect of commercial transactions, with transactions involving demand guarantees being no exception. Therefore, such a balance of power in relation to demand guarantees is considered an inherent aspect of commercial transactions and not an exceptional or uniquely prejudicial phenomenon.

2.11.2 An Interdict/Injunction Preventing Payment by a Guarantor versus an Interdict/Injunction Preventing a Demand by a Beneficiary

Several disputes stemming from allegations of unjustified or abusive demands have come before the courts of different jurisdictions. In such disputes, injunctions (also referred to as interdicts under South African law) are usually sought by an applicant (or principal) as a countermeasure in respect of a demand perceived to be unjustified. Two types of injunctions are typically sought: either an injunction to prevent a beneficiary from making a demand under the demand guarantee or an injunction preventing a guarantor from making payment to honour a demand that has already been made under a demand guarantee.

Two aspects in respect of the autonomy principle were emphasised in the Australian case of *Wood Hall.* Firstly that, "[t]here is no basis whatever upon which the unconditional nature of the bank's promise to pay on demand can be qualified by reference to the terms of the contract between the contractor and the owner" and secondly, "there is no basis on which the owner's unqualified right at any time to demand payment by the bank can be qualified by reference to the terms or purpose

[574] See Carr, I *International Trade Law*, 4 ed, Routledge-Cavendish, 2010 (hereinafter "Carr, *International Trade Law*"), at 464: "The bill of exchange is an autonomous contract and is not affected by breach in the underlying contract", and at 445 where this principle is stated in respect of buyers and sellers in the context of international trade, particularly sale of goods, transactions, and extrapolated in the thesis to illustrate application in the wider context of documentary credits.

[575] Cowan, K, Paswan, A and Steenburg, E "When Inter-firm Relationship Benefits Mitigate Power Asymmetry" (2015), 48, *Industrial Marketing Management* 140, at 140.

[576] Idem, 143.

of that contract".[577] It is worth noting that some jurisprudence does not distinguish between the effect of an injunction to restrain a bank from making payment and one restraining a beneficiary from calling for payment in the context of demand guarantees.[578] However, others support the view that these two aspects represent distinct arms of the autonomy principle, namely the entitlement of a beneficiary to make a demand and the corresponding obligation of a guarantor to make payment pursuant to the demand.[579] In line with this view, injunctions can be seen as being targeted at one of the two arms, being either the right of a beneficiary to make a demand or the obligation of a guarantor to make payment when a demand has been made respectively.[580]

2.11.3 Effect of an Interdict/Injunction Restraining a Beneficiary from Making a Demand Under a Demand Guarantee on the Autonomy Principle

Cases have been known to exist whereby the terms of the underlying contract require a beneficiary to give notice to the applicant before making an actual demand.[581] In such cases, if the beneficiary notifies the applicant of an impending claim before such claim is made, the injunction sought will usually be to enjoin the beneficiary from making a demand.[582]

The position regarding how or whether an injunction seeking to block a beneficiary from making a demand affects the autonomy principle is a subject of debate. As the basis for seeking an injunction to restrain a beneficiary from making a demand is typically founded on the terms of the underlying contract and not the demand guarantee itself,[583] it has been opined that injunctions must be targeted at restraining a demand. This is premised on the argument that the obligation of a guarantor to make payment and the autonomy principle on which such obligation is based must not be interfered with, as restraining a guarantor in such a manner would undermine the value of demand guarantees.[584]

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[577] [1979] 141 CLR443, para 3.

[578] *Bocotra Construction Pte Ltd & Others v Attorney General* [1995] 2 SLR 733, at 744.

[579] Wooler, *Lifting the Veil of Autonomy*, at 43.

[580] Ibid.

[581] Whitten, *Calling on a Performance Security*, at 13.

[582] Ibid.

[583] Ibid.

[584] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27.

Where an applicant (principal) seeks to obtain an injunction to prevent a beneficiary of a demand guarantee from making a demand thereunder, the effect sought is to ensure that the guarantor's obligation to pay does not arise. This approach is argued to have no impact on the autonomy principle and the effectiveness of demand guarantees.[585] It is, however, acknowledged as a general rule that courts will not grant an injunction against a beneficiary, even, as depicted in *Wood Hall*,[586] where a demand made by such a beneficiary verges on being an abusive demand, for example, a demand made by an employer simply to exert pressure on a contractor.[587]

2.11.4 Effect of an Interdict/Injunction Restraining a Guarantor from Making Payment Under a Demand Guarantee on the Autonomy Principle

The autonomy principle is often invoked to support and give effect to the obligation to pay under a demand guarantee when disputes arise, as exemplified in the case of *Power Curber International Ltd v National Bank of Kuwait SAK*.[588] In this case, the autonomy principle was emphasised by reference to the need for issuers of documentary credits to honour their payment obligations thereunder and not concern themselves with any disputes that may arise between the beneficiary and the applicant.[589] A similar view was echoed in the USA case of *Colorado National Bank v Board of County Commissioners*,[590] where the court, citing the UCC, stated:

> "in view of this independent nature of the letter of credit engagement the issuer is under a duty to honor the drafts for payment which in fact conform with the terms of the credit without reference to their compliance with the terms of the underlying contract".[591]

Wooler asserts that the autonomy principle embodies a *status quo* with which the courts will not interfere, being one whereby if there is a dispute between an applicant and a beneficiary, in the

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[585] Stephen O'Reilly, "Bank Guarantees - Are They Worth the Paper They're Written on?" *(2000), 33(72), Australian Construction Law Newsletter* 30 (hereinafter "O'Reilly, *Bank Guarantees - Are They Worth the Paper They're Written on*?"), at 31.

[586] [1979] 141 CLR443.

[587] O'Reilly, *Bank Guarantees - Are They Worth the Paper They're Written on*?, at 31.

[588] [1981] 3 All ER 607.

[589] Idem, at 611-612.

[590] 634 P.2d 32 (1981).

[591] *Colorado National Bank v Board of County Commissioners* 634 P.2d 32 (1981), at 37. See also *Alaska Textile Co, Inc v Chase Manhattan Bank, N.A.*, 982 F 2d 813 (2d Cir.1992), at 815 and *Optopics Laboratories v Savannah Bank*, 816 F Supp 898 (1993), at 907-908.

absence of fraud (or another recognised exception to the autonomy principle), the issuer has an absolute obligation to pay when faced with a compliant demand.[592] The default position pursuant to the autonomy principle appears to be that courts will not interfere with the obligation of a guarantor to make payment when presented with a compliant demand under a demand guarantee, save for in exceptional circumstances.[593]

In the Australian case of *Olex Focas Pty Ltd v Skodaexport Co Ltd*[594] citing another case *Bolivinter Oil SA v Chase Manhattan Bank and Ors*,[595] knowledge by a guarantor that a demand was fraudulent was recognised as one of the exceptional circumstances in which an injunction might be granted to enjoin payment by a guarantor. To emphasise this approach, the court, with reference to the case of *Power Curber International Ltd v National Bank of Kuwait SAK*,[596] expressed the view that injunctions preventing an issuer from fulfilling their payment obligation under a documentary credit would significantly undermine a bank's reputation for financial and contractual probity, as well as the value of the documentary credit itself.[597]

In the South African case of *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture*[598] though the interdict sought was to prohibit the beneficiary from calling up a performance guarantee, the beneficiary had already requested the guarantor to make payment in terms of the performance guarantee. This seems to straddle the line between an interdict/injunction to prevent a demand from being made and one to prevent the payment from being made after a demand has already been made. Regardless of which side of the line the interdict/injunction sits, key aspects concerning the autonomy principle and the potential effects of interdicts/injunctions on it were explored. The court in *Sulzer* agreed with and referenced the Australian case of *Olex*

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[592] Wooler, *Lifting the Veil of Autonomy*, at 46. See also *Hollard Insurance Co. Ltd v Jeany Industrial Holdings (Pty) Ltd and Others* [2016] ZAGPJHC 175.

[593] See *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136, paras 76-77 and *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812.

[594] [1997] FCA 27.

[595] [1984] 1 Lloyds Rep 251, at 257. See also the South African case of *Hollard Insurance Co. Ltd v Jeany Industrial Holdings (Pty) Ltd and Others* [2016] ZAGPJHC 175, paras 27 and 32.

[596] See *Power Curber International Ltd v National Bank of Kuwait* SAK [1981] 3 All ER 607, at 612-614.

[597] *Bolivinter Oil SA v Chase Manhattan Bank and Ors* [1984] 1 Lloyds Rep 251, at 257; *Ex parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) and *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27. See also Hooley, R and Sealy L *Commercial Law: Text, Cases, and Materials*, 4 ed, Oxford University Press, 2009 (hereinafter "Hooley and Sealy, *Commercial Law: Text, Cases, and Materials*"), at 851.

[598] *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695.

Focas as well as the *English Bolivinter* and *Power Curber* cases, reiterating that any interdict/injunction preventing payment under demand guarantee would destroy the commercial purpose thereof and undermine the issuing bank's reputation.[599]

While it is apparent, given the autonomy principle, that guarantors are not required to obtain an applicant's permission to honour a demand under a demand guarantee, it is common practice, however, that guarantors, typically banks, may make enquiries with or update their clients (i.e., the applicants/principals) in respect of a claim made pursuant to a demand guarantee before paying, as a courtesy extended in the interests of maintaining a good relationship with the relevant client.[600] The tension between a guarantor's obligation to pay under a demand guarantee, on the one hand, and the need to maintain a good business relationship with its client (i.e., the applicant) on the other, has been attributed to bank staff deliberately taking up just enough time in considering a demand to enable an aggrieved applicant to urgently apply for an injunction prohibiting payment.[601]

An injunction restraining payment by a guarantor under a demand guarantee undoubtedly strikes at a core purpose of the autonomy principle – certainty of payment notwithstanding any disputes between parties to the underlying contract. For this reason, applications for injunctions to prevent payment by a guarantor are historically unsuccessful,[602] as evidenced by many cases.[603] Court decisions are considered to play an integral role in defining the scope of the autonomy principle. They can thus be looked to for guidance on when it is justifiable to encroach upon the autonomy principle using an injunction.[604]

According to Kelly-Louw, even where fraud and illegality in the underlying contract are absent, and other recognised exceptions such as unconscionability are established, an applicant must seek to enjoin a beneficiary from making a demand or receiving payment instead of pursuing an

[599] Idem, para 40.

[600] Whitten, *Calling on a Performance Security*, at 12.

[601] Ibid.

[602] Whitten, *Calling on a Performance Security*, at 13.

[603] *Washington Constructions v Westpac Banking Corporation* [1983] 1 Qd R 179.

[604] Wooler, *Lifting the Veil of Autonomy*, at 28.

injunction to prevent a guarantor from making payment.[605] Kelly-Louw, however, discourages a liberal approach to granting interdicts for a wide range of exceptions to the autonomy principle on the basis that it would make the dichotomy between demand guarantees and accessory guarantees such as suretyships obscure and undermine the cash equivalence function of demand guarantees.[606] She emphasises that interdicts must be granted by the courts sparingly, if at all, and be limited to cases where there is clear evidence of fraud and illegality in the underlying contract.[607]

2.11.5 Other Remedies

Where payment by a guarantor pursuant to a demand by the beneficiary has already been made, remedies that an applicant could seek, include an injunction preventing the beneficiary from utilising the funds paid and for repayment of the guarantee amount to the issuing bank in exchange for a new guarantee (i.e., effective reversal of the demand and payment process under the demand guarantee).[608] Such a scenario (i.e., where the use of funds remitted to a beneficiary pursuant to a demand considered to be unjustified is restricted) was envisaged in the *Bolivinter* and *Bhoja Trader* cases, wherein it was noted that restrictions could "well be imposed upon the freedom of the beneficiary to deal with the money after he has received it".[609] A *modus operandi* noted to be commonly adopted by beneficiaries to frustrate the execution of any judgment in favour of the applicant is to dispose of assets or move them outside the relevant jurisdiction.[610] An applicant's recourse in such circumstances would be a freezing injunction, previously and still commonly referred to as *Mareva* injunction, or as it is known under the South African law, an anti-dissipation interdict. This is essentially a temporary order preventing the person against whom it is issued (usually a beneficiary who has received payment pursuant to an abusive demand in the context of

[605] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 459. See also Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 216.

[606] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 459.

[607] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle,* at 216.

[608] Whitten, *Calling on a Performance Security*, at 11, See also the Australian case of *Thiess Pty Ltd v Pacific National (Victoria) Pty Ltd* [2009] VSC 670, where an injunction was sought to compel a beneficiary to repay the amount they had received pursuant to a demand guarantee on the condition that a substitute guarantee would be issued, albeit one which could not be called upon until finalisation of the hearing relating to the disputed matters.

[609] *Bolivinter Oil SA v Chase Manhattan Bank and Ors [1984]* 1 Lloyds Rep 251, at 257 and *Intraco* Ltd *v Notis Shipping Corporation (The Bhoja Trader)* 1981 2 Lloyd's Rep 256 CA, at 258.

[610] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 298.

a demand guarantee) from dealing with, disposing of, or diminishing, the value of all or part of their assets or money pending settlement of the substantive court process.[611]

In support of non-interference with the autonomy principle, a remedy argued to be available for an applicant in the case of an abusive or unjustified demand pursuant to the underlying contract or otherwise is a claim for damages against a beneficiary. However, it is posited that such a claim should not disrupt the documentary credit machinery and would, therefore, be envisaged based on payment by the guarantor pursuant to its independent obligation to pay upon presentation of a proper demand and the corresponding reimbursement of the guarantor by the applicant per the terms of the indemnity or equivalent agreement between the applicant and the guarantor.[612]

2.11.6 Conclusion regarding Interdicts/Injunctions

Due to the differentiation of the implications of preventing a beneficiary from making a demand versus preventing a guarantor from making payment, as discussed above, several scholars support the view that any enjoinment must be on the former, as interfering with an obligation to pay would directly compromise the autonomy principle in an unacceptable manner.[613] Non-interference with the payment obligation has also been argued to be an approach which is conducive to the maintenance of market confidence and public policy considerations.[614] Freezing (*Mareva*) injunctions or anti-dissipation interdicts are beneficial in the context of demand guarantees due to their non-interference with the autonomy principle. They also facilitate due consideration and resolution of disputes relating to demand guarantees in an equitable manner as they maintain the status quo and prevent potential frustration of a judgment by a beneficiary dissipation of assets. In this regard, they provide a form of recourse against abusive demands by a beneficiary by levelling the playing field between a beneficiary and an applicant pending resolution of a dispute without in any way undermining the autonomy principle.

2.12 SUMMARY AND CONCLUSIONS

[611] See Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 298-306 for more detailed consideration of freezing orders in the context of demand guarantees.

[612] See Alavi, H "Contractual Restrictions on Right of Beneficiary to Draw on a Letter of Credit: Possible Exception to Principle of Autonomy" (2016), 16(2), *ICLR*, 67, at 69 and 86.

[613] Wooler, *Lifting the Veil of Autonomy*, at 28.

[614] Ibid.

Various definitions of a demand guarantee, differing in aspects such as prescriptiveness, granularity and even one or two elements, as illustrated in the sample definitions considered above, have been established by different authorities and commentators. Despite these variations, the two crucial elements which run through the definitions, and are submitted to be the core elements characterising a demand guarantee, are the autonomy principle and the documentary nature of demand guarantees.

The principle of autonomy, inculcating the independence of a guarantor's obligations from all other contractual relationships or transactions surrounding the documentary credit, particularly the demand guarantee, plays an important role in the different arising commercial relationships. In addition to its importance to the commercial utility, security and risk allocation function of demand guarantees, the autonomy principle clarifies (by limiting it) the role of a guarantor and neutralises competing interests of parties within the framework of the intention of the parties. However, the autonomy principle is considered to skew demand guarantees to the beneficiary's advantage and render them susceptible to abuse by unscrupulous beneficiaries. Perhaps to mitigate certain recognised circumstances which may be tantamount to such abuse, the autonomy principle is not absolute and is subject to limited recognised exceptions, such as established fraud and illegality in the underlying contract. As constituting possible exceptions, in addition to the documentary character of demand guarantees, unconscionability and the breach of a negative stipulation under the underlying contract, will be examined within the context of the autonomy principle in the chapters that will follow.

The autonomy principle is widely accepted, including in South Africa,[615] England,[616] and Australia[617] as considered in this thesis. It is also entrenched in prominent international rules pertinent to demand guarantees and other documentary credits, particularly UCP 600,[618] URDG 758,[619] the ISP 98, and the UNCITRAL Convention.[620] The documentary nature of demand guarantees, like the principle of autonomy, is generally recognised universally and is also

[615] See section 2.4.2 above.

[616] See section 2.4.3 above.

[617] See section 2.4.4 above.

[618] ICC Uniform Customs and Practice for Documentary Credits (ICC Publication No 600, Paris (2006), (hereinafter, "UCP 600"), Articles 4(a), 4(b) and 5.

[619] URDG 758, 5(a).

[620] United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) (hereinafter "UNCITRAL Convention"), Articles 2 and 3.

incorporated in the URDG 758,[621] UCP 600[622] and the ISP 98,[623] and the UNCITRAL Convention.[624]

Demand guarantees share many notable similarities with contracts[625] but, at the same time, lack some key *essentialia* required to form a contract, notably the absence of a clear offer and acceptance and the lack of consideration for the issuance of the demand guarantee as discussed above.[626] Despite the contractual elements they lack, there is no universally satisfactory explanation to rationalise the binding, valid and/or enforceable nature of demand guarantees. Numerous theories have been advanced in this regard, including, non-novatory delegation, cession, suretyship, agency and the stipulation in favour of a third party and mere consensus, but it is ultimately acknowledged that none of these explanations are satisfactory and this remains an area of conjecture.[627] Still, the settlement of this controversy is beyond the scope of this thesis. This thesis subscribes to the view that, rather than fixating on solving the "contract-esque" aspects of documentary credits and their perceived deficiencies from a contract law perspective, the focus should remain and be redirected at this juncture to the pertinent indubitable aspects of documentary credits, one of which is that they are indeed binding.

There are several types of demand guarantees, including performance guarantees, tender guarantees, advance payment guarantees, maintenance guarantees, and retention guarantees, split out mainly by their usage. However, they all serve a security function in one form or another.

A complete understanding of the nature of demand guarantees also requires understanding the distinction between a demand guarantee and other instruments it is often associated with or confused with, particularly a true guarantee or a suretyship agreement and commercial letters of credit. Critical differences that stand out in the comparison between a suretyship agreement/true guarantee and a demand guarantee include that the former is an accessory obligation. In contrast,

[621] See Articles 6-7.

[622] Articles 5 and 14(h).

[623] See Rules 1.06(d) and 4.11.

[624] Articles 2 and 3.

[625] See section 2.2.2 of this thesis.

[626] Ibid.

[627] Van Niekerk and Schulze, *The South African Law of International Trade*, at 275 and the discussion in sections 2.2.2.3 to 2.2.2.5 of this thesis.

the latter is an independent and standalone obligation.[628] While a demand guarantee is autonomous from the underlying contract, a suretyship agreement is, in contrast, reliant upon the existence of a valid principal obligation and cannot independently exist without it. In addition, while demand guarantees are a primary undertaking, suretyship agreements are "secondary both in intent and in form",[629] and performance or payment under a suretyship or true guarantee will only be called upon if, and only to the extent that the principal debtor is in default.[630]

While commercial letters of credit are considered effective payment instruments, demand guarantees and standby letters of credit are security instruments by design and share a closely similar commercial purpose and legal nature. Any distinction between them is deemed to be superficial. However, there are a few differences between the latter two instruments.[631] Considering the similarities and distinctions between commercial letters of credit, demand guarantees and standby letters of credit, the ultimate determination of the nature of a specific instrument depends on the construction of that instrument. Proper construction of an instrument may be aided by reference to factors such as language, context, background and the relevant matrix of facts.

The doctrine of strict compliance is broadly accepted to apply to standby letters of credit under South African law as supported by case law, which is in line with the influence of English law. However, there is no clear consensus on applying the doctrine of strict compliance or the degree of compliance applicable to a demand guarantees under South African law. Some support the idea that the same strict standard of compliance applicable to letters of credit should also apply to demand guarantees. At the same time, other commentators have supported applying a lesser strict degree of compliance to demand guarantees. Given the uncertainty in this regard, a prudent approach is to focus on adherence to the following two points of general consensus: that a demand must comply with the terms called for in a demand guarantee and that where such terms require it, a demand must strictly comply.

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[628] See the discussion of the differences between demand guarantees and suretyship agreements and/or traditional guarantees, in section 2.6.1 above.

[629] Ibid.

[630] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 36.

[631] See the discussion of the distinction between standby letters of credit, commercial letters of credit and demand guarantees in section 2.6.2 above.

Two types of interdict/injunction are typically sought when disputes arise regarding demand guarantees: either an injunction to prevent a beneficiary from making a demand under the demand guarantee or an injunction preventing a guarantor from making payment to honour a demand that has already been made under a demand guarantee. An interdict/injunction against a beneficiary typically seeks to prevent a payment obligation arising on the part of the guarantor by thwarting the one thing that could give rise to it: a demand. A distinction is drawn between the effect on the autonomy principle of an interdict/injunction restraining a beneficiary from making a demand on the one hand and, on the other hand, one preventing payment by a guarantor who has received a seemingly valid demand. Given that in the latter situation, the injunction has a comparatively lesser impact on the autonomy principle, enjoinment against a beneficiary to prevent him from making a demand here, where he is not entitled to do so, is seemingly the preferable method of obtaining recourse.

However, injunctions (interdicts) in general, even those against a beneficiary, are by no means encouraged and must only be considered in exceptional circumstances, if at all. Therefore, regardless of whether an injunction is sought to prevent a demand by a beneficiary or to block payment by a guarantor, any form of court interference with the enforcement of a demand guarantee arrangement must be avoided in the first instance and any recourse to it taken only in exigent circumstances. A similarly restrained approach to interfering with demand guarantees must be applied in respect of exceptions to the autonomy principle, whether they be commonly accepted exceptions such as fraud and illegality or other potential ones such as unconscionability and breach of a negative stipulation, which will be explored in this thesis.

Other remedies that an applicant may have recourse to with little to no risk of adversely affecting the autonomy principle (likely because they are typically used after payment by a guarantor has occurred to honour a beneficiary's demand) include a claim for damages or a freezing (*Mareva*) injunction (order) or the South African anti-dissipation interdict against a beneficiary.

CHAPTER 3: UNCONSCIONABILITY AND THE BREACH OF A NEGATIVE STIPULATION AS POSSIBLE EXCEPTIONS TO THE AUTONOMY PRINCIPLE OF DEMAND GUARANTEES UNDER SOUTH AFRICAN LAW

3.1 GENERAL

3.1.1 Introduction

This chapter will comprise a South African law discussion of the unconscionability and the breach of a negative stipulation in the underlying contract or another agreement as standalone exceptions to the autonomy principle of demand guarantees. The current South African law position, including the possible acceptance, application and parameters of these exceptions, as evidenced by case law, will be considered under separate headings. Arguments for and criticisms levelled against the acceptance and other elements of the two exceptions will also be evaluated from a South African perspective under the relevant headings.

3.1.2 Anti-dissipation Interdict under South African law

The *Mareva* injunction, now commonly referred to as a freezing order, was fashioned in 1975 and named after *Mareva Compania Naviera SA v International Bulkcarriers SA*.[1] The nature of the *Mareva* injunction, largely now referred to as a freezing order/injunction[2] or, in South Africa, an anti-dissipation interdict is such that a court may grant it to prevent a debtor from disposing of his assets if it appears that the debt is due and owing and that there is a danger that the debtor may dispose of his assets before judgment to defeat the creditor's claim.[3] The anti-dissipation interdict is part of South African law and has been acknowledged to be a powerful weapon against defendants who have no bona fide defence and are seeking to conceal or dispose of their assets to frustrate a judgement. [4]

A prominent South African case on anti-dissipation interdicts, the South African counterpart of the *Mareva* injunction, is *Knox D'arcy & Others v Jamieson & Others.*[5] The South African common law remedy described in *Knox D'arcy* was referenced as "an anti-dissipation interdict *in securitatem debiti*" (i.e., an interdict to secure a debt). Stegman J, in *Knox D'arcy* where the anti-

[1] *Mareva Compania Naviera SA v International Bulkcarriers* SA [1975] 2 Lloyd's Rep 509. See also *Nippon Yusen Kaisha v Karageorgis* [1975] 3 All ER 282 (CA).
[2] *Mareva* injunctions became known as "freezing injunctions" with the advent of the English Civil Procedure Rules of 1998. In particular, Rule 25.1(1)(f) of the Civil Procedure Rules of 1998, which provides that the court may grant an order (1) restraining a party from removing from the jurisdiction assets located there; or (2) restraining a party from disposing of, dealing with, or diminishing the value of any assets, whether located within the jurisdiction or not.
[3] Hillestad, H "Never Mareva" (1995), 3(1), *Juta's Business Law*, 29 (hereinafter, Hillestad, *Never Mareva*"), at 29.
[4] Hillestad, *Never Mareva*, at 30.
[5] 1994 (3) SA 700 (W). See also *Schiebler v Kiss* 1985 (3) SA 489 (SWA).

dissipation interdict was granted, asserted that using the English-derived term *Mareva* injunction would likely "obscure the fact that the equivalent remedy provided by [South African] common law is of a truly ancient origin, with its roots in the civil law".[6] The requirements to establish *prima facie* grounds for the granting of such a remedy were noted to be that the defendant should have no bona fide defence against an apparently valid claim by the plaintiff; have assets in South Africa; and intend to defeat the plaintiff's claim, or render it meaningless/hollow by secreting, disposing of or removing their assets from the court's jurisdiction.[7]

Notwithstanding the broad view that South Africa imported the *Mareva* injunction from or was influenced by English law,[8] it has been averred that the same or similar principles already existed under South African law[9] since the case of *Yamamoto v The Rand Canvas Company*[10] Stegmann J, in *Knox D'arcy* however observed, in connection with the *Mareva* injunction's English law connection that: "[t]he developments in modern commercial life which rendered it necessary for the English courts to adopt the Mareva jurisdiction are also tending to manifest themselves in [South Africa]".[11] Ancillary relief provided in the *Knox D'arcy* case and which has been said to reflect further similarity to the English law *Mareva* injunction includes an order for a defendant to disclose by affidavit details and location of their assets, as there would be little point in granting an anti-dissipation interdict if it could be easily circumvented.[12]

A distinction which has been highlighted between the requirements of the English law and South African law iterations of the *Mareva* injunction or anti-dissipation interdict is that South African courts require proof of the defendant's lack of a bona fide defence to the action, whereas under English law it is not required, and consideration is instead given to the probability of the plaintiff recovering judgment against the defendant.[13] Moreover, unlike in terms of the English law, South

[6] See *Knox D'arcy & Others v Jamieson & Others*1994 (3) SA 700 (W), at 705 and 706A–E.
[7] Hillestad, *Never Mareva*, at 29.
[8] Cooke, D "Evangeline's Search: A Critical Analysis and Comparison of Mareva Injunctions, Security Arrests and Rule B Attachments" (2009), 126(3), *South African Law Journal*, 429, at 432.
[9] Hillestad, *Never Mareva*, at 29.
[10] 1919 WLD 100. The 1919 case of *Yamamoto v The Rand Canvas Company* 1919 WLD 100, reflecting very similar principles as the *Mareva* injunction or South African anti-dissipation interdict it was held that barring a vindicatory action in which the plaintiff claims some right in the asset disposed of, the court would refrain from interdicting asset disposal prior to its ruling in an action unless there was a strong *prima facie* case made that there is no genuine defence to the action, and the defendant has the objective of disposing of their assets to defeat the plaintiff's prospective judgment.
[11] *Knox D'arcy & Others v Jamieson & Others* 1994 (3) SA 700 (W), at 707.
[12] Hillestad, *Never Mareva*, at 30.
[13] Ibid.

African law has no statutory measures governing courts' jurisdiction to grant interdicts, including anti-dissipation interdicts.[14]

Some commentators view *Knox D'arcy* to have, "charted a new course for Mareva-type relief in South Africa".[15] It is worth noting though that *Knox D'arcy* is considered to have presented a unique and unprecedented combination of facts and courts should exercise their discretionary power conservatively in a manner not extending to cases not substantially and uniquely comparable to the *Knox D'arcy* case.[16] The South African anti-dissipation interdict, which is similar to the *Mareva* injunction (now commonly known as the freezing injunction) under English law, is applicable only in exceptional circumstances.[17] Anti-dissipation interdicts are capable of being abused and should be granted sparingly, noting especially that they are very intrusive and may have a devastating impact on the person against whom they are granted. To this end. South African courts have been rightly urged to consider the balance of convenience test with great circumspection prior to granting an anti-dissipation interdict. However, there remains little, if any, indication that South African courts have been directly confronted with and addressed the topic of anti-dissipation interdicts specifically in the context of demand guarantees or other documentary credits.

In the context of demand guarantees or other documentary credits, as relevant to this thesis, an anti-dissipation interdict is intended to prevent a beneficiary from concealing or transferring its assets beyond the reach of the applicant. The legal requirements for the granting of an anti-dissipation interdict have been found to be substantively the same as those for any other interim interdict.[18] A *prima facie* claim against the beneficiary, a well-grounded apprehension of irreparable harm and a balance of convenience in favour of the applicant or principal would be

[14] Kelly-Louw, M "*Selective Legal Aspects of Bank Demand Guarantees: The Main Exceptions to the Autonomy Principle*", LLD thesis, University of South Africa, 2008 (hereinafter "Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*"), at 322. In particular, there is no equivalent statutory provisions to in South Africa to the provisions of section 37(3) of England's Supreme Court Act of 1981: "The power of the High Court under subsection (1) to grant an interlocutory injunction restraining a party to any proceedings from removing from the jurisdiction of the High Court, or otherwise dealing with, assets located within, that jurisdiction shall be exercisable in cases where that party is, as well as in cases where he is not, domiciled, resident or present within that jurisdiction." For a comprehensive comparative analysis of the *Mareva*/freezing injunction under English law and the South African anti-dissipation interdict, see Prest, CB *The Law and Practice of Interdicts*, Juta, 1996, at 160-172.
[15] Hillestad, *Never Mareva*, at 29-30
[16] *Knox D'arcy & Others v Jamieson & Others* 1994 (3) SA 700 (W), at 703.
[17] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 323. See also Herbstein, J; De Villiers Van Winsen, L; Gardner Eksteen, JP; Cilliers, AC, Herbstein and Van Winsen *The Civil Practice of the Superior Courts in South Africa*, 3 ed, Juta, 1979, at 645.
[18] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 322.

required to establish grounds for an anti-dissipation interdict in the context of a demand guarantee or other documentary credit under South African law.[19]

3.2 UNCONSCIONABILITY

3.2.1 Introduction

Unconscionability will be explored as a possible separate exception to the autonomy principle of demand guarantees. To facilitate the analysis and discourse on this topic, consideration must be given to what is meant by the term "unconscionability". In addition, due to the relevance of unconscionability in the context of the validity and enforceability of a contract, the general principles of the law of contract and how the courts have dealt with unconscionability regarding contracts generally will also be looked at for guidance. Case law on unconscionability, specifically in relation to demand guarantees, will be considered to establish the prevailing position in this regard under South African law, as reflected by the inclinations of South African courts when this topic came before them.

The term's normal grammatical roots will be briefly discussed as a starting point in tracing the definition and scope of unconscionability. According to the Oxford dictionary, the word "unconscionable" in relation to an act or action connotes conduct which is "so bad, immoral, etc. that it should make [one] feel ashamed".[20] Illustrating a typical quagmire with subjective aspects such as morality, feelings and/or emotions, which are incorporated in this definition, circumstances where a person actually feels shame or where it is considered that they "should" feel shame are extremely fluid territory. Such elements could easily depend on a number of variables, including individual personality and values that a person subscribes to, which themselves are subjective. Subjectivity does not aid the need for certainty in the law (including contract law). In contrast, certainty is a prerequisite to ensuring effective application and enforcement of the law to a significant degree.

In order to lend the term unconscionability the certainty it needs in the context of the law, whether common law or statutory law, certain jurisdictions have formulated definitions or parameters of

[19] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 255 and 315 and 320. See also for example the case of *Z Enterprises v Standard Bank of South Africa Ltd* 9 1995 CLD 769 (W) in which the application for the interdict was denied due to, *inter alia*, failure to show an apprehension of irreparable harm and the absence of another satisfactory remedy.

[20] https://www.oxfordlearnersdictionaries.com/definition/english/unconscionable (Accessed on 21 February 2021).

conduct which would be considered to fall within the ambit of unconscionability.[21] However, a common denominator of such formulations is that they are linked to principles relating to equity and fairness. The South African law formulation of unconscionability and the approach of the courts in respect thereof will be considered in detail below, with a brief outline of the position in relation to the USA's Uniform Commercial Code ("UCC"),[22] which exemplifies the codification of unconscionability in respect of contracts generally. Furthermore, comparative analysis in respect of the approaches and/or definitions or understanding regarding unconscionability in the jurisdictions covered in this thesis will be considered in later chapters.[23]

3.2.2 Fraud, Duress, Misrepresentation, Undue Influence – Unconscionability by Other Names?

3.2.2.1 Comparative Consideration of the USA Approach under the UCC: Codification of Unconscionability Generally in relation to Contracts and the Fraud Exception regarding Letters of Credit

In jurisdictions such as the USA, unconscionability was, as far back as 1952, considered to be a perhaps abstract concept capable of being addressed under the remit of fraud, duress, misrepresentation, undue influence and unequal bargaining power on the premise of the latter being flexible enough to accommodate unconscionability.[24] This seems to support the view that unconscionability need not be considered a standalone principle in the context of its impact on a contract. Moreover, according to this line of thinking, the mischief unconscionability would seek

[21] See Chapters 4 and 5 of this thesis for an analysis of the approach taken by the UK and Australia which appear to have a more established position on the recognition of unconscionability as exception to the autonomy principle of documentary credits. The USA's Uniform Commercial Code, Revised UCC Article 5, Letters of Credit, 1995 is also referenced with a focus on how it exemplifies codification of documentary credit law and also the codification of a concept of unconscionability, although the recognition and codification of unconscionability therein is only in respect of general law of contract and not in respect of letters of credit.

[22] Uniform Commercial Code, Revised UCC Article 5, Letters of Credit, 1995 (hereinafter, "UCC").

[23] There seems to be an emerging trend whereby South African courts glean guidance from Australian case law, as exemplified in *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 41 where unconscionability was explained with reference to a paper by Whitten (Whitten, M "Calling on a Performance Security: As Good as Cash?" presented on 18 June 2013 to the Victorian Bar, Commercial Bar Association, Construction Law Section, Neil McPhee Room, Owen Dixon Chambers East, 205 William Street, Melbourne (hereinafter, "Whitten, *Calling on a Performance Security*")) as a concept which entails "taking advantage of a special disadvantage of another"' or "unconscientious reliance on strict legal rights" or "action showing no regard for conscience, or that are irreconcilable with what is right or reasonable and where Whitten (at pages 14-15) also referred to *Olex Focas Pty Ltd v Skodaexport Co Ltd and ACCC v Samton Holdings Pty Ltd* (2002) 117 FCR 301 in which, "(i) exploitation of vulnerability or weakness; (ii) abuse of a position of trust or confidence; (iii) insistence upon rights in circumstances which make that harsh or oppressive; and(iv) inequitable denial of legal obligations", were considered to constitute unconscionability.

[24] Corbin, AL, *Corbin on Contracts*, 1 ed, West Publishing Company, 1952, at 188.

to address is sufficiently contemplated under and thus subsumed by other contractual concepts as referred to above. Based on such an approach, unconscionability as a standalone concept would have very limited, if any, utility to the courts. If this view is pursued, one may well conclude that the enforcement of unconscionable agreements may be refused by courts based on any one ground or a combination of grounds such as those mentioned above.

It has been opined that courtesy of its "hybrid legal heritage",[25] South African law has developed along similar lines as the USA and has largely retained this position in relation to the concept of unconscionability.[26] This may explain why unconscionability has not gained recognition on a standalone basis as a concept applicable to South African law of contract generally. The USA, however, with the introduction of section 2-302 of the Uniform Commercial Code[27] in 1962, went on to incorporate the doctrine of unconscionability in its codified rules relating to contracts.[28] In light of this development of the law in the USA, the previous position of which was argued to have influenced the South African law, it could be argued that South African law was left in need of consequential updates in the form of an explicit general concept of unconscionability akin to the one incorporated in section 2-302 of the UCC.[29]

Despite the codification of unconscionability in section 2-302 of the UCC, the term unconscionability has not been defined therein. Therefore, some definitions of unconscionability have been developed in common law on the basis of case law precedents, some of which specifically referenced section 2-302 of the UCC. Definitions of unconscionability in the context of contracts in cases that came before USA courts ranged from contemplation of contractual terms that are unreasonably harsh and burdensome to one of the parties[30] to more subjective explanations. One such subjective explanation is that an unconscionable contract is one in which no, "sensible

[25] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 508.

[26] Ibid.

[27] Uniform Commercial Code, Revised UCC Article 5, Letters of Credit, 1995 (hereinafter, "UCC").

[28] UCC section 2-302 states: "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making its determination."

[29] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 508

[30] *Banaghan v Malaney, 200 Mass.* 46, 85 NE 839 (1908); *Kleinberg v Ratett*, 252 NY 236, 169 NE 289 (1929).

man not under delusion, duress, or in distress would [enter into], and such as no honest and fair man would accept",[31] which was proffered in the USA case of *Stiefler v McCullough*.[32]

Definitions which are considered to lean heavily on subjective language, such as the one from *Stiefler*, have, rather expectedly, been criticised for "being phrased in terms of an emotional response to a given factual situation" and "providing little help in understanding" the meaning of unconscionability.[33] However, official comments to section 2-302 of the UCC provide useful guidance in the form of the following test, "[w]hether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract".[34] The comment elaborates further on this through the stated principle of preventing "oppression" and "unfair surprise".[35]

However, a key point worth noting is that in respect of letters of credit, the UCC expressly recognises only fraud as a legitimate exception to the autonomy principle.[36] While unconscionability is recognised in a general commercial context in section 2-302 of the UCC,[37] unlike the Australian Trade Practices Act,[38] which seems more open to the application of the concept of unconscionability to demand guarantees and other documentary credits, the UCC does not provide for statutory recognition of unconscionability in respect of letters of credit. Therefore, some conduct which may be considered to give rise to the statutory unconscionability exception in jurisdictions like Australia would be tested under the ambit of fraud in the USA.

The UCC's reticence regarding unconscionability in the context of documentary credits is arguably a deliberate stance adopted by the UCC because the section of the UCC specifically applicable to

[31] *Stiefler v McCullough* 174 NE 823 (Ind. Ct. App. 1931), at 826.

[32] Ibid.

[33] Martin, B "Shulkin, Unconscionability - The Code, the Court and the Consumer" (1968) 9(2), *BCL Rev.* 367, at 367.

[34] Official commentary to Section 2-302 of the UCC, Comment 1.

[35] Ibid.

[36] UCC Section 5-109.

[37] See footnote 6 above.

[38] Trade Practices Act, 1974 (Cth). This is discussed further in Chapter 5 of this thesis.

letters of credit[39] explicitly incorporates the fraud exception and makes no mention of unconscionability. By way of comparison, South African law of contract and of demand guarantees is currently common-law based and not codified by way of statute.[40] However, because South African law is founded on the tenets of the Constitution of the Republic of South Africa,[41] constitutional mores, including considerations such as unconscionability, have come before the courts and have been recognised in relation to the law of contract in several cases.[42]

Under USA law, unconscionability is not accepted as an exception to the autonomy principle of demand guarantees, even though unconscionability in the context of the general law of contract seems recognised as codified in Article 2 of the UCC. Despite letters of credit and contracts being, strictly speaking, distinct instruments, the separate treatment in terms of unconscionability is prone to causing confusion. If parameters of unconscionability could be codified and recognised in respect of the law of contract, it is unclear why it cannot similarly be finessed and applied to documentary credits as appropriate. However, this aspect of the USA approach falls beyond the scope of this thesis. It will not be considered further, nor will the general question of whether South African law of contract and demand guarantees is better off codified instead of common-law based as is presently the case.

Further consideration of the definition of unconscionability and analysis of what the concept entails will be discussed further below in a South African law context.[43] South African law may benefit from incorporating a firmly recognised general concept of unconscionability into its common law akin to the one adopted in the UCC, which could perhaps also be extended to apply to demand guarantees in the same way other principles of the contract are applied to it. However, reiterated that it is not within the scope of this thesis to consider South African contract law in general, which is common-law based or any potential codification thereof. Regarding demand

[39] Article 5.

[40] A concept of unconscionable conduct has, however, been codified in relation to certain contracts under the Consumer Protection Act 68 of 2008, which is considered in section 3.2.5 of this Chapter.

[41] The Constitution of the Republic of South Africa, Act 108 of 1996.

[42] For example, *Brisley v Drotsky* 2002 (4) SA 1 (SCA); *Napier v Barkhuizen* 2006 (4) SA 1 (SCA) and also *Barkhuizen v Napier* 2007 (5) SA 323 (CC); *Citibank NA v Thandroyen Fruit Wholesalers CC and Others* 2007 (6) SA 110 (SCA); *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 (2) SA 150 (SCA), *Maphango v Aengus Lifestyle Properties (Pty) Ltd* 2011 (5) SA 19 (SCA); *Potgieter v Potgieter NO* 2012 (1) SA 637 (SCA); *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC); *Botha v Rich* 2014 (4) SA 124 (CC) and *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC).

[43] See the more detailed consideration of unconscionability and its scope in sections 3.2 of this Chapter.

guarantees only, guidance could be drawn from the UCC's approach to unconscionability regarding the general law of contract to be extrapolated directly for the South African common law of demand guarantees only. However, one cannot rationalise this approach without first confronting the fact that the UCC seems to deliberately exclude the concept of unconscionability from its codified law of letters of credit.

Without delving into the rationale of the UCC, it could be reasonably speculated that the UCCs non-recognition of an unconscionability exception in respect of letters of credit was due to a legislative assessment of the pros and cons of introducing an unconscionability exception to the autonomy principle, not yielding a result in favour of the exception. Given the nature of documentary credits, it could be opined that their commercial utility relies on certainty to a much larger degree than the general law of contract. Taking this need for a higher degree of certainty into account, this thesis explores whether South African law in respect of demand guarantees may be ripe for further development to keep in step with changes in the laws of jurisdictions from which its "hybrid heritage" is derived.

3.2.2.2 Essentialia of a Contract under South African law and Flaws related to Unconscionability

Under South African law, a contract may contain the *essentialia* required to form a valid contract. Still, it may have been entered into in circumstances where there is an existing flaw which entitles a party/parties to repudiate the agreement and seek restoration to the extent possible, to their original positions (such restitution is known as *restitutio in integrum*). A flawed contract of such a nature is considered to be voidable[44] at the election of the party prejudiced by it. Still, it remains *prima facie* valid and binding on the parties pending repudiation by the prejudiced party.[45] The flaws that may render a contract voidable under South African law are typically categorised into types which include fraudulent or non-fraudulent misrepresentation, duress, and undue influence.[46] Fraudulent or non-fraudulent misrepresentation, duress, and undue influence have also been

[44] Distinct from a contract which is *void ab initio*, being one which lacks one or more of the elements essential to the formation of a contract and has no legal effect from its inception. See Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 508.

[45] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 515.

[46] Brief re-caps of trite principles of common-law are given in this thesis where appropriate in the context of unpacking various arguments relating to unconscionability. It is not within the scope of this thesis to provide a comprehensive summary or analysis of South African law of contract, for that, see sources such as Christie, RH, *Christies Law of Contract in South Africa*, 7 ed, Lexis Nexis, 2016 and Hutchison, D et. al *The Law of Contract in South Africa*, 3 ed, Oxford, 2017.

asserted to encompass conduct which would be the "equivalent" of the doctrine of unconscionability as applied in the USA and other jurisdictions.[47]

The arguable overlap between the concept of unconscionability and the flaws mentioned above, which could make a contract voidable under South African law, is illustrated in the South African case of *Preller and Others v Jordaan.*[48] The court in *Preller* proffered what could be considered to be a definition of undue influence, finding that the exercise by one person of influence over another which weakens the latter's powers of resistance and renders their will compliant, and where such person then used their influence in an unconscionable manner to persuade the other to agree to a prejudicial transaction which he would not have concluded with normal free will, was grounds for *restitutio in integram.*[49] The reference to using influence in an unconscionable manner clearly alludes to the intersection of undue influence and the notion of unconscionability.

It is in view of cases such as *Preller* that commentators have urged South African courts to adopt a concept of unconscionability that "seeks to merge, where possible, the existing doctrines of misrepresentation, duress, and undue influence."[50] The existence of potential merits of conflating misrepresentation, duress and undue influence into a catch-all concept of unconscionability, including the benefit of a streamlined South African law position on the general application of unconscionability, is acknowledged. However, an alternative viewpoint is that if the concept of unconscionability is already captured under the existing contract-law doctrines such as misrepresentation, duress, and undue influence, then presumably, the recourse sought to be provided to prejudiced contractual parties is already available to them under the existing dispensation.

It would then follow from the above that regardless of whether such recourse falls under the banner of misrepresentation, duress, and/or undue influence, or that of unconscionability, the mischief potentially giving rise to it is addressed. Equally, in the context of documentary credits and particularly demand guarantees, misrepresentation, duress, and undue influence, in lieu of the concept of unconscionability, could be considered potential exceptions to the autonomy principle subject to parameters determined to be appropriate by the courts. A separate standalone concept

[47] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 515.

[48] 1956 (1) SA 483 (A).

[49] *Preller v Jordaan* 1956 (1) SA 483 (A), at 492.

[50] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 525.

of unconscionability will be redundant if that is the case. Considering whether misrepresentation, duress, and undue influence can be packed together into a hybrid concept of unconscionability falls outside the scope of this thesis. However, the merits and disadvantages of a standalone general concept of unconscionability under South African contract law are an integral part of this thesis. If the merits outweigh the cons, it would be worth analysing whether misrepresentation, duress, and undue influence can be streamlined under unconscionability.

3.2.3 Unconscionability and Good Faith under South African Law

3.2.3.1 Origins and Background of Good Faith and the Rise and Fall of the Exeptio Doli Generalis

In some quarters, the term "unconscionability" is considered to be synonymous with "bad faith", and the terms are sometimes used interchangeably, particularly where demand guarantees are concerned, in the context of bad faith by the beneficiary.[51] On the basis that bad faith connotes the absence of good faith, consideration will be given to the origins and development of good faith under South African law, to trace its overlap with and contribution to the concept of unconscionability.

Roman law and Roman-Dutch law are noted as the leading influencers in the development of South African law, including good faith considerations.[52] Roman law, being originally focused on formalism and strict adherence to procedure, subsequently evolved to incorporate the concept of good faith due to potential injustices arising from that approach.[53] This development afforded courts the discretion to infuse the concepts of justice, fairness and reasonableness into the determination of the rights and obligations of parties to contractual disputes and the e*xceptio doli generalis* (i.e., the Roman law defence of bad faith in the general form)[54] defence against claims by parties whose conduct was in bad faith also gained traction.[55]

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[51] See generally Lupton, CS "*A Comparative Legal Perspective on the Impact of Good or Bad Faith on the Independence of Documentary Credits and Demand Guarantees*", LLM dissertation, University of Johannesburg, 2018 (hereinafter, "Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith"*).

[52] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 38.

[53] Idem, at 38-39.

[54] Hutchinson D, Pretorius CJ, et al. *The Law of Contract in South Africa*, Oxford University Press Southern Africa, 2009, at 450.

[55] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 39.

The concept of good faith was received in the Netherlands as part of the development of what became known as Roman-Dutch law. However, good faith under Roman-Dutch law was noted to be distinct from the Roman law concept of good faith in that the former was narrower in definition and remained subject to substantive aspects of law which could not be overridden by notions of fairness and justice. Therefore, good faith under Roman-Dutch law could not be applied to restrict or extend the rights of contracting parties. Some commentators attributed this distinction to social context differences and the fact that Roman-Dutch law did not embrace the strict legal procedure to the same degree as Roman law.[56]

One early case relating to equitable notions is the case of *Mills and Sons v The Trustees of Benjamin Bros,*[57] where the concept of equity was stated to apply only to the extent that it was consistent with Roman-Dutch law.[58] South African law adopted significant elements of Roman-Dutch law. Consequently, applying the concept of good faith under South African law developed along similar lines as under Roman-Dutch law.[59] In deference to freedom of contract and the *pacta sunt servanda*[60] principle, South African law was not permissive of the terms of a contract being altered to accommodate good faith. Therefore, the position was clear that sanctity of contract trumped good faith considerations regarding the law governing contracts.[61] However, with the advent of English law principles being accepted and English law having a supplementary influence on South African law, a uniquely hybrid South African law system resembling neither pure Roman-Dutch law nor English Law emerged, also partly due to the dissonance between certain aspects of Roman-Dutch law and English law.[62]

The case of *Judd v Fourie*[63] provided an early reference to the concept of good faith under South African law. In this case, it was unequivocally stated that good faith is a requirement of contracts.[64]

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[56] Ibid.

[57] (1876) 6 Buch 115.

[58] (1876) 6 Buch 115, at 121

[59] Ibid.

[60] This means that agreements must be honoured by the parties thereto, based on recognition of the principle that parties are free to contract and must be bound by contracts they enter into.

[61] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 39.

[62] Ibid.

[63] (1881) 2 EDC 41.

[64] Idem, at 76.

However, other cases after that gravitated away from applying equitable notions to the law of contract. In particular, the case of *Burger v Central South African Railways*,[65] per Innes CJ, explicitly rejected unreasonableness as a basis on which a contract may refuse to be enforced, stating categorically that South African law did not recognise the right of a court to release a contracting party from the consequences of a contract they have duly entered into merely because the contract seems to be unreasonable.[66]

The notion of fairness, which is often linked to good faith, was also considered fundamental in the context of contracts in the 1916 case of *Trustee, Estate Cresswell and Durbach v Coetzee*[67] where the court regarded it proper to avoid a "manifestly inequitable result".[68] In yet another example of the invocation of good faith by South African courts, the court in *Neugebauer and Co v Herman*,[69] per Innes CJ, emphasised the fundamentality of the requirement of bona fides between the parties to a contract of sale.[70]

A further case which exemplifies judicial support for the recognition of equitable considerations in respect of South African law of contract at the time is *Rand Rietfontein Estates Ltd v Cohn.*[71] In this case, De Wet JA held that:

> "The court will lean to that interpretation which will put an equitable construction upon the contract and will not, unless the intention of the parties is manifest, so construe the contract as to give one of the parties an unfair or unreasonable advantage over the other".[72]

Despite the indications of support by the courts, the *exceptio doli generalis* and the role of good faith under South African law remained somewhat of an unsettled issue, as reflected by some

[65] 1903 TS 571.

[66] *Burger v Central South African Railways* 1903 TS 571, at 576.

[67] 1916 (AD) 14.

[68] Idem, at 19. Other early South African cases supporting the application of the principle of good faith/bona fides to contracts prior to it being dispensed with include, *Paddock Motors (Pty) Ltd v Igesund* 1976 (3) SA 16 A; *Meskin NO v Anglo American Corporation of SA Ltd and Another* 1968 (4) SA 793 (W); *Savage and Lovemore Mining (Pty) Ltd v International Shipping Co (Pty) Ltd* 1987 (2) SA 149 (W) and *Tuckers Land and Development Corporation (Pty) Ltd v Hovis* 1980 (1) SA 645 (A).

[69] 1923 AD 564.

[70] Idem, at 573.

[71] 1937 (AD) 317.

[72] 1937 (AD) 317 at 330.

intermittent cases which broke the mould. One such case was *Weinerlein v Goch Buildings Ltd*[73] in which it was highlighted that equitable principles were only enforceable where they had been authoritatively incorporated and recognised as rules of positive law.[74] Kotze JA clarified that equity distinct from the law did not prevail under South African law and that it could not and did not override clear provisions of South African law.[75] A differing view, supported by Wessels JA in the same case, was that courts are imbued with an inherent right to refuse enforcement of an unconscionable claim.[76] This early reference to unconscionable conduct, in this case, is illustrative of the close association between principles of equity and the concept of unconscionability. In addition, this case depicts the two divergent approaches debated under South African law regarding the role of equitable principles in the law of contract.

Equitable notions, however, continued to gain some ground, as evidenced by the later case of *Zuurbekom Ltd v Union Corporation Ltd*[77] which recognised the continued subsistence of the *exceptio doli generalis* under South African law.[78] In the case of *Paddock Motors (Pty) Ltd v Igesund*[79] the continued existence of the *exceptio doli generalis* was also acknowledged but caveated by the view that it could neither override substantive law nor give rise to the amendment of an agreement that had been validly entered into.[80]

The landmark case of *Bank of Lisbon and South Africa Ltd v De Ornelas and Another*[81] is most notable for its crystallisation of the position that the *exceptio doli generalis* was not part of South African law. This was determined on the basis that the *exceptio doli generalis* had never been received into Roman-Dutch law. The court denounced the *exceptio doli generalis*, and stated and expressed the view that the *exceptio doli generalis* was a "superfluous, defunct anachronism".[82]

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[73] 1925 AD 282.

[74] 1925 AD 282, at 295.

[75] Ibid.

[76] 1925 AD 282, at 292-3.

[77] 1947 (1) SA 514 (A).

[78] Idem, at 535.

[79] 1976 (3) SA 16 (A).

[80] Idem, paras 28E-G.

[81] 1988 (3) SA 580 (A).

[82] 1988 (3) SA 580 (A), at 604.

The court went on to support the view that there was no general substantive defence based on equity in Roman-Dutch Law.[83] It was further noted that South African courts had been unwavering in their refusal to impose equitable discretion to release a prejudiced party from an unconscionable but otherwise valid contract.[84] Therefore, the *Bank of Lisbon* case effectively jettisoned the view that courts had the discretion to adjudicate contractual disputes by direct invocation of the notions of fairness and good faith.[85] Another view advanced regarding the *exceptio doli generalis* is that it is simply a convenient label for a number of rules such as rectification, mistake and estoppel and has no specific substantive content as a standalone remedy, which view was touched upon in the case of *Bredenkamp and others v Standard Bank of South Africa Ltd*[86] more than a decade later.

It is worth noting that the minority judgment in *Bank of Lisbon*, per Jansen J, supported the view that the *exceptio doli generalis* was firmly entrenched in South African law. The minority judgment adopted the view that freedom of contract should not be considered absolute. In appropriate circumstances, relief may be granted by courts to alleviate potential adverse outcomes of freedom of contract such as inflation and monopolistic conduct, which could, in turn, lead to or exacerbate issues like "unequal bargaining power and the large scale of standard-form contracts often couched in small print".[87]

Despite the round rejection of the *exceptio doli generalis* in the *Bank of Lisbon*[88] case, many cases continued to doggedly suggest that this may not have been the final death knell for equitable notions like good faith.[89] Perhaps because of the seeming *lacuna* in the law following the *Bank of Lisbon*[90] case, the issue of good faith continued to come before the appellate courts. It is argued that the lack of sufficient legislative clarity incorporating the principles of fairness and equity into

[83] Idem, at 605-607.

[84] Ibid.

[85] 1988 (3) SA 580 (A), at 607.

[86] 2010 (4) SA 468 (SCA), paras 32-35.

[87] Idem, at 619.

[88] 1988 (3) SA 580 (A) 601.

[89] The notion of good faith appears to have maintained a presence in the mix of factors taken into account in the South African law of contract, as exemplified by the minority judgment of Olivier, JA in the case of *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 (4) SA 302 (SCA); *Janse van Rensburg v Grieve Trust* 2000 (1) SA 315 (C); *Mort NO v Henry Shields-Chiat* 2001 (1) SA 464 (C) and *Miller & Another NNO v Dannecker* 2001 (1) SA 928 (C).

[90] 1988 (3) SA 580 (A) 601.

contracts, coupled with the unavailability of the now banished *exceptio doli* generalis as a remedy, have left contractual parties with no other choice but to clutch at constitutional straws to enforce some semblance of fairness in the context of contracts.[91]

In 1989, approximately a year after ostensible certainty had been attained on the matter of equitable notions in the South African law of contract, the Appellate Division, in what can be argued to have been a step back towards such equitable notions, upheld the unenforceability of a contract due to public policy considerations in the case of *Sasfin (Pty) Ltd v Beukes*.[92] In *Sasfin*, citing Strafford, CJ, in the case of *Jajbhay v Cassim*,[93] the court held that the terms of a contract that did not meet the "demands of simple justice between man and man" could be found to be contrary to public policy and thus illegal.[94]

The court in *Sasfin* struck down an agreement of cession of book debts because certain unseverable provisions thereof were found to be contrary to public policy and to have the effect of enslaving the debtor.[95] The court found that the agreement having such effect was "clearly unconscionable and incompatible with the public interest, and, therefore, contrary to public policy".[96] The explicit reference to unconscionability in the *Sasfin* case underscores the potential synonymity of or overlap between unconscionable conduct and conduct, which is contrary to public policy considerations.

While the *Sasfin* case can indeed be perceived as a step back toward equitable principles in general, it has also been opined that the *Sasfin* case marked the beginning of a period whereby the notion of good faith was largely sidelined in favour of public policy. In support of this view, the distinction between public policy and good faith has been averred to be that while public policy is focused on illegality or unconscionability after the fact of contracting, good faith espouses a consistent standard of good faith at the beginning and throughout the various stages of the

[91] Stewart, T, *Unreasonable, Unconscionable and Oppressive Contract Terms in South African and Western Australian Law*, LLM dissertation, University of Johannesburg, 2015, at 16.

[92] 1989 (1) SA 1 (A).

[93] 1939 AD 537, at 544.

[94] 1989 (1) SA 1 (A), para 14.

[95] Idem, para 13H

[96] Idem, para 13I-14A.

contracting process.[97]

Another case depicting that equitable considerations were still on the judicial agenda is *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO.*[98] In the minority judgment delivered in this case, it was suggested that despite all appearances of the principle of good faith having been dispensed with in *Bank of Lisbon,*[99] courts continued to apply it under the guise of public policy and public interest considerations.[100] This minority judgment in *Eerste Nasionale Bank van Suidelike Afrika Bpk*[101]was invoked in the later High Court case of *Miller and Another NNO v Dannecker,*[102] which supported the application of the requirement of good faith to contracts. In *Miller and Another NNO,* it was stated that "bona fides constitute an independent basis for not giving effect to the principles of the law of contract."[103]

The case of *Brisley v Drotsky*[104] has been credited with "laying the foundation" for the Supreme Court of Appeal's approach to "the proper roles of good faith, fairness and reasonableness in the law of contract in the new constitutional era".[105] Like the *Bank of Lisbon* case before it, this case reaffirmed that equitable notions such as good faith did not carry the clout to scupper the enforceability of a contract. The court in *Brisley,* with reference to Hutchinson,[106] stated that good faith was not an independent reason for rescission or non-application of contractual terms but was rather a fundamental principle underlying the law of contract in general and which found expression in specific rules and principles thereof.[107] Cameron JA in *Brisley* also emphasised that

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[97] Hutchison, A "Good Faith in Contract: A Uniquely South African Perspective" (2019), 1, *Journal of Commonwealth Law*, 227, at 236.

[98] 1997 (4) SA 302 (A).

[99] 1988 (3) SA 580 (A) 601.

[100] 1997 (4) SA 302 (A), at 318-322.

[101] 1997 (4) SA 302 (A).

[102] 2001 (1) SA 928 (C).

[103] *Miller and Another NNO v Dannecker* 2001 (1) SA 928 (C), at 938D-F. See also *Mort NO v Henry Shields-Chiat* 2001 (1) SA 464 (C) supporting application of good faith in the law of contract.

[104] 2002 (4) SA 1 (SCA) .

[105] *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 29. See also *Brisley v Drotsky* 2002 (4) SA 1 (SCA).

[106] Hutchison, D "Non-variation Clauses in Contract: Any Escape from the Shifren Straitjacket?" (2001), 118, *SALJ*, 720 (hereinafter, "Hutchison, *Non-variation Clauses in Contract*").

[107] See *Brisley v Drotsky* 2002 (4) SA 1 (SCA), at para 22, referring to Hutchison, *Non-variation Clauses in Contract,* at 743-744.

constitutional principles, particularly those entrenched in the Bill of Rights,[108] permeate all law, including the law of contract, such that contracts which offend public policy must be struck down.[109]

Further citing Hutchison, the court in *Brisley* recognised that good faith could be regarded as "an ethical value or controlling principle based on community standards of decency and fairness that underlies and informs the substantive law of contract".[110] However, the court went further to explain the nature of its somewhat limited status as follows:

> "It finds expression in various technical rules and doctrines, defines their form, content and field of application and provides them with a moral and theoretical foundation. Good faith thus has a creative, a controlling and a legitimating or explanatory function. It is not, however, the only value or principle that underlies the law of contract, not, perhaps, even the most important one."[111]

The minority judgment in *Brisley,* on the other hand, adopted a stance which seems insistent that equitable principles indeed live on in South African contract law and asserted that,

> "reasonableness and equity in the form of bona fides has become more prominent. It is clear that our law is in a phase of development where contractual justice has emerged stronger than ever before as a moral and judicial norm. This tendency will in all probability… be strengthened by constitutional values."[112]

It would appear, therefore, that notwithstanding the denunciation by the courts of the *exceptio doli generalis* principle in the 1988 case of *Bank of Lisbon and South Africa Ltd v De Ornelas*,[113] the principles entrenched in the Constitution, and in particular the Bill of Rights therein, are entwined

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[108] Chapter 2 of the Constitution of South Africa, Act 108 of 1996.

[109] *Brisley v Drotsky* 2002 (4) SA 1 (SCA), paras 91-93. See also *Capitec Bank Holdings Limited and Another v Coral Lagoon Investments 194 (Pty) Ltd and Others* 2021 [ZASCA] 99, para 63 and 65.

[110] 2002 (4) SA 1 (SCA), para 22.

[111] Ibid. See also Hutchison, D "Non-variation clauses: any escape from the *Shifren* straitjacket?" (2001), 118, SALJ, 720, at 744, cited and endorsed by the court. See also Hutchison, D "Good Faith and the South African Law of Contract" (1999) in Brownsword, R, Hird, NJ, and Howells G, eds, *Good Faith in Contract, Concept and Context*, Ashgate, 1999, at 215 and Hugo, C and Marxen, K "Exceptions to the Independence of Autonomous Instruments of Payment and Security: The Growing Emergence of Good Faith" in Hugo, C and Möllers, TMJ, (eds) *Transnational Impacts on Law: Perspectives from South Africa and Germany*, eds, Juta, 2018, (hereinafter, "Hugo and Marxen, *Exceptions to the Independence of Autonomous Instruments of Payment and Security"*), at 145.

[112] Hugo and Marxen, *Exceptions to the Independence of Autonomous Instruments of Payment and Security*, at 145.

[113] 1988 (3) SA 580 (A) 601.

with considerations of fairness in relation to contract terms. It is submitted that the law of contract without reference to the public policy and equitable principles would create an environment in which contracts are abused. Such abuse could entail contracts being weaponised to inflict, *inter alia*, "rampant inflation, monopolistic practices giving rise to unequal bargaining power and the large scale of standard-form contracts often couched in small print"[114] in a manner which would be at odds with public policy and constitutional mores.

The stance taken in the *Brisley* case was supported in the case of *Afrox Healthcare Bpk v Strydom*,[115] where it was again confirmed that courts generally do not have discretion regarding enforcement of contractual provisions based on abstract considerations like good faith, reasonableness, fairness, and may only exercise such discretion on the basis of established legal rules.[116] The court in *Afrox Healthcare* acknowledged that while good faith, reasonableness and fairness underpin legal rules, they are not themselves legal rules.[117]

In the case of *Afrox Healthcare*, the court uncompromisingly reiterated the importance of autonomy of contract, a position which seemingly reaffirmed the supremacy of freedom of contract. It is worth noting that freedom of contract is often viewed as a notion which would be generally irreconcilable with the juxtaposition of good faith and the law of contract, particularly because the absence of good faith could impede the enforceability of a contract. Therefore, freedom of contract is an oft-cited argument against developing good faith as a substantive concept in the law of contract.

In the case of *South African Forestry Co Ltd v York Timbers Ltd*,[118] the Supreme Court articulated the position quite succinctly as follows:

> "[A]Ithough abstract values such as good faith, reasonableness and fairness are fundamental to our law of contract, they do not constitute independent substantive rules that courts can employ to intervene in contractual relationships. These abstract values perform creative, informative and controlling functions through established rules of the law of contract. They cannot be acted upon by the courts directly. Acceptance of the notion that judges can refuse to enforce a contractual

[114] Idem, at 619.

[115] 2002 (6) SA 21 (SCA).

[116] *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA), para 32.

[117] Ibid.

[118] 2007 (5) SA 323 (CC).

> provision merely because it offends their personal sense of fairness and equity will give rise to legal and commercial uncertainty. After all, it has been said that fairness and justice, like beauty, often lie in the eye of the beholder".[119]

In the later case of *Botha v Rich,*[120] the Constitutional Court further referred to the entrenchment of the principle of good faith in the law of contract in South Africa, stating that South African law of contract, "based as it is on the principle of good faith, contains the necessary flexibility to ensure fairness."[121]

In the tug of war between freedom of contract and equitable considerations, the case of *Bredenkamp v Standard Bank of SA Ltd*[122] seemed to ultimately give support to the latter. In *Bredenkamp,* the court *a quo* issued an interdict precluding closure of a bank account by the bank on the rationale that one could neither impose contractual terms on a counterparty to a contract if those terms would operate unfairly nor enforce unfair contractual terms.[123] This position stood for a brief period before being swiftly dispensed with on appeal, where the Supreme Court of Appeal vindicated the bank's actions and stated that the bank was,

> "entitled to take what it believes is a morally correct stance. Part of having the freedom to contract and maintain dignity, within the parameters avoiding discrimination, is the right to choose customers based on a morality you choose to apply."[124]

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119 2007 (5) SA 323 (CC), para 27. See also the earlier case of *Brisley v Drotsky* 2002 (4) SA 1 (SCA) and later cases of *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 2 SA 150 (SCA). See further the minority judgment of the Constitutional Court *Maphango v Aengus Lifestyle Properties (Pty) Ltd* 2011 (5) SA 19 (SCA), para 124 (majority did not consider the merits of the case on the basis of their finding that the matter should have been referred to the Gauteng Rental Housing Tribunal) where Zondo, AJ stated, *inter alia*, that, "… if it is found that the objective terms of the contract are not inconsistent with public policy, the further question will be whether the terms are contrary to public policy in the light of the relative situations of the contracting parties. Ngcobo J said that this was 'an important principle in a society as unequal as ours'. Also to be taken into account is the freedom of contract, although courts will not let blind reliance on the principle of freedom of contract override the need to ensure that contracting parties respect the constitutional values enshrined in our Bill of Rights. Public policy also requires that, in general, parties to contracts should honour their obligations that have been voluntarily and freely undertaken. I would add that public policy also requires that parties to contracts that have been freely and voluntarily agreed to should respect the exercise by other parties to their contracts of their rights provided for in them"; and *Potgieter v Potgieter NO* 2012 (1) SA 637 (SCA). See further *Capitec Bank Holdings Limited and Another v Coral Lagoon Investments 194 (Pty) Ltd and Others* 2021 [ZASCA] 99, para 63 and 65.

120 2014 (4) SA 124 (CC).

121 Idem, para 45.

122 2009 (5) SA 304 (GSJ) and on appeal, 2010 (4) SA 468 (SCA).

123 2009 (5) SA 304 (GSJ), para 48.

124 2010 (4) SA 468 (SCA), para 64.

The court in *Bredenkamp* also highlighted the view that the *exceptio doli generalis* could be considered to be simply a convenient label for a number of rules, but that it had no specific content in itself.[125]

Despite the recurrence of good faith as a theme to be considered, the continued uncertainty in this regard and the urgent need for a definitive position on whether good faith requirements are enforceable in contract law was reinforced in the following statement by Yacoob, J in the minority judgment in *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd*:[126]

> "Good faith is a matter of considerable importance in our contract law and the extent to which our courts enforce the good faith requirement in contract law is a matter of considerable public and constitutional importance. The question whether the spirit, purport and objects of the constitution require courts to encourage good faith in contractual dealings and whether our constitution insists that good faith requirements are enforceable should be determined sooner rather than later."[127]

Perhaps it is with this background in mind that good faith has been elevated to a concept that has "deep roots" in the South African legal system.[128] Referring to the tension between elements of good faith and freedom of contract, Hutchison and Pretorius note that

> "there has been much debate about the role [that good faith] might play in the modern law of contract, as a counterweight to the dominant idea of freedom of contract, and as a means of developing a doctrine of unconscionability to ensure greater fairness in contractual relations."[129]

In light of the intersection between unconscionability and bad faith, a potent argument that has been advanced is that the erstwhile *exceptio doli generalis*[130] was a closer equivalent of the concept of unconscionability and could thus have been developed into the principle of unconscionability under South African law.[131] This has been caveated by the argument that the lack of recognition of the good faith under South African law as a standalone doctrine of general application, despite being defined narrowly compared to unconscionability. This indicates that recognising a general

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[125] 2010 (4) SA 468 (SCA), paras 32-35.
[126] 2012 (1) SA 256 (CC).

[127] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers* 2012 (1) SA 256 (CC), para 22.

[128] Hutchison and Pretorius *The Law of Contract in South Africa*, at 26-27.

[129] Ibid.

[130] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, at 4-5.

[131] Ibid.

concept of unconscionability under South African law, which is considered significantly broader, would pose significant challenges.[132]

Unconscionability has been compared to and argued to be as "equally confusing" as the concept of good faith, which, as discussed above,[133] is itself recognised under South African law of contract, albeit as a supporting principle and not as an independent defence.[134]

From the case law considered above, it would appear that South African courts have a history of vacillation when it comes to the potential tension between freedom of contract and equitable notions, regardless of whether they are clothed as unconscionability, unfairness, bad faith/*mala fides*, contrary to public policy or the concept of ubuntu or any combination thereof. The courts of South Africa have for a long time noted the need for caution in respect of any adoption of good faith as a freestanding principle under South African law, noting a likely adverse effect it could have on legal certainty.[135]

The continued references to the concept of good faith in several South African cases, as discussed above, are considered by some to be providing impetus toward full recognition of the unconscionability exception to the autonomy principle of demand guarantees.[136] It has also been seen as an indicator of an increased willingness by South African courts to consider "general notions of justice and fairness and good faith".[137]

Commenting on the application of the principle of good faith under South African law, with regard to the *Barkhuizen* case, Hugo infers the following position:

> "Whether this means that our courts, in the wake of a growing importance of good faith in the South African law of contract, will become more open towards exceptions to independence in the law of guarantees remains to be seen. I am inclined to the view that the answer is "yes". In this

[132] Ibid.

[133] Idem, at 4.

[134] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, at 4-5.

[135] *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 22.

[136] *Group Five Construction (Pty) Ltd and Others v Member of the Executive Council for Public Transport Roads and Works Gauteng and Others* [2015] 2 All SA 716 (GJ), para 50 and *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA), para. 65.

[137] Hugo and Marxen, *Exceptions to the Independence of Autonomous Instruments of Payment and Security*, at 139.

> respect it is of interest to note that the South African law of contract appears to be developing towards a greater recognition of good faith".[138]

It is, however, submitted that stumbling blocks such as uncertainty, which have thus far contributed to the courts' inhibited approach to good faith in relation to the law of contract, will continue to inform a similar approach going forward. More so in the context of demand guarantees where certainty is arguably more imperative. Despite the lack of universal agreement and clarity on the role of good faith in relation to contracts, what is clear is that it is, at the very least, a recognised underlying value which does have some role to play in informing contractual relations and existing rules or principles of the law of contract. It may also find expression in public policy considerations, which will be discussed further below in this chapter. As good faith arises and is considered frequently in the context of unconscionability, it will be taken into account in this thesis in the context of the unconscionability exception to the autonomy principle of demand guarantees.

3.2.4 Public Policy Considerations and Ubuntu in the Constitutional Era

3.2.4.1 Ubuntu in the South African Law of Contract

The concept of ubuntu can be traced back to the Interim Constitution of South Africa,[139] where it was encapsulated in the post-amble in the following terms:

> "The adoption of this Constitution lays the secure foundation for the people of South Africa to transcend the divisions and strife of the past, which generated gross violations of human rights, the transgression of humanitarian principles in violent conflicts and a legacy of hatred, fear, guilt and revenge. These can now be addressed on the basis that there is a need for understanding but not for vengeance, a need for reparation but not for retaliation, a need for ubuntu but not for victimisation."[140]

Ubuntu was also defined in the case of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd*[141] as a concept which,

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[138] Hugo, C "Demand Guarantees in the People's Republic of China and the Republic of South Africa" (2019), 6(2), *BRICS Law Journal,* 4 (hereinafter, "Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*), at 30-31.

[139] Constitution of the Republic of South Africa Act 200 of 1993.

[140] Idem, in post-amble titled, "National Unity and Reconciliation".

[141] 2012 (1) SA 256 (CC).

> "emphasises the communal nature of society and 'carries in it the ideas of humaneness, social justice and fairness' and envelopes 'the key values of group solidarity, compassion, respect, human dignity, conformity to basic norms and collective unity'."[142]

The question of whether the Constitution has any place in relation to the law of contract is a contentious one, which feeds into the issue of whether the Bill of Rights has any business being invoked in respect of private or contract law relations.[143] The role of ubuntu as a constitutional value and related concepts such as reasonableness and fairness in the law of contract has been observed to be a widely contentious issue, particularly among legal academics, courts and judges speaking extra-curially.[144]

In the case of *Du Plessis v De Klerk*[145] horizontal application of the Bill of Rights seemed to receive support from the ruling that a court should have regard for the spirit, purport and objects of the Bill of Rights.[146] Regarding the concept of ubuntu, the Constitutional Court in *Everfresh Market Virginia,* highlighted the importance of good faith considerations in developing the South African law of contract. The Constitutional Court, per Moseneke CJ, found that it was,

> "…highly desirable and in fact necessary to infuse the law of contract with constitutional values, including values of ubuntu, which inspire much of our constitutional compact."[147]

3.2.4.2 Parameters of Public Policy and the Infusion of Constitutional Values into South African Law of Contract

Unconscionability is sometimes explained with reference to public policy considerations applicable to the law of contract in South African law. Therefore, an analysis of what constitutes unconscionability requires an understanding of what constitutes public policy. A clear determination of what constitutes public policy has been observed to often be problematic given

[142] 2012 (1) SA 256 (CC), para 71.

[143] See Van Der Walt, "Progressive Indirect Horizontal Application of the Bill of Rights: Towards a Co-operative between Common Law and Constitutional Jurisprudence" (2001) *SAJHR*, 341, at 342.

[144] *Beadica* case, para 17.

[145] 1996 (3) SA 850 (CC).

[146] This was with reference to the interim Constitution of the Republic of South Africa, Act 200 of 1993, however, this approach was largely retained in the final constitution.

[147] 2012 (1) SA 256 (CC), para 71.

the arguably nebulous parameters of public policy.[148] Illustrating the rather amorphous nature of public policy, it has been pointed out that while public policy is generally understood to denote the interest of society as a whole, society's interest may be served by upholding the interest of a subset of society or those of an individual and that it also supports utmost freedom of contract.[149]

The fact that public policy seems to contemplate both notions of fairness and equity on the one hand, and freedom of contract on the other, renders it all the more difficult to pin down as a concept because of the difficulty of reconciling these potentially conflicting notions. This difficulty and the potential infiltration of subjectivity relating to public policy considerations were captured in the following statement in *Preller and Others v Jordaan*:[150] "if judges are allowed to decide cases on the basis of what they regard as reasonable and fair, the criterion will no longer be the law but the judge."[151] Similar issues were highlighted in the later case of *Potgieter v Potgieter NO*[152] where the definition of what is fair and equitable was noted to be different among reasonable people, including judges leading the court to find that imposing such concepts would thus be dependent on subjective elements such as, "the personal idiosyncrasies of the individual judge".[153]

Public policy has been described by reference to the founding values of the Constitution,[154] including, *inter alia,* the advancement of human rights and freedoms.[155] The case of *Barkhuizen v Napier*[156] heralded the escalation and consideration of the controversial matter of judicial control over the enforcement of contracts to the Constitutional Court of South Africa. In *Barkhuizen,* the Constitutional Court categorically stated:

> "notions of fairness, justice and equity, and reasonableness cannot be separated from public policy. Public policy takes into account the necessity to do simple justice between individuals. Public

[148] Ibid.

[149] Kelly-Louw, M "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees" (2009), 42, *CILSA*, 339, at 376-377.

[150] 1956 (1) SA 483 (A).

[151] Idem, at 500.

[152] 2012 (1) SA 637 (SCA).

[153] 2012 (1) SA 637 (SCA), para 34.

[154] Constitution of the Republic of South Africa, Act 108 of 1996.

[155] See *Napier v Barkhuizen* 2006 (4) SA 1 (SCA) and also *Barkhuizen v Napier* 2007 (5) SA 323 (CC).

[156] 2007 (5) SA 323 (CC).

policy is informed by the concept of Ubuntu."[157]

Also, highlighting that the concept of good faith is pertinent to considerations of public policy is expressed in the case of *Barkhuizen* in the Constitutional Court's statement that,

> "in the case of long-term international commercial transactions reasonableness rather than purely formal compliance is regarded as the yardstick against which duties of requisite good faith are tested."[158]

However, in the case of Barkhuizen, the Constitutional Court still made it clear that good faith is not a self-standing rule. Public policy was the remedial vehicle of choice rather than good faith.[159]

One of the essential elements of a contract under South African law, without which it would be invalid, is that the contract must not be *contra bonos mores*[160]or contrary to "statutory law, public policy, or good morals in its formation, performance, or purpose".[161] The importance of public policy under South African law was highlighted by the statement in *Barkhuizen v Napier*[162] that public policy is "deeply rooted in [the] Constitution and the values which underlie it."[163] It is thus considered a trite principle of South African law of contract[164]that a contract which is in contravention of the law, good morals or public policy is illegal and, therefore, void.[165] In *Sasfin (Pty) Ltd v Beukes*,[166] the court recognised the doctrine of public policy as the benchmark for determining fairness and reasonableness, with it being declared that "[n]o court should ... shrink from the duty of declaring a contract contrary to public policy when the occasion so demands".[167]

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[157] 2007 (5) SA 323 (CC), para 51. For more on *ubuntu* and its definition see section 3.2.4.1 of this chapter.

[158] 2007 (5) SA 323 (CC), para167.

[159] Idem, para 82.

[160] Meaning against good morals.

[161] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 513.

[162] 2007 (5) SA 323 (CC), para 28.

[163] Ibid.

[164] See Havenga, P et al *General Principles of Commercial Law*, 6th ed, Juta, 2007, at 85-92 and Niekerk, JP and Schulze, WG *The South African Law of International Trade: Selected Topics*, 2 ed, SAGA Legal Publications, 2006, at 66.

[165] Ibid.

[166] 1989 (1) SA 1 (A).

[167] Idem, para 9A-B.

The court in *Barkhuizen* echoed *Sasfin* by endorsing the concept of public policy as the benchmark for determining fairness and reasonableness.[168] Ngcobo J stated, regarding constitutional challenges to contractual terms, that "[o]rdinarily constitutional challenges to contractual terms will give rise to the question of whether the disputed provision is contrary to public policy".[169] The Constitutional Court, being South Africa's highest court, has thus earmarked public policy as a key yardstick in determining the validity of contracts.

The effect of public policy considerations on the law of contract makes it a powerful instrument by which judicial control of contracts can be asserted, but one which must not be used with abandon, as will be highlighted in the discussion of pertinent cases to follow below. Due to the roots of public policy being embedded in the Constitution of the Republic of South Africa, the issue of whether a contract is unenforceable on public policy grounds is considered to be one that falls under the remit of constitutional law.[170] Therefore, a significant number of cases in this regard have been considered in a constitutional context, with some escalated to the Constitutional Court of South Africa, and a key selection thereof is considered herein.

The case of *Citibank NA v Thandroyen Fruit Wholesalers CC and Others*[171] sheds some light on when an agreement would be considered contrary to public policy. In this regard, the Supreme Court of Appeal, seeking to set the parameters of public policy, clarified that an agreement is not contrary to public policy merely because it offends one's sense of propriety and fairness but that it should be unconscionable, immoral or illegal.[172] The court upheld the view that an agreement will be considered contrary to public policy if its effect or its purpose is harmful to the public interest, taking into account the tendency of the proposed transaction pursuant to the agreement as opposed to its actual result.[173]

Breach of public policy is considered to be so closely linked or even synonymous with unconscionable conduct. This understanding is exemplified in the more recent case of *Beadica*

[168] *Barkhuizen v Napier* 2007 (5) SA 323 (CC), paras 52 and 163.

[169] Idem, para, 28.

[170] *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 16.

[171] 2007 (6) SA 110 (SCA).

[172] *Citibank NA v Thandroyen Fruit Wholesalers CC and Others* 2007 (6) SA 110 (SCA).

[173] Idem, para 14.

231 CC and Others v Trustees for the time being of the Oregon Trust and Other,[174] where strict enforcement of contractual provisions was challenged because it would be "contrary to public policy, or unconscionable".[175]

The circumstances in which a court may decline the enforcement of a contract on the basis of public policy considerations, such as the fact that a contract is unfair, unreasonable or unduly harsh, has been recognised as a "burning issue" under South African law.[176] The historical controversy surrounding when notions of good faith, fairness and reasonableness can be invoked in the South African law of contract at the expense of the competing need for certainty in the law of contract and freedom of contract has been depicted in several significant South African cases which are discussed below in this chapter.

The case of *Magna Alloys & Research (SA) (Pty) Ltd v Ellis*[177] illustrates the fine balance required to ensure that the right to freedom of contract, which itself is supported by public policy, does not impinge upon other rights or freedoms in a manner which is contrary to public mores. This case centred on a restraint of trade agreement, which the court found to be valid and enforceable, so long as it was not contrary to public policy, with the onus to prove any infringement of public policy falling to the party alleging the same.

Regarding the potential tension between freedom of contract and public policy considerations, the court in *Magna Alloys & Research*[178]noted that while public policy supports the honouring of agreements that are entered into freely and voluntarily, this did not extend to a contract which imposed an unreasonable restriction on a person's freedom to trade and the enforcement of such a contract would be precluded by public policy considerations. Therefore, it would appear that freedoms supported by South Africa's Constitution, most notably, in this case, the freedom of contract, are subject to and required to be exercised within the boundaries of public policy.

The concepts of fairness and equity have been observed to be increasingly permeating the South

[174] 2020 (5) SA 247 (CC).

[175] *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 10.

[176] Idem, para 1.

[177] 1984 (4) SA 874 (A).

[178] 1984 (4) SA 874 (A).

African law of demand guarantees.[179] In relation to contracts generally, the potential conflict between the *pacta sunt servanda* and the concepts of "fairness, justice and equity, and reasonableness" was also considered in the *Barkhuizen* case. *Barkhuizen* exemplifies the tensions that can arise between constitutional principles and contractual terms agreed upon between private contracting parties. Faced with the question of how to deal with contractual terms that are at odds with the Constitution, the court in *Barkhuizen* held that a contract in contravention of public policy was unenforceable, noting that public policy had to be determined by reference to the Constitution.[180]

Although the *pacta sunt servanda* principle was acknowledged by the Constitutional Court in *Barkhuizen*, the Constitutional Court still held that the freedom of contract it entails did not override the need for fairness. Highlighting that the notions of fairness and justice informed public policy,[181] the Constitutional Court in *Barkhuizen* upheld the view that a contractual term that is inimical to the Constitution is unenforceable.[182] Therefore, a consistent theme seems to be that freedom of contract is espoused under the Constitution. It must not infringe upon public policy and would likely be fettered by public policy considerations to the extent that it does.

A specific concept of unconscionability with the effect of general application is not uniformly recognised under South African law, including in the context of documentary credits.[183] South African courts and the legislature have, as early on as the 1990s,[184] been called upon to establish a coherent concept of unconscionability under South African law, which calls have yet to be properly acquiesced to in a general context. The concept of unconscionability as an exception to the autonomy principle is similarly generally not recognised under South African law (save for the limited cases supporting it or alluding to its recognition as considered in this thesis).

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[179] Lurie, J "On Demand Performance Bonds: Is Fraud the Only Ground for Restraining Unfair Calls?" (2008), 25(4), *International Construction Law Review*, 443, at 465.

[180] *Barkhuizen v Napier* 2007 (5) SA 323 (CC), para 29.

[181] Idem para 52.

[182] Idem, para 29.

[183] Berat, L "South African Contract Law: The Need for a Concept of Unconscionability*"*, (1992), 14, *Loy. L.A. Int'l & Comp. L. Rev.* 507 (hereinafter "Berat, *South African Contract Law: The Need for a Concept of Unconscionability*"), at 507 and 508 and Woolf, HS "*The Doctrine of Unconscionability as an Independent Exception to the Doctrine of Independence in Documentary Credit Practice*", LLM dissertation, University of Johannesburg, 2014, (hereinafter, "Woolf, *The Doctrine of Unconscionability as an Independent Exception*") at 4-5.

[184] Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 525.

The legal *lacuna* that became apparent in the wake of abolishing the *exceptio doli generalis* may have contributed to the prevailing uncertainty regarding the exact role and degree of sway conferred to public policy notions, including unconscionability in the law of contract. It would appear that where freedom of contract would have enjoyed an edge when pitted against considerations of fairness or unconscionability, this is tempered by the concept of public policy considerations, generally, as demonstrated by the case law discussed above.

From the above consideration of public policy, it appears that its role is to be the vehicle by which the rights and freedoms embodied in the Constitution of the Republic of South Africa are infused into the law of contract.[185] Given the potential friction between this discretion of the courts and the *pacta sunt servanda* principle, a commonly accepted caveat, noted in the *Trustees, Oregon Trust v Beadica*[186] case is that courts must apply this discretion "sparingly, and only in the clearest of cases".[187] A similar cautionary note was echoed in the earlier case of *Afrox Healthcare Bpk v Strydom*[188] wherein it was stressed that any refusal by courts to enforce a contract based on public policy must be exercised with "perceptive restraint".[189]

Summing up the rather intertwined and somewhat co-dependent notions that together constitute public policy, the court in *Beadica*, also citing *Barkhuizen*, stated that,

> "public policy, as informed by the Constitution, imports "notions of fairness, justice and reasonableness", takes account of the need to do "simple justice between individuals" and is informed by the concept of ubuntu."[190]

Unconscionability, being a concept intertwined with the above notions, may well be encompassed under the ambit of public policy. It could be argued that any unconscionable conduct in relation to the law of contract could be addressed by invocation of public policy considerations. If a demand

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[185] See Ncobo J's majority judgment in *Barkhuizen v Napier* 2007 (5) SA 323 (CC), paras 23-30.

[186] 2019 (4) SA 517 (SCA).

[187] *Trustees, Oregon Trust v Beadica 231 CC* 2019 (4) SA 517 (SCA), at para 34 and *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 88. See also *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A), para 9B-C; *AB v Pridwin Preparatory School* 2019 (1) SA 327 (SCA), para 27; *Botha (now Griesel) v Finanscredit (Pty) Ltd* 1989 (3) SA 773 (A) at 783A-B and *Eerste Nasionale Bank v Saayman NO* 1997(4) SA 302 (SCA) at 324B-G which reiterate and re-affirm this position.

[188] 2002 (6) SA 21 (SCA).

[189] Idem, para 22-23. See also *Brisley*, para 94.

[190] *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 35, citing *Barkhuizen v Napier* 2007 (5) SA 323 (CC), paras 51 and 73.

guarantee was found to be unconscionable in circumstances that establish an infringement of public policy, then similarly to how public policy can fetter the enforceability of a contract, recourse against enforcement of a demand guarantee could be sought based on public policy considerations. The perceptive restraint that courts have already noted should be applied when declining to enforce a contract based on public policy considerations, would in the context of demand guarantees curtail any abuse of this remedy in a manner that would corrode the autonomy principle to an unacceptable degree.

3.2.5 Contributions of the South African Law Commission and the Consumer Protection Act of 2008 to the Development of the Concept of Unconscionability under South African Law

As discussed earlier in this chapter, the concept of unconscionability and the developing literature regarding it under South African law have been generally intertwined with the notions of fairness in contractual dealings. Particular developments are also notable in this regard on the consumer protection front. Consumer protection considerations under South African law appear to have propelled some consideration of unconscionability, albeit in the limited framework and context of consumer protection.

The South African Law Reform Commission[191]is the body mandated with *inter alia*, research and making "recommendations for the development, improvement, morderni[s]ation or reform"[192] of South African law, published a discussion paper[193] aimed at determining, among other things, whether sufficient measures were in place to restrict, "unreasonable stipulations and practices in contracts".[194] The discussion paper also considered what recourse courts could provide in respect of contracts which were entered into and subsequently found to be unfair and unconscionable.[195] The discussion paper was followed by further consultation and considerations, which highlighted the need for legislation to address the gaps identified in consumer law, particularly in the context of unconscionable practices and contractual terms.

[191] The South African Law Reform Commission was established by the South African Law Commission Act, 1973 (Act 19 of 1973), which was assented to on 27 March 1973 and came into operation on 1 September 1973.

[192] South African Law Commission Act, 1973 (Act 19 of 1973), section 4.

[193] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Discussion Paper 65, Project 47, 1996.

[194] South African Law Commission Twenty-Fourth Annual Report, 1996, at 36.

[195] Idem, at 37.

The South African Law Reform Commission's consultations and investigation into unreasonable contract terms culminated in a report on "unreasonable stipulations in contracts and the rectification of contracts"[196] ("SALC Report"). The SALC Report touched upon elements pertinent to unpacking unconscionability from a South African law perspective and incorporated several recommendations regarding how unfair contract terms should be dealt with, some of which were fed through into the South African Consumer Protection Act of 2008 ("CPA").[197] The CPA applies to agreements concluded between consumers and suppliers in the ordinary course of business and is, therefore, somewhat limited in its contextual scope[198] where recognising unconscionability is concerned. However, the CPA does provide a potential blueprint from which the concept of unconscionability in respect of the broader law of contract in South Africa could be developed.[199]

One of the main dissuasive arguments considered in the SALC Report against making contracts subject to the notions of fairness is that foreign contractual parties may become reluctant to contract under South African law due to a perceived ability of South African courts to effectively review and alter contracts between parties, which would impinge on the freedom of parties to contract. This is an argument that is also applicable in respect of demand guarantees. A counter-argument raised against such a view is that many foreign jurisdictions have recognised the need to regulate unfair contracts. South Africa could adopt concepts of fairness and equity that are in line with universally or internationally recognised principles, particularly the standard(s) of good faith.[200] Again, a similar counter-argument, being the fact that an unconscionability exception to

[196] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998 (hereinafter the "SALC Report").

[197] Consumer Protection Act 68 of 2008.

[198] The scope of application of the Consumer Protection Act 68 of 2008 ("CPA") includes, subject to certain specific exemptions/caveats, every transaction, the promotion of any goods or services or of the supplier of any goods or services within/occurring within the Republic of South Africa and/or goods or services that are supplied or performed in terms of a transaction to which the CPA applies. The CPA would, however, not apply to, *inter alia*, juristic persons whose asset value/annual turnover equals or exceeds relevant thresholds set under the CPA, the state, or transactions covered under other legislation (e.g., credit transactions to which the National Credit Act 34 of 2005 applies).

[199] For a detailed discussion and analysis of the Consumer Protection Act 68 of 2008 and its impact in respect of the law of contract in South Africa, see Van Eeden, EP *Consumer Protection Law in South Africa*, LexisNexis, 2017; Naudé, T, Eiselen, S, *Commentary on the Consumer Protection Act*, Juta Limited, 2015; Jacobs, W, Stoop, PN and Van Niekerk, R "Fundamental Consumer Rights Under the Consumer Protection Act 68 of 2008: A Critical Overview and Analysis" (2010), 13(3) *Potchefstroom Electronic Law Journal/Potchefstroomse Elektroniese Regsblad*; Sharrock, R D, "Judicial Control of Unfair Contract Terms: The Implications of Consumer Protection Act" (2010), 22, *SA Merc LJ*, 295.

[200] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998, at xiv. Annexure A.

the autonomy principle is recognised in some jurisdictions such as Australia, can be raised.

Another argument against incorporating notions of fairness into South African law of contract was that such a move might introduce unnecessary legal uncertainty.[201] To this, the South African Law Reform Commission's assessment was that:

> "a price that must be paid if greater contractual justice is to be achieved, that certainty is not the only goal of contract law, or of any other law, and lastly in any event, that the fears provoked by the proposed Bill are exaggerated, in the light of the experience of countries that have already introduced such legislation."[202]

With reference to jurisdictions in which unconscionability is recognised as an exception to the autonomy principle and the need for justice in respect of demand guarantees, this assessment also holds water regarding demand guarantees.

Despite some arguments that South African courts had sufficient tools under common law to provide recourse in respect of unfairness relating to contracts,[203] the prevailing view, being that there was a need to legislate the matter,[204] seems to have propelled the Consumer Protection Act

[201] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998, at xiv. The argument in favour of certainty in relation to contracts was summed up articulately in *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 (2) SA 150 (SCA) para 16, wherein it was stated that:

> "A legal system in which the outcome of litigation cannot be predicted with some measure of certainty would fail in its purpose", and citing the case *Foscote in Lagden v O'Connor* [2004] 1 AC 1067 (HL) para 86: 'One of the main functions of the law of obligations, contractual or tortious, is to provide, or attempt to provide, a set of yardsticks for determining whether a legal injury has been inflicted ... the cost of litigation, often excessive both in absolute terms and in relation to the amount in dispute, and the inevitable delay, worry and anxiety that accompany court proceedings provide impelling reasons why the yardsticks by means of which legal liability is to be measured should be kept as simple and uncomplicated as practicable."

[202] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998, at xiv. For a complete consideration of the South African Law Commission's "Summary of Findings and Recommendations", and the rationale thereof, which is beyond the scope of this thesis, see South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998, at xiv-4.

[203] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998, at 36-41. Also see the discussion in section 3.2.2 of this Chapter regarding the argument that remedies available to address fraud, undue influence, duress and misrepresentation under South African law of contract could potentially provide sufficient recourse for instances of unconscionable conduct.

[204] Idem, at 41.

of 2008[205] into existence.[206] An important feature of the SALC Report was that it included an annexure entitled, "The Commission's Bill on the Control of Unreasonableness, Unconscionableness or Oppressiveness in Contracts or Terms"[207] ("Proposed SALC Bill"), which was recommended to be enacted as an Act.

The Proposed SALC Bill did not, however, go on to develop into standalone legislation or an act, an approach that perhaps may have established a baseline for dealing with unfairness and unconscionability across all manner of contracts under South African law. Instead, certain selective aspects from the SALC Report were incorporated into the CPA, an approach which was criticised for its failure to address the gaping lack of clarity on what constituted unfair or unconscionable contract terms and also one which appeared to proffer a consumer protection-oriented solution to a wider general contract law problem. This incorporation of only some of the South African Law Reform Commission's recommendations into the CPA was also criticised as an approach that only addressed unfair, unconscionable and oppressive contractual terms in the context of selectively typical scenarios, thereby not banishing contracts with such terms as a whole.[208]

Despite criticisms against the limited adoption of the South African Law Reform Commission's recommendations into the CPA, the definition of unconscionable under the CPA may still provide a useful framework within which the concept can be developed and understood in South Africa and also in the context of demand guarantees. According to the CPA, unconscionable means "(a) having a character contemplated in section 40; or (b) otherwise unethical or improper to the degree that would shock the conscience of a reasonable person".[209] Section 40, as referenced in the definition of unconscionable in the CPA, describes specific conduct on the part of the supplier, including, without limitation:

> "40. (1) … physical force against a consumer, coercion, undue influence, pressure, duress or harassment,

[205] Consumer Protection Act 68 of 2008 (hereinafter the "CPA").

[206] Naude, "Unfair Contract Terms Legislation: The Implications of Why We Need It for its Formulation and Application", (2006), 3, *Stellenbosch Law Review*, 361, at 362-363.

[207] South African Law Commission, "Unreasonable Stipulations in Contracts and the Rectification of Contracts", Report, Project 47, April 1998 (hereinafter, "Proposed SALC Bill"), at 208-218, Annexure A.

[208] Stewart, T, *Unreasonable, Unconscionable and Oppressive Contract Terms in South African and Western Australian Law*, Magister Legum Dissertation, University of Johannesburg, 2015, at 7.

[209] Section 1 of the CPA (Definitions).

unfair tactics or any other similar conduct, …

(2) … knowingly to take advantage of the fact that a consumer was substantially unable to protect the consumer's own interests because of physical or mental disability, illiteracy, ignorance, inability to understand the language of an agreement, or any other similar factor."[210]

In addition, Part G of the CPA espouses the right to fair, just and reasonable terms and conditions. In this regard, section 48 of the CPA, under the heading, "Unfair, unreasonable or unjust contract terms", explicitly prohibits specific types of conduct on the part of suppliers (e.g., entering into an agreement, marketing any foods or services etc.) which is or in a manner which is, "*unfair, unreasonable or unjust*".[211] Section 48 of the CPA goes on to explain what is contemplated by "*unfair, unreasonable or unjust*"[212]conduct, as follows:

"a transaction or agreement, a term or condition of a transaction or agreement, or a notice to which a term or condition is purportedly subject, is unfair, unreasonable or unjust if—

(a) it is excessively one-sided in favour of any person other than the consumer or other person to whom goods or services are to be supplied;

(b) the terms of the transaction or agreement are so adverse to the consumer as to be inequitable;

(c) the consumer relied upon a false, misleading or deceptive representation … provided by or on behalf of the supplier, to the detriment of the consumer; or

(d) the transaction or agreement was subject to a term or condition, or a notice to a consumer contemplated in section 49 (1), and—

(i) the term, condition or notice is unfair, unreasonable, unjust or unconscionable; or

(ii) the fact, nature and effect of that term, condition or notice was not drawn to the attention

[210] Sections 40(1) and 40(2) of the CPA.

[211] Section 48(1) of the CPA:

"48. (1) A supplier must not—
(a) offer to supply, supply, or enter into an agreement to supply, any goods or services—
(i) at a price that is unfair, unreasonable or unjust; or
(ii) on terms that are unfair, unreasonable or unjust;
(b) market any goods or services, or negotiate, enter into or administer a transaction or an agreement for the supply of any goods or services, in a manner that is unfair, unreasonable or unjust; or
(c) require a consumer, or other person to whom any goods or services are supplied at the direction of the consumer—
(i) to waive any rights;
(ii) assume any obligation; or
(iii) waive any liability of the supplier, on terms that are unfair, unreasonable or unjust, or impose any such terms as a condition of entering into a transaction."

[212] Ibid.

of the consumer in a manner that satisfied the applicable requirements of section 49."[213]

For completeness, section 49 of the CPA relates to requirements concerning certain notices, including notices to customers or provisions of customer agreements that limit risk or liability of the supplier/another person, transfer risk or impose obligations on the customer, limit in any way the risk or liability of the supplier or any other person; any notice concerning an activity or facility subject to any risk of an unusual character or nature; the presence of which a consumer could not reasonably be expected to be aware/ notice, or would not be noticed/contemplated by an ordinarily vigilant consumer under the circumstances in the circumstances or one that could result in serious injury or death.[214] Section 52 of the CPA pertains to the relief that courts are empowered to provide where a transaction or document is determined to be unconscionable, unjust, unreasonable or unfair.

However, despite the CPA's incorporation of specific provisions to curtail and provide recourse against conduct which is unconscionable, unjust, unreasonable or unfair, it is considered by some commentators to be short of "the desirable point of certainty one would have hoped for" in this regard.[215]

Comparatively, the South African CPA has been considered significantly more conservative and

[213] Section 48(2) of the CPA.

[214] "49. (1) Any notice to consumers or provision of a consumer agreement that purports to— (a) limit in any way the risk or liability of the supplier or any other person; (b) constitute an assumption of risk or liability by the consumer; (c) impose an obligation on the consumer to indemnify the supplier or any other person for any cause; or (d) be an acknowledgement of any fact by the consumer, must be drawn to the attention of the consumer in a manner and form that satisfies the formal requirements of subsections (3) to (5). (2) In addition to subsection (1), if a provision or notice concerns any activity or facility that is subject to any risk— (a) of an unusual character or nature; (b) the presence of which the consumer could not reasonably be expected to be aware or notice, or which an ordinarily alert consumer could not reasonably be expected to notice or contemplate in the circumstances; or (c) that could result in serious injury or death, the supplier must specifically draw the fact, nature and potential effect of that risk to the attention of the consumer in a manner and form that satisfies the requirements of subsections (3) to (5), and the consumer must have assented to that provision or notice by signing or initialling the provision or otherwise acting in a manner consistent with acknowledgement of the notice, awareness of the risk and acceptance of the provision. (3) A provision, condition or notice contemplated in subsection (1) or (2) must be written in plain language, as described in section 22. (4) The fact, nature and effect of the provision or notice contemplated in subsection (1) must be drawn to the attention of the consumer— (a) in a conspicuous manner and form that is likely to attract the attention of an ordinarily alert consumer, having regard to the circumstances; and (b) before the earlier of the time at which the consumer— (i) enters into the transaction or agreement, begins to engage in the activity, or enters or gains access to the facility; or (ii) is required or expected to offer consideration for the transaction or agreement. (5) The consumer must be given an adequate opportunity in the circumstances to receive and comprehend the provision or notice as contemplated in subsection (1)."

[215] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 31 and 39.

lagging behind the Australian Trade Practices Act,[216] a distinction which some commentators have attributed to the fact that Australian consumer law developed several years ahead of its South African counterpart.[217] The uncertainty beleaguering the CPA has been likened to the situation prevailing prior to the 2010 iteration of Australia's Competition and Consumer Act 2010 [218] coming into operation.[219] Such uncertainty is largely caused by a lack of a clear definition of key terms such as "unfair contract terms".[220]

The CPA has, however, aptly been credited with paving the way for a greater role to be played by equitable considerations in the law of contract in South Africa.[221] It would appear correct, as noted by some commentators, that one cannot consider the concept of fairness, which is tied to and overlaps with unconscionability, without considering the South African Constitution.[222] Calls have long since been made for the acknowledgement of the role that fairness and equity have to play in the law of contract because such a role can be effected without completely compromising legal certainty.[223]

With an emphasis on the role of courts in developing the common law, certain questions have been proposed as key considerations to be settled regarding the role of fairness and equity in South Africa's contract law.[224] In particular, these include determining if and the extent to which the spirit, purport and objects of the Bill of Rights are offended, where deficiencies lie and whether exceptions to the rule can be established. In addition, it has been pointed out that the interaction between any newly recognised remedies based on fairness and equity with already-existing well-

[216] Trade Practices Act, 1974 (Cth). This is discussed further in Chapter 5 of this thesis.

[217] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 39.

[218] Australian Competition and Consumer Act 51 of 1974, as amended, compilation prepared on 1 January 2011, taking into account amendments up to Act No 148 of 2010, also known as Competition and Consumer Act 2010.

[219] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 38.

[220] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 34.

[221] Van der Sijde, E *The Role of Good Faith in the South African Law of Contract*, LLM Dissertation, University of Pretoria, 2012, at 37.

[222] Stewart, T, *Unreasonable, Unconscionable and Oppressive Contract Terms in South African and Western Australian Law*, LLM Dissertation, University of Johannesburg, 2015 (hereinafter, "Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*"), at 11.

[223] Van der Sijde, E *The Role of Good Faith in the South African Law of Contract*, LLM Dissertation, University of Pretoria, 2012, at 38.

[224] Brand, FDJ "*The Role of Good Faith, Equity and Fairness in the South African Law of Contract: A Further Instalment*" (2016), 27(2), *Stellenbosch Law Review*, 238, at 253.

established remedies also based on concepts of equity and fairness, for example, misrepresentation, rectification, undue influence, and so on, would need to be clarified.[225] Furthermore, it has been averred that the established principles must stand and be protected by the courts pending satisfactory resolution of such questions.[226] Given the above, it seems to be a fair assessment that South African courts have yet to clarify the precise role of good faith in the law of contract.[227]

3.2.6 Unconscionability in the Context of Demand Guarantees in South Africa

3.2.6.1 The Doctrine of Unconscionability and the Fraud Exception

Some commentators have sought to articulate the parameters of unconscionability with reference to fraud as the benchmark.[228] In this vein, it has been contended that unconscionability covers conduct that falls short of fraud but also includes fraud.[229] An interesting area of commonality between the fraud exception and the unconscionability exception is their association with public policy related elements such as bad faith. Equitable notions such as bad faith are, therefore, broad enough in scope to support distinct legal principles, such as the fraud exception and a potential unconscionability exception.

To clearly delineate the sometimes-fuzzy boundary between fraud and unconscionability, one must understand at least an outline of the fraud exception in a South African law context. The fraud exception has been categorised by two forms of interpretation, the first being a narrow approach, which entails direct fraudulent conduct in respect of the relevant transaction documents. An example of this in the context of a demand guarantee is the fraudulent presentation of documents containing express or implicit material misrepresentation with knowledge of the same.[230] The focus on documents which is characteristic of this narrow approach, while affording more deference to the principle of autonomy, is oblivious of the broader context or circumstances in which fraud may be perpetrated.

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[225] Ibid.

[227] See *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 123.

[228] See Woolf, *The Doctrine of Unconscionability as an Independent Exception*, generally, for a discussion of the unconscionability exception to the autonomy principle of documentary credits in the context of unconscionable conduct benchmarked against and falling short of fraud.

[229] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, at 5.

[230] *United City Merchants (Investments) Ltd v Royal Bank of Canada* (1983) 1 AC 168, para 83F-G.

It has been observed that the fixed focus on the documents in the narrow approach of the fraud exception is detrimental to the effectiveness of the exception itself, as it leaves room for fraud not directly involving the transaction documents to occur with relative impunity.[231] Some credit this gap with giving rise to the development of the second, wider approach of the fraud exception, which is based on the notion that in addition to documentary fraud, the conduct of a beneficiary *vis-à-vis* the underlying contract may establish fraud.[232] An example of conduct falling within the ambit of the wider approach to the fraud exception would be where a seller (beneficiary) presents compliant documentation with the knowledge that the merchandise being sold is worthless or non-existent.[233]

The fraud exception was clearly addressed before South African courts in the case of *Loomcraft Fabrics CC v Nedbank Ltd*,[234] in which the narrow approach to the fraud exception seemed to be preferred.[235] However, subsequent cases under South African law seemed to apply an interpretation of the fraud exception, which was more aligned with the wide approach and with particular reference to knowledge by a beneficiary that they are not entitled to claim under a demand guarantee.[236] While the parameters of the fraud exception may be less than perfectly certain under South African law, the recognition of the fraud exception is trite.

In the case of *Hollard Insurance Co Ltd v Jeany Industrial Holdings (Pty) Ltd and Others*,[237]it was held that payment could only be refused in "the most perfect cases of fraud",[238]noting that payment could not be refused unless there was an allegation that the relevant demand was made fraudulently

[231] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 15.

[232] Ibid.

[233] Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* (2016), at 291.

[234] See *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A), para 817.

[235] Idem, para 817.

[236] See the cases of *Union Carriage and Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) 730, 735; *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 17; *Scatec Solar SA 163 (Pty) Ltd v Terrafix Suedafrika (Pty) Ltd* (2014) ZAWCHC 63; and *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* [2015] 2 All SA 716 (GJ), paras 25-36.

[237] [2016] ZAGPJHC 175.

[238]Idem, para 27. See also, *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA), at 20, where, with reference to irrevocable letters of credit, the fraud exception to the autonomy principle was emphasised as only applying within a narrow scope (i.e., fraudulent documentation/fraud in respect of the documents presented themselves).

and in bad faith.[239] *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd*[240] is another case in which bad faith was considered in relation to fraud in the context of demand guarantees and conduct connoting bad faith by the beneficiary. In this case, bad faith was deemed to be established where a beneficiary's demand is based on "statements of fact which, to its own positive knowledge, are incorrect or contain misrepresentations".[241]

Further to the case law considered above, the following test for assessing fraud in relation to demand guarantees was proposed:

> "an assessment of the (1) underlying relationship between the applicant and the beneficiary, (2) the mutual obligations arising thereunder (whether payment was due or not), and finally, (3) an evaluation of the beneficiary's knowledge in this respect. Regarding the last point, the crucial question revolves around the beneficiary's positive knowledge of its lack of entitlement."[242]

The criteria for establishing fraud outlined in the *Guardrisk*[243] case were tested in *Scatec Solar SA 163 Ltd v Terrafix Suedafrika Ltd*,[244] which involved multiple guarantees. Echoing the test applied in *Guardrisk*,[245] the following reasoning was advanced in the *Scatec Solar* case:

> "the question is whether [the beneficiary] knew when he presented the demand for payments … that [the beneficiary] was in fact not entitled to payment in terms of the relevant invoices… He might have been wrong, he might even have been negligent, but I cannot find that he knew that it was wrong and that he presented the demand under the [guarantee] … in bad faith."[246]

The court in *Scatec Solar* concluded that although the beneficiary might have been wrong or negligent, there was no indication that the beneficiary or their representative knew that they were not entitled to claim and that it had been made in bad faith.[247] This approach can be construed as

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[239] *Hollard Insurance Co Ltd v Jeany Industrial Holdings (Pty) Ltd and Others* [2016] ZAGPJHC 175, para 27.

[240] *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA).

[241] Hugo and Marxen, *Exceptions to the Independence of Autonomous Instruments of Payment and Security*, at 140.

[242] Idem, at 135.

[243] *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA).

[244] [2014] ZAWCHC 63.

[245] *Guardrisk Insurance Company Limited and Others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA).

[246] (2014) ZAWCHC 63, para 22-23 and para 40.

[247] See (2014) ZAWCHC 63, para 22-23.

supporting the wider interpretation of fraud as referenced above. From the court's consideration of whether, *inter alia*, there were indications of bad faith when determining the presence of fraud, one can deduce that bad faith is viewed in some cases as conduct which is a subset of fraud. It seems, therefore, that an overlap between fraud and bad faith cannot be denied and that the boundaries in any attempt to draw a mutual exclusivity between the two may be obscure. In line with this view, it has been submitted that a wide interpretation of the fraud exception may well encompass instances of bad faith on the part of the beneficiary in a documentary credit arrangement.[248] That has, however, not deterred proponents of the recognition of good faith from arguing that a stand-alone exception independent from fraud is warranted.

Despite a potential commonality in fraudulent conduct, even more so on a wider interpretation thereof, and unconscionable conduct, the distinction between the two concepts is clear from the parallels between the two. While the law has not developed to a point where one true meaning of fraud is settled definitively, fraud is defined adequately enough to be universally accepted as an exception to the autonomy principle. By contrast, unconscionability is difficult to pin down and define in universally accepted objective terms, an element which may have contributed to its lack of traction in certain jurisdictions, including South Africa.[249] Also, some commentators' comparative analysis of fraud and unconscionability seems to be premised on the view that unconscionable conduct falls short of or is less than fraud.[250]

A distinction can also be drawn between the procedural and substantive elements of unconscionability and fraud. The procedural aspect of fraud speaks to the negotiation process leading up to a contract. The substantive element has to do with the terms of the contract itself. With unconscionability, while the procedural element also deals with the negotiation leading up to a contract, the substantive element, unlike the approach for fraud, considers not only the terms of the contract itself but goes further to consider the resultant contract itself.[251]

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[248] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 43.

[249] See some of the arguments against the recognition of unconscionability as an exception to the autonomy principle of demand guarantees discussed in section 3.2.5 of this Chapter. Consideration will also be given to the approach adopted in other jurisdictions in respect of unconscionability as an exception to the autonomy principle of demand guarantees in Chapters 4-6 of this thesis.

[250] See the discussion of unconscionability with reference to its connection with fraud in Woolf, *The Doctrine of Unconscionability as an Independent Exception* and in Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith* generally.

[251] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, 27.

While there may be elements of potential overlap and similarity between fraud and unconscionability, as exemplified above, the subject of a standalone unconscionability exception would not be mooted if such similarities were considered of such a nature as to adequately provide for recourse to unconscionability under the fraud exception. There is clearly an area of recourse in the context of unconscionability, which is not considered to be addressed by the fraud exception. For the purposes of this thesis, unconscionability will be considered in the context of whether it can be a standalone exception to the autonomy principle, separate from the fraud exception.

3.2.6.2 Unconscionability, Bad Faith or Lack of Good Faith: A Potential Standalone Exception?

Despite the lack of a settled position regarding the recognition of unconscionability as an exception to the autonomy principle under South African law, there have been some cases in which court intervention has been mooted in respect of demand guarantees on the grounds closely resembling or alleged to constitute unconscionability. As discussed further below, the Supreme Court of Appeal case of *Dormell Properties 282 CC v Renasa Insurance Co Ltd*,[252] which has since been overridden, is an example of such a case.

In *Dormell*, the question arose as to whether the findings of an arbitration award in respect of a construction dispute could be admitted as evidence in relation to non-payment of a claim under a demand guarantee. The minority, being two of the five judges presiding over the case, held that there was no valid defence against payment under the guarantee in the face of a valid claim for payment. Cloete J, for the minority, went on to explain that the arbitrator's determination (in favour of the contractor/applicant) of the beneficiary in the case was only relevant *vis-à-vis* the applicant and was *res inter alios acta* (i.e., irrelevant) in respect of the issuer or the guarantor, who remained obliged to meet their obligations as arising from presentation of a compliant demand under the demand guarantee.[253]

The majority judgment in *Dormell*, however, took a different view. Considering the arbitration award finding in favour of the applicant, it was held that "there was no legitimate purpose to which the guaranteed sum could be applied".[254] The Supreme Court of Appeal explained that if the guarantor was ordered to make payment pursuant to the guarantee, the applicant would be entitled

[252] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA).

[253]Idem, para 64.

[254] Idem, paras 40-41.

to repayment of the paid sum,[255] which in its view was not practical and would, in turn, give rise to additional cost and inconvenience.[256] On that basis, citing the Supreme Court Act,[257] the Supreme Court of Appeal dismissed the appeal.[258] This ruling faced an onslaught of heavy criticism, and later cases effectively rescinded the position taken in *Dormell*.

Prior to consensus being reached to overturn it in subsequent cases, the ruling in *Dormell* was considered to have established a new exception to the autonomy principle of demand guarantees under South African law as recognised by the Supreme Court of Appeal. According to Hugo, the point made in the *Dormell* case, "although not stated expressly in these terms – was clearly that another exception to the independence principle had been recognised by the Supreme Court of Appeal: if the underlying dispute has been finally determined against the beneficiary of the guarantee in arbitration (or litigation) this would provide a defence against liability on the guarantee, or the basis for an injunction preventing payment thereof."[259]

A prior adverse finding against a beneficiary, for example an arbitration ruling, was thus seemingly proposed as an exception under South African law. While some commentators focused on such a prior determination as an exception in itself,[260] the beneficiary's pursuit of a claim under the guarantee, presumably with knowledge that there was no legitimate purpose to which the claimed sum could also be construed to possibly be encapsulated under other exceptions like the fraud exception or an unconscionability exception.

Mounting discomfort with the rather radical impact of the majority judgment in *Dormell* was observed by commentators from various obiter dicta in cases following in the wake of *Dormell*.[261]

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[255] Idem, para 42.

[256] Idem, para 45.

[257] Supreme Court Act 59 of 1959, section 21A, being the statute in force at the time of this case and has now been replaced by the Superior Courts Act 10 of 2013 which has a similar provision, section 16(2).

[258] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA), paras 45-47.

[259] Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*, at 18-19.

[260] Ibid. See generally Hugo's discussion of non-payment under a demand guarantee on the grounds of a court judgment or arbitral award finding that the party obligated under the underlying transaction is not liable for payment or damages with reference to "The Provisions of the Supreme People's Court of the People's Republic of China on Several Issues Concerning the Trial of Disputes Over Independent Guarantees" which were released by the Judicial Committee of the Supreme People's Court on 7 July 2016 and came into effect on 1 December 2016, in Hugo C, "Demand Guarantees: Insights from the People's Republic of China", in *M Jopie: Jurist, Mentor, Supervisor and Friend - Essays on the Law of Banking, Companies and Suretyship*, (eds), Juta, 2017, 129.

[261] Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*, at 19.

This discomfort culminated in a marked preference for the minority judgment in *Dormell* and a categorical statement by the Supreme Court of Appeal in the case of *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association*[262] that the minority judgment in the *Dormell* case had been correct and the majority judgment wrong.[263] The *Dormell* case was noted to have resulted in guarantors seeking to introduce contractual disputes to avoid their payment obligations under demand guarantees, with applicants sometimes jumping into the fray.[264] The Supreme Court in the *Coface* case highlighted that such consequences (i.e., opening the floodgates of potential exceptions) were precisely what case law preceding the *Dormell* case had sought to avoid.[265] The case of *Coface,* therefore, effectively reversed the *Dormell* decision and unequivocally (re)established the position that a prior decision on an underlying contract dispute is neither an acceptable defence against payment obligations pursuant to the autonomy principle of demand guarantees nor a basis upon which an interdict would be granted to prevent payment thereunder. The polarity between the Supreme Court of Appeal decisions in the *Dormell* and *Coface* cases has been observed as depicting the non-static and constantly developing nature of the law relating to demand guarantees in South Africa.[266] It is submitted that this starkly highlights the urgent need for certainty regarding the exceptions to the autonomy principle that are recognised under South African law.

In *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*,[267] an applicant for a demand guarantee sought an interdict to prevent a beneficiary from making a demand. The application for the interdict was made on the basis that the beneficiary had, via amendment letters to the demand guarantee, undertaken not to call up the demand guarantee (i.e., a *pactum de non*

[262] 2014 (2) SA 382 (SCA).

[263] *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 23-25. The fact that the majority ruling in *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 1 SA 70 (SCA) is considered wrong and was overturned is widely acknowledged and referenced in a number of other cases, including *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 23; *Group Five Power International (Pty) Limited v Cenpower Generation Company Limited and Others* [2018] ZAGPJHC 663, paras 88-89; *Fast Track Contracting (Pty) Ltd v Constantia Insurance Company Limited and Others* [2018] ZAGPJHC 633, para 5 and *Granbuild (Pty) Ltd v Minister of Transport And Public Works, Western Cape and Another* [2015] ZAWCHC 83, para 24.

[264] *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), para 24.

[265] Ibid.

[266] Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*, at 18-19.

[267] [2014] ZAGPPHC 695.

petendo), prompting the court to, *inter alia*, consider what, in its view, were acceptable exceptions to the autonomy principle. Unconscionability was recognised, alongside fraud, as an exception to the autonomy principle, with Jansen J declaring:

> "not only fraud may prohibit the calling up of a construction guarantee, but also unconscionable conduct… the court holds it clear that when it is unconscionable to rely on the literal wording of a contract without reading such wording within the context of the background facts, the surrounding circumstances and the purpose of the agreement, then a construction guarantee cannot be called up."[268]

In a testament to their close connection or overlap, unconscionability and bad faith, or lack of good faith, have been considered in the context of a potential further defence against enforcement of a demand guarantee in the case of *Sulzer*.[269] The court in *Sulzer* highlighted the importance of good faith with reference to the case of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers Ltd*.[270] It appeared to acknowledge that a beneficiary may be prevented from calling upon a demand guarantee where the beneficiary has acted, *inter alia*, in "bad faith".[271] In support of applying principles of fairness and good faith in the law of contract, the court in *Sulzer* seemed to uphold the view that, despite the autonomy of contract and/or the *pacta sunt servanda* principle being a freedom protected under the Constitution, the scope of public policy effectively limits freedom of contract and, therefore, the principle of *pacta sunt servanda*.[272]

The case of *Sulzer* serves as authority supporting the position that contractual provisions that are unfair, in a similar vein to those contrary to law, morality or public policy, would be unenforceable or void because they would be in conflict with the public interest. However, the *Sulzer* case did not sufficiently establish a firm stance regarding the role of bad faith concerning demand guarantees to lay the subject to rest. *Sulzer* underscored that the precise role of good faith in the

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[268] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para. 125.

[269] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695. The case is discussed further in section 3.3.6 below.

[270] 2012 (1) SA 256 (CC).

[271] Kelly-Louw, M "Construing Whether a Guarantee is Accessory or Independent is Key", in Hugo, C and Kelly-Louw, M *Jopie: Jurist, Mentor, Supervisor and Friend – Essays on the Law of Banking, Companies and Suretyship*, (eds), Juta, 2017 (hereinafter, "Kelly-Louw, *Construing Whether a Guarantee is Accessory or Independent is Key*") at 115.

[272] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, paras 121-122.

context of South African law of contract and, therefore, demand guarantees remained an unsettled and contentious matter.[273] *Sulzer* acknowledged that South African courts had not yet "grasped the nettle of pronouncing with clarity what the precise role of bona fides in the law of contract entails".[274] The court in *Sulzer* provided no further proposition or clarity regarding the role or impact of good faith or the absence thereof (i.e., bad faith) in relation to contracts.[275]

Some commentators have been vocal in their criticism of the *Sulzer Pumps* case, particularly given its divergence from settled precedents upholding the supremacy of the autonomy principle. The observed lack of clarity regarding the basis upon which the court's ruling in *Sulzer* was founded, prompted commentators to criticise the judgment, with Kelly-Louw and Marxen noting that the judgment is "not a well-reasoned judgment."[276] Kelly-Louw and Marxen further noted that, to that point, neither unconscionability nor bad faith had been dealt with or raised as possible exceptions under South African law and that they should be avoided as they undermine and diminish the utility of demand guarantees.[277] This criticism is, respectfully, perhaps fair, as given *Sulzer*'s divergence from a well-beaten path of several preceding cases regarding accepted exceptions to the autonomy principle, the line of reasoning underpinning the statements and conclusions reached in the judgment could have been made clearer.

In *Group Five Construction Ltd v Member of the Executive Council for Public Transport Roads and Works Gauteng*,[278] the High Court invoked the minority judgment of Cloete J in *Dormell*[279] to support the view that the absence of good faith is a valid ground for declining enforcement of a demand guarantee.[280] Bad faith also seems to have also been recognised as a valid exception to the autonomy principle of demand guarantees in the case of *Hollard Insurance Co Ltd v Jeany*

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[273] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, paras 121-123.

[274] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 123.

[275] Idem, para 125.

[276] Kelly-Louw, M & Marxen, K "General Update on the Law of Demand Guarantees and Lettersof Credit", a paper delivered at the 2015 *Annual Banking Law Update*, 276 (hereinafter, "Kelly-Louw and Marxen, *General Update on the Law of Demand Guarantees*"), at 292. See also Marxen, K "*Demand Guarantees in the Construction Industry: A Comparative Legal Study of their Use and Abuse from a South African, English and German Perspective*" LLD thesis, University of Johannesburg, 2017, at 252.

[277] Kelly-Louw and Marxen, *General Update on the Law of Demand Guarantees*, at 293.

[278] 2015 (5) SA 26 (GJ).

[279] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA).

[280] *Group Five Construction Ltd v Member of the Executive Council for Public Transport Roads and Works Gauteng* 2015 (5) SA 26 (GJ), para 50.

Industrial Holdings.[281]

In *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited & Another*,[282] some consideration was given to whether noncompliance with an interim arbitration ruling was sufficient to establish fraud and/or bad faith.[283] In this case, the consideration of bad faith in conjunction with fraud again illustrates the broad and perhaps abstract nature of bad faith, enabling it to underpin both the fraud exception and the unconscionability exception, respectively.[284] In *Bombardier*, such conduct (i.e., pursuing a claim under a demand guarantee contrary to an arbitration ruling) was clearly found to fall short of the narrow interpretation of the fraud exception.[285] Citing the minority judgment of Cloete J in the *Dormell* case, the court in *Bombardier* ruled that neither bad faith nor the fraud exception was established where a beneficiary made a proper demand for payment in terms of a demand guarantee, despite an (interim) adverse arbitration decision. Extrapolating the approach taken in *Bombardier* and applying it to the similar circumstances of *Dormell*, it would appear likely that the circumstances in *Dormell* also fall short of the fraud rule on a narrow interpretation thereof.

Rather notably, the court in *Bombardier* repeatedly made it clear that a "narrow compass" of fraud was contemplated in its analysis of whether the relevant conduct was sufficient to establish the fraud rule.[286] The ruling in *Bombardier* is reticent on whether the conduct in question met the criteria for the wider interpretation of the fraud rule, an interpretation which, as noted above, is a few steps closer to unconscionable conduct. Given that, to date, South African case law has yet to take an unequivocally declaratory stance regarding the wide interpretation of fraud, a fact that may have influenced the reticence on this matter in *Bombardier*, conjecture on whether the wide interpretation of fraud could have encompassed the circumstances in *Dormell* or *Bombardier*.

Noting, however, that unconscionable conduct has been generally considered to include behaviour falling short of fraud, a more compelling proposition is that a beneficiary's claim under a demand

[281] [2016] ZAGPJHC 175.

[282] [2020] ZAGPPHC 554.

[283] Idem, paras 25-26 and para 28.

[284] Refer to discussion in section 3.2.6 of this Chapter.

[285] *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited & Another* [2020] ZAGPPHC 554, para 26.

[286] Idem, paras 13, 22 and 26.

guarantee with the knowledge that there is no legitimate purpose to which the proceeds claimed could be applied could meet the requirements of unconscionability exception. One of the conceptual distinctions noted between the fraud and unconscionability exceptions is that unconscionability, unlike fraud, is also concerned with the outcome or resultant contract.[287] Applying this distinction to the conduct presented in *Dormell* and *Bombardier,* it may well be that where a claim under a demand guarantee results in a payment to which a beneficiary is not entitled and can, therefore, not apply to a legitimate purpose, the criteria for an unconscionability exception is established.

3.2.7 Unconscionability Exception: An Analysis in the Context of South African Law

The lack of a precise general definition of the term unconscionability for general application under South African law lends itself to uncertainty and has contributed to unconscionability being perceived as "an elusive concept to apply.[288] Some have attributed unconscionability with uncertainty because it generally seems to cover a wide scope and parameters even in jurisdictions where it is recognised.[289]

The element of discretion, which is argued to be required due to the uncertainty of unconscionability, is, however, not necessarily a bad thing, some would argue. While a degree of uncertainty can render the law overly uncertain, the absence of a rigidly certain position can be seen as conducive to the equitable application of the law. According to this line of thinking, concepts perceived to be legally uncertain, such as unconscionability, can thus also facilitate "judicial manoeuvring in the interest of justice"[290] in the same way that public policy considerations enable justice to be effected via judicial intervention where appropriate. Proponents of the unconscionability exception argue that the autonomy principle must not be allowed to shield truly unconscionable conduct, which flies in the face of a court's duty to ensure justice, much in

[287] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, 27.

[288] Mugasha, A "Enjoining the Beneficiary's Claim on a Letter of Credit or Bank Guarantee" (2004), *The Journal of Business Law,* 515, at 518. See also Lee, A "Injuncting Calls on Performance Bonds: Reconstructing Unconscionability" (2003), *Singapore Academy of Law Journal*, 30, at 31.

[289] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, at 4-5.

[290] Hutchison, D and Pretorius, CJ et. Al, *The Law of Contract in South Africa, 3* ed, Oxford University Press, 2012 (hereinafter "Hutchison and Pretorius, *The Law of Contract in South Africa*"), at 22.

the same way it can be subverted to avoid the shielding of fraudulent conduct.[291]

To counter the argument that unconscionability is too vague and uncertain a concept, it has been pointed out that few legal concepts, including fraud itself, are certain enough for mechanical application.[292] Moreover, it is asserted that established exceptions such as fraud did not start off with the level of certainty they enjoy now. This was cultivated over time by case law, a development trajectory that unconscionability may well follow.[293] In a South African law context, the unsettled issue of whether fraud should be applied in the narrow sense or wider sense and developing case law that appears to support wider interpretation are evidence of the evolving level of certainty that even the accepted fraud exception is subject to.

It is not disputed that a practical working definition and parameters of unconscionability would be required from the outset if it was introduced as an exception to the autonomy under South African law. Moreover, it is acknowledged that a less than the perfectly solid level of certainty on the scope and meaning of unconscionability should in itself not preclude the development of an unconscionability exception. However, in a uniquely South African context, considering the importance of preserving the autonomy principle (and commercial utility) of demand guarantees, there may not be enough compelling reason to introduce an unconscionability exception. In light of the analysis and case law considered earlier in this chapter, the rationale for this view is outlined below.

In the absence of established fraud or illegality in the underlying contract, it has been contended that a demand constituting, *inter alia*, conduct which would be unconscionable or unreasonable is insufficient grounds for an interdict. Therefore, it should not be possible for courts to grant an interdict against the issuer of a demand guarantee on such grounds.[294] Kelly-Louw, a proponent of this view, with seeming reluctance to encourage a *laissez-faire* approach, stresses that even then, interdicts must be granted only in exceptional circumstances or denied altogether, the latter being

[291] Loi, KCF "Two Decades of Restraining Unconscionable Calls on Demand Guarantees" (2011), *Singapore Academy of Law Journal*, 504, at 511.

[292] Idem, at 512.

[293] Ibid.

[294] Kelly-Louw, M "*Selective Legal Aspects of Bank Demand Guarantees: The Main Exceptions to the Autonomy Principle*", LLD thesis, University of South Africa, 2008 (hereinafter "Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*"), at 348 and 372.

the option she considers preferable.[295] Interestingly, the note of caution in this regard is the same consistent parsimony with which South African courts appear to approach the non-enforcement of contracts because they are contrary to public policy.[296]

As highlighted in the *Sulzer* case and the discussion above,[297] the precise role of good faith in the South African law of contract and demand guarantees is a contentious matter yet to be fully settled. Given the uncertainty surrounding its status, good faith does not seem to have enough substantive authority behind it to be considered a possible standalone ground giving rise to an exception to the autonomy principle. Given the connection and overlap between unconscionability and bad faith or lack of good faith, which have led to them being considered in conjunction with each other or sometimes perhaps interchangeably, including by courts, unconscionability is burdened by the same uncertainty. Unconscionability was given apparent recognition in the *Sulzer* case but, like bad faith, appears to be an abstract concept which can perhaps only be effected in relation to the law of contract through the vehicle of public policy.

One reason that may be inferred for the inability of the courts in the cases mentioned above to definitively settle the issue of bad faith/lack of good faith in relation to demand guarantees is the abolishment of the *exceptio doli generalis* under South African law.[298] Despite some cases being seen as regressing towards the *exception doli generalis* because of their invocation of equitable notions like bad faith and unconscionability, this perspective may be missing some nuance. In particular, what may have been banished with the *exceptio doli generalis* is the previous role of good faith rather than the notion of good faith itself.

Under the *exceptio doli generalis*, the enforcement of a contract could be blocked directly on the grounds of bad faith. After abolishing the *exceptio doli generalis* and particularly in the

[295] Ibid. See also Kelly-Louw, M "Limiting exceptions to the autonomy principle of demand guarantees and letters of credit", Visser, C & Pretorius, JT (eds) *Essays in honour of Frans Malan: Former Judge of the Supreme Court of Appeal*, LexisNexis, 2014, at 197 (hereinafter "Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*"), at 216.

[296] See *Trustees, Oregon Trust v Beadica* 231 CC 2019 (4) SA 517 (SCA), at para 34 and *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), para 88. See also *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A), para 9B-C; *AB v Pridwin Preparatory School* 2019 (1) SA 327 (SCA), para 27; *Botha (now Griesel) v Finanscredit (Pty) Ltd* 1989 (3) SA 773 (A) at 783A-B and *Eerste Nasionale Bank v Saayman NO* 1997 (4) SA 302 (SCA) at 324B-G which reiterate and re-affirm the need for a restrained approach by courts to interfering with contracts on public policy grounds.

[297] See the discussion of the development and role of good faith in the South African law of contract in section 3.2.3 above.

[298] Refer to the discussion of the *exceptio doli generalis* and its demise under South African law further to *Bank of Lisbon and South Africa Ltd v De Ornelas and Another* 1988 3 SA 580 (A) 601 in section 3.2.3 above.

constitutional era, as demonstrated by the case law considered above, good faith has not ceased to be a factor the courts consider. Still, it has been conferred a new (arguably lesser) role. The caveat introduced to the role and consideration of good faith post the *exceptio doli generalis* is that it is in status relegated to an abstract value which informs substantive rules of law rather than a rule in itself. Alone, it is not a ground upon which one can rely to resist the enforcement of a contract. However, it gains potency when cleaved to a substantive common-law principle, owing perhaps to its amorphous nature.

South African courts have considered the role of equitable considerations such as good faith several times[299] and concluded that abstract values such as good faith are fundamental to contract law but are nevertheless not substantive rules that courts can employ to intervene in contractual relationships. Good faith in such cases has been afforded the broader, yet some might say lesser, role of performing "creative, informative and controlling functions through established rules of the law of contract",[300] and in the Constitutional era seemed to be encapsulated in the concept of public policy.[301]

Given the arguably inextricable link between the notion of bad faith and the notion of unconscionability, it is submitted that this link extends to their role and status in respect of South African law of contract and of demand guarantees. Turning to frame this in the context of demand guarantees, being the focus of this thesis, it is posited that unconscionability is not entirely unrecognised by the present *status quo*. Perhaps just like bad faith, it is an abstract concept that would be enough to block the enforcement of a demand guarantee if it fits within the parameters required to establish an infringement of public policy.

Bad faith and, concomitantly, unconscionability could fall within the remit of some common-law tools of recourse already available under South African law, including in respect of demand guarantees. As discussed earlier in this chapter and depending on the unique circumstances of a case, such tools could include undue influence, misrepresentation, duress, fraud (particularly on the wide approach thereof), or, most notably, the concept of public policy as enshrined in the Constitution, respectively. Therefore, where unconscionability is embedded in or intersects with an infringement of public policy, the enforcement of a contract or demand guarantee may be

[299] See the discussion of good faith and public policy considerations in sections 3.2.3 and 3.2.4 of this Chapter.

[300] See *South African Forestry Co Ltd v York Timbers Ltd*, 2007 (5) SA 323 (CC), para 27. *Capitec Bank Holdings Limited and Another v Coral Lagoon Investments 194 (Pty) Ltd and Others* 2021 [ZASCA] 99, para 63 and 65.

[301] See the discussion of good faith and public policy considerations in sections 3.2.3 and 3.2.4 of this Chapter.

challenged on that basis.

It is proposed that unconscionability and/or good faith can feed into and, therefore, establish an infringement of public policy in certain circumstances. Regarding the interaction of good faith and public policy, Huyssteen and Maxwell assert, albeit in respect of contracts generally, that,

> "the main principle that is applied in South African law with respect to the content, execution and enforcement of contracts is that the agreement must not offend against public policy or the public interest. However, good faith, being an underlying value, may very well influence the content of public policy."[302]

References to bad faith and seeming recognition of unconscionability exception to the autonomy principle in cases such as *Sulzer* notwithstanding, it appears that lack of good faith, and arguably unconscionability, would likely only be a potent argument where they are supported by enough evidence to establish a violation of public policy.

Given the above, there seems to be no cogent reason why public policy considerations would not afford sufficient recourse to the participants in a demand guarantee arrangement in the instance of unconscionable conduct. A more restrained test of whether public policy has been violated seems to be a fair median point between a wholesale unconscionability exception and no recourse at all. Most importantly, in the context of demand guarantees, it defers to the autonomy principle.

Given the coinciding parameters and the likely overlap between unconscionable conduct (and/or in bad faith) and conduct contrary to public policy, a stand-alone unconscionability exception to the autonomy principle of demand guarantees is not pushed for in this thesis. Instead, attention is redirected to the concept of public policy or other already-existing common law avenues for recourse as may apply to a situation. Also, the codification of unconscionability in the CPA in relation to consumer law would arguably curtail any mischief that an unconscionability exception may have sought to address regarding consumers or non-commercially sophisticated members of society.

The limited scope of the CPA and unconscionability considerations in a consumer protection context also lends itself to the fact that the consumer demographic had a more compelling need for such recourse than the sophisticated commercial parties typically involved with demand

[302] Huyssteen, LF and Maxwell, CJ *Contract Law in South Africa*, 4 ed, Wolters Kluwer Law & Business, 2015, at 214.

guarantees. For such sophisticated commercial parties in the context of demand guarantees, it is submitted to be fair that they are held to the *pacta sunt servanda* doctrine, with less room for potential derogation from the sanctity of a demand guarantee and derogation therefrom. Furthermore, it is posited that such commercial parties, in respect of demand guarantees, should have the remedies existing for duress, misrepresentation and undue influence etc. available to them. Also importantly, demands with knowledge of lack of entitlement can be met with the fraud exception on a wide interpretation, while unconscionable conduct falling foul of public mores could be extinguished under public policy grounds, as applicable.

While jurisdictions like Australia have incorporated an unconscionability exception applied in respect of demand guarantees, it does not necessarily follow that the circumstances giving rise to such an approach in the relevant jurisdiction apply uniformly in a South African context. The approach adopted in other jurisdictions is considered in the preceding chapters to aid a complete analysis of whether the benefits of recognising an unconscionability exception to the autonomy principle under South African law of demand guarantees outweigh the costs *or vice versa*. More definitive recommendations regarding the South African position will be determined from such analysis.

3.3 BREACH OF A NEGATIVE STIPULATION

3.3.1 Introduction: Brief Rationale and Perspectives on the Breach of a Negative Stipulation Exception

A negative stipulation in the context of a demand guarantee typically entails an undertaking normally in the underlying contract, but may also be in another/separate contract/agreement, to refrain from making a demand before taking certain other action or before certain events (i.e., the condition). The underlying contract or breach of a negative stipulation exception is effected generally by enforcement of underlying contract terms that restrict a beneficiary’s entitlement to make a demand pursuant to a demand guarantee. The reference to this exception as the underlying contact exception has been criticised as potentially pointing courts toward underlying contracts to demand guarantees as the starting point for ascertaining parties' rights when adjudicating applications for interdicts (injunctions), and Enonchong argues that for this reason, perhaps the

use of different nomenclature would be more appropriate.[303]

However, given the nature of the breach of a negative stipulation exception, especially that it typically has its roots in the underlying contract giving rise to a documentary credit, referring to it as the underlying contract exception can be defended as a logically apt description. For the purposes of this study, the analysis is focused on negative stipulations by a beneficiary, not only in an underlying contract but also those that can be potentially housed in a separate agreement or even in the demand guarantee itself.

It is technically also possible for a negative stipulation to be included in a demand guarantee itself. However, due to the "on-demand" element of demand guarantees and the fact that they are by nature intended to be "as good as cash",[304] any conditionality in a demand guarantee would detract from its nature as such. The inclusion of a negative stipulation in a demand guarantee itself could, in my view, be construed as an intention by the parties to it to rather establish a true/conditional guarantee or a suretyship arrangement, perhaps. For demand guarantees, the inclusion of any stipulations which may detract from or obfuscate the "on demand" nature of the demand guarantee must be avoided in the interests of certainty for the parties.

In the case of *Eskom Holdings Soc Limited v Hitachi Power Africa (Pty) Ltd & Another*[305], which involved, *inter alia*, a dispute as to whether the instrument in question was a demand guarantee or a conditional guarantee, Mthiyane AP stated:

> "A claimant under a conditional guarantee is required, not only to allege but sometimes also to establish liability on the part of the contractor for the amount claimed. An on demand guarantee requires no allegation of liability on the part of the contractor under the construction contracts."[306]

Even though the contested instrument in the *Eskom Holdings* case was upheld as a demand guarantee, it is worth noting that its status as a demand guarantee was vindicated because the wording in the demand guarantee was clear in that it did not impose any uncharacteristic condition

[303] Enonchong, N "The Problem of Abusive Calls on Demand Guarantees" (2007), 1, *Lloyd's Maritime and Commercial Law Quarterly*, 83 (hereinafter, "Enonchong, *The Problem of Abusive Calls on Demand Guarantees*"), at 88.

[304] See the discussion of the nature and key characteristics of demand guarantees in Chapter 2 of this thesis.

[305] [2013] ZASCA 101.

[306] Idem, para12.

to payment thereunder.[307]

In another case, *Minister of Transport and Public Works, Western Cape, & Another v Zanbuild Construction (Pty) Ltd & Another*[308], the potential malaise associated with lack of clarity in this regard is illustrated. In this case, conditional wording in the guarantee itself, which cross-referenced the underlying contract, was considered to create a liability akin to that of a surety.[309] While the *Eskom Holdings* and *Zanbuild Construction* cases referenced here did not involve a negative stipulation in the relevant instrument/guarantee, these cases clearly emphasise the distinction between a demand guarantee (primary obligation) and a conditional guarantee (accessory liability) and the importance of language in the document itself when deciding on the nature of an instrument.

An inevitable corollary of such a stipulation is the positive onus it creates to establish or evidence the fulfilment of the condition in a manner akin to the requirement under a suretyship agreement or conditional guarantee. It is submitted that an instrument that includes a conditional negative stipulation in its body will likely not pass as a demand guarantee under South African law, and rightly so, even if it purports to be one. In line with the reasoning that a negative stipulation contained in a demand guarantee itself will generally compromise the status of the instrument as a demand guarantee, it is not proposed to delve further into the paradox that is a negative stipulation in the demand guarantee itself.[310] To maintain clarity regarding the scope of this thesis, references to a negative stipulation or breach thereof, even without further specificity, will generally be to a negative stipulation in an underlying contract or a separate contract/agreement. The specific source of a negative stipulation will only be referenced where the context or the specific facts of a case/scenario require specificity regarding the document from which such a stipulation arose.

Various jurisdictions have taken differing approaches to applications for interdicts (injunctions) based on a breach of the underlying contract exception.[311] It is considered to be accepted that in

[307] Idem, para 15. See also *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA).

[308] 2011 (5) SA 528. See also *Mutual and Federal Insurance Company Limited and Another v KNS Construction (Pty) Limited and Another* [2016] ZASCA 87 and *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd & Others* 2001 (2) SA 760 I.

[309] *Minister of Transport and Public Works, Western Cape, & another v Zanbuild Construction (Pty) Ltd & Another* 2011 (5) SA 528, para 19.

[310] The acceptable form of the negative stipulation and location thereof is discussed further in section 3.3.8.3 below.

[311] Enonchong, N *The Independence Principle of Letters of Credits and Demand Guarantees*, Oxford University Press, 2011, at 212.

certain circumstances, South African courts may defer to the terms and conditions of the underlying contract over the autonomy principle, for instance, in the case of clearly established fraud in respect of demand guarantees.[312]

3.3.2 The Potential Overlap and Divergence of Fraud and Breach of a Negative Stipulation

It has been argued that breach of a negative stipulation and fraud overlap with each other in some circumstances.[313] This gives rise to the question of whether a breach of a negative stipulation exception could thus be covered under the fraud exception, thereby obviating the need for a standalone breach of a negative stipulation exception. In *Union Carriage and Wagon Co Ltd v Nedcor Bank*,[314] remarks were made to the effect that where a beneficiary and principal agree in the underlying contract that a letter of credit cannot be called up before the occurrence of a certain event, attempts to exact payment by the beneficiary prior to the occurrence of the relevant events would constitute fraud.[315] Such *obiter dicta* do not aid the demarcation between the fraud exception and a potential breach of a negative stipulation exception.

The case of *Phillips v Standard Bank*[316] is regarded to have confirmed the position that a mere "innocent breach of contract"[317] (without the involvement of any fraud on the part of the beneficiary), as was found to be the case therein, is not sufficient grounds for a prohibitory interdict to prevent payment pursuant to a documentary credit. The finding in *Phillips* clearly illustrates the reality of circumstances in which fraud and the breach of contract or a negative stipulation in a contract can be mutually exclusive and distinct. However, where the breach of contract involves an element of fraud by the beneficiary, such a scenario has been noted to possibly fall within the ambit of the wide definition of fraud.[318] Therefore, it would seem that fraud and breach of a negative stipulation can indeed intersect in cases of a fraudulent breach of contract. However,

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[312] Kelly-Louw, *Limiting Exceptions to the Autonomy Principle*, at 200.

[313] This view/perspective was considered in the case of *Phillips v Standard Bank* 1985 (3) SA 301 (W).

[314] 1996 CLR 724 (W).

[315] Idem, at 735.

[316] 1985 (3) SA 301 (W).

[317] Idem, para 303I-304A.

[318] See Hugo, CF "*The Law relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks*", LLD Dissertation, University of Stellenbosch, 1996 (hereinafter, "Hugo, *The Law relating to Documentary Credits*"), at 322.

barring cases in which they may intersect, they are typically distinct grounds on which a contract or a demand guarantee may be challenged.

Seeming to follow the path followed by the *Phillips* case, the case of *ZZ Enterprises v Standard Bank*,[319] despite its focus on the documentary collection and not documentary credits, supported the existence of distinct parameters between fraud on the one hand and simple breach of contract on the other. This indicates that a beneficiary's breach of an underlying contract does not necessarily equate to fraud.[320] Therefore, despite any potential overlap between the two, depending on the circumstances of a given case, breach of an underlying contract by a beneficiary would not, as a matter of course, establish the existence of the fraud exception. Quite importantly, this also affirms the view that breach of a negative stipulation cannot automatically be considered to constitute a scenario covered by the fraud exception in normal circumstances. Any consideration of breach of negative stipulation as an exception to the autonomy principle of demand guarantees should, therefore, be on a standalone basis.

3.3.3 Rationale and Role of the Breach of a Negative Stipulation Exception

3.3.3.1 General Aspects of the Breach of a Negative Stipulation Exception

The role of the underlying contract in the context of any demand guarantee arrangement is quite an important one. The underlying contract is archetypally the agreement which instigates the existence of a demand guarantee and has been described as a base without which subsequent undertakings such as demand guarantees would not exist.[321] Although a beneficiary would be entitled to payment upon presentation of a compliant demand, agreeing to restrictive underlying contract terms would fetter their entitlement to make such a demand pursuant to the framework of the underlying contract.[322]

The paradox inherent in a beneficiary's agreement to restrictions in respect of a demand guarantee

[319] *ZZ Enterprises v Standard Bank of South Africa Ltd* 1995 CLD 769 (W). In this case, an application for an interdict seeking to prevent payment to a seller on the grounds of fraud was unsuccessful because the facts of the case were found to indicate mere breach of contract as opposed to fraud, and, therefore, a case of fraud had not been established.

[320] Ibid.

[321] Thayer, P "Irrevocable Credits in International Commerce: Their Legal Effects" (1937), 37, *Colum L Rev*, 1326 at 1333.

[322] Alavi, H, "Contractual Restrictions on Right of Beneficiary to Draw on a Letter of Credit; Possible Exception to Principle of Autonomy" (2016), 16(2), *ICLR*, 67 (hereinafter, Alavi, *Contractual Restrictions on Right of Beneficiary to Draw*"), at 68.

in an underlying contract has been expressed in the following question: where a beneficiary, regardless of their awareness of the autonomy principle, agrees in the underlying contract to restrictions on their right to draw on the documentary credit, should they be allowed to rely on the autonomy principle to flout the obligations to which they have committed themselves under the underlying contract?[323] This will be considered below.

3.3.3.2 Rationale of Negative Stipulation Provisions from an Applicant's Perspective

The negative stipulation exception has been referenced as an exception premised on providing contracting parties with the ability to mitigate their concerns that independent guarantees are too fraud-prone.[324] Given the imbalance of bargaining power created by the autonomy principle and its susceptibility to abuse,[325] it is acknowledged that applicants may have concerns about the possibility of fraud or unconscionable conduct on the part of a beneficiary.

It has been opined regarding the purpose of the underlying contract exception that it is one of the most effective avenues for recourse against abusive calls on-demand guarantees, especially because guarantors are blinkered by the autonomy principle from considering any extraneous factors.[326] With this in mind, the option of safeguarding an applicant's economic interests through restrictive provisions in the underlying contract to a demand guarantee has been proposed as a practical solution.[327]

In this regard, it has been noted that two conflicting contractual rights are pitted against each other in the context of breach of a negative stipulation in relation to a demand guarantee: (1) the beneficiary's right for payment of a guaranteed amount upon presentation of a compliant demand pursuant to the autonomy principle; and (2) the applicant's right to restrain a demand according to the terms of the underlying (or other) contract.[328] This begs the question of which of the two rights

[323] Alavi, *Contractual Restrictions on Right of Beneficiary to Draw*, at 68-69.

[324] Todd, P *Maritime Fraud and Piracy*, 2 ed, Informa Law, 2010, at 129.

[325] See sections 2.3.3 and 2.10.1 in Chapter 2 of this thesis.

[326] Alawamleh, KJA *Documentary Credits and Independent Guarantees: A Critique of the 'Fraud Exception' Position in English and Jordanian Law*, PhD thesis, University of Central Lancashire, 2013 (hereinafter, "Alawamleh, *Documentary Credits and Independent Guarantees: A Critique of the Fraud Exception*"), at 199–200.

[327] Alavi, *Contractual Restrictions on Right of Beneficiary to Draw*, at 72.

[328] Idem, at 194.

takes precedence over the other,[329] or alternatively, which element should prevail between the autonomy principle and the breach of a negative stipulation exception.

Despite the overriding sanctity of the autonomy principle, it has been correctly caveated by warnings not to blindly emphasise or apply it, which caveat may apply, *inter alia*, in circumstances where the terms of the underlying (or other) contract are determined to qualify the autonomy principle.[330] Although lauding the drive to keep underlying contract defences from choking South African demand guarantee practice, Hugo highlights that the abuse of demand guarantees is an "undeniable truth" and boldly asserts that thrombosis may indeed be a good thing in certain circumstances.[331] On this basis, a knee-jerk dismissal of evidence arising from an underlying contract (or, it is submitted, another/separate contract) when considering documentary credits has been discouraged on the basis that it may prove the absence of a genuine belief by a beneficiary of their entitlement to make a demand, which revelation would enable courts to block the conveyance of "bad blood" (i.e., an abusive or illegitimate claim by a beneficiary).[332]

3.3.3.3 Rationale of Underlying Contract Provisions from a Beneficiary's Perspective

One of the reasons a beneficiary may agree to restrictive terms in an underlying or other contract is the need to level the playing field with an applicant. This can be achieved by eliminating the steep difference in bargaining power between the beneficiary and the applicant, which could well be what makes the latter willing to enter into a demand guarantee arrangement in the first place. A beneficiary may want to build trust and indicate "good faith" to an applicant who is jittery at the prospect of abusive demands on a proposed demand guarantee. Another cogent reason for a beneficiary agreeing to be bound by contractual restrictions on their ability to make a demand under a demand guarantee may be to avoid a protracted negotiation which, for sophisticated parties, would likely lead to a counter-guarantee being demanded by an applicant.[333] In such cases, a beneficiary may prefer the restrictive terms in an underlying contract to taking on the costs of

[329] Ibid.

[330] Alawamleh, *Documentary Credits and Independent Guarantees: A Critique of the Fraud Exception*, at 193.

[331] Hugo, C "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal Relating to Demand Guarantees" (2014), 4, *TSAR*, 661 (hereinafter "Hugo, *Protecting the Lifeblood of Commerce*"), at 674

[332] Ibid.

[333] Alavi, *Contractual Restrictions on Right of Beneficiary to Draw*, at 72.

issuing a counter-guarantee in favour of the applicant.[334]

3.3.4 *Kwikspace Modular Buildings Limited v Sabodala Mining Company*

3.3.4.1 General

The underlying contract exception was considered in the appellate case of *Kwikspace Modular Buildings Limited v Sabodala Mining Company* ("Kwikspace")[335] where it was successfully contended that an underlying contract could, "as a matter of law, qualify the right of the Principal to present the guarantees for payment to the Bank, despite the unconditional wording of the guarantees".[336] Cloete JA, in *Kwikspace*, invoked Australian case law as the applicable choice of law to support this stance and cited Austin J's statement from *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd*[337] that while the Court would not restrain the issuer of a performance guarantee from acting to fulfil an unqualified promise to pay,

> "… [i]f the party in whose favour the bond has been given has made a contract promising not to call upon the bond, breach of that contractual promise may be enjoined on normal principles relating to the enforcement by injunction of negative stipulations in contracts."[338]

The Australian case of *Wood Hall Ltd v Pipeline Authority*[339] in which it was recognised that the provisions of an underlying contract might qualify a beneficiary's right to call on a documentary credit, was also referenced in *Kwikspace* to support recognition of the breach of a negative stipulation exception.[340]

3.3.4.2 Restricting a Beneficiary from Making a Demand versus Restricting a Guarantor from Making Payment

The case of *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd*,[341] as referenced in

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[334] Ibid.

[335] [2010] 3 All SA 467 (SCA).

[336] Idem, para 6.

[337] (1999) 15 BCL 158, at 164.

[338] *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA), para 77.

[339] (1979) 141 CLR 443.

[340] Idem, para 8.

[341] [2008] FCAFC 136.

the case of *Kwikspace,* is notable for the distinction it makes between restraining a guarantor from fulfilling its unqualified obligation to pay, an approach which is widely considered to impinge on the autonomy principle, versus enjoining a beneficiary from breaching its obligation to comply with a negative stipulation that they have agreed to in the underlying contract. Despite some authorities upholding the view that restraining an issuer of a documentary credit from making a payment and restraining a beneficiary from making a demand both have the same effect on the autonomy principle,[342] this view has been widely debunked, as depicted in the case of *Kwikspace*, where the following statement from *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd*[343] was cited:

> *"*There is nevertheless an important difference between restraining a bank from honouring a guarantee and restraining the beneficiary from calling upon it. In the former case the moving party seeks to prevent the bank from performing its contract; in the latter case the moving party seeks to prevent the beneficiary from breaching a provision of the underlying contract."[344]

3.3.4.3 Express versus Implied Negative Stipulations

The court in *Kwikspace* also noted the distinction highlighted in the *Fletcher Construction* case between express restrictions in an underlying contract and a beneficiary's right to draw on a demand guarantee and implied restrictions.[345] The latter was noted to be harder to establish, particularly given that implicit restrictions would not be enforced where they would impede or be inconsistent with the purposes of the relevant demand guarantee.[346]

3.3.4.4 Decision and Summary of Position Established

The Australian law position, as determined and applied in *Kwikspace* was that, without an allegation of fraud, a beneficiary could be restrained from calling up a demand guarantee based on evidence that doing so would breach the terms of the relevant underlying contract. However, such a stance would not be readily read into a situation. It would, therefore, have to be clearly expressed or presented. In determining the applicable Australian law position in *Kwikspace*, the court was

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[342] *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152, at 1161-2.

[343] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812.

[344] *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA), para 9, citing *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, at 826.

[345] Ibid.

[346] Ibid.

notably reticent on the matter of whether a similar position prevailed under South African law.

Despite the court's avoidance of a declaration on whether its construction of the breach of a negative stipulation exception under Australian law in *Kwikspace* also reflected the South African law position, some commentators have concluded that it did.[347] It is, however, worth noting, for completeness, that following a holistic consideration of all factors determined to be relevant in the case, including the relevant contractual clauses therein and arguments regarding potential tacit terms, the verdict in *Kwikspace* found that the beneficiary, in this case, was not precluded from demanding payment of the demand guarantee.

Hugo concisely sums up the two main points that can be gleaned from the *Kwikspace* case as being first, that a beneficiary can be interdicted from demanding payment under a demand guarantee on the basis that such a demand would breach an underlying or other contract, and secondly, the caveat that such an interpretation of an underlying contract will not be taken lightly and would, therefore, have to be undoubtedly clear from the agreement.[348] Hugo noted the danger of glibly reading a negative stipulation into an underlying contract, stating that to do so could stultify the purpose of demand guarantees.[349] The *Kwikspace* case has been credited for appreciating the distinction between an interdict seeking to prohibit a beneficiary from making a demand versus one seeking to prohibit a guarantor from making payment when faced with an otherwise compliant demand, which position is also considered to prevail under Australian and English law.[350]

In his analysis, Hugo has largely maintained deference to the autonomy principle, endorsing the position that in the absence of the traditionally accepted exception of fraud, a guarantor cannot refuse to pay under a demand guarantee.[351] However, Hugo goes on to stress that the autonomy principle need not extend to permitting outright breach of clear contract terms, particularly where a beneficiary has agreed to comply with certain conditions before claiming under a demand guarantee.[352] Hugo also correctly assessed this situation as one in which an interdict may be sought

[347] Hugo, *Protecting the Lifeblood of Commerce*, at 669.

[348] Ibid.

[349] Ibid.

[350] Hugo, *Protecting the Lifeblood of Commerce*, at 672 and 674.

[351] Idem, at 673-674.

[352] Idem, at 673-674.

to enforce the relevant contractual terms flouted by a beneficiary.

A key point highlighted by Hugo, which one can agree with is sound upon legal scrutiny, is that any litigation between parties to the underlying contract seeking to enforce any terms thereof which restrain the beneficiary from claiming under the guarantee has no bearing on the autonomy principle.[353] As neither the guarantor nor the demand guarantee, which retains its independent nature, would need or be expected to be embroiled in such litigation, Hugo's logic that the issue of independence of the demand guarantee does not arise seems to hold true. Given the stark imbalance of power in favour of beneficiaries, which is characteristic of demand guarantees, it is imperative to guard against the abusive application of the autonomy principle to evade contractual obligations that are freely entered into by a beneficiary.

In addition, autonomy is a two-way street. The nature and independence of a demand guarantee should have no impact on the enforcement of an independent contract, underlying or otherwise, between the parties to it. Put another way, the only significance of a demand guarantee in relation to the enforcement of a negative stipulation in a separate contract against a beneficiary making a claim is akin to that of a passive object. Similarly to how an object is typically treated as passive in a dispute between two subjects over a said object, so must the demand guarantee be viewed *vis-à-vis* litigation between the parties (i.e., subjects) to an underlying or other contract regarding how the object may be utilised. In the event of or during the course of any skirmishes between disputing parties in respect of the object, the object, being in the custody or control of a neutral third party (i.e., the guarantor), would remain unscathed and unaffected in nature and independence.

Continuing with the analogy, a guarantor's role with respect to the autonomy principle is not compromised in any way, as such role remains simply to deal with the object/demand guarantee in accordance with the terms thereof. In turn, the beneficiary's ability to comply with the terms of a demand guarantee by making a compliant demand may depend on the outcome of the litigation regarding the breach of a negative stipulation.

If a beneficiary was successful in bucking the enforcement of the alleged negative stipulation, they would proceed to make a demand that a guarantor would honour in accordance with the terms of the demand guarantee and in line with the autonomy principle. Conversely, if the applicant or principal was successful in restraining the beneficiary from making a claim by enforcing the negative stipulation in an underlying/other contract, the beneficiary would be prevented from

[353] Idem, at 674.

making a demand. The question of a guarantor's obligation to pay would not arise. Hugo's conclusion that the independence of a demand guarantee does not arise at all in the context of enforcement of a contract preventing a beneficiary from making a demand[354] is thus illustrated to be correct.

3.3.5 *Eskom Holdings Soc Ltd v Hitachi Power Africa*

3.3.5.1 General

Another important South African case that considered the effect of a negative stipulation in an underlying contract in the context of the autonomy principle is the case of *Eskom Holdings Soc Ltd v Hitachi Power Africa* ("Eskom Holdings").[355] In this case, an interdict/injunction was sought based on an alleged failure by the beneficiary to comply with the underlying construction contract as well as a breach of an agreement in the form of a letter undertaking not to call on the demand guarantees at the centre of the dispute before a specified date. The case again pitted contravention of the underlying construction contract against the guarantee and the autonomy principle thereunder.

The first ground on which the interdict was sought before the court *a quo*, was the beneficiary's non-compliance with the terms of the underlying construction contract. This was premised on a clause in the contract stipulating that where the beneficiary (the employer in this case) considered themselves entitled to any payment, they had to provide the applicant (the contractor in the case) with notice and particulars. It was further stipulated that such particulars were required to specify the clause or the basis of the claim and include substantiation of the amount to which the beneficiary considered themselves entitled.[356] The second contention was that Eskom (the beneficiary), in correspondence between the parties, had waived its right to make a demand under the guarantee before a date specified therein.[357] The court *a quo* accepted the alleged non-compliance of the beneficiary with the underlying contract and granted the interdict sought.[358] An appeal against this ruling was pursued.

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[354] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[355] [2013] ZASCA 101.

[356] Idem, para 8.

[357] Ibid.

[358] [2013] ZASCA 101, para 9.

However, on appeal, the Supreme Court of Appeal held a different view. The Supreme Court of Appeal (per Mthiyane AP) observed the unclear and seemingly contradictory provisions in the construction contract, and zooming in on, *inter alia*, a provision (clause 4.2 of the contract) stated that:

> "The Employer shall not make a claim under a Performance Security, except for amounts to which the Employer is entitled under the Contract in the event of …
>
> (d) circumstances which entitle the Employer to termination under Sub-Clause 15.2 … irrespective of whether notice of termination has been given"[359]

Considering such provisions and the construction contract as a whole, the Supreme Court of Appeal found that the construction contract did not oblige the beneficiary to give notice before making a claim for payment under the demand guarantee. While this aspect of the ruling was generally noted to be refreshingly clear, some other obiter remarks made by the court have been considered by some commentators as rather unfortunate in that they detract from such clarity.[360] Hugo notes that the court then refers to the terms of the demand guarantee relating to when the beneficiary is entitled to make a demand, including that the demand amount "is payable to Eskom in the circumstances contemplated in … clause 4.2 of the Contract".[361]

Mthiyane AP further stated that the guarantor was not "required to investigate whether notice was given and whether Eskom has complied with the construction contract" and went on to declare:

> "In my view it makes business sense for the terms of the guarantee not to have required the Bank to embark on this exercise. A bank is in the business of handling money, not assessing and evaluating the merits or demerits of contracts. The interpretation contended for by Hitachi and endorsed by the court below would have required the bank, which was not even party to the proceedings, to traverse areas which fall outside the scope of its authority".[362]

It was also noted in the judgment that the court *a quo*'s finding that the beneficiary was required to give notice before making a demand under the guarantee "flew in the face of the plain meaning

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[359] Idem, para 15.

[360] Hugo, *Protecting the Lifeblood of Commerce*, at 672.

[361] *Eskom Holdings Soc Ltd v Hitachi Power Africa* [2013] ZASCA 101, para 15, and Hugo, *Protecting the Lifeblood of Commerce*, at 672.

[362] Ibid.

of the terms of the guarantee …"[363] and was not provided for in the terms of the demand guarantee.

3.3.5.2 Restricting a Beneficiary from Making a Demand versus Restricting a Guarantor From Making Payment

Obiter remarks from the *Eskom Holdings* case have been argued to indicate that had the interdict sought been granted, such interdict would have simply given effect to the enforcement of the underlying construction contract. It would not have been considered to harm the autonomy principle.[364] In this regard, Hugo correctly observes that it would have been different had the interdict been one seeking to prevent the bank from making payment.[365]

While the court's further comments in *Eskom Holdings* relating to the guarantor's remit in a context alluding to the autonomy principle are, in principle, correct, it is submitted that the switch in focus to the parameters of the guarantor's obligations with reference to the provisions of the demand guarantee was not at all necessary. As the interdict challenged the demand for payment, it is, respectfully, difficult to appreciate the relevance of the guaranteeing bank's obligations or lack thereof under the demand guarantee at that stage as they were neither challenged nor in question.

In *Eskom Holdings*, the court emphasised, firstly, that "assessing and evaluating the merits or demerits of contracts" fell out of the scope of the guarantor's authority".[366] Secondly, it was noted that the court had, in considering the case, conducted such an assessment with reference to the underlying contract. Taking these two points into account, it could be argued that consideration of extraneous factors to a demand guarantee, particularly an underlying or other contract that binds a beneficiary, is a task reserved solely for the courts, albeit one that would only apply where the terms of the underlying or other contract bring into question the legitimacy of a demand. It is worth flagging that this view is focused on the enforcement of a beneficiary's contractual obligations under an underlying or separate contract and does not presume to have any bearing on the autonomy principle. In addition, such a view would appear consistent with recognising the breach of negative stipulation exception and the potential recourse available to an applicant where a

[363] *Eskom Holdings Soc Ltd v Hitachi Power Africa* [2013] ZASCA 101, para 19.

[364] See Hugo, *Protecting the Lifeblood of Commerce*, at 670-673.

[365] Hugo, *Protecting the Lifeblood of Commerce*, at 672.

[366] *Eskom Holdings Soc Ltd v Hitachi Power Africa* [2013] ZASCA 101, para 15.

beneficiary has indeed agreed to terms that restrict their entitlement to claim under a guarantee.

There are two notable aspects of the *Eskom Holdings* case which provide a steer as to the form(s) of negative stipulation South African courts may be amenable to consider. Firstly, the court deliberated and considered whether the beneficiary's demand was in breach of the underlying contract, particularly the alleged condition therein to provide notice. This seems to reflect that negative stipulations housed in an underlying contract have a fair chance of consideration by courts. Secondly, the court in *Eskom Holdings* also considered whether there had been an agreement, documented in correspondence between the principal and the beneficiary, that a demand would not be made until a certain date. It is inferable from the court's consideration of this element that negative stipulations housed or documented separately from the underlying contract are considered on the same footing as those in the underlying contract.

Further to the *Eskom Holdings* case, prominent scholars such as Hugo, while acknowledging the importance of the autonomy principle to commerce, have supported the view that this does not translate to a beneficiary under a demand guarantee being permitted to demand payment in flagrant breach of an underlying construction or other contract.[367] In line with this view, it is considered justified for an applicant to seek an interdict to enforce their rights against the beneficiary pursuant to the underlying contract. Making clear a distinction which was made murky by the further comments of Mthiyane AP in the *Eskom Holdings* case as mentioned above, Hugo correctly states that the litigation pursuant to which an interdict preventing an unjust demand is sought is "litigation between the parties to the construction (or other) contract and not between the parties to the guarantee. Hence the independence of the guarantee does not arise".[368]

3.3.6 *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*

3.3.6.1 General

Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture ("Sulzer Pumps")[369]is a seminal South African case which again brought to the fore, *inter alia*, the issue of whether a beneficiary could be interdicted from making a demand under a demand guarantee on the basis of

[367] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[368] Ibid. See the discussion of Hugo's comments and the interaction (or lack thereof) of the enforcement of a negative stipulation preventing a beneficiary from making a demand and the autonomy principle, in section 3.3.8.1 below.

[369] [2014] ZAGPPHC 695.

an agreement by the beneficiary to restrictions on their entitlement to make a demand.[370] In this case, the court contended and accepted that correspondence between the parties, in the form of amendment letters to the demand guarantee, constituted an agreement by the beneficiary not to make a demand pending the finalisation of arbitration proceedings in relation to disputed matters between the parties.[371]

3.3.6.2 Express versus Implied Negative Stipulations

Citing sources on the Australian law position,[372] Jansen J in *Sulzer Pumps* noted the identification of the breach of an express or implied negative stipulation in the underlying contract as one of the exceptional scenarios where a court could stage an intervention in respect of documentary credits.[373] Despite the acknowledgement in this approach that an implied negative stipulation could still be recognised, it stands to reason that, if so, it would be considerably harder to establish. Also, given the impact that a breach of a negative stipulation exception would have in the context of a demand guarantee arrangement, the existence of the negative stipulation and/or breach thereof is of pivotal value and cannot be assumed lightly or assumed at all. An implied negative stipulation is quite rightly held to a higher bar, which is submitted to be a prudent approach, as supported by the case of *Kwikspace*, wherein it was noted that implicit restrictions would not be enforced where they would impede or be inconsistent with the purposes of the relevant demand guarantee.[374] It is submitted that the standard for considering an implicit restriction in respect of the breach of a negative stipulation exception should only be considered, if at all, in circumstances where the restriction and contravention thereof are indubitably clear. In reality, such a standard would, in any event, likely be satisfied only with the support, at the very least, of some express terms or agreement.

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[370] While the court granted the interdict sought in *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695, the court did not sufficiently clarify the specific ground on which the interdict was granted (i.e., whether it was fraud, unconscionability, or a breach of a negative stipulation), a deficiency also observed by commentators, e.g., Kelly-Louw and Marxen, *General Update on the Law of Demand Guarantees*, at 292.

[371] *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695, paras 9, 11, 37, 109-110 and 128.

[372] Whitten, M "Calling on a Performance Security: As Good as Cash?" presented on 18 June 2013 to the Victorian Bar, Commercial Bar Association, Construction Law Section, Neil McPhee Room, Owen Dixon Chambers East, 205 William Street, Melbourne.

[373] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695, paras 40-41.

[374] Ibid.

3.3.6.3 Restricting a Beneficiary from making a Demand versus Restricting a Guarantor from Making Payment

Interestingly, the factual circumstances in *Sulzer* were such that the interim interdict applied for was granted after the beneficiary had already called on the guarantor to make payment.[375] Therefore, despite the court's order prohibiting the beneficiary from calling up the guarantee pending the final determination of arbitration proceedings between it and the applicant (subject to extension of the guarantee in line with the terms thereof),[376] in effect/reality, it could be argued that the interdict prohibited the guarantor from making payment as opposed to one restricting the beneficiary from making a demand. Despite this effect, the court (Jansen, J) underscored both the autonomy principle and the fact that court intervention prohibiting payment pursuant to it would only ever occur in very limited circumstances.[377]

An alternative view that can be applied to the granting of an interdict against a beneficiary who has already called up a demand guarantee could be that the interdict nullifies or revokes the demand. A court order in such circumstances could be averred to have the effect of nullifying or revoking the beneficiary's demand because the beneficiary had bound itself to conditions precedent to making such a demand, which conditions had not been satisfied. This alternative view would seem more palatable with the autonomy principle. The concept that restricting a beneficiary from making a demand has no adverse effect on the autonomy principle of demand guarantees. Similarly, any court order nullifying and/or revoking a demand for payment under a demand guarantee circumvents any interference with the autonomy principle by effectively reversing the demand, and thus the act which instigated the application of the autonomy principle.

The general willingness of courts to interfere with the mechanics of a documentary credit arrangement, particularly the making of a demand by a beneficiary, was also supported in the case of *Sulzer* with reference to the Australian case of *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd.*[378] In *Clough Engineering*, the court held that as a general rule, it would not prevent a beneficiary from calling upon a bank guarantee unless, *inter alia*, such beneficiary has

[375] [2014] ZAGPPHC 695, para 9.

[376] Idem, para 128.

[377] Idem, paras 40 and 42.

[378] [2008] FCAFC 136.

"made a contractual promise not to call upon the guarantee".[379]

3.3.6.4 Decision and Summary of Position

The court in *Sulzer Pumps* invoked Whitten's assertion that breach of a negative stipulation was a common basis relied upon by contractors to challenge claims for payment under demand guarantees, but to succeed, proof that there are terms restricting a demand in the underlying contract is required.[380] Jansen J also observed the distinction between such terms being ensconced in an underlying contract versus where they are in a separate agreement altogether, with the latter being the case in *Sulzer*.[381]

The potentially corrosive effect that qualification of a beneficiary's entitlement to make a demand may have on the commercial currency of demand guarantees was acknowledged in the case of *Sulze*r. However, with due deference to the intention of the parties, the court in *Sulzer* held that there was an agreement between the parties to the effect that a demand under the construction guarantee at the centre of the case could only be made after the resolution of any pending disputes between the parties via arbitration proceedings.[382] The *Sulzer* case is deemed as acknowledging, *inter alia*, that a beneficiary may be prevented from calling upon a demand guarantee where the beneficiary has given a contractual undertaking not to call upon a guarantee, thereby giving effect to the breach of negative stipulation as an exception.[383]

3.3.7 *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another*

3.3.7.1 General

In *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* ("Joint Venture")[384] the issue that came

[379] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 42.

[380] Idem, para 41 and Whitten, *Calling on a Performance Security*, at 15.

[381] [2014] ZAGPPHC 695, para 41.

[382] Idem, para 108. See also Kelly-Louw, M "*Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695 (2 September 2014) [South Africa]", (2015), 19(5), *Documentary Credit World*,17 for a concise summary of the *Sulzer Pumps* case.

[383] Kelly-Louw, *Construing Whether a Guarantee is Accessory or Independent is Key,* at 115.

[384] [2020] ZASCA 146.

before the Supreme Court of Appeal was whether a beneficiary was restrained from making a demand under a demand guarantee on the basis of a restrictive provision in the underlying contract between the beneficiary and the applicant (principal). In particular, the applicant/principal asserted that a demand under the guarantee was unlawful because the beneficiary had not met certain conditions in the underlying contract, which limited the beneficiary's entitlement to call up the demand guarantee.[385]

In the court *a quo*, a decision was not made regarding the allegation of a restriction pursuant to the underlying contract terms. However, Makhuvele, J remarked that if this had been the only issue to consider, she would have decided in favour of the principal.[386] While this is notable for its leaning towards recognising the breach of a negative stipulation exception, the rationale for this statement was not unpacked or delved into further as the application was dismissed on other grounds. On appeal, the principal/applicant argued that South African law should be developed to recognise a reach of negative stipulation exception entitling a principal/applicant to interdict a beneficiary from calling up a demand guarantee on the basis of a restriction or qualification on a beneficiary's right to call up a demand guarantee in the underlying contract.[387]

3.3.7.2 Express versus Implied Negative Stipulations

In the *Joint Venture* case, Australian law and English law positions,[388] as well as the *Kwikspace* case,[389]were invoked by the court to support the position that without alleging fraud, an applicant/principal may restrain a beneficiary from calling up a performance guarantee if the applicant/principal could show that by doing so the beneficiary would be in breach of a term of the building/underlying contract.[390] The requirement for the applicant/principal to clearly show a breach of a term of the relevant underlying contract referred to herein implies that such a stance would be applied where this is evidenced by a clear and express term of the relevant contract, as

[385] *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 5.

[386] Idem, para 6.

[387] Idem, para 9.

[388] See Chapters 4 and 5 of this thesis for a detailed discussion of the English law and Australian law positions regarding the breach of a negative stipulation exception, respectively.

[389] See section 3.3.4 of this Chapter for more detailed discussion of *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA).

[390] *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 11.

opposed to an implied one. This view is unequivocally supported by the warning in the *Kwikspace* case, cited in *Joint Venture*, that "the terms of the building [or underlying] contract should not readily be interpreted as conferring such a right."[391]

Although the matter of recognition of a negative stipulation exception under South African law remains to be settled, in *Joint Venture*, the Supreme Court of Appeal was "willing to assume that there is room in South African law to follow the same path as that taken in Australian and English law",[392] subject to the caveat in *Kwikspace* (i.e., that restrictive terms in the underlying contract must not be readily interpreted as conferring upon the applicant/principal a right to restrain a beneficiary from making a demand on the basis that such a demand would be in breach of the underlying contract). This approach, the court opined, would go some way towards resolving the tension between the unconditional nature of a demand guarantee and express conditionality in an underlying contract. Noting the importance of demand guarantees to international trade and commerce and alluding to the need to preserve certainty in respect of such instruments as espoused by the autonomy principle, the court implored parties seeking to allege a breach of negative stipulation in an underlying contract to approach such allegations with caution.[393]

The emphasis in *Joint Venture* that restrictive terms would not readily translate into an entitlement to restrain a beneficiary from calling on a demand guarantee is important. It is indicative of the parameters within which the courts would likely consider a potential breach of a negative stipulation. In particular, the position inferred from Joint Venture is that a negative stipulation must be established in clear express terms for a breach thereof to be considered sufficient grounds for restraining a beneficiary from calling up a demand guarantee. In cases of implied or tacit provisions that would leave room for a discretionary interpretation, the courts will not lean towards an interpretation that restricts the beneficiary from exercising their entitlement to make a demand in accordance with the autonomy principle.

3.3.7.3 Restricting a Beneficiary from making a Demand versus Restricting a Guarantor from Making Payment

The application of the autonomy principle of demand guarantees was common cause between the parties in *Joint Venture*, and the autonomy principle was reiterated with reference to the cases of

[391] Ibid.

[392] [2020] ZASCA 146, para 17.

[393] Ibid.

Edward Owen[394] and *Loomcraft*.[395] Although the court did not delve much into the interaction between the enforcement of terms restricting a beneficiary from calling up a demand guarantee and the autonomy principle, it noted the existence of tension between the two. It is accepted that the immediacy of the beneficiary's recourse pursuant to the autonomy principle of demand guarantees is curtailed by underlying contract terms restricting the beneficiary from making a demand. This does illustrate the tension inherent in the competing interests advanced or protected by an underlying contract and a demand guarantee, respectively.

Noting, however, that the circumstances in *Joint Venture* were in respect of restriction a beneficiary from submitting a demand under a demand guarantee, it is submitted that any perceived tension is only indirect, in respect of the competing interests. A demand guarantee confers an unfettered entitlement to payment on a beneficiary upon the beneficiary making a demand. Without detracting from or fettering a beneficiary's entitlement to be paid after the beneficiary submits a demand, a restrictive underlying or other contract undercuts such entitlement by fettering instead the beneficiary's ability to activate the entitlement (i.e., by submitting a demand). Put another way, no direct tension or confrontation arises between the autonomy principle and any restriction ensconced in an underlying or other contract on a beneficiary calling up a demand guarantee. In line with Hugo's assertion, the issue of the independence principle does not arise where a beneficiary is restricted from calling up a demand guarantee under the underlying contract,[396]as was the case in *Joint Venture*.

Going with Hugo's stance as discussed above and dispensing with the view that a restriction on a beneficiary calling up a demand guarantee has an impact on the autonomy principle still leaves open the matter of competing interests for and against the beneficiary under the underlying contract and the demand guarantee. As alluded to in *Kwikspace* and *Joint Venture* (also citing *Kwikspace*), any tension between these competing interests may be alleviated by ensuring that the enforcement of restrictive underlying contract terms against the beneficiary is done only in the clearest of cases. This is particularly important because, given the adverse impact of such enforcement on the beneficiary's interests in the context of a demand guarantee (not the autonomy principle), it is imperative not to loosely interpret and apply such restrictions to a contract. It must be clear that a beneficiary agreed to such restrictive terms. The best way to establish such an agreement remains

[394] *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 (CA) 983b-d.

[395] *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (A).

[396] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

to include clear and express terms to that effect in the relevant contract (i.e., underlying contract) entered into by the beneficiary.[397]

3.3.7.4 Decision and Summary of Position Established

It was the applicant's/principal's contention in *Joint Venture* that, under the provisions of the underlying contract which it sought to rely on,[398] the beneficiary was only entitled to call up the demand guarantee in circumstances entitling the beneficiary to terminate the underlying contract under a cross-referenced sub-clause in the contract. Citing *force majeure* as the reason for failure to execute works under the underlying contract, the applicant/principal argued that no circumstances existed that entitled the beneficiary to terminate the underlying contract in accordance with the relevant provisions thereof.[399] The applicant/principal further supported its position on the grounds that arbitration proceedings which were pending would establish the lawfulness of the principal's cancellation of the contract, thus blocking the beneficiary's entitlement to call up the demand guarantee under the relevant clauses of the underlying contract. Moreover, the applicant/principal challenged the beneficiary's entitlement to call up the guarantee on the basis of a stipulation that there had to be an amount to which the beneficiary was entitled.[400]

[397] See also discussion in section 3.3.8.3 of this Chapter.

[398] In *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, the underlying contract provisions sought to be relied upon by the principal to support its allegation that the beneficiary was not entitled to call up the demand guarantee read, "The employer [SANRAL] shall not make a claim under the performance security, except for an amount to which the employer is entitled under the contract in the event of: … (d) circumstances which entitle the employer to termination under sub-clause 15.2 [termination by employer], irrespective of whether notice of termination has been given. The employer shall indemnify and hold the contractor harmless against and from all damages, losses and expenses (including legal fees and expenses) resulting from a claim under the performance security to the extent to which the employer was not entitled to make the claim." See *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 19. The circumstances entitling the employer/beneficiary to termination as envisaged in the cross-referenced sub-clause 15.2 of the underlying contract were summarised by the court in *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146 as: "where SANRAL cancelled the contract either on the basis that the Joint Venture: failed to comply with a notice to correct; had abandoned the works; or demonstrated its intention not to continue performance of its obligations." See *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 20.

[399] *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 21.

[400] Idem, para 24.

The court, from its analysis of the relevant provisions in the underlying contract sought to be relied upon by the applicant/principal to support its allegations that the beneficiary was not entitled to/restricted from calling up the guarantee, found that they did not lend themselves to such an interpretation. The court elaborated that the beneficiary's entitlement was not established under (and was, therefore, not fettered by) the dispute resolution provisions of the contract, including by reason of *force majeure* as alleged by the principal.[401]

The court further highlighted the unconditional nature of the demand guarantee, which ensconced, *inter alia*, an obligation to pay on receipt of a written demand. The demand guarantee further provided that a demand could be made if in the beneficiary's opinion and sole discretion, the applicant/principal failed and/or neglected to commence or proceed with the prescribed work or for any reason failed and/or neglected to complete the services in accordance with the conditions of the contract. The court considered this wording to indisputably reflect an intention for a demand guarantee under which the beneficiary would be entitled to payment upon demand and before the settlement of any underlying dispute/arbitration proceedings.

An interesting aspect in the *Joint Venture* case is that the court did not blindly make a beeline for the autonomy principle in a blinkered fashion. The court could have simply asserted the autonomy principle from the outset and declined to entertain the application on the basis of the independence of the demand guarantee from extraneous factors/disputes and the underlying contract and *vice versa*. In addition, the court could have considered whether any purported conditionality on the instrument brought into question whether it was indeed a demand guarantee. If upon considering the wording thereof the court determined that the intention of the parties was to establish a demand guarantee, the enquiry could have ended there. However, despite covering some of those aspects directly in its analysis, the court entertained the notion of failure to satisfy a condition in an underlying contract precluding a beneficiary from making a demand under a demand guarantee. A significant portion of the judgment considered the alleged conditionality in the underlying contract and, quite tellingly, whether the condition that the beneficiary could only call up the guarantee is entitled to do so had been met.

The court in *Joint Venture* considered the conditionality in the underlying contract. It determined that the beneficiary's entitlement to claim under the demand guarantee was not established under the dispute resolution provisions of the contract. It concluded that there was no limitation on the

[401] Idem, para 22.

beneficiary's entitlement to enforce the performance security. By taking this approach, the court appears to have agreed or at the very least conceded several things. Firstly, the court seemingly acknowledged that the breach of a negative stipulation in an underlying contract might restrict a beneficiary's entitlement to call up a demand guarantee (e.g., in the form of a condition that a beneficiary is only entitled to/can only claim in prescribed circumstances) effectively. In the second place, the court also seemed to accept that a beneficiary is entitled to claim where a condition in the underlying contract is fulfilled and/or where non-fulfilment of the condition cannot be established.

The court in Joint Venture implicitly endorsed the stance that a beneficiary would be interdicted from making a claim where a condition in the underlying contract is/is established to be unfulfilled. In such circumstances, one may infer, in line with Makhuvele J's remark in the *Joint Venture* court *a quo* judgment, that if the court was tasked only with deciding whether the beneficiary's right to call a demand guarantee was limited in the underlying contract, it would decide in favour of the principal. Therefore, one of the most notable aspects of the *Joint Venture* case is its implicit support for a court granting an interdict restraining a beneficiary's right to call up a demand guarantee in circumstances where such right is restricted in the underlying contract.

Without seeking to detract from the Joint Venture case's contribution to the development of a South African law position regarding breach of a negative stipulation exception, it is worth noting that it has given rise to or left unanswered a number of questions. These include whether a negative stipulation restricting a beneficiary from calling up a demand guarantee is indeed an exception to the autonomy principle, what standard of proof is required for an interdict to be granted on the basis of such a negative stipulation, and whether there are any circumstances where implied restrictions could be considered in this regard. Guidance will be sought from English and Australian law, which will be considered in this thesis in respect of these questions with a view to establishing the approaches that can perhaps be adopted under South African law.

3.3.8 General analysis of the Acceptance, Scope and Parameters of the Breach of Negative Stipulation Exception and the Importance of the Autonomy Principle

3.3.8.1 Acceptance of the Breach of Negative Stipulation as an Exception under South African Law

Arguments supporting the autonomy principle have correctly emphasised the fact that issuers of documentary credits are not concerned with any dispute arising out of any possible breach of the

underlying contract.[402] Disputes arising out of the underlying contract may give rise to allegations of breach by either the applicant or the beneficiary. The emphatic reference to underlying contract disputes makes it clear that an issuer (guarantor) is not expected to verify the statement, which is typically required to be included in a demand for payment, that the principal or applicant has breached an underlying contract. Such reference also highlights that the issuer (guarantor) must similarly be undeterred in meeting its payment obligations by claims of a breach of an underlying contract by the beneficiary.

This principle was reiterated by Goldstone J in the case of *Phillips v Standard Bank of South Africa*,[403] which is considered to be the first case adjudicated by a South African court to consider the legal effects and consequences of documentary credits in South Africa in the context of an applicant seeking to interdict a bank from making payment to honour a letter of credit.[404] In *Phillips*, the court held that the purchaser may not, "go behind the documents and cause payment to be stopped or suspended because of … alleged breaches of contract by the seller".[405] Subsequent cases however illustrate how courts may sway in a different direction where an interdict is sought, instead, to restrict a beneficiary from calling up a demand guarantee in accordance with the terms of an underlying contract.

Based on the key cases considered above, it would appear that South African courts are open to the possibility of a further exception to the autonomy principle. South African courts have not unequivocally or even expressly accepted the breach of a negative stipulation as an exception autonomy principle. Still, it has, rather encouragingly, been alluded to in cases such as *Joint Venture*, where the Supreme Court of Appeal indicated its amenability to the exception by actively exploring whether an alleged condition in an underlying contract had been fulfilled. *Obiter* remarks in the court *a quo Joint Venture* case also indicated that where a right to call up a demand guarantee was restricted in the underlying contract, the court may rule in favour of a principal to enforce such restriction against a beneficiary. A similar approach (i.e., examining the underlying contract to determine whether there was a restrictive condition not complied with) was taken in the *Eskom Holdings* case, from which a favourable inference towards acceptance of a breach of a

[402] Schulze, WG "Attachment *Ad Fundandam Jurisdictionem* of the Rights Under a Documentary Letter of Credit - Some Questions Answered, Some Questions Raised" (2000), 63, *THRHR*, 672, at 674.

[403] 1985 (3) SA 301 (W).

[404] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 353.

[405] Idem, at 304.

negative stipulation exception can be drawn.

In *Kwikspace*, the court invoked Australian law recognition of the breach of negative stipulation exception. Still, it declined to make a declaration on whether the Australian law position cited would be applied by South African courts and be adopted under South African law. Despite this reticence in *Kwikspace*, prominent scholars such as Hugo seem to have inferred that the Australian law position would apply in a South African context.[406] *Sulzer*, like *Kwikspace*, leaned heavily on the Australian law position in support of the recognition of a breach of a negative stipulation as an exception to the autonomy principle.

Perhaps aided by a different set of circumstances, the court in *Sulzer* was less coy and notably went on to find that there had, in fact, been an agreement to restrict a beneficiary from calling up a demand guarantee pending arbitration proceedings. However, the rationale behind the judgment or lack of clarity thereof, and the judgment itself generally, have been the subject of abundant criticism, with Kelly-Louw opining that it was not "well-reasoned".[407] Nevertheless, the *Sulzer* case and the other cases, specifically Joint Venture, considered above, seem to indicate that South African law may be moving inexorably towards accepting the breach of a negative stipulation exception to the autonomy principle. To facilitate the development of the law with clarity and decisiveness in this regard, the present may be an opportune time to glean lessons and guidance from other key decisions jurisdictions that have been faced with whether or not to recognise the exception, including those like Australia, which have better embraced this exception. It is hoped that the comparative analysis of the South African law position versus the position in a selection of such jurisdictions as considered in this thesis will facilitate this exercise.

3.3.8.2 Distinction between a Restriction on a Beneficiary Making a Demand and a Restriction on a Guarantor Making Payment: Effect on the Autonomy Principle

In view of the autonomy principle, claims that, *inter alia*, a beneficiary has breached an underlying contract are generally not considered a valid defence against the obligation to pay under a documentary credit.[408] It has been opined that where there is no fraud or illegality in the underlying

[406] Hugo, *Protecting the Lifeblood of Commerce*, at 669.

[407] Kelly-Louw, M & Marxen, K "General Update on the Law of Demand Guarantees and Letters of Credit", a paper delivered at the 2015 *Annual Banking Law Update*, 276 (hereinafter, "Kelly-Louw and Marxen, *General Update on the Law of Demand Guarantees*"), at 292.

[408] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 44.

contract involved, but the case relates to a breach of an underlying contract or an unconscionable demand being made, an applicant should not be permitted to obtain an interdict preventing a bank from making payment in such instances.[409] A proposed alternative is for an applicant to seek an interdict against only the beneficiary, to prevent the latter from making a demand and receiving payment pursuant to it, albeit in very limited circumstances, if at all.[410] The *Kwikspace*[411] case has been cited in support of the position that tacit restrictions on a beneficiary's entitlement to claim under a demand guarantee will not be readily accepted and have less chance of success compared to express and clear terms.[412] Therefore, an applicable caveat as supported in *Joint Venture* and *Kwikspace* is that a contract should not be readily interpreted as conferring upon a principal the entitlement to restrain a beneficiary from calling up a demand guarantee on the grounds of breach of contract.[413] While the indication from South African case law so far is that such a restriction on the beneficiary must only be enforced only in the clearest of cases, the exact standard of proof required for an interdict restraining a beneficiary from calling up a demand guarantee due to a negative stipulation is yet to be established and remains unclear. The approach taken under English law and Australian law will be considered in this thesis for guidance in this regard.

If a breach of negative stipulation in an underlying or other contract is to be recognised as an exception to the autonomy principle of demand guarantees under South African law, such recognition must be within the framework of workable parameters within which the exception can reasonably be applied. In light of the default function of demand guarantees, which includes the provision of easy monetary recourse to the beneficiary in accordance with the terms thereof, any provision which is alleged to restrict a beneficiary's entitlement to claim is thus required to be unequivocally clear.[414]

The difference of approach in seeking to prevent a beneficiary from making a demand under a demand guarantee, as opposed to preventing payment from being made by a guarantor, appears to have been recognised or alluded to in some cases. The interdict sought in the *Eskom* case was

[409] Idem, at 348 and 372.

[410] Ibid.

[411] *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA).

[412] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[413] See *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, paras 11 and 17 and *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA), para 11.

[414] Ibid.

intended in the first instance to prevent the beneficiary from demanding payment.[415] To the extent that the guaranteed amounts had already been paid, the applicant in Eskom sought a final order directing the beneficiary to revoke the demand and instruct the bank accordingly and ancillary relief.[416] A rather pronounced avoidance of any perceived interference with the autonomy principle/guarantor's obligation to pay against a valid demand is evident from the fact that the recourse requested was targeted at either preventing or revoking the beneficiary's demand. It could even be argued that upon failure to prevent a beneficiary from making a demand, revocation/nullification of the demand was seen as the next best viable option for a close to final remedy. This ties in with the understanding that once a valid demand for payment is made, the obligation for payment triggered by that demand per the autonomy principle cannot be interfered with, barring very limited recognised exceptions such as fraud or illegality.

Explaining the importance of not allowing a beneficiary to flout their contractual obligations under an underlying contract by reference to the lifeblood analogy, Hugo eloquently sums up the position thus:

> "… it must be stressed that commerce does not depend only upon the artery between the employer-beneficiary and the guarantor. There is another important artery, contract – that between the employer and the contractor. This artery, too, should not be improperly clotted."[417]

Further supporting this view, Hugo points out that litigation on the basis of a breach of an underlying contract is litigation *vis-à-vis* the parties to the underlying or other contract as opposed to the parties to the guarantee, a nuance he further observes was not sufficiently considered in the *Eskom Holdings* case.[418] As mentioned above,[419] Hugo supports the view that the independence of a demand guarantee does not arise at all in the context of enforcement of a contract preventing a beneficiary from making a demand.[420] This approach not only strikes a fine balance between the need to preserve the autonomy of demand guarantees and the need to mitigate potential abuse thereof, but also importantly aligns itself with the concept of freedom of contract.

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[415] *Eskom Holdings Soc Ltd v Hitachi Power Africa* [2013] ZASCA 101, para 7.

[416] Ibid.

[417] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[418] Ibid.

[419] See section 3.3.8.2 of this chapter.

[420] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

3.3.8.3 Acceptable Form of the Negative Stipulation: Express, Implied, in the Demand Guarantee Itself or in a Separate Agreement

The case of *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration*[421]has been conferred the status of the *locus classicus* in respect of reading implied terms into a contract.[422] An "implied term" was explained as follows in this case:

> "an unexpressed provision of the contract which the law imports therein, generally as a matter of course, without reference to the actual intention of the parties. …[I]t does not originate in the contractual consensus: it is imposed by the law from without. … Such implied terms may derive from the common law, trade usage or custom, or from statute. … The implied term … is essentially a standardised one, amounting to a rule of law which the Court will apply unless validly excluded by the contract itself. While it may have originated partly in the contractual intention, often other factors, such as legal policy, will have contributed to its creation."[423]

The materiality of the location of restrictive terms which may prevent a beneficiary from calling up a demand guarantee is unclear. In *Joint Venture, Kwikspace* and *Eskom Holdings*, although the relevant facts of the respective cases did not ultimately lead to the conclusion that there was indeed a negative stipulation and/or that it had indeed been breached, the fact that the alleged negative stipulations or conditions were in the underlying contract seemed acceptable and did not give the courts pause. In addition, the court in *Eskom Holdings* gave an implicit nod to the possibility of negative stipulations outside the underlying contract by considering whether correspondence or letters between the principal and the beneficiary constituted an agreement that a demand would not be made until a certain date. The underlying contract seems to be the probable and most typical place in which a negative stipulation would be housed. However, this does not preclude a negative stipulation from being incorporated elsewhere, particularly in a separate contract altogether. In the event that South African law recognises such an exception, it is submitted that conditions or negative stipulations in both the underlying contract or elsewhere would be contemplated under

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[421] 1974 (3) SA 506 (A).

[422] Vorster, JP, "The influence of English law on the implication of terms in the South African law of contract" (1987), 104, *SALJ*, 588, at 594; Hugo, CF, "*The Law Relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks*", LLD thesis, The University of Stellenbosch, 1996 (hereinafter, "Hugo, *The Law Relating to Documentary Credits"*), at 172; and Bailly, C, "*The Role of Implicit Contract Terms as a Determinant of Contractual Consequences*", LLM dissertation, University of Stellenbosch, 2005, at 30.

[423] *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 (3) SA 506 (A), at 531.

such recognition.

In the *Sulzer* case, a beneficiary's agreement not to call up the guarantee before the occurrence of certain events was considered sufficiently established and enforceable from correspondence between the relevant parties. A key aspect to note is that the correspondence comprised amendment letters in respect of the guarantees, with riders which were considered to form part of the guarantees themselves. While *Sulzer* appears to indicate a willingness by courts to provide succour in cases where a restriction on the beneficiary's entitlement to demand payment is housed in the demand guarantee itself,[424] one would be inclined to agree with the general criticism against the lack of clarity in the reasoning of this case, as such a restriction in an instrument cannot be reconciled with the nature of a demand guarantee.[425]

Although the *Sulzer* case is notable for its support of the recognition of a breach of a negative stipulation exception, it is submitted that the incorporation of such a stipulation in a demand guarantee modifies its status as a guarantee in a fundamental way. This thesis does not support the incorporation and/or recognition of a negative stipulation housed in an instrument purporting to be a demand guarantee. Once a conditionality of this form is introduced to a demand guarantee, the demand guarantee becomes a conditional guarantee which is accessory in nature and akin to a suretyship.[426] The form of negative stipulations that this thesis considers potentially viable and will explore in the context of a South African law exception to the autonomy principle are only those housed outside of the guarantee itself (i.e., an underlying or other contract/agreement).

3.4 CONCLUSIONS

3.4.1 Unconscionability as an Exception to the Autonomy Principle under South African Law

The conflation and classification of fraud, duress, misrepresentation, undue influence and unequal bargaining power under the umbrella of unconscionability may be considered to be a plausible tack on some fronts. However, the fact that fraud, duress, misrepresentation, undue influence and unequal bargaining power enjoy relative certainty as established concepts under South African law, while unconscionability is plagued by uncertainty both in terms of its definition and

[424] See also *Granbuild (Pty) Ltd v Minister of Transport and Public Works, Western Cape and Another* [2015] ZAWCHC 83.

[425] See also section 3.3.6 of this chapter.

[426] See also section 3.3.8.3 of this chapter.

application, seems to support the need for retention of distinction and clear parameters between these different legal concepts.

Viewed broadly, there may indeed be room for overlap, and indeed specific circumstances in which such overlap may be realised. However, a conflated understanding of fraud, duress, misrepresentation, undue influence and unequal bargaining power and unconscionability would seem to be a disingenuous approach. Such an understanding is, in any event, belied by the numerous South African cases as considered above in which courts have wrestled with unconscionability, fairness, public policy and/or good faith considerations, despite the existence of fraud etc. as alternative routes for recourse. Calls for clarifying the position of unconscionability as a separate concept in South Africa and more so a standalone exception to the autonomy principle of demand guarantees, therefore have a great deal of merit.

USA law, which is regarded as having had some influence on South African law in relation to unconscionability and its status as an abstract concept, has gone on to develop into a fine example of the codification of the doctrine of unconscionability in the general law of contract. It is beyond the scope of this thesis to consider South African contract law in general, which is common-law based, or any potential codification thereof. The UCC seems to deliberately exclude the concept of unconscionability from its codified law of letters of credit, whereas the fraud exception is recognised.

Without delving into the rationale of the UCC, it may be inferred from this that a legislative assessment of the pros and cons of introducing an unconscionability exception to the autonomy principle did not support recognition of the exception. The UCCs approach also seems to support the conclusion that the commercial utility of documentary credits is dependent on a higher standard of certainty (and thus less derogation from the autonomy principle) than the general law of contract. This overriding importance of preserving certainty must be taken into account in a South African law analysis of whether to recognise the unconscionability exception in respect of demand guarantees.

An interesting observation of the UCC approach is that, whilst the necessity of the concept of unconscionability under the general law of contract was recognised, the necessity of not allowing it to permeate every area of law, an example being letters of credit, was recognised too. This was achieved, seemingly, by a localised application of the doctrine of unconscionability to only those areas of the law where it was assessed to be required. Turning to South African law, South African law of contract is common-law based, and unlike the USA, South Africa has no codified general

principle of unconscionability in respect of the law of contract. The closest example of a codified principle of unconscionability is in respect of consumer law, with a view of protecting consumers, particularly the smaller and typically more vulnerable party, from a balance of power perspective in contract relations. Traces of a similar approach to the USA's UCC could be inferred from the fact that unconscionability was recognised and codified in the CPA as part of South Africa's consumer protection law regime, where it was clearly assessed to be needed.

In the context of South African consumer protection law, the initial calls for broader recognition and codification of the concept of unconscionability were acquiesced to only to a limited extent.[427] Despite the onslaught of criticism against the CPA for not being or not doing enough in respect of providing certainty and recourse against unconscionable conduct in respect of contracts and unfair contract terms, it would be remiss not to acknowledge that the CPA's entrenchment of some aspects of unconscionability into South African consumer law can be credited with a forerunner role leading, perhaps, to greater recognition of equitable considerations, particularly unconscionability, under South African law of contract. The statutory recognition of unconscionability in respect of contracts under the CPA may be considered a building block for establishing a broader concept of unconscionability under South African law of contract and, ultimately, an unconscionability exception to the autonomy principle in the law of demand guarantees.

The same reservations which have thus far prevented a broader codification of unconscionability[428] apply not only to consumer law but to South African law of contract, in general, are submitted to be equally, if not more applicable in the context of demand guarantees. The boundaries of unconscionability are notoriously difficult to define. It is submitted that demand guarantees would be prone to more damaging consequences than contracts generally if the concept of unconscionability is shoehorned into the South African law of demand guarantees. Such damaging consequences would be especially pronounced for demand guarantees because these instruments share a unique reliance on certainty to maintain and retain their commercial utility.

While South African courts seem to have indicated an inclination towards recognising unconscionability as an exception to the autonomy principle, particularly in cases like *Sulzer*, the reasoning behind this judgment is somewhat obscure, a fact that critics of the judgment have

[427] See the discussion in section 3.2.5 of this chapter above.

[428] Ibid.

expectedly pointed out. There appears to be no clearly established blueprint approach or test that courts could apply in recognising the exception. The lack of a precise general definition of the term unconscionability for general application under South African law lends itself to uncertainty and has contributed to unconscionability being perceived as an elusive concept.[429]

In the context of demand guarantees, the interaction of and parameters between an unconscionability exception to the autonomy principle and established exceptions such as the fraud exception, which can and have been argued to incorporate aspects of bad faith/unconscionable conduct, would, therefore, also need to be hashed out and clarified by South African courts if a standalone unconscionability exception was to be developed. This thesis will look to the other jurisdictions for guidance on whether such hurdles can be overcome in a South African context.

In counter-arguments to this, proponents of the unconscionability exception argue that the concept of unconscionability facilitates "judicial manoeuvring in the interest of justice"[430] and that the autonomy principle must not be allowed to shield truly unconscionable conduct. [431] It has also been contended that even the fraud exception is not entirely certain, and therefore, uncertainty alone should not preclude recognition of unconscionability as its certainty can be further refined and developed via application. Despite some of the arguments raised in favour of unconscionability and particularly in respect of demand guarantees carrying merit, such merit may not necessarily be cogent enough to override the importance of preserving the autonomy principle (and commercial utility) of demand guarantees in a uniquely South African law context.

The emphasis on the concept of good faith in a number of South African cases in relation to demand guarantees indeed seems to indicate a gradual thawing of South African courts in respect of the unconscionability exception[432]and has given impetus to calls for full recognition of the unconscionability exception to the autonomy principle of demand guarantees.[433] As highlighted in

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[429] Mugasha, A "Enjoining the Beneficiary's Claim on a Letter of Credit or Bank Guarantee" (2004), *The Journal of Business Law,* 515, at 518. See also Lee, A "Injuncting Calls on Performance Bonds: Reconstructing Unconscionability" (2003), *Singapore Academy of Law Journal*, 30, at 31.

[430] Hutchison, D and Pretorius, CJ *et. al, The Law of Contract in South Africa,* 3 ed, Oxford University Press, (2012) (hereinafter "Hutchison and Pretorius, *The Law of Contract in South Africa*"), at 22.

[431] Loi, KCF "Two Decades of Restraining Unconscionable Calls on Demand Guarantees" (2011), *Singapore Academy of Law Journal*, 504, at 511.

[432] Hugo and Marxen, *Exceptions to the Independence of Autonomous Instruments of Payment and Security*, at 139.

[433] *Group Five Construction (Pty) Ltd and Others v Member of the Executive Council for Public Transport Roads and Works Gauteng and Others* [2015] 2 All SA 716 (GJ), para 50 and *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 1 SA 70 (SCA), para 65.

the *Sulzer* case and the discussion above,[434] the precise role of good faith in the South African law of contract and demand guarantees is a contentious matter yet to be fully settled. The denunciation of the *exceptio doli generalis*, a remedy viewed by some as the closest concept to the notion of unconscionability under South African law, arguably opened a legal *lacuna* pertaining to recourse against unconscionable conduct. Several cases depicting differing views regarding the application of concepts such as unconscionability, bad faith, unfairness or contravention of public policy, and including some arguments that the *exceptio doli generalis* remains alive to this day, certainly seem to validate this point of view.

A nuance which it is proposed encapsulates the pre *exceptio doli generalis* position and transition to the post *exceptio doli generalis* position is the change in the role of good faith, particularly in the post-constitutional era. Under the *exceptio doli generalis*, the enforcement of a contract could be blocked directly on the grounds of bad faith. After abolishing the *exceptio doli generalis*, good faith serves a new (arguably lesser) role as an abstract value that informs substantive rules of law rather than a rule in itself. It is submitted that unconscionability holds the same role under South African law. Turning to frame this in the context of demand guarantees, being the focus of this thesis, it is posited that unconscionability is thus an abstract concept which, if and when it fits within the parameters required to establish an infringement of public policy, would be enough to block the enforcement of a demand guarantee.

In the absence of established fraud or illegality in the underlying contract, it has been contended that interdicts to block payment under a demand guarantee on the grounds of unconscionable conduct by a beneficiary should only be granted in exceptional circumstances, if at all.[435] This echoes the restraint with which South African courts appear to approach the non-enforcement of contracts on the basis that they are contrary to public policy.[436]

In light of the coinciding parameters and the likely overlap between conduct which is

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[434] See the discussion of the development and role of good faith in the South African law of contract in section 3.2.3 above.

[435] Kelly-Louw, M "*Selective Legal Aspects of Bank Demand Guarantees: The Main Exceptions to the Autonomy Principle*", LLD thesis, University of South Africa, 2008 (hereinafter "Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*"), at 348 and 372.

[436] See *Trustees, Oregon Trust v Beadica* 231 CC 2019 (4) SA 517 (SCA), at para 34. See also *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A), para 9B-C; *AB v Pridwin Preparatory School* 2019 (1) SA 327 (SCA), para 27; *Botha (now Griesel) v Finanscredit (Pty) Ltd* 1989 (3) SA 773 (A) at 783A-B; and *Eerste Nasionale Bank v Saayman NO* 1997(4) SA 302 (SCA) at 324B-G which reiterate and re-affirm the need for a restrained approach by courts to interfering with contracts on public policy grounds.

unconscionable (and/or in bad faith) and conduct which is contrary to public policy, a stand-alone unconscionability exception to the autonomy principle of demand guarantees is not pushed for in this thesis. It is suggested that the concept of public policy or other already-existing common law avenues for recourse as may be applicable to a situation may be sufficient, noting that unconscionability under South African law has already been recognised and codified in areas of law where this has been assessed to be necessary, particularly consumer protection law via the CPA.

Given the above, there seems to be no cogent reason why public policy considerations would not afford sufficient recourse to the participants in a demand guarantee arrangement in an instance of unconscionable conduct. The stringent standard for establishing a public policy violation seems to be a reasonable median between a *laissez-faire* recognition of an unconscionability exception and no recourse against unconscionable conduct at all. Most importantly, in the context of demand guarantees, such an approach defers to the autonomy principle

While jurisdictions like Australia have incorporated an unconscionability exception which has been applied in respect of demand guarantees, the legal landscape and general context supporting that approach in such jurisdictions may not be applicable in a South African context. To facilitate the complete and balanced cost-benefit analysis in respect of the unconscionability exception to the autonomy principle of demand guarantees under South African law, the approach adopted in other jurisdictions is considered in the preceding chapters of this thesis. More definitive recommendations regarding the South African position will be determined from such analysis.

Looking to other jurisdictions from a "lessons to be learned" perspective has long proved instrumental in the development of South African law. In this vein, this thesis seeks to contribute to South African law of demand guarantees proposals regarding unconscionability as an exception to the autonomy principle through a comparative analysis of English law and Australian law[437] in this regard.

3.4.2 Breach of a Negative Stipulation as an Exception to the Autonomy Principle under South African Law

In support of the autonomy principle, the view that issuers (guarantors) of demand guarantees should not concern themselves with any dispute arising out of any possible breach of the

[437] Refer to section 1.3.2 in Chapter 1 for the rationale of the selection of jurisdictions covered in this thesis.

underlying contract[438] is correct. A guarantor should not be expected to verify the validity of a demand, including whether the principal or applicant has breached an underlying contract. A guarantor must be undeterred in meeting its payment obligations by claims of the beneficiary's breach of an underlying contract. Despite this, where a court has determined it appropriate (e.g., where recognised exceptions like fraud and illegality in an underlying are established) to grant an interdict preventing payment by a guarantor where an otherwise valid demand for payment has been made under a demand guarantee, the guarantor is, therefore, justified in and must comply with the interdict by not making the relevant payment.

Notwithstanding the rights/entitlements conferred on a beneficiary by the autonomy principle, it is not uncommon for a beneficiary to still agree to contractual terms in an underlying contract or otherwise restricting their ability to call upon a demand guarantee. While applicants may insist on such restrictive terms to neutralise the bargaining power advantage of the beneficiary, reasons for a beneficiary agreeing to such terms include inducing/securing the applicant's agreement to a demand guarantee arrangement, as a show of good faith and/or to avoid having to provide certain assurances to an applicant in the form of a counter-guarantee.

Consideration of a breach of a negative stipulation exception in demand guarantees has been perceived to entail an inevitable battle which pits the terms of the underlying contract against the terms of the guarantee and the autonomy principle thereunder. It begs the key question of whether a beneficiary who, despite being fully aware of the autonomy principle, agrees (whether in an underlying contract or otherwise) to terms that restrict his right to draw on a demand guarantee should be permitted to then turn around and breach those same terms by invoking the autonomy principle. Despite the sanctity of the autonomy principle, questions around such conduct by a beneficiary have led to the emerging view that it should not be blindly applied or abused, particularly where it is determined to be qualified by the underlying or other contract terms. In addition to thwarting abuse of demand guarantee arrangements by beneficiaries, such an approach is submitted to be in alignment with the *pacta sunt servanda* principle on the basis that where a beneficiary exercises his freedom to enter into a contract which fetters his entitlement to claim under a demand guarantee, then such freedom must be enforced in the same way it would in respect of any other contract.

The autonomy principle should thus not be permitted to give succour to unscrupulous beneficiaries

[438] Schulze, WG "Attachment *Ad Fundandam Jurisdictionem* of the Rights Under a Documentary Letter of Credit - Some Questions Answered, Some Questions Raised" (2000), 63, *THRHR*, 672, at 674.

seeking to avoid contractual terms to which they agreed. Also, as opined by Hugo, there is no reason why an applicant cannot apply for an interdict against a beneficiary who has clearly agreed to meet certain conditions under the terms of a contract prior to calling up a demand guarantee, and any resulting litigation has no bearing on the principle of independence.[439] In accordance with the constitutional right to contract freely, a beneficiary is free to enter into any contract, including one which fetters his right to call up a demand guarantee. A beneficiary that utilises their freedom of contract in this way must not be permitted to breach their contractual obligations with impunity, nor must the autonomy principle be abused for the purposes of shielding a flagrant breach of a contract.

The breach of a negative stipulation has been noted to sometimes overlap or possibly be subsumed by the fraud exception. Whilst fraud and breach of a negative stipulation can intersect in certain circumstances (i.e., where there is a fraudulent breach of contract), they are typically distinct, as depicted in the *Phillips* and *ZZ Enterprises* cases considered above.[440] Considering breach of negative stipulation as an exception to the autonomy principle of demand guarantees and the comparative analysis of same against the approach in other jurisdictions covered in this thesis is, therefore, on a standalone basis.

From the case law considered above, the parameters of the breach of a negative stipulation exception which appear to have expressly or implicitly been accepted by South African courts, are outlined as follows:

- There is an important distinction between restraining a guarantor (e.g., bank) from honouring a demand guarantee and restraining the beneficiary from calling upon it. In the former case the principal/applicant (moving party) seeks to prevent the bank from performing its obligations in terms of the demand guarantee; in the latter case the applicant party seeks to prevent the beneficiary from breaching a provision of the underlying contract."[441] Restraining a beneficiary from calling upon a demand guarantee pursuant to a negative stipulation agreed to by the beneficiary is perceived as giving effect to the enforcement of a contract entered into by a beneficiary and is considered not to have an

[439] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[440] See section 3.3.2 of this chapter.

[441] *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA), para 9, citing *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, at 826.

adverse impact on the autonomy principle. An interdict seeking to prevent a guarantor from making payment under a demand guarantee appears to be considered a direct affront to the autonomy principle.[442]

- There is a recognised difference between express restrictions on a beneficiary's right to draw on a demand guarantee and implied restrictions. In addition to being harder (not impossible, though, it would seem) to establish, the latter would likely not be enforced where they would be inconsistent with the purposes of the relevant demand guarantee.

- It appears to be generally accepted that a negative stipulation restricting a beneficiary from calling on a demand guarantee can be housed in either the underlying contract (i.e., the contract giving rise to the demand guarantee or the obligations secured by the demand guarantee) or in a separate contract/agreement. This distinction is seemingly not one belaboured by the courts, although restrictions in cases considered by the courts so far are typically incorporated in the underlying contract. Where a negative stipulation is in the demand guarantee itself, it is submitted that the relevant instrument becomes a conditional guarantee and ceases to be on-demand in nature. This thesis will focus on considering a potential exception applicable only where the terms purported to comprise a negative stipulation are in the underlying contract or a separate agreement (e.g., per *Kwikspace*, *Eskom Holdings* and *Joint Venture* cases considered above).

Although the remarks and findings of the courts, with reference to *Kwikspace*, *Sulzer, Eskom* and *Joint Venture*, are significantly reliant on Australian law, the position recognised by South African courts seems to be that the provisions of an underlying contract may qualify a beneficiary's right to call on a documentary credit.[443] While, as a general rule, courts would not prevent a beneficiary from calling upon a bank guarantee, circumstances where such beneficiary has "made a contractual promise not to call upon the guarantee"[444]may be considered to be an exception to this rule, particularly where such a promise is expressed clearly.[445]

The broad strokes of the parameters within which South African courts appear inclined to

[442] Hugo, *Protecting the Lifeblood of Commerce*, at 672.

[443] Idem, para 8.

[444] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 42.

[445] See *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 42 and Kelly-Louw, *Construing Whether a Guarantee is Accessory or Independent is Key*, at 115.

recognise a breach of a negative stipulation as a ground to interdict the beneficiary from making a demand appear relatively consistent and discernible. In line with the caveat noted in *Kwikspace* and *Joint Venture*, courts would not (and indeed should not) readily interpret a contract as conferring a right on a principal to seek an injunction restricting the beneficial owner from calling up a demand guarantee. Heeding this caveat, only clear and express restrictions in a contract are likely to be entertained by South African courts when considering whether a breach of a negative stipulation is a sufficient basis on which to grant an interdict preventing the beneficiary from making a demand.

An area still deficient in certainty is whether the breach of a negative stipulation has acquired enough traction and carries enough merit in a South African law context to be recognised as a ground on which courts will grant an interdict preventing a beneficiary from calling up a demand guarantee. Given the fact that the enforcement of a negative stipulation is firmly in step with freedom of contract (including any restrictive contracts that a beneficiary may agree to), it appears as though courts recognise that a beneficiary's right to call on a demand guarantee may be restricted under the terms of an underlying or other contract the beneficiary has entered into.

In some respects, however, the abovementioned cases, particularly *Joint Venture*, being a recent leading case, raised some questions and/or left existing ones unanswered. Despite indicating that a clear express restriction in an underlying contract may be grounds for an interdict restraining a beneficiary from making a demand, the court in *Joint Venture* did not sufficiently clarify or explore whether such a scenario represents a true exception to the autonomy principle of demand guarantees. Two possible arguments can be considered in respect of breach of a negative stipulation by South African courts. It could be considered a defence or ground upon which a guarantor can be prevented from rendering payment under a demand guarantee. Alternatively, a breach of a negative stipulation could be considered as simply a ground for an interdict blocking a beneficiary from making a demand, which is not intended to have any interaction *per se* with the autonomy principle. Although South African courts have yet to make an unequivocal pronouncement on this matter, it is submitted, as discussed further below, that the latter approach has a more feasible legal rationale.

The enforcement of a restrictive clause in an underlying contract (or perhaps elsewhere) against a beneficiary does not constitute a derogation from the autonomy principle. It is not inimical to but rather lends itself to, application within the framework of the autonomy principle. Despite the breach of a contractual restriction on a beneficiary calling up a demand guarantee being given the

moniker breach of a negative stipulation exception, strictly speaking, it is submitted that this is a misnomer as it is not an exception to the autonomy principle.

The precise standard of proof required for South African courts to grant an interdict to restrain a beneficiary from calling up a demand guarantee on the basis of a restrictive stipulation is another aspect yet to be clarified. Furthermore, the requirement for a negative stipulation to be clear and express before a court can consider an alleged breach thereof as grounds for an interdict against a beneficiary was supported in cases such as *Joint Venture* and *Kwikspace*. However, implied or tacit restrictions have not been outright dismissed as supported by the reference to the same in the case of *Sulzer Pumps*. However, the circumstances, or whether indeed there are any circumstances in which courts may consider implicit/tacit restrictions on a beneficiary's entitlement to call up a demand guarantee as grounds for an interdict is an area devoid of clarity.

South African case law is still limited and in the budding stages of development with regards to the effect of breach of a negative stipulation on a beneficiary's entitlement to claim under a demand guarantee. In addition to the limited cases which hint at an outline of what its recognition would look like in South Africa, more defined guidance can be drawn from relevant jurisdictions such as Australia and the UK, from which the courts have already drawn some direction. The dependence on foreign law precedents by the Supreme Court of Appeal, as evidenced in the cases considered above, particularly Australian and English law, together with a certain reticence on whether the foreign law positions referenced in the relevant cases can then be interpreted as the prevailing positions applying equally under South African law, leave greater certainty still to be desired. The analysis in this thesis will consider the approaches adopted under English law and Australian law and seek to facilitate greater certainty by drawing on these laws to recommend parameters on which a South African law position can be anchored and solidified. Consideration of the laws of jurisdictions in this thesis may yield further insight and recommendations that can be adopted for the development of South African law in this regard.

CHAPTER 4: UNCONSCIONABILITY AND THE BREACH OF A NEGATIVE STIPULATION AS POSSIBLE EXCEPTIONS TO THE AUTONOMY PRINCIPLE OF DEMAND GUARANTEES UNDER ENGLISH LAW

4.1 INTRODUCTION

4.1.1 General

This chapter will examine the English law position in respect of unconscionability and breach of a negative stipulation in the underlying contract or another agreement as standalone exceptions to the autonomy principle of demand guarantees. The English law position will be analysed to establish suitable recommendations for South African law in this regard, including consideration of aspects such as the recognition, application, and parameters of these exceptions, as evidenced by case law. Arguments for and criticisms levelled against the acceptance and other elements of the two exceptions from an English law perspective will also be evaluated.

4.1.2 Overview of Key Aspects relevant to both Unconscionability and Breach of a Negative Stipulation as Potential Exceptions to the Autonomy Principle

4.1.2.1 The Importance of the Autonomy Principle

As is the case under South African law and several other jurisdictions, the autonomy principle under English law is considered to be a crucial element of the nature and utility of demand guarantees. Courts, therefore, generally tend to be reluctant to interfere with payments under these instruments, and English courts are no different. This stance was reflected in *Discount Records Ltd v Barclays Bank Ltd*[1] wherein it was stated (*per* Justice Megarry) that the court:

> "would be slow to interfere with bankers' irrevocable credits, and not in the least in the sphere of international banking unless a sufficiently grave cause is shown; for interventions by the court that are too ready or too frequent might gravely impair the reliance which, quite properly, is placed on such credits …".[2]

A common rationale raised to support non-interference by courts in relation to documentary credits was further underscored by Kerr J in the case of *Harbottle v National Westminister Bank Ltd*:[3]

[1] [1975] WLR 315.

[2] Idem, at 320.

[3] [1977] 2 All ER 862.

> "It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts litigation or arbitration as available to them or stipulated in the contracts. … The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged."[4]

The need for courts to steer clear of an interventionist approach was also supported in *Intraco Ltd v Notis Shipping Corp (The "Bhoja Trader")*[5] when Donaldson LJ declared, "[t]hrombosis will occur if, unless fraud is involved, the Courts intervene and thereby disturb the mercantile practice of treating rights thereunder as being the equivalent of cash in hand".[6] Moreover, it was remarked in the case of *Bolivinter Oil SA v Chase Manhattan Bank*[7] that if courts habitually interfered with payment thereunder, "the value of all irrevocable letters of credit and performance bonds and guarantees will be undermined".[8]

In England, it is trite law that the autonomy principle of demand guarantees is not absolute and can be overridden in certain instances, the most universally agreed one being the fraud exception. Sentiments regarding the non-absolute nature of the autonomy principle were repeated in the case of *Potton Homes Ltd v Coleman Contractors (Oversea) Ltd*,[9] where Eveleigh LJ remarked:

> "… in principle I do not think it possible to say that in no circumstances whatsoever, apart from fraud will the court restrain the buyer. The facts of each case must be considered. If the contract is avoided or if there is a failure of consideration between the buyer and the seller for which the seller undertook to procure the issue of a performance bond, I do not see why, as between seller and

[4] Idem, at 870.

[5] [1981] 2 Lloyd's Rep 256.

[6] Idem, at 257. See also Barnes, JG "Limiting the Availability of Court Injunctions" (2021), 25(7), *Documentary Credit World*, 37, at 37-38 where he advocated, *inter alia*, that courts must grant injunctions (e.g., on grounds such as assertions of fraudulent, abusive, illegal, bad faith, unconscionable, or like conduct) very sparingly, and that parties to documentary credit arrangements may utilise more robustly codified jurisdictions and applicable law provisions or the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) to support this end. See also Fayer's response to this in Fayers, R "The Jurisprudential Principle Underlying Preclusion Derives from Equity" (2021), 25(7), *Documentary Credit World*, 8, at 8-9.

[7] [1984] 1 Lloyd's Rep 251.

[8] Idem, at 257.

[9] (1985) 28 BLR 19.

> buyer, the seller should not be unable to prevent a call on the bond by the mere assertion that the bond is to be treated as cash in hand."[10]

This seminal declaration in *Potton Homes* may well have set the scene for the contemplation of other exceptions to the autonomy principle under English law. The degree of recognition of potential other exceptions under English law, such as the unconscionability exception and breach of a negative stipulation, as well as an analysis of whether and how they intersect with the autonomy principle, will be considered in this chapter.

4.1.2.2 The Need to Support the Reputation of Issuers

In addition to the emphasis on the detrimental effects of an interventionist approach by courts on the basis of the autonomy principle, a fairly common argument raised against admitting any further exceptions to the autonomy principle into the realm of recognition is that doing so would be detrimental to the reputation of the issuer/bank. It is argued that additional exceptions would, by extending the grounds of non-payment under demand guarantees, erode the reliability of not only demand guarantees themselves but the issuers thereof by proxy.

The view that an issuer's compliance with its obligations under documentary credits is crucial to its reputation has been supported by various *dicta* from a number of English law cases. This perception was depicted in the early case of *Harbottle v National Westminister Bank Ltd,*[11] where Kerr J stated that a guarantor bank's "reputation depends on strict compliance with its obligations [and that] [t]his has always been an essential feature of banking practice."[12]

The importance of reputational considerations was also highlighted in the following missive reiterating the need to protect the reputation of issuers by Donaldson MR in *Bolivinter Oil SA v Chase Manhattan Bank*:[13]

> "The unique value of such a letter, bond or guarantee is that the beneficiary can be completely satisfied that, whatever disputes may thereafter arise between him and the bank's customer in relation to the performance or indeed existence of the underlying contract, the bank is personally undertaking to pay him provided that the specified conditions are met. In requesting his bank to

[10] Idem, at 28.

[11] [1977] 2 All ER 862.

[12] Idem, at 864-866.

[13] [1984 1 Lloyd's Rep 251.

> issue such a letter, bond or guarantee the customer is seeking to take advantage of this unique characteristic. If save in the most exceptional cases, he is to be allowed to derogate from the bank's personal and irrevocable undertaking, given be it again noted at his request, by obtaining an injunction restraining the bank from honouring that undertaking, he will undermine what is the bank's greatest asset, however, large and rich it may be, namely its reputation for financial and contractual probity. Furthermore, if this happens at all frequently, the value of all irrevocable letters of credit and performance bonds and guarantees will be undermined..."[14]

Injunctions which, for whatever reason, restrain an issuer from meeting its payment obligations are, therefore, prone to be considered, *per* the words of Donaldson MR in *Bolivinter,* to compromise the issuer's reputation for "financial and contractual probity".[15]

Tukan Timber Ltd v Barclays Bank PLC[16] is another case which emphasises the reputational risk that playing fast and loose with additional exceptions to the autonomy principle could have on issuers of demand guarantees, typically banks. The House of Lords, in this case, stated that:

> "The reputation of Barclays depends on strict compliance with its obligations... the machinery of irrevocable obligations assumed by banks is essential to international commerce. Unless such commitments by banks can be honoured, trust in international commerce could be irreparably damaged."[17]

Failure by banks/issuers to honour their payment obligations under a documentary credit once they have received a compliant demand would certainly have an adverse impact on their reputations, as exemplified by the cases touched upon above. Even compulsion not to honour such a demand due to an injunction would not shield the reputation of such institutions from adverse perceptions arising from non-payment under a documentary credit. One would, therefore, agree that the need to protect the reputation of the issuers, which is somewhat conjoined with the reputation of the documentary credit they issue, would suffer from a liberal recognition of exceptions to the autonomy principle. However, that is not to say a balance cannot and should not be struck between preserving the autonomy principle, the utility of documentary credits and the reputation of their

[14] Idem, at 257. See also *Tetronics (International) Ltd v HSBC Bank Plc* [2018] EWHC 201 (TCC), para 26.

[15] *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251 at 257.

[16] [1987] 1 Lloyd's Rep 171. See also the cases of *Howe Richardson Scale Co Ltd v Polimex-Cekop and National Westminster Bank* [1978] 1 Lloyd's Rep 161 (CA) and *Edward Owen Ltd v Barclays International Bank (*1978) 1 All ER 976.

[17] *Tukan Timber Ltd v Barclays Bank PLC* [1987] 1 Lloyd's Rep 171, at 214.

issuers on the one hand, and the need to mitigate against abusive calls on such instruments on the other hand.

In the case of *United Trading Corp v Allied Arab Bank,* Ackner LJ who, while reiterating that any delay of payment under letters of credit and performance bonds would strike at the proper workings of international commerce, also counterbalanced this view by noting that the reputation and standing of the international banks could also be overemphasised.[18] Ackner J observed that:

> "While accepting that letters of credit and performance bonds are part of the essential machinery of international commerce (and to delay payment under such documents strikes not only at the proper working of international commerce but also at the reputation and standing of the international banking community), the strength of this proposition can be over-emphasised."[19]

Ackner J went on to substantiate this view by comparing English courts' narrow/conservative approach to interfering with documentary credits in relation to fraud against the approach of liberal intervention that American courts are perceived to apply. Furthermore, Ackner J opined that despite American courts being amenable to issuing injunctions on the basis of a suspicion of fraud, instead of only in clear cases of fraud, "this more liberal approach ... had not resulted in commercial dislocation."[20]

Another valid counter-argument raised against fixating on the reputation of issuing banks in relation to compliance with documentary credits is that such an approach does not do such banks' reputations any favours with applicants who commission the issuance of such documentary credits.[21] This is a fair point in the context of client relationships, as the client of the bank issuing a demand guarantee is typically the applicant or underlying principal (or principal debtor), as opposed to the beneficiary.

The on-demand nature of documentary credits skews the balance of power and risk in favour of the beneficiary. It is further susceptible to abuse in the hands of an unscrupulous beneficiary, as evidenced by the existence of the fraud exception and other potential exceptions to be considered herein. The considerations of English courts in respect of striking such a balance, with particular

[18] *United Trading Corp v Allied Arab Bank* [1985] 2 Lloyd's Rep 554, at 561.

[19] Ibid.

[20] Ibid.

[21] Rodrigo, T "Toward Fairness in the Guarantee Market: The Rationale for Expanding Interventions from Fraud to Unconscionability in the Enforcement of Demand Guarantees" (2013), 16, *International Trade and Business Law Review*, 225 (hereinafter, "Rodrigo, *Toward Fairness in the Guarantee Market*"), at 249.

reference to unconscionability and the breach of a negative stipulation as potential exceptions to the autonomy principle, will be explored in this chapter.

Another factor mitigating the reputational risk that non-payment under documentary credit may expose issuers to is that not all formulations of court intervention in respect of documentary credits would necessarily have an impact on the autonomy principle. In particular, where an injunction is issued to restrain the beneficiary from making a demand, for instance, on grounds such as breach of a negative stipulation as considered in this thesis, it does not interfere with the autonomy principle. The distinction between restraining a beneficiary, as opposed to restraining an issuer or guarantor of a documentary credit from an English law perspective will be explored further in subsequent sections of this chapter.

4.1.3 The Freezing Orders (Mareva Injunction) under English law

4.1.3.1 Overview of the Freezing Order (Mareva Injunction)

In light of the limited circumstances in which courts would consider issuing an injunction restraining a beneficiary from calling up a demand guarantee as considered in this thesis, and the reality that a beneficiary sometimes manages to call up a demand guarantee prior to the injunction being granted, the freezing order (formerly known as the *Mareva* injunction) is worth mentioning very briefly. The *Mareva* injunction is a remedy available on certain grounds[22] and has become a tool of popular use under English law.[23] It is a relevant option available in cases where a beneficiary has already made a demand and received payment in contravention of a breach of a negative stipulation exception. It is a temporary freezing remedy preventing a person from dissipating their assets within a jurisdiction or removing the assets from the jurisdiction, commonly to frustrate a pending judgment against that person.[24] The *Mareva* injunction is named after the

[22] *Mareva* injunctions and/or the grounds on which they can be granted (e.g., where: there is a real risk of a defendant dissipating or disposing of their assets and frustrating execution of judgment; the plaintiff has an accrued cause of action against the defendant or the plaintiff is able to show a good arguable case) were considered in the cases of *Siskina (Cargo Owners) v Distois Compania Naviera SA* (1979) AC 210; *Veracruz Transportation Inc v Compamia C Shipping Co Inc and Den Norske Bank A/S, The Veracruz* (1992) 1 Lloyd's Rep 353; *Ninemia Maritime Corpn Trave Schiffahrtgessellschaft mbH, KG; The Niedersachen* (1983) 1 WLR 1412; *Third Chandris Shipping Corporation v Unimarine SA* (1979) QB 645; and *Z Ltd v A-Z* (1982) 2 WLR 288.

[23] Lee, M "Prejudgement Attachment in England: The Mareva Injunction" (1982), 5(1), *Loyola of Los Angeles International and Comparative Law Review*, 143, at 144.

[24] For a more detailed consideration of the *Mareva* injunction under English law, see O'Driscoll, P S "Performance Bonds, Bankers' Guarantees, and the Mareva Injunction" (1985), 7(2), *Northwestern Journal of International Law & Business*, 380 (hereinafter, "O'Driscoll, *Performance Bonds, Bankers' Guarantees, and the Mareva Injunction*").

Mareva Cia Naviera SA v International Bulk Carriers SA[25] case, further to which it was recognised under English law. Guidelines with regard to the application of the *Mareva* injunction under English law were built by case law over time.[26]

4.1.3.2 The Application of the Freezing Order (Mareva Injunction) to Demand Guarantees

Before the Freezing Order (*Mareva* injunction) had been explicitly established under English law, cases such as *Elian and Rabbath v Matsas and Matsas*[27]and *Edward Owen Ltd v Barclays International Bank*[28] alluded to situations in which an injunction of such a nature could perhaps have been appropriate in relation to documentary credits.

Consideration of the *Mareva* injunction in respect of a demand guarantee was central in the case of *Intraco Ltd v Notis Shipping Corporation (The "Bhoja Trader").*[29] In this case, Staughton J, upon lifting an initial injunction that had been granted restraining a beneficiary from calling up a guarantee, imposed a *Mareva* injunction preventing the beneficiary from "removing from the jurisdiction or otherwise disposing of any of their assets and in particular moneys payable under

[25] [1980] 1 All ER 213.

[26] The body of case law laying down the foundational guidance for the applicable scope and tests that must be satisfied before the granting of a *Mareva* injunction includes: *Rasu Maritima SA v Perusahaan Pertambangan Minyak Dan Gas Bumi Negara* [1978] 1 QB 644 (1977); *Siskina (Cargo Owners) v Distos Compania Naviera SA* [1979] AC 210; *Third Chandris Shipping Corporation v Unimarine SA* [1979] 1 QB. 645; *Barclay-Johnson v Yuill* [1980] 1 WLR 1259; *Clipper Maritime Co Ltd of Monrovia v Mineralimportexport* [1981] 1 WLR 1262. The first comprehensive set of guidelines for the grant of a *Mareva* injunction were established by Lord Denning, MR, in *Third Chandris Shipping Corporation v Unimarine SA* [1979] 1 QB 645, at 668-669, in which Lord Denning, MR, said an applicant for a *Mareva* injunction should: (1) make "full and frank" disclosure of all matters in its knowledge which are material for the judge to know; (2) give particulars of the claim against the defendant, including the grounds of the claim and the amount in issue, and the points made against the claim by the defendant; (3) provide some grounds for believing the defendant has assets within the jurisdiction; (4) give some grounds for believing that there is a risk of assets being removed from the jurisdiction prior to judgment or satisfaction of the award; and (5) undertake to pay damages in the event the claim fails or the injunction proves to be unjustified. See also *Z Ltd v A-Z and AA-LL* [1982] 1 QB 558 at 575-77 in which more comprehensive guidance in the form of ten requirements required to be met by plaintiffs wanting to impose *Mareva* injunctions on funds and other assets of defendants' which were in the possession of a bank or a third party within the jurisdiction of the court were set out by Lord Denning, MR.

[27] [1966] 2 Lloyd's Rep 495. In this case, a ship owner (the beneficiary) agreed to release a lien imposed against the goods of a Beirut shipping firm in return for a bank guarantee. After release of the lien, the beneficiary imposed a second lien on the goods and proceeded to call up the demand guarantee, notwithstanding the understanding between the parties that with a demand guarantee in place no further liens would be imposed on the goods (at 496-497). Highlighting that courts would do their best to enforce a demand guarantee according to its terms, Lord Denning went on to state that certain circumstances may arise which would warrant interference by injunction and that he believed the case to be a special one in which an injunction should be granted (at 497). Concurring with Lord Denning, Danckwerts LJ agreed, stating that "it seems to me this is an instance where the Court should interfere and prevent what might be an irretrievable injustice being done to the plaintiffs in the circumstances" (at 498).

[28] [1978] 1 All ER 976.

[29] [1981] 2 Lloyd's Rep 256.

[the] guarantee...".[30] On appeal, Donaldson LJ acknowledged that the fraud exception did not preclude the court from "imposing a *Mareva* injunction upon the fruits of the letter of credit or guarantee",[31] despite going on to discharge the *Mareva* injunction on the grounds relating to the jurisdiction in which the demand guarantee was payable.[32]

Despite the lack of international consensus, the premise that an injunction can prevent a beneficiary from making a demand in breach of a contractual term they bound themselves to in favour of the person seeking an injunction has had significant traction. It is considered to be embedded under English law.[33]

4.2 UNCONSCIONABILITY

4.2.1 Introduction and Background of Unconscionability under English Law

4.2.1.1 Early Development of Unconscionability under English law

Unconscionable contracts are considered to have featured in English law as early as 1697.[34] One view of early English case law is that unconscionability was turned to as a last resort of sorts in circumstances where there was a failure to establish fraud, duress or illegality.[35]

The very early English case of *Earl of Chesterfield v Janssen*[36] is notable for its allusion to the principle of unconscionability in the context of recourse against fraud. In *Earl of Chesterfield*,

[30] Idem, para 9

[31] Idem, at 258.

[32] Ibid. Donaldson, LJ, reasoned that the demand guarantee in question was payable in Greece and not in London and, therefore, if the guarantee were to be treated as cash in hand between the parties, it must be treated as cash in hand in Greece. See also *Z Ltd v A* [1982] 1 QB 558 where Lord Denning, MR stated that, while the *Mareva* injunction did not prevent payment under a documentary credit, "it may apply to the proceeds as and when received by or for the defendant" (at 574).

[33] Kelly-Louw, M and Fayers, R "The 'Breach of a Negative Stipulation' as an Exception to the Autonomy Principle in England and South Africa" (2021), 84, *THRHR*, 515 (hereinafter, Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*"), at 516. See also, for example, the cases of *Sirius International Insurance Corp v FAI General Insurance Co Ltd* [2003] 1 WLR 87; *Simon Carves Ltd v Ensus UK Ltd* [2011] CILL 3009 at 3012; *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC) and *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC) as cited therein. See Chapter 5 of this thesis for consideration of the breach of a negative stipulation exception under the law of Australia.

[34] Alavi, H "Comparative Study of Unconscionability Exception to the Principle of Autonomy in Law of Letter of Credits" (2016), 2016(2), *Acta Universitatis Danubius Juridica*, 94 (hereinafter, "Alavi, *Comparative Study of Unconscionability Exception*"), at 101.

[35] Idem, at 101.

[36] (1750) 28 ER 82 Ch.

unconscionability was argued to be a possible remedy against "every species of fraud",[37] including unconscientiousness, a lack of honesty, fairness and equitability.[38] Lord Hardwicke in *Earl of Chesterfield* also encapsulated what may today count as unconscionable conduct in the following statement:

> "It may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under a delusion would make on the one hand, and as no honest man and fair man would accept on the other; which are unequitable and unconscientious bargains; and of such even the common law has taken notice."[39]

It would appear from this *dictum* that unconscionability thus included unconscientious bargains.

The concept of unconscionability has been considered in other early English cases. Grounds for relief against unconscionable conduct in relation to a transaction were outlined as follows in the case of *Cresswell v Potter*[40] by Megarry J with reference to the much earlier case of *Fry v Lane*:[41]

> "The judge thus laid down three requirements. What has to be considered is, first, whether the plaintiff is poor and ignorant; second, whether the sale was at a considerable undervalue; and third, whether the vendor had independent advice."[42]

Another early formulation of unconscionability under English law was in the case of *Multiservice Bookbinding Ltd v Marden*[43]in which it was held that for a transaction to be set aside as an unconscionable bargain, objectionable terms must have been sought to be imposed by a party to the transaction "in a morally reprehensible manner".[44] The case of *Multiservice Bookbinding* received endorsement in subsequent English cases such as *Alec Lobb (Garages) Ltd v Total Oil*

[37] Idem, at 100-103.

[38] Ibid.

[39] Ibid.

[40] [1978] 1 WLR 255.

[41] (1888) 40 Ch D 312.

[42] [1979] Ch 84.

[43] [1978] 2 All ER 489.

[44] [1979] Ch 84 at 110. See also *Credit Lyonnais Bank Nederland NV v Burch* [1997] 1 All ER 144 (CA) at 152-153 and *Portman Building Society v Dusangh* [2000] 2 All ER (Comm) 221 (CA).

(Great Britain) Ltd.[45]

In *Alec Lobb*, three requirements for relief on the ground of unconscionability were established. Firstly, it was required that one party must be at a serious disadvantage to the other, e.g., due to poverty, ignorance, lack of advice, or otherwise, such that there were circumstances which could be taken unfair advantage of. Secondly, the disadvantaged party's weakness must have been exploited in a morally culpable manner. Thirdly, the transaction arising under the circumstances should not be merely hard or improvident but overreaching and oppressive in nature.[46] From such cases, this formulation seems to have been followed in perhaps a majority of subsequent English case law.[47]

Some critics of recognition of the unconscionability exception have argued that the English law formulation thereof is a broad one and has broadened over time.[48] However, this view has been respectfully dispensed with by other scholars, who contend rather that while the English doctrine of unconscionability may have evolved over time, the nature of such evolution has been a move away from a broader to a narrower approach.[49]

4.2.1.2 Implicit and Explicit Unconscionability under English Law

Some commentators have adopted the view that unconscionability falls within the confluence of two distinct lines of jurisprudence, the first being implicit unconscionability and the other being explicit unconscionability.[50] A number of English cases have given an implied nod to the possibility of an unconscionability exception to the autonomy principle of documentary credits,

[45] [1983] 1 WLR 87 (HC).

[46] Idem, at 94-95.

[47] See, e.g., *Boustany v Pigott* (1995) 69 P & CR 298, at 303; *Deakin v Faulding* [2001] EWHC 7 (Ch), para 86; *Singla v Bashir* [2002] EWHC 883 (Ch), para 28; *Humphreys v Humphreys* [2004] EWHC 2201 (Ch), para 106; *Strydom v Vendside Ltd* [2009] EWHC 2130 (QB), para 35; and more recently *Fineland Investments Ltd v Pritchard* [2011] EWHC 113 (Ch), para 77; Evans v Lloyd [2013] EWHC 1725 (Ch) paras 50 and 76 and *Nosworthy v Instinctif Partners Ltd* [2019] UKEAT 0100/18/RN, para 49.

[48] *Bol v Bok* [2018] SGCA 83, para 135-138.

[49] Enonchong, N "The State of the Doctrine of Unconscionability in Singapore" (2021), 1, *Singapore Journal of Legal Studies*, 100, at 125-126.

[50] Johns, RJ and Blodgett, MS "Fairness at the Expense of Commercial Certainty: The International Emergence of Unconscionability and Illegality as Exceptions to the Independence Principle of Letters of Credit and Bank Guarantees" (2011), 31, *Northern Illinois University Law Review*, 297 (hereinafter, "Johns and Blodgett, *Fairness at the Expense of Commercial Certainty* at 311.

such as the 1984 case of *Potton Homes v Coleman Contractors*.[51]

The *Potton Homes* case effectively rolled out the carpet for additional exceptions to the autonomy principle by acknowledging that there could be some circumstances, other than fraud, where a beneficiary could be restrained from making a claim, e.g., where contractual obligations have been avoided, or there has been a total failure of consideration.[52] There is little if any case law under English law that one could comfortably fit into the category of unequivocal explicit unconscionability. Whilst not entirely clear or explicit in accepting unconscionability as an exception to the autonomy principle of documentary credits, jurisprudence on implicit unconscionability is credited with having paved the way for new exceptions to the autonomy principle by repudiating the exclusivity of the fraud exception.[53]

4.2.2 Unconscionability under English Law as a Standalone Exception to the Autonomy Principle or a Mere Variation of the Fraud Exception

4.2.2.1 Potential Overlap of Unconscionability with Fraud

The references to unconscionability in cases such as *Earl of Chesterfield* may have also served as a prelude to later recognition of the concept of unconscionability under English law. However, the apparent attempt to shoehorn unconscionability into the folds of the fraud exception, in this case, seems indicative of a reluctance by the courts to base their judgments on equitable grounds alone[54] and offers little guidance in respect of unconscionable conduct falling short of fraud.

The association of unconscionability with fraud in relation to demand guarantees has received support from some quarters, with prominent commentators such as Horowitz arguing that cases pertaining to objectionable conduct could easily be dealt with within the remit of the wider fraud exception.[55] Therefore, rather than seeing a new unconscionability exception as the only solution to objectionable conduct in relation to documentary credits, an alternative approach which has

[51] [1984] 28 Build LR 19 (Eng).

[52] (1984) 28 Build LR 24, at 28.

[53] Idem, at 311.

[54] See Lupton, CS "*A Comparative Legal Perspective on the Impact of Good or Bad Faith on the Independence of Documentary Credits and Demand Guarantees*", LLM dissertation, University of Johannesburg, 2018 (hereinafter, "Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith"*), at 20.

[55] See Horowitz, D *Letters of Credit and Demand Guarantees: Defences to Payment*, Oxford University Press, 2010 (hereinafter, "Horowitz, *Letters of Credit and Demand Guarantees"*), at 129-130.

been suggested is that such conduct could be addressed under the wider fraud exception.[56]

4.2.2.2 Traditional Recognition of the Fraud Exception under English Law

The fraud exception or fraud rule is well-known and accepted by English courts. For a long time, it has been the only recognised exception to the autonomy principle and a guarantor's payment obligations in relation thereto. This position has been acknowledged, reiterated and/or supported in several cases, with a seminal example being *Edward Owen Engineering Ltd v Barclays Bank International Ltd*,[57] where Lord Denning MR stated that:

> "A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relation between the supplier and the customer nor with the question whether the supplier had performed his contracted obligation or not, nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or condition. The only exception is when there is a clear fraud of which the bank has notice."[58]

In *Edward Owen* Lord Denning, MR, further cited the stance of the United States case of *Sztejn v J Henry Schroder Banking Corp*[59] that "the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances when there is no right to payment".[60] Furthermore, in *United City Merchants (Investments) Ltd v Royal Bank of Canada*,[61] Lord Diplock reiterated the well-established position of the fraud exception by stating:

> "The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio of,* if plain English is to be preferred, 'fraud unravels all'."[62]

It is clear that notwithstanding the autonomy principle, English courts will not abide fraud and the

[56] Horowitz *Letters of Credit and Demand Guarantees*, at 129-130.

[57] [1978] 1 QB 159.

[58] Idem, at 171. See also *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146, at 156.

[59] (177 Misc 719, 31 NYS 2d 631 (NY Sup Ct 1941)).

[60] Idem, at 169. See also *See United City Merchants (Investments) Ltd v Royal Bank of Canada*, [1982] 2 All ER 720

[61] [1983] AC 168.

[62] Idem, at 184

use of the court process for fraud by dishonest persons. The courts will not allow their process to be used by a dishonest person to carry out a fraud.[63]

4.2.2.3 Fraud and the "No Honest Belief" Formulation of Fraud Generally

Earlier views on the fraud exception adopted the interpretation that fraud arises where, upon presentation of the documents by a beneficiary, the documents are forged or contain a false representation (fraudulent).[64] In addition to the narrow and wide approaches to the fraud exception, which are also recognised in South Africa,[65] and as demonstrated in the discussion further below in this chapter,[66] English law seems to have established a further approach premised on a beneficiary having "no honest belief" of their entitlement to call up a documentary credit. Pursuant to this approach, the fraud exception to the principle of autonomy would be sufficiently established where it is shown that a beneficiary lacked an honest belief in their entitlement to claim payment under a demand guarantee at the time of making such a claim.[67]

A number of English cases have facilitated the entrenchment of the "no honest belief" approach to the fraud exception under English law, with the premise being that court intervention on the basis of the fraud exception is justifiable. This will be considered further below. As the exception goes, this would thus enable certain types of unconscionable conduct to be dealt with within the remit of the fraud exception, for instance, the calling up of a demand guarantee while lacking an honest belief of one's entitlement to payment. Some scholars have subscribed to this approach, with Bridge determining that fraud is established by the absence of an honest belief in the validity of the documents presented by a beneficiary.[68]

A very early case which supported consideration of honesty or lack thereof in respect of fraud in

[63] Idem, at 725.

[64] See Marxen, K "*Demand Guarantees in the Construction Industry: A Comparative Legal Study of Their Use and Abuse from a South African, English and German Perspective*" LLD thesis, University of Johannesburg, 2017 (hereinafter, "Marxen, *Demand Guarantees in the Construction Industry*"), at 110-111.

[65] See section 3.2.6.1 in Chapter 3 above. See also Chivizhe, T "*A Comparative Study of the Law and Practice Relating to the Compliance of Documents Calling for Payment under Letters of Credit and Demand Guarantees*" LLD thesis, North-West University, 2021, at 49-53 which comments on the narrow and broad formulation of the fraud exception mainly from a South African law perspective, but with some comparative commentary worth noting in respect of English law.

[66] See section 4.2.2.3 of this chapter.

[67] Marxen, *Demand Guarantees in the Construction Industry*, at 112.

[68] Bridge, M *Benjamin's Sale of Goods,* 9 ed, Sweet & Maxwell, 2014, at 2219.

English common law is *Derry v Peek.*[69] In this well-known House of Lords' decision, Lord Herschell outlined the requirements for proof of fraud accordingly:

> "First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial."[70]

The formulation of fraud as requiring a lack of honest belief was affirmed time and time again in other English case law. *Edward Owen*[71] is also considered to have played the lynchpin role in establishing the lack of honest belief formulation in respect of fraudulent demands under demand guarantees, as demonstrated by the fact that it was invoked in a number of subsequent cases. In *State Trading Corporation of India Ltd v ED & F Man (Sugar) Ltd*,[72] Lord Denning, MR, citing remarks from *Edward Owen*, lent support to the honest belief approach by asserting that, in respect of a performance bond, the only implied term was that the buyer:

> "when giving notice of default, must honestly believe that there has been a default on the part of the seller. Honest belief is enough. If there is no honest belief it may be evidence of fraud. If there is sufficient evidence of fraud, the court might intervene and grant an injunction. But otherwise not."[73]

The Court of Appeal in *Bolivinter* also cited Lord Denning's formulation of fraud as the lack of honest belief by the beneficiary calling up the demand guarantee.[74] Furthermore, in *Potton Homes*

[69] *Derry v Peek* [1875] 14 App Cas 337.

[70] Idem, at 374. See also Frederick Pollock, "Derry v Peek in the House of Lords" (1889) *5 Law Quarterly Review* 410, at 423.

[71] *Edward Owen Ltd v Barclays International Bank* [1978] 1 All ER 976.

[72] *State Trading Corp of India Ltd v ED & F Man (Sugar) Ltd* [1981] Comm L R 235.

[73] Idem, 235.

[74] *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251, at *255.*

Ltd v Coleman Contractors Ltd,[75] fraud was discussed with reference to a lack of honest belief as set out in *Edward Owen* and *State Trading Corp.*

In the Court of Appeal case of *United Trading Corp SA and Murray Clayton Ltd v Allied Arab Bank Ltd*,[76]the court addressed the issue of a fraudulent demand by invoking *Edward Owen* and the approach therein of applying lack of honest belief as the criterion for establishing a fraudulent demand under a demand guarantee.[77] In the prominent case of *United Trading Corporation SA v Allied Arab Bank Ltd* case,[78] Ackner J remarked, in relation to the fraud exception to the autonomy principle under a demand guarantee, that "the only realistic inference is that [the beneficiary] could not honestly have believed in the validity of its demands ....".[79]

Edward Owen was also invoked in the appellate case of *Manx Electricity Authority v JP Morgan Chase Bank*,[80] in which it was surmised that:

> "[the] language of ... 'honestly believes' presumably takes its shape from the underlying law regarding such performance guarantees, which makes them effectively into obligations to pay on demand within the terms of the guarantee, irrespective of the rights and wrongs of any dispute between beneficiary and principal under the terms of their separate contract, subject only to fraud."[81]

In *Banque Saudi Fransi v Lear Siegler Services Inc*,[82] the formulation of the fraud exception with reference to the absence of an honest belief was further entrenched in the context of incontrovertible evidence that a beneficiary to a performance demand had made a fraudulent call on it with the issuing bank's awareness of the fraud. The *United Trading* case was, in turn, referenced in support of the "no honest belief" yardstick for fraud in the following statement in *Banque Saudi*:

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[75] *Potton Homes Ltd v Coleman Contractors Ltd (1984)* 28 BLR 19.

[76] (1985) 2 Lloyd's Rep 554.

[77] Idem, at 558.

[78] (1985) 2 Lloyd's Rep 554.

[79] Idem, at 561.

[80] *Manx Electricity Authority v JP Morgan Chase Bank* [2003] EWCA Civ 1324 (CA).

[81] Idem, para 31.

[82] [2007] 2 Lloyd's Rep 47. The court in this case referenced and seemingly agreed with the approach taken in *United Trading Corp SA and Murray Clayton Ltd v Allied Arab Bank Ltd* (1985) 2 Lloyd's Rep 554.

> "In the *United Trading* case, this court … held that the evidence of both the fraud and the bank's knowledge must be clear and that the appropriate test (in relation to fraud) was whether it was seriously arguable that on the material available the only realistic inference was that the beneficiary could not honestly have believed in the validity of its demand on the performance bond".[83]

Moreover, in *Uzinterimpex JSC v Standard Bank Plc*,[84] reference was made to the lack of honest belief criterion in a decision involving a claim under a demand guarantee. Further support of the "no honest belief" formulation of the fraud exception was provided by *Alternative Power Solution Ltd v Central Electricity Board*[85] where the court held that the determining question for whether an interim injunction could be granted was whether "the beneficiary could not honestly have believed in the validity of its demand".[86]

In view of the above body of case law supporting it, the "no honest belief" formulation of fraud in respect of demand guarantees appears to be firmly entrenched under English law. There is a discernible parallel and similarity between the "knowledge of lack of entitlement" construction of the fraud exception under South African law[87]and the "no honest belief" and fraud can "unravel all" formulation of fraud under English law. It can be concluded from this approach that honesty is a requirement of a valid claim under a demand guarantee and, conversely, that dishonesty or "no honest belief" is an essential element of the fraud exception to the autonomy principle.

4.2.2.4 Commonality between Unconscionability and the Fraud Exception on a "No Honest Belief" Formulation

From the above consideration of the formulation of fraud in the context of establishing a fraud exception, some commonality with unconscionability can be traced. Despite the demonstrable possibility of covering elements of dishonesty and even a beneficiary seeking to call up a demand guarantee while he is aware of his lack of entitlement to do so, under the fraud exception, the same could certainly amount to unconscionable conduct. This commonality is best exemplified and

[83] *Banque Saudi Fransi v Lear Siegler Services Inc* [2007] 2 Lloyd's Rep 47, at 51.

[84] [2008] EWCA Civ 819.

[85] (2014) UKPC 31.

[86] Paragraph 5.

[87] See sections 3.2.6.1 and 3.2.7 of Chapter 3 of this thesis, where this approach is discussed in the context of South African law.

encapsulated in the case of *TTI Team Telecom International Limited v Hutchison 3G UK Limited,*[88] which rather ironically exemplified how fraud could address unconscionable conduct on the one hand (thereby obviating the need for a standalone unconscionability exception), and yet, on the other hand, is still considered to be a seminal building block in the case for unconscionability as discussed below.[89] In *TTI,* Thornton J, seemingly contemplating an exception tantamount to an unconscionability exception separate from the fraud exception, however, asserted that a demand guarantee could be restrained where there is "a lack of an honest or bona fide belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond had been provided, actually exist".[90]

TTI, however, seemed to contemplate an exception tantamount to an unconscionability exception separate from the fraud exception, as shown by Thornton J's that a demand guarantee could be restrained where there is "a lack of an honest or bona fide belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond had been provided, actually exist".[91] This reference to the absence of an honest belief seems to echo the "no honest belief" formulation of the fraud exception and leads one to the conceivable deduction that unconscionable conduct can be caught under the already existing fraud exception.

It arguably is due to the inclination to hold fast to known quantities such as the traditional fraud exception in the face of perceived or potential uncertainty that fraud remains viewed as the focal point in relation to objectionable conduct by beneficiaries under English law.[92] Some would argue that attempting to fit unconscionability within the ambit of fraud may still fail to address the matter of unconscionable conduct falling short of fraud on any approach. Despite this, English law has failed to recognise unconscionable conduct, which falls short of fraud as a standalone exception to the autonomy principle of demand guarantees.[93] One could speculate that such a stance resulted from trying to balance the pros and cons of an additional exception to the autonomy principle. The conclusion of such a balancing exercise may perhaps be that the more egregious types of unconscionable conduct (i.e., that which would justify derogation from the autonomy principle)

[88] [2003] 1 All ER 914.

[89] See section 4.2.2.4 of this chapter.

[90] [2003] 1 All ER (Comm) 914, para 46.

[91] Ibid.

[92] See Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith,* at 34.

[93] Horowitz, *Letters of Credit and Demand Guarantees*, at 129.

would be sufficiently caught in the fraud exception.

4.2.3 Unconscionability and Good Faith under English Law

4.2.3.1 Intersection of Unconscionability and Bad Faith or Lack of Good Faith in relation to Documentary Credits

According to some scholars, bad faith can be treated as materially similar to and perhaps synonymous with unconscionability.[94] Bad faith is considered to encompass any conduct that breaches the boundaries of what is acceptable conduct expected of a reasonable party to a commercial transaction but falls out of the ambit of the fraud exception (under both English law and South African law).[95] Despite the apparent overlap and sometimes synonymous use of bad faith and unconscionability, what is encompassed by the latter term, particularly in the context of exceptions to the autonomy principle of demand guarantees, is not entirely clear.

Unconscionability in relation to documentary credits was alluded to in the 1966 English case of *Elian and Rabbath v Matsas and Matsas*,[96] where the court acknowledged the existence of circumstances in which bad faith may justify the encroachment on the autonomy principle, particularly to prevent an irrevocable or irretrievable injustice from happening.[97] The *Elian and Rabbath* case recognised "bad faith" by a party to a transaction as a potentially justifiable inroad into the autonomy principle[98] and, with reference to the close association of bad faith and unconscionability, could also be seen as a signifying a step towards recognition of exceptions on equitable notions such as the unconscionability exception.

While a defined unconscionability exception was not clearly and unequivocally established in this case, what was made explicitly clear in *Elian and Rabbath* was the fact that the obligation to honour the terms of a demand guarantee pursuant to the autonomy principle is not absolute. In this regard, Lord Denning stated:

> "Now I quite agree that a bank guarantee is very much like a letter of credit. The Courts will do their utmost to enforce it according to its terms. They will not, in the ordinary course of things,

[94] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 20.

[95] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 37.

[96] [1966] 2 Lloyd's Rep 495.

[97] Idem, at 498.

[98] Ibid.

interfere by way of injunction to prevent its due implementation. But that is not an absolute rule. Circumstances may arise such as to warrant interference by injunction."[99]

4.2.4 Rationales for the Recognition of the Unconscionability Exception from an English Law Perspective.

4.2.4.1 Historical Support for Recognition of Unconscionability in English Law

The historical development and recognition of unconscionability as part of English common law has been invoked to support its application as an exception to the autonomy principle in relation to documentary credits.[100] As already mentioned, the concept of unconscionability under English law was alluded to with reference to the terms "inequitable and unconscientious"[101] as early as 1697 in the *Earl of Chesterfield* case.[102] However, it has been noted that this case seemed to envisage unconscionable conduct within the context of vulnerable parties to a transaction, which lent itself to the perception that the application of unconscionability was limited to cases involving vulnerable persons.[103] However, this perceived limitation was considered to be dispensed with by the later cases such as *Multiservice Bookbinding v Marden.*[104]

In *Multiservice Bookbinding*, unconscionability defence was provided for in the context of any type of contract, including contracts which did not involve vulnerable persons.[105] Other relatively more recent cases like the *TTI* case lent credibility to this view by seemingly endorsing the consideration of unconscionability as a potential exception to the autonomy principle. Notwithstanding the criticism levelled against *TTI* for not sufficiently establishing a position regarding recognition of the unconscionability exception, the *TTI* case further depicts the traction gained by the unconscionability exception throughout its historical development under English law. The *National Infrastructure Development Co Ltd v Banco Santander SA*[106] discussed further

[99] [1966] 2 Lloyd's Rep para 172.

[100] Alavi, *Comparative Study of Unconscionability Exception*, at 114.

[101] Ibid.

[102] 28 Eng Rep 82 (Ch 1751).

[103] Alavi, *Comparative Study of Unconscionability Exception*, at 113.

[104] (1979) Ch 84. See also later cases of *Alec Lobb v Total Oil* (1983) 1WLR 87 and *Ruddick v Ormston* (2005) EWHC 2547.

[105] Alavi, *Comparative Study of Unconscionability Exception*, at 113.

[106] [2017] EWCA Civ 27.

below,[107] is another English case that demonstrates support for recognising unconscionability as a standalone exception to the autonomy principle. These cases have been construed as affirming the application of "a general principle entitling a court to intervene on the grounds of unconscionability"[108] under English law.

4.2.4.2 The Potential Complementary Relationship between Unconscionability Exception and the Fraud Exception

Some commentators assert that the recognition of unconscionability as an exception to the autonomy principle bridges the gap left by the fraud exception when it comes to providing recourse against unconscionable conduct falling short of fraud.[109] Supporters of the unconscionability exception justify it further on the basis that it fills the gap arising where the fraud exception cannot be effectively applied and is, therefore, complementary to the fraud exception.[110] Following this line of thinking, the unconscionability exception could be used to curtail abusive calls on documentary credits where recourse cannot be had to well-established exceptions such as the fraud exception.[111]

Unconscionability is also supported on the basis of its potentially complementary relationship with the fraud exception, as discussed further in this chapter.[112] In this regard, unconscionability could arguably plug any gaps left by the fraud exception and provide recourse against abusive conduct by beneficiaries which falls short of fraud but in respect of which aggrieved parties deserve no less of a remedy as with the case of fraud.

This argument gains particular relevance from the perspective of the challenges associated with establishing some of the elements of common-law fraud, such as knowledge, intention, and

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[107] See section 4.2.6.3 of this chapter.

[108] Siopis, A "Unconscionable Bargains and General Principle" (1984), 100, *LQR*, 523, at 525.

[109] Alavi, *Comparative Study of Unconscionability Exception*, at 113 and 117; Alawamleh, KJA "*Documentary Credits and Independent Guarantees: A Critique of the 'Fraud Exception' Position in English and Jordanian Law*", PhD thesis, University of Central Lancashire, 2013 (hereinafter "Alawamleh, *Documentary Credits and Independent Guarantees*"), at 186. Enonchong also attributes the issue of abusive calls in the context of documentary credits to the narrowness with which the fraud exception is applied (Enonchong, N "The Problem of Abusive Calls on Demand Guarantees" (2007), 1, *LMCLQ*, 83 at 106).

[110] Enonchong, N *The Independence Principle of Letters of Credit and Demand Guarantees,* Oxford University Press, 2011 (hereinafter Enonchong*, The Independence Principle of Letters of Credit*), at 169.

[111] Ibid.

[112] See section 4.2.2 of this chapter.

dishonesty.[113] The difficulty of establishing sufficient grounds for the fraud exception to the autonomy principle is exemplified by the case of *Discount Records Ltd v Barclays Bank Ltd*[114] where the court held that fraud had not been established despite the existence of significant indicators which could be construed to be fraudulent, e.g., material discrepancy in the quality and quantity of goods delivered versus what was promised in the underlying contract.[115]

In cases where fraud cannot be established to a standard required by the courts, the unconscionability exception provides recourse against unscrupulous beneficiaries seeking to benefit from abusive calls on documentary credits. However, an approach that may obviate the need to turn to unconscionability is the extension of the fraud rule to protect bona fide applicants from *mala fide* beneficiaries in a documentary credit arrangement.[116] Enonchong advances the view that courts could extend the ambit of the fraud exception to guard against abusive calls on demand guarantees by unscrupulous beneficiaries.[117] A counter-argument to this approach is that it is unlikely to get past the criticism that it is inimical to the traditionally established fraud rule and cannot be justified within its boundaries.[118]

Unconscionability, therefore, finds greater relevance and perhaps room for acceptance in circumstances where conduct may not meet the requirements of establishing the fraud exception but is nevertheless abusive or unconscionable to an extent warranting a remedy.

4.2.4.3 Flexibility Afforded by an Unconscionability Exception to the Autonomy Principle[119]

Flexibility is another ground upon which proponents of the unconscionability exception to the autonomy principle of demand guarantees rely to support it.[120] This is because the largely criticised nebulous nature of unconscionability could translate into a virtuous absence of rigid prescriptive

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[113] Alavi, *Comparative Study of Unconscionability Exception*, at 114.

[114] *Discount Records Ltd v Barclays Bank Ltd* (1975) 1 WLR 315.

[115] Ibid.

[116] Enonchong, N "The Problem of Abusive Calls on Demand Guarantees" (2007), 1, *Lloyd's Maritime & Commercial Law Quarterly,* 83 (hereinafter, "Enonchong, *The Problem of Abusive Calls on Demand Guarantees*"), at 104.

[117] Ibid.

[118] Alavi, *Comparative Study of Unconscionability Exception*, at 114. See also *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251.

[119] Alavi, *Comparative Study of Unconscionability Exception*, at 114.

[120] Ibid.

parameters for its application. While others see unconscionability as a nebulous concept, others may argue that this is much-needed flexibility that increases the utility of the remedy offered by the exception by enabling unconscionability to be used or moulded around numerous sets of unique facts or circumstances.

4.2.4.4 Recognition of Unconscionability in Other Jurisdictions

Foreign jurisdictions' recognition of unconscionability as an exception to the autonomy principle[121] is also argued to be a significant factor propelling it to standing status on the agenda of English law.[122] Some common-law jurisdictions have already recognised unconscionability in addition to fraud as a defence to the autonomy principle of documentary letters of credit and demand guarantees. For instance, under Australian law, unconscionability as a defence to non-payment is codified into statute.[123] Although it is largely consumer protection oriented, the Australian Competition and Consumer Act, 2010 [124] provides for payment to be restrained where a beneficiary makes an unconscionable demand.[125]

4.2.4.5 Potential for Over-Weighting the Reputation of Issuers

The argument (or any variation thereof) that, barring the fraud exception, any attempts to avoid payment by an issuer, e.g., by claiming other exceptions to the autonomy principle of demand guarantees, would have an adverse effect on issuers or their reputation(s) is a common one.[126] This view has, however, not gone without challenge. As mentioned above,[127]it has been posited in a number of court cases that the danger to the reputation of issuers is somewhat exaggerated and that critical scrutiny of the legal position in respect thereof is overdue, particularly in the context

[121] Alavi, *Comparative Study of Unconscionability Exception*, at 115.

[122] Ibid.

[123] See the Competition and Consumer Act 2010 (Cth) (Schedule 2 of which is the Australian Consumer Law).

[124] See section 51AA of the Australian Trade Practices Act 1974 (Cth), which has now been replaced by the Competition and Consumer Act 2010 (Cth) (Schedule 2 of which is the Australian Consumer Law).

[125] See Chapter 5 for a comprehensive analysis of the position regarding unconscionability as an exception to the autonomy principle under Australian law.

[126] See *RD Harbottle (Mercantile) Ltd v Nat'l Westminster Bank Ltd* [1978] 1 Q.B. at 151; *Bolivinter Oil SA v Chase Manhattan Bank*, [1984 1 Lloyd's Rep 251, at 257. See also Alawamleh, *Documentary Credits and Independent Guarantees*, at 39.

[127] See sections 4.1.2.2 and 4.2.4.5 of this chapter.

of documentary credits.[128]

4.2.5 Rationales Against Recognition of Unconscionability Exception from an English Law perspective

4.2.5.1 Independence of Documentary Credits and the Need to Support the Reputation of Issuers

The autonomy principle under English law is considered to be essential to the nature and utility of demand guarantees. Failure to apply the autonomy principle on the part of guarantors has predictably attracted criticism, and the need to protect the reputation of guarantors has thus been one of the grounds cited against additional exceptions to the autonomy principle.[129] Due to this role, any additional exceptions to the independence principle are considered in the context of their impact on the utility of such instruments. As discussed above,[130] the autonomy principle is a crucial element of demand guarantees but should not be blindly exaggerated to quash compelling factors that may justify considering additional exceptions to the autonomy principle, such as unconscionability.

4.2.5.2 Uncertainty and Vagueness of Unconscionability

Some commentators have postulated that unconscionability is a "well defined" doctrine.[131] Some cases have also sought to provide clarity, as exemplified by the *TTI* case, which seemingly attempted to insert an objective and certain standard regarding what constitutes unconscionability by reference to a requirement for unconscionability to be "significant and clearly established".[132] The majority view, however, appears to be critical of unconscionability on the basis that it is a nebulous concept.[133] Unconscionability is criticised largely for its uncertainty and the associated difficulties in defining it.[134] Hooley opines that "it is not entirely clear what constitutes

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[128] Rodrigo, *Toward Fairness in the Guarantee Market*, at 24.

[129] See section 4.1.2.2 of this chapter for a discussion of the reputational connotations of guarantors derogating from autonomy principle.

[130] See section 1 of this chapter.

[131] Guest, A *Benjamin's Sale of Goods*, 7 ed, Sweet & Maxwell, 2006, at 2075.

[132] *TTI Team Telecom International v Hutchinson 3G* (2003) 1 All ER 914 at [37].

[133] See Enonchong, *The Independence Principle of Letters of Credits*, at 170; Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 105; Hooley, R & Sealy L *Commercial Law: Text, Cases, and Materials*, 4 ed, Oxford University Press, 2009, at 867; Horowitz, *Letters of Credit and Demand Guarantees*, at 142 and Ganotaki, A "Unconscionability and Bank Guarantees" (2004), *LMCLQ* 148, at 152.

[134] Enonchong, *The Independence Principle of Letters of Credits*, at 170.

unconscionability"[135] and further emphasises that "[t]he uncertainty that this creates is obvious".[136] Other scholars such as Horowitz and Ganotaki have also agreed that unconscionability is an uncertain concept,[137] with Enchonong chiming in with this view by stating that unconscionability is an "imprecise and vague ground for relief".[138]

Infusing uncertainty in the form of an unconscionability exception into an area of law in which certainty is crucial is considered to pose a threat to the attractiveness of documentary credits. It is also argued that such uncertainty will have the likely effect of causing a spike in litigation and contractual disputes, which in turn would detract from the unique value and quality of documentary credits.[139]

The ascension of unconscionability into the arena of recognised exceptions to the autonomy principle of demand guarantees is considered a development that would undermine the well-established autonomy principle.[140] Due to its somewhat nebulous nature, unconscionability is averred to be a concept that, if recognised as an exception to the autonomy principle, would go beyond the fraud test and entail more analysis of extraneous factors such as an underlying contract or the conduct of the beneficiary.[141] On this basis, some commentators have advanced the argument that uncertainty is, in any event, an inherent element of commerce.[142] While this is acknowledged to hold some truth, it does not debunk the valid point that introducing unconscionability and the uncertainty which plagues it as an exception to the autonomy principle would likely detract from the commercial utility and reliability of demand guarantees.

4.2.5.3 Potential Proliferation of Litigation and Injunctions

The recognition of an unconscionability exception to the autonomy principle is also discouraged due to apprehension that it will cause a proliferation of litigation due to parties seeking such

[135] Hooley, R & Sealy L *Commercial Law: Text, Cases, and Materials*, 4 ed, Oxford University Press, 2009, at 867.

[136] Ibid.

[137] See Ganotaki, A "Unconscionability and Bank Guarantees" (2004), *LMCLQ* 148, at 152 and Horowitz, *Letters of Credit and Demand Guarantees*, at 142.

[138] Enonchong, *The Problem of Abusive Calls on Demand Guarantees,* at 105.

[139] Horowitz, *Letters of Credit and Demand Guarantees*, at 169.

[140] Ibid.

[141] Horowitz, *Letters of Credit and Demand Guarantees*, at 132.

[142] Alavi, *Comparative Study of Unconscionability Exception*, at 115.

certainty from the courts on a case-by-case basis.[143] However, applying an unconscionability exception within very strict parameters has been argued to offer sufficient mitigation against unlimited litigation. In the case of *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd,*[144] a plaintiff seeking an injunction was required to have the balance of convenience in his favour and have a cause of action against the defendant. This was argued to counterweigh fears of a proliferation of litigation on the basis that the requirements for injunctions to be granted would remain quite stringent even in relation to unconscionability.[145]

4.2.5.4 Entanglement of Issuers/Guarantors in Underlying or Other Contractual Disputes

The prospect of banks (issuers/guarantors) becoming entangled in contractual disputes outside of the documentary credit is also considered a militating factor against recognition of an unconscionability exception to the autonomy principle.[146] A demand guarantee by design envisages payment of monies owing thereunder, notwithstanding any disputes, which aspect is a key part of their core purpose and utility.[147] Any scenario requiring issuers to untangle themselves from extraneous disputes in relation to demand guarantees would be an affront to the cash-equivalent status of demand guarantees. Some scholars have acknowledged the contention that the same argument could be raised in respect of the well-established fraud exception, which may be grounds for an injunction pending settlement of outstanding disputes between parties to a documentary credit arrangement.[148]

4.2.5.5 Injunctions Against Receipt of Payment

In scenarios where an injunction is sought after a beneficiary has already made a compliant demand, albeit wrongful (e.g., fraudulent or unconscionable) demand and triggered the autonomy principle mechanism by which they are entitled to payment, it is submitted that an injunction can be sought to prevent receipt of payment.[149] In lieu of an unconscionability exception, such an

[143] Ibid.

[144] *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* (1999*)* 2 Lloyd's Rep 187.

[145] Alavi, *Comparative Study of Unconscionability Exception*, at 116.

[146] Idem, at 116-117.

[147] Idem at 117.

[148] Ibid.

[149] This option is considered in Ndekugri, I "Performance Bonds and Guarantees: Construction Owners and Professionals Beware" (1999), Vol 125(6), *Journal of Construction Engineering and Management*,

injunction would presumably be effective in preventing the beneficiary from accepting receipt and utilising or enjoying the proceeds received from payment pursuant to an unconscionable demand. From this perspective, introducing a standalone unconscionability exception would be unjustified given the availability of another means to remedy the relevant mischief, especially noting that such means would not interfere with the autonomy principle. As the position of English courts in respect of this approach is uncertain,[150] such an approach is arguably more palatable on the basis that it somewhat steers clear of the autonomy principle. However, seeking a *mareva* injunction may be the best course of action once the funds are in the hands of the beneficiary.[151]

4.2.6 Unconscionability as a Potential Exception to the Autonomy Principle under English Case Law

4.2.6.1 Early Cases Supporting/Introducing Unconscionability or Accepting Only Fraud as an Exception

4.2.6.1.1 Earliest Cases

A few early cases have supported the recognition of unconscionability as an exception to the autonomy principle. Unconscionable contracts have come before courts under English law as early as the 1697 case of *Earl of Chesterfield v Janssen.*[152] In *Earl of Chesterfield,* the court alluded to the view that judicial interference with demand guarantees is acceptable under common law in respect of unequitable and unconscientious bargains and/or where it is apparent that a bargain is one which no person in their right senses and in the absence of delusion would enter into.[153]

In the 1966 case of *Elian and Rabbath v Matsas and Matsas,*[154]unconscionability was not pronounced on directly but was arguably alluded to with reference to bad faith. In the context of documentary credits, the Court of Appeal in *Elian and Rabbath* in the context of documentary

November/December, 428, at 433, although it is acknowledged therein that the stance of the English courts was difficult to ascertain due to the lack of definitive English law cases in this regard.

[150] Ndekugri, I "Performance Bonds and Guarantees: Construction Owners and Professionals Beware" (1999), Vol 125(6), *Journal of Construction Engineering and Management*, November/December, 428, at 433.

[151] The use of the *Mareva* injunction in the context of demand guarantees from an English law perspective is discussed in section 4.1.3.2 of this chapter.

[152] *Earl of Chesterfield v Janssen* (1750) 28 ER 82 Ch.

[153] Idem, at 100.

[154] *Elian and Rabbath v Matsas and Matsas* [1966] 2 Lloyd's Rep 495.

credits, held that in certain circumstances the bad faith of a party might warrant a court making inroads on the autonomy principle to prevent "irrevocable injustice"[155]by issuing an injunction to prevent it.

4.2.6.1.2 RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd

The case of *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd*[156] is quite seminal to the consideration of exceptions to the autonomy principle under English law. It illustrates the early attitude of English courts to the autonomy principle, being a strong inclination towards the retention of fraud as the only exception and the subsequent progressive shift towards acceptance of other exceptions. The decision of Kerr J in *RD Harbottle* holds sway under English law and has been referenced and invoked in a number of subsequent cases. In this case, a supplier of goods agreed to issue a demand guarantee for 5 per cent of the amount of its obligations, subject to the buyers procuring issuance of letters of credit for payment to the supplier for the goods. Upon failure by the buyers to, in turn, procure issuance of the letters of credit, the supplier stopped shipment of the relevant goods and sought an injunction to, *inter alia*, restrain payment by the relevant bank and to prevent buyers from obtaining payment under the demand guarantee. Kerr J dismissed the application for the injunction, noting that court interference with irrevocable payment obligations under such instruments was rare, as they were the "lifeblood of international commerce".[157]

4.2.6.1.3 Edward Owen Engineering Ltd v Barclays Bank International

Another case which is notable for its depiction of English courts' reluctance to entertain allegations of any exception to the autonomy principle other than the fraud exception is *Edward Owen Engineering Ltd v Barclays Bank International.*[158] The case of *Edward Owen Engineering* concerned a performance bond relating to a contract for the supply and installation of glass houses for a state enterprise in Libya, provided by the supplier in favour of the buyer. The supplier's bank arranged for a Libyan bank to issue a performance guarantee against a counter-guarantee issued by the supplier's bank. Similarly to the facts in the *Harbottle* case, the buyer was obliged to procure the issuance of a letter of credit for payment of the purchase price but failed to do so. The supplier

[155] Ibid.

[156] *RD Harbottle (Mercantile) Ltd v Nat'l Westminster Bank Ltd* [1977] 2 All ER 862.

[157] Idem, at 870.

[158] [1978] 1 All ER 976.

considered this failure a rescission of the agreement by the buyer and did not supply the glass houses to the buyer. The buyer proceeded to make a call on the performance guarantee. The supplier obtained an interim injunction preventing payment under the performance guarantee, but this interim injunction was subsequently discharged by Kerr J. The plaintiffs appealed against this decision, which was the matter before the court of appeal. Lord Denning in the Court of Appeal found that demand guarantees, though a "new creature",[159] were similar to letters of credit and the issuing bank was required to pay "on demand without proof or conditions"[160] and not to embroil itself in any underlying contract dispute. Judge Lane, MR concurred with this analysis, finding that bank guarantees were tantamount to promissory notes that are payable on demand.[161] Only fraud was considered to be a potential exception in this regard.

Despite its seeming receptiveness to the fraud exception, English law, as depicted in cases such as *Harbottle* and *Edward Owen,* has traditionally adopted the traditional non-interventionist approach to the autonomy principle of demand guarantees, barring instances where the fraud exception is established to be applicable. English law has been criticised for its ultra-conservative approach of not wanting to interfere with the autonomy principle by default. It has been averred that English law does not offer sufficient protection to bona fide parties to transactions against unscrupulous beneficiaries[162] and that adopting such a strict approach even regarding the fraud exception defeats the purpose of the fraud exception.[163] Some commentators have gone as far as asserting that the fraud exception is merely a theoretical concept under English law, as opposed to being applied in practice.[164]

[159] Idem, at 981.

[160] Idem, at 986.

[161] Ibid.

[162] See Demir-Araz, Y "International Trade, Maritime Fraud and Documentary Credits" (2002), 8(4), *Int T L R,* 128 (hereinafter, "Demir-Araz, *International Trade, Maritime Fraud and Documentary Credits*"), at 134; Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 85; Murray, D "Letters of Credit and Forged and Altered Documents: Some Deterrent Suggestions" (1993), 98, *Com LJ,* 504, at 515; and Pugh-Thomas, A "Can a Buyer Bypass the Guarantor and Stop the Seller from Demanding Payment from the Guarantor?" (1996), 7(4), *ICCLR,* 149, at 149.

[163] Low, HY "Confusion and Difficulties Surrounding the Fraud Rule in Letters of Credit: An English Perspective" (2011), 17(6), *Int JLM,* 462 at 462.

[164] Demir-Araz, *International Trade, Maritime Fraud and Documentary Credits,* at 134.

4.2.6.2 Later Cases Alluding/Accepting Possible Other Exceptions

4.2.6.2.1 Potton Homes Ltd v Coleman Contractors (Oversea) Ltd

In the Court of Appeal case of *Potton Homes Ltd v Coleman Contractors (Oversea) Ltd,*[165] Eveleigh LJ opened up English law to the possibility of other exceptions to the autonomy principle by acknowledging that it could not be said that fraud was the only scenario in which a court would restrain a beneficiary from calling up and enjoying the proceeds of a performance bond.[166] Some considered this openness to additional exceptions to the autonomy principle to create a conducive environment for progressive development and recognition of the unconscionability exception under English law. A number of scholars, however, remained less optimistic. O'Driscoll is one such scholar and asserted that English courts remained staunch in recognising only fraud as an exception to the autonomy principle of demand guarantees.[167]

4.2.6.2.2 TTI Team Telecom International Limited v Hutchison 3G UK Limited

A seminal case as far as an unconscionability exception to the autonomy principle under English law is concerned is *TTI Team Telecom International Limited v Hutchison 3G UK Limited.*[168] In *TTI,*[169] the seller (applicant) agreed to supply computer software and hardware to a buyer (beneficiary). The buyer made an advance payment defraying a portion of the purchase price in return for the seller procuring the issuance of a demand guarantee for the repayment of the funds paid in advance if the seller defaulted on its obligation in respect of the transaction. A dispute later arose in relation to delays by the seller in honouring the sale agreement, leading to the buyer giving notice of its intention to call up the demand guarantee. The seller sought an injunction to prevent the buyer from calling up and receiving payment under the advance payment bond.[170]

The court in *TTI* found, per its interpretation, that English law permitted restraint of a beneficiary for, *inter alia*, "a breach of faith by the beneficiary in threatening a call [on the advance payment

[165] (1985) 28 BLR 19.

[166] Idem, at 28.

[167] See O'Driscoll, *Performance Bonds, Bankers' Guarantees, and the Mareva Injunction*, at 395-396 and *Dodsal PVT Ltd v Kingpull Ltd* CA July 1, 1985 and *Esal (Commodities) Ltd v Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546, as cited therein.

[168] [2003] 1 All ER 914.

[169] Ibid.

[170] [2003] 1 All ER 914, para 5.

bond]."[171] Expanding upon its rationale, the court noted that a breach of faith as contemplated in such circumstances included "a threatened call by the beneficiary for an unconscionable ulterior motive".[172] The injunction sought in *TTI* was, however, ultimately denied for lack of sufficient evidence on the facts of the case.[173] The court in *TTI* appeared to view the *Potton Homes* case as the originator of the concept of unconscionability under English law.[174] The court in *TTI* also pointed to the recognition of the unconscionability exception in Singapore to support the view that overriding the autonomy principle under English law could be justified in certain circumstances.

Although the injunction in *TTI* was not granted, the case was seminal due to remarks regarding the unconscionability exception, which are relevant to considering its potential recognition under English law.

In this regard, Thornton J held that apart from the well-established fraud exception, payment under a demand guarantee could be restrained where there is:

> "a failure by the beneficiary to provide an essential element of the underlying contract on which the bond depends; a misuse by the beneficiary of the guarantee by failing to act in accordance with the purpose for which it was given; a total failure of consideration in the underlying contract; a threatened call by the beneficiary for an unconscionable ulterior motive; or a lack of an honest or bona fide belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond had been provided, actually exist".[175]

It could be argued that the recognition of notions of fairness and equity, largely considered to be synonymous or inextricably tied to good faith and bad faith in cases such as *TTI,* also propelled unconscionability further into the spotlight of the debate regarding its recognition as an exception to the autonomy principle. The *TTI* case is considered particularly important for going a step further by explicitly highlighting that good faith had long been considered a basis upon which a beneficiary could be restrained from calling a demand guarantee.[176] In this regard, it was also

[171] Idem, para 46.

[172] Ibid.

[173] [2003] 1 All ER (Comm) 914, para 34.

[174] Idem, para 41.

[175] [2003] 1 All ER (Comm) 914, para 46. Also see also *Potton Homes Ltd v Coleman Contractors (Oversea) Ltd* (1985) 28 BLR 19*;* and Ellinger, P and Neo, D *The Law and Practice of Documentary Letters of Credit*, 1 ed, Hart Publishing, 2010, at 324.

[176] [2003] 1 All ER 914, para 34.

proposed in *TTI*, with reference to the case of *HLC Engenharia e Gestao de Projectos SA v ABN AMRO Bank Ltd*,[177] that a "bad faith" exception to the autonomy principle be established.[178] Moreover, this is depicted in the following statement by Thornton J in *TTI*:

> "Only if the issuer is about to make payment to the beneficiary in circumstances where fraud, dishonesty or bad faith in relation to the demand is shown to exist or where the original issue of the documentary credit was procured by fraud or, possibly, where the underlying transaction was itself procured by fraud will a court intervene to restrain payment by the issuer to a beneficiary."[179]

Thornton J went on to declare that a "lack of good faith has for a long time provided a basis to restrain a beneficiary from calling a bond or guarantee."[180]

The reference by Thornton J to "bad faith" as a potential ground upon which an injunction could be granted to prevent payment under a documentary credit appeared to favour the recognition of a new/standalone bad faith exception to the autonomy principle. [181] It is thus possible to argue that the *TTI* case was a clear recognition of an exception to the autonomy principle based on equitable grounds, noting that bad faith is generally considered to fall within the ambit of unconscionable conduct.

TTI does not seem to have had a convincing impact in favour of the unconscionability exception for some commentators, however, and is said to have fallen short of creating a clear basis for the incorporation of unconscionability as an exception to the autonomy principle under English law.[182] The *dicta* from the *TTI* case can be criticised for a lack of sufficient clarity, and some commentators have not placed much significance on such cases as *TTI* on the basis that they do not establish any significant move towards the recognition of unconscionability as an exception.[183] Horowitz, for instance, maintains that despite these *dicta*, the unconscionability exception to the autonomy

[177] [2005] EWHC 2074 (TCC).

[178] 2005 EWHC 2074 (TCC), paras 33-34.

[179] [2003] 1 All ER 914, para 31.

[180] Idem, para 34.

[181] Ibid. See also *HLC Engenharia e Gestao de Projectos SA v ABN AMRO Bank Ltd* 2005 EWHC 2074 (TCC), para 33.

[182] Johns and Blodgett, *Fairness at the Expense of Commercial Certainty*, at 328.

[183] Horowitz, *Letters of Credit and Demand Guarantees*, at 129-130

principle is still not recognised under English law.[184] Horowitz has also considered an infringement of the autonomy principle as another factor militating against recognition of the unconscionability exception.[185]

The apparent assessment by scholars such as Horowitz that the *TTI* case did not sufficiently cement a significant change regarding the unconscionability exception[186] does seem to be a fair assessment. These references to equitable principles and bad faith in *TTI* are insufficient in themselves to evidence recognition of unconscionability as an exception to the autonomy principle under English law. The references to bad faith in *TTI* indeed contributed little by way of certainty regarding the English law stance on unconscionability as an exception to the autonomy principle. It is perhaps for this reason that the consensus appears to be that the doctrine of unconscionability is not a recognised exception to the autonomy principle under English law.[187]

Further depicting the prevailing rejection of recognition of unconscionability as a separate standalone ground for injunctive relief in relation to documentary credits, scholars such as Enonchong, like Horowitz, have advanced compelling grounds for such rejection.[188] Enonchong has raised three solid arguments in this regard.[189] Firstly, Enonchong argues that readily available injunctive relief in the form of an unconscionability exception would destroy confidence in demand guarantees, particularly their cash equivalence, which would also detract from their commercial utility.[190] Enonchong's second contention against the recognition of unconscionability exception is that it may result in courts becoming embroiled in underlying transaction disputes that should instead be considered as part of separate proceedings.[191] A similar rationale, being that overriding the autonomy principle with the unconscionability exception would entail direct reference to the underlying transaction, was echoed by Horowitz against the unconscionability

[184] Ibid.

[185] Horowitz, *Letters of Credit and Demand Guarantees*, at 169-171.

[186] Idem, at 129-130.

[187] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith,* at 34.

[188] See Kelry, CF "Two Decades of Restraining Unconscionable Calls and Performance Guarantees from Royal Design TJBE Properties" (2011), 23, *SACLJ*, 504, at 508-514 for a more comprehensive analysis of Enonchong's objections against recognition of the unconscionability as an additional exception to the autonomy principle.

[189] Ibid.

[190] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 104.

[191] Idem, at 105

exception.[192] The third ground upon which Enonchong has objected to recognising unconscionability as an exception to the autonomy principle is that unconscionability is too vague and uncertain a concept. This is seen as a flaw which would infuse an undesirable degree of uncertainty into the commercial arena.[193]

4.2.6.3 More Recent Case Law Alluding to/Accepting Possible Other Exceptions

4.2.6.3.1 National Infrastructure Development Co Ltd v Banco Santander SA

The more recent case of *National Infrastructure Development Co Ltd v Banco Santander SA*[194] seems to support the recognition of the unconscionability exception with more clarity than the *TTI* case. In *National Infrastructure Development*, Knowles J remarked that:

> "the law should develop to recognise a different approach to standby letters of credit used to settle performance obligations from the approach to letters of credit used to settle primary payment obligations. It is argued that such a development in the law is especially suited to the construction industry context and where parties to the contract in dispute were already in arbitration. The effect would, it is suggested, be to admit an exception for unconscionable conduct alongside the existing, recognised, fraud exception… ultimately what weighs with me particularly heavily is that this is a context in which if I postpone I positively undermine the element of time that was an important part of this type of transaction."[195]

The *National Infrastructure* case offers more explicit support for the unconscionability exception to the autonomy principle of demand guarantees. Despite this, English law does not appear to have taken decisive steps heralding full recognition of unconscionability as an exception to the autonomy principle.

4.2.6.4 The Distinction Between Restraining a Beneficiary from Claiming and Restraining a Guarantor from Paying

The assertion of scholars such as Horowitz that unconscionability is not recognised as an exception to the autonomy principle places staunch emphasis on the sanctity of the autonomy principle that one cannot disagree with. Horowitz argues that English cases in which unconscionability was

[192] Horowitz, *Letters of Credit and Demand Guarantees*, at 139.

[193] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 102 and 105.

[194] [2017] EWCA Civ 27.

[195] Idem, para 26-27.

considered did not intend for it to trump the autonomy principle. Horowitz contends that several English cases that considered unconscionability markedly took the approach of considering restraining a beneficiary from making a demand instead of seeking to restrain a guarantor from making payment to honour the demand.[196] This argument is compelling because of its emphasis on the difference between restraining a beneficiary from calling upon a demand guarantee versus preventing a guarantor from making payment to honour a valid claim under a demand guarantee.

Horowitz argues that the majority of English cases which explored the possibility of a standalone unconscionability exception to the autonomy principle contemplated restraining the beneficiary from making a demand under a demand guarantee, as opposed to preventing a guarantor from honouring the demand.[197] In a similar vein as Horowitz, Marxen seems convinced that the references to unconscionability or notions thereof in various English cases have little, if anything, to do with the autonomy principle. Instead, unconscionability in such cases is argued to be considered in the context of the relationship between the parties to the underlying contract (i.e., the beneficiary's conduct) and to have no bearing on the autonomy principle.[198]

4.2.7 Conclusion: The Position of Unconscionability under English Law

The absence of an unequivocal position established by English courts in respect of unconscionability as an exception to the autonomy principle appears indicative of a reluctance to accept it into the fold of traditionally recognised exceptions.[199] Such a lack of clarity is exemplified by the case of *Earl of Chesterfield,* which referenced unconscionability but did not foray any further to address questions such as its role in relation to documentary credits and the autonomy principle. Enonchong also describes the approach of English courts in relation to the unconscionability exception to the autonomy principle as a "hands-off" approach.[200]

The position can be summed up as being that there was never any general consensus from courts, scholars and relevant industry participants and commentators to recognise unconscionability as an exception to the autonomy principle or confer it a similar status as that of the well-recognised fraud exception under English law. Notwithstanding the allusion to, and sometimes express reference to

[196] Horowitz, *Letters of Credit and Demand Guarantees*, at 169-172.

[197] Ibid.

[198] Marxen, *Demand Guarantees in the Construction Industry*, at 179.

[199] Hooley, R and Sealy, L *Commercial Law: Text, Cases, and Materials*, Oxford University Press, 4 ed, 2009, at 867.

[200] Enonchong, *The Independence Principle of Letters of Credit*, at 180.

recognition of unconscionability as an exception to the autonomy principle or ground for an injunction restraining payment under a documentary credit, as depicted in the above-mentioned cases, the position of unconscionability is far removed from unequivocal certainty, such as that enjoyed by the fraud exception.

Despite the English courts' clear leaning towards not recognising the unconscionability exception, it has remained a floating question raised and alluded to in a number of cases but never answered absolutely. This jurisprudential indecisiveness is perhaps the key contributor to the uncertainty regarding the English law position. Some of the English cases considered above may lend themselves to the interpretation that English law is slowly but inexorably inching towards acceptance of the unconscionability exception to the autonomy principle. However, the continued reticence of the courts as to whether unconscionability can attain full recognition like the fraud exception has meant that unconscionability remains far from an established exception to the autonomy principle under English law and thus far from at par with the fraud exception.[201]

It is acknowledged that though there may be some public policy reasons for the recognition of unconscionability as an exception to the autonomy principle, there are also cogent reasons against it.[202] Some scholars believe that the case against recognition of the unconscionability exception is much stronger than that advocating for recognition thereof.[203] Having arrived at the view perhaps that the disadvantages of adopting an unconscionability exception outweigh the advantages, English courts' reluctance to embrace it has been supported by some scholars as the correct approach.[204] The fact that several cases relating to documentary credit disputes came before English courts, but only a small number of cases mentioned or considered the possibility of unconscionability as an exception to the autonomy principle reflects the low appetite that English courts have for such an exception.[205]

[201] Alavi, *Comparative Study of Unconscionability Exception*, at 102.

[202] Idem, at 112-113.

[203] "[The] policy reasons against recognition of the exception outweigh the reasons in favour of recognition and, therefore, English law should not adopt the exception" (Enonchong, *The Independence Principle of Letters of Credits*, at 169).

[204] Alawamleh, *Documentary Credits and Independent Guarantees*, at 192-193.

[205] See, for example, *Enka Insaat Ve Sanayi AS v Banca Popolare Dell'Alto Adige SpA* [2009] CILL 2777 (first instance) and *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC).

4.3 BREACH OF A NEGATIVE STIPULATION

4.3.1 Introduction and Brief Rationale of Negative Stipulations in relation to Demand Guarantees

4.3.1.1 Conflicting Rights Arising in the Context of Breach of a Negative Stipulation

The breach of a negative stipulation exception pits two sets of conflicting rights against each other. On the one hand is the beneficiary's right to call up a demand guarantee free from interference or engagement with underlying contractual disputes, in line with the autonomy principle. On the other hand, is the applicant's contractual right under the underlying (or other) contract to restrain the beneficiary from making a demand in contravention of an agreed stipulation or stipulations under the contract. The exception thus begs the question of which of these rights ought to prevail over the other.

Some also refer to the breach of a negative stipulation exception as the underlying contract exception. As reiterated by Enonchong:

> "[s]uch an exception is called the underlying contract exception. However, such a nomenclature has been criticised as it does carry … certain risks such as the misconception that such an exception is a wide invitation to analyse and delve into the underlying contract in order to determine the rights of the parties in order to grant an injunction or not.[206] Accordingly, another name could be more appropriate".[207]

Moreover, it is submitted that referring to it as the underlying contract exception is inaccurately limiting as it implies that the terms giving rise to the exception are required to be couched in the underlying contract. While negative stipulations appear to be traditionally housed in an underlying contract,[208] English law appears to have made allowance for negative stipulations housed in separate agreements from the underlying contract.[209] This thesis will, except where a specific case

[206] Horowitz, *Letters of Credit and Demand Guarantees*, at 141.

[207] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 88, cited in Alawamleh, *Documentary Credits and Independent Guarantees*, at 193.

[208] It appears that for the most part, as shown for example in *TTI Team Telecom International v Hutchinson 3G* [2003] 1 All ER 914; *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC)*; MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC) and *Shapoorji Pallonji & Co v Yumn Ltd* 2021 EWHC 862 (Comm), matters related to the breach of a negative stipulation have been in respect of a negative stipulation in the underlying contract.

[209] See discussion in 4.3.8.2 below.

or context requires otherwise, refer to the breach of a negative stipulation or covenant, being the preferred terminology.

Some commentators have questioned whether the breach of a negative stipulation exception should only be accepted to prohibit a beneficiary from making an unjustified demand.[210] While the potential merits of such an approach are acknowledged, as will be considered further below, one must also question whether or not such a scenario even presents an exception to the autonomy principle at all or even has any bearing on it. The answer might be debatable. The interaction or lack thereof of the autonomy principle and the enforcement of a negative stipulation to prevent a beneficiary from making a demand in contravention of contractual obligations will be considered further in this chapter. The terminology in common use, which has also been adopted in this thesis for that reason, refers to a scenario where a beneficiary makes a demand despite being restricted from doing so by a clear contractual term either in the underlying contract or a separate contract (thus, in breach of a negative stipulation). As explained below, it is submitted that where such a stipulation is enforced against a beneficiary, there is no impact on the autonomy principle, thus obviating the need for an exception.

4.3.1.2 The Potential Overlap and Divergence of Fraud and Breach of a Negative Stipulation

The question of whether breach of a negative stipulation could be recognised as an exception to the autonomy principle was alluded to in *Themehelp Ltd v West and Others*,[211] but the court found it unnecessary to consider this matter further and declined to pronounce on it. In the case of *Themehelp,* an interlocutory injunction was granted against a beneficiary on the grounds of alleged fraud, but the appellate court went on to address the allegation that the beneficiary's claim had been in breach of the underlying contract. In this regard, Waite J stated:

> "I do not find it necessary to consider whether the principle extends beyond instances of fraud to cases where the beneficiary under the guarantee is alleged to be in non-fraudulent breach of the main contract".[212]

The court in *Potton Homes*, while acknowledging the potential relevance of the underlying contract, appeared to imply that a claim by a beneficiary which contravened the underlying

[210] See also Alavi, H "Contractual Restrictions on Right of Beneficiary to Draw on a Letter of Credit; Possible Exception to Principle of Autonomy" (2016), 16(2), ICLR, 67 (hereinafter, "Alavi, *Contractual Restrictions*"), at 74.

[211] [1995] 4 All ER 215.

[212] Idem, at 227.

contract was tantamount to fraud and could thus justify an injunction preventing a beneficiary from calling up a demand (performance) guarantee or dealing with the proceeds thereof.[213]

Fraud, being the most widely accepted exception to the autonomy principle, has been increasingly determined under English law by reference to the "no honest belief" criterion. This yardstick includes, in particular, scenarios where a beneficiary calls up a demand guarantee while lacking an honest belief of their entitlement to do so or to the proceeds thereof. An argument that can be advanced is that a beneficiary that knowingly makes a demand in breach of a binding negative stipulation has no honest belief of entitlement to make such a demand and would thus be caught within the scope of the fraud exception. While such an argument has been touched upon in the case of *Themehelp* and by implication in *Potton Homes*, this was not ruled upon conclusively.[214]

There may be circumstances where a breach of a negative stipulation could meet the requirements of the fraud exception, but it is submitted that the two are distinct grounds for interference with documentary credits and that there is an equally or perhaps more probable range of scenarios where a breach of a negative stimulation would not amount to fraud. If this was not the position and the breach of a negative stipulation was considered to fall squarely within the scope of the fraud exception, then there would likely be no discourse around breach of a negative stimulation as a potential exception to the autonomy principle in the industry. In other words, the existence of a robust school of thought[215] and a smorgasbord of English case law[216] considering the recognition of the breach of a negative stipulation as an exception to the autonomy principle or grounds to restrain a beneficiary from making a demand points to a legal *lacuna* not capable of being plugged by the fraud exception. This warrants recognition of a standalone breach of a negative stipulation exception to address the legal *lacuna* in which breach of a negative stipulation falling short of

[213] O'Driscoll, *Performance Bonds, Bankers' Guarantees, and the Mareva Injunction*, at 391-392.

[214] Idem, at 391-393 and Alavi, *Contractual Restrictions*, at 73 for a succinct outline of the conclusion in *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19 and *Themehelp Ltd v West and Others* [1995] 4 All ER 215, respectively.

[215] See for instance Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 515-542 regarding the position in England on breach of a negative stipulation and the autonomy principle and Alavi, *Contractual Restrictions*, at 67-86 regarding breach of a negative stipulation under English law.

[216] See, for example, *Potton Homes Ltd v Coleman Contractors Ltd (1984)* 28 BLR 19; *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd & Others* [2003] 1 WLR 2214; *TTI Team Telecom International v Hutchinson 3G* [2003] 1 All ER 914; *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC); *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC)*; MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC) and *Shapoorji Pallonji & Co v Yumn Ltd* 2021 EWHC 862 (Comm), which are discussed further below.

fraud sits.

Further support for the retention of a firm distinction between the fraud exception and the breach of a negative stipulation exception under English law can be drawn from the *Simon Carves* case. In *Simon Carves*, Akenhead J noted, *inter alia*, that while it was possible to get into an academic debate as to whether a breach of a negative covenant could reflect a type of fraud, it was not necessary to thrash this out. Akenhead J went on to state

> "… in my view it represents a second type of exception. [Where a beneficiary proceeds to make a demand in breach of an express term in a commercial contract, the] Court could properly restrain a beneficiary from doing either because it is committing a straight breach of contract or because it is or should be taken to be clear fraud by the beneficiary."[217]

Any perceived overlap between the "no honest belief" formulation of fraud and/or the fraud exception itself on the one hand, and the breach of a negative stipulation exception on the other has also been further dispelled, *inter alia*, by the distinction that when dealing with the former, courts are concerned with whether a beneficiary had or lacked an honest belief in their entitlement to make a claim, whereas, with the latter, the issue is whether a beneficiary's demand is in breach of the terms of the underlying or another contract.[218] Moreover, as will be explored further below, a key reason for the proposal to keep fraud and breach of a negative stipulation separate is the difference in the nature of the remedy that an aggrieved party can avail themselves of and the interaction of such remedy with the autonomy principle. The status of the breach of a negative stipulation exception as an exception to the autonomy principle in its own right under English law is undertaken below.

4.3.2 Rationale and Role of The Breach of a Negative Stipulation Exception

4.3.2.1 Rationale of Negative Stipulation Provisions from an Applicant's Perspective

Negative stipulations are employed in underlying contracts for a variety of reasons on the part of the applicant of demand guarantees. One common rationale that stands out in light of the nature of demand guarantees favouring beneficiaries is the need for a measure of protection or control to guard against abusive demands by beneficiaries.

The breach of a negative stipulation exception supports the premise that the vulnerability of a

[217] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC), para 34.

[218] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 527.

demand guarantee to fraudulent abuse is counterweighed by the freedom of parties to defend themselves contractually.[219] Such a defence on the part of applicants can take the form of positive or negative conditions or stipulations in an underlying contract which must be met prior to a demand guarantee being called up. It is on the basis of these stipulations, which dictate the parameters and align with the purpose of a demand guarantee that a court may restrain a beneficiary from making a demand in contravention of such stipulations, particularly where the circumstances required for a valid demand did not arise.[220] Negative stipulations thus provide some assurance to applicants that a demand guarantee will only be called up for the purpose of and in factual circumstances agreed upon between the applicant and the beneficiary. In other words, the applicant should be entitled to hold the beneficiary to what it agreed to in the relevant contract regarding the demand guarantee and the circumstances in which it can be called upon.

4.3.2.2 The Rationale of Negative Stipulation Provisions from a Beneficiary's Perspective

From a beneficiary's perspective, acquiescence to restrictive terms on an underlying or other contract may occur for a number of reasons. These include showing "good faith" to an applicant, avoiding the need to issue a counter-guarantee, or a protracted negotiation process with the applicant, culminating in the requirement for a beneficiary to provide a counter-guarantee.[221]

4.3.3 Arguments Against and In Favour of Recognising the Breach of a Negative Stipulation as an Exception to the Autonomy Principle

4.3.3.1 Arguments Against the Breach of a Negative Stipulation Exception

A criticism which has been lodged against recognition of the breach of a negative stipulation exception is that it renders the position of issuing banks/guarantors unclear, particularly in the context of the autonomy principle.[222] The autonomy principle envisages a detached guarantor who is concerned exclusively with the conformity of demand documents when determining whether to make payment under a demand guarantee. It is submitted that recognition of the breach of a negative stipulation exception would require guarantors to themselves descend into the arena of the dispute and investigate underlying (or perhaps other) contracts in order to reach a determination

[219] Todd, P *Maritime Fraud and Piracy*, 2 ed, Lloyd's List, 2010, at 129.

[220] Bradgate, R, White, F & Fennell, S *Commercial Law*, 9 ed, Oxford University Press, 2002, at 276.

[221] See Alavi, *Contractual Restrictions on Right of Beneficiary to Draw*, at 72.

[222] Idem, 85.

on whether to make payment under the demand guarantee.

In addition to the postulation that it will cause uncertainty for guarantors as outlined above, the breach of a negative stipulation exception has been criticised that recognising it would be adverse to the commercial utility of demand guarantees by creating uncertainty in this area.[223] While the perspective that the breach of a negative stipulation exception diminishes the cash equivalence and commercial utility of documentary credits is conceded to have some truth, a corollary that has been pointed out is that this is at the parties' election.[224] The circumstances giving rise to this, being the negative stipulation(s), can thus be argued to exist by agreement of the parties involved, i.e., the applicant and, more importantly, the beneficiary, being the potentially prejudiced party.

4.3.3.2 Arguments In Favour of and Counterarguments Against Criticism of Breach of a Negative Stipulation Exception

A number of points have been argued in favour of recognising the breach of negative stipulation as an exception to the autonomy principle generally and under English law. One such point simply put is that the autonomy principle cannot be blindly applied, particularly in "the very special case"[225] where a beneficiary has expressly agreed not to draw down on the letter of credit unless certain conditions are met.[226] It has been argued that one cannot forget that underlying contracts are the lynchpin which gives rise to the issuance of demand guarantees, and the latter cannot exist without the former.[227] Caution is also urged against casting aside the ordinary rules of the law of contract, which rules have facilitated the development of the breach of negative stipulation exception to the autonomy principle of demand guarantees.[228]

It has been opined that the breach of negative stipulation exception could actually contribute to the

[223] Enonchong, *The Problem of Abusive Calls on Demand Guarantees,* at 94-96.

[224] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 529. See also the Canadian case of *Veolia Water Technologies Inc v K+S Potash Canada General Partnership* 2019 SKCA 25, para 43, where Richards CJ noted he was unable " to see the logic in permitting a beneficiary to clearly agree to the conditions on which it can have resort to a bond and to then allow the beneficiary to immediately allow the beneficiary to immediately avoid those same conditions by invoking the autonomy principle".

[225] See *Sirius Insurance Co v FAI General Ltd* [2003] 1 WLR 2214, para 9.

[226] Ibid.

[227] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 1333.

[228] Idem, at 88.

commercial utility of demand guarantees by making them less vulnerable to abuse.[229] In support of this perspective, it is submitted that recognition of the breach of a negative stipulation exception may also serve as a means of curtailing the rather scourge of abusive calls on demand guarantees, particularly where a beneficiary agreed to a negative stipulation and then seeks to circumvent restrictive terms they agreed to. Given the arguable susceptibility of demand guarantees to abusive calls, the breach of negative stipulation exception is seen as a way in which an applicant can protect themselves. An abusive call may have a serious negative impact on an applicant's solvency and reputation.

In line with the principle of freedom of contract between commercial parties and the manipulation of demand guarantees by beneficiaries to escape their contractual obligations must not be condoned. Enonchong has quite correctly stated that a beneficiary should not, "be allowed to hide behind the independence principle in order to break his promise in the underlying contract".[230]

The criticisms that the breach of negative stipulation exception would cause uncertainty regarding the role of guarantors and that it would breed uncertainty to the detriment of the commercial utility of demand guarantees[231]have not gone without challenge. Such criticisms have been challenged on the basis of assertions that they cannot withstand legal and commercial rights analysis.[232] It is argued that the role of guarantors need not be affected in any way by an investigation into the underlying contract, as such a task lies solely within the remit of the courts, leaving guarantors confined to their documentary analysis in line with the autonomy principle.[233] As the enforcement of a negative stipulation against a beneficiary does not require the guarantor to check if there is indeed such a stipulation and, if so, whether or not it has been breached, which is a matter for the courts to determine, where appropriate, the role and obligations of a guarantor with regard to a demand guarantee indeed seem to be unaffected.

Regarding the argument that the breach of negative stipulation exception would introduce an unacceptable level of uncertainty relating to its application,[234]a navigable compromise could be to

[229] Enonchong, *The Problem of Abusive Calls on Demand Guarantees,* at 94.

[230] Enonchong, *The Independence Principle of Letters of Credits*, at 224.

[231] See section 4.3.3 of this chapter above.

[232] Alawamleh, *Documentary Credits and Independent Guarantees,* at 199.

[233] Bridge, M, *Benjamin's Sale of Goods*, 8 ed, Sweet & Maxwell, 2010, at 23.

[234] See section 4.3.3 of this chapter above.

set clear parameters around the application of the exception. It can be argued that the available English case law relating to the breach of negative stipulation exception, such as the *Sirius* and *Simon Carves*[235] cases, have made some start towards introducing such parameters, for instance, by establishing a strong preference for express terms as opposed to implied ones in relation to the breach of negative stipulation exception claims, which approach has some scholarly support.[236] This view is supported, *inter alia*, by Horowitz, who advances the argument that "[t]he other reason for which the 'exception' should be welcomed is that it may be limited to cases in which only an express restriction is involved".[237] Whilst the need to temper uncertainty and apply breach of a negative stipulation exception within the ambit of clear measured rules holds appeal, an interesting divergence between Horowitz's proposal and the approach adopted by English courts relates to the status of implied negative stipulations. As will be discussed further below with reference to the cases examined, the possibility of implied negative stipulations being sufficient to give rise to an injunction against a beneficiary for breach of a negative stipulation has been recognised by English courts and even passed in some cases where such a scenario arose.[238]

A marked distinction is drawn between restraining a beneficiary from calling up a demand guarantee merely because there is a dispute between the beneficiary and the underlying principle versus where such a beneficiary has expressly undertaken not to call up the demand guarantee unless certain conditions are fulfilled.[239] In the latter case, it is submitted that all a court would have to establish would be whether there is a condition for calling up a demand guarantee in the underlying contract which has not materialised or been fulfilled.[240] This distinction is important in discussing the breach of a negative stipulation exception, particularly because the sanctity of the autonomy principle and application of the underlying contract is somewhat more nuanced.

It is not suggested that an underlying contract dispute is a justifiable reason to interfere with the autonomy principle and the beneficiary's right to receive payment. In fact, the autonomy principle is unchallenged when it comes to the position that a guarantor must honour their obligation to pay on receipt of a compliant demand under a demand guarantee without regard to any disputes

[235] *Simon Carves Ltd v Ensus UK Ltd* [2011] CILL 3009 at 3012.

[236] Alawamleh, *Documentary Credits and Independent Guarantees,* at 200.

[237] Horowitz, *Letters of Credit and Demand Guarantees,* at 142.

[238] See in particular sections 4.3.7 of this chapter. See also 3.3.8.3.

[239] Alawamleh, *Documentary Credits and Independent Guarantees*, at 201.

[240] Enonchong, *The Independence Principle of Letters of Credits*, at 224.

between the beneficiary and the applicant whether under the underlying contract or otherwise. However, where a beneficiary has bound themselves contractually not to call up a demand guarantee except upon the occurrence of a certain event or fulfilment of a condition, the situation is rightly different. It, therefore, follows from the above that the enforcement of such a contractual obligation need not and does not have any bearing on the autonomy principle, particularly where it is launched against the beneficiary and not the guarantor.

4.3.4 Recognition of Breach of Negative Stipulation as an Exception under English Law

English law seems to have certainly developed in favour of recognising the breach of negative stipulation in the context of demand guarantees as a ground for issuing an injunction against the beneficiary.[241] What is less clearly agreed upon is whether it should be treated as an exception to the autonomy principle, but there are growing calls for English law to clarify that enjoining a beneficiary from breaching a negative stipulation is not, in fact, an exception to the autonomy principle.[242] This is a view that is agreed with in this thesis, as discussed further below in this section. This seeming indecisiveness is evident in the absence of either an unequivocal rejection or endorsement of breach of a negative stipulation as a ground for injunctive relief in relation to documentary credits.[243]

The lack of clarity in the English position can be traced to early English case law. In *RD Harbottle (Mercantile) v National Westminster* Bank,[244] the court skirted around the possibility of granting an injunction restraining a beneficiary from making a demand in contravention of their contractual obligations under the underlying contract. Kerr J noted that the "the plaintiffs may well be right in contending that the buyers have no contractual right to payment of any part, let alone the whole, of the guarantee… But all these issues turn on contractual disputes".[245] However, in this case, the final injunction was not granted, with the court noting that in the absence of fraud, it would not interfere, and parties would instead be allowed to settle their disputes via litigation or arbitration as applicable.[246]

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[241] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 542.

[242] Ibid. See Alavi, *Contractual Restrictions*, at 82.

[243] Alavi, *Contractual Restrictions*, at 72.

[244] [1977] 2 All ER 862.

[245] Idem, at 870.

[246] Idem, at 863.

4.3.5 Early English Law Cases relevant to Breach of a Negative Stipulation Exception

Under English law, the legal basis for granting an injunction on the grounds of a negative covenant was explored in cases such as the early case of *Doherty v Allman.*[247] In *Doherty*, the court considered the existence of a negative covenant of a beneficiary in a contract as a ground for enjoining the beneficiary.

In *Doherty*, the following analysis and unequivocal conclusion was arrived at by Lord Cairns:

> "if there had been a negative covenant, I apprehend, according to well-settled practice, a Court would have had no discretion to exercise. If parties, for valuable consideration, with their eyes open, contract that a particular thing shall not be done, all that a Court has to do is to say, by way of injunction, that which the parties have already said by way of covenant, that the thing shall not be done; and in such case the injunction does nothing more than give the sanction of the process of the Court to that which already is the contract between the parties. It is not then a question of the balance of convenience or inconvenience, or of the amount of damage or of injury— it is the specific performance, by the Court, of that negative bargain which the parties have made, with their eyes open, between themselves".[248]

In a later case, *Howe Richardson Scale Ltd v Polimex-Cekop and National Westminster Bank Ltd*,[249] an injunction was sought to prevent a beneficiary from calling up an advance payment guarantee issued in relation to a contract for the delivery of equipment. Roskill J found that issuers of demand guarantees were,

> "in a position not identical but very similar to the position of a bank which has opened a confirmed irrevocable letter of credit. . . the bank here is simply concerned to see whether the event has happened upon which its obligation to pay has arisen."[250]

The *Howe Richardson* case is considered to have diverged from the tenets of the autonomy principle by acknowledging that guarantors could be concerned with the trigger event or

[247] (1877-78) LR 3 App Case 709. See also the earlier *Lumley v Wagner* (1852) 1 De, GM & G 604.

[248] See *Doherty v Allman* [1878] 3 App Cas 709, at 719-720. See also Fayers' response to this in Fayers, R "The Jurisprudential Principle Underlying Preclusion Derives from Equity" (2021), 25(7), *Documentary Credit World*,8, at 8-9.

[249] [1978] 1 Lloyd's Rep 161.

[250] Idem, at 165.

underlying contract performance.[251]

4.3.6 Later English Law Cases relevant to Breach of a Negative Stipulation Exception

4.3.6.1 Potton Homes Ltd v Coleman Contractors Ltd

4.3.6.1.1 General Summary

In *Potton Homes Ltd v Coleman Contractors Ltd* ("Potton Homes")[252] the seller (applicant), an English company, issued two performance bonds in relation to two contracts for the building and supply to Libya of prefabricated building units to the buyer (beneficiary). A dispute arose regarding alleged defects in the building units supplied and money owed, resulting in the buyer (beneficiary) calling up the performance bonds. With reference to the buyer's failure to make certain payments in accordance with the terms of the underlying contract, the seller sought payment of monies due under the underlying contract, together with an injunction prohibiting the buyer from obtaining payment under the performance bond. The seller obtained an interim injunction blocking the beneficiary from calling up the performance bonds.

The recognition of the underlying contract being potentially relevant in the *Potton Homes* case is a marked departure from the traditional view that the underlying contract and any related disputes thereunder and a demand guarantee or other documentary credit are completely separate and have no correlation whatsoever, regardless of any disputes between parties. Categorically debunking the traditional view, Eveleigh, LJ in *Potton Homes* held that:

> "As between buyer and seller the underlying contract cannot be disregarded so readily. If the seller has lawfully avoided the contract prima facie, it seems to me he should be entitled to restrain the buyer from making use of the performance bond. Moreover, in principle I do not think it possible to say that in no circumstances whatsoever, apart from fraud, will the court restrain the buyer. ... If the contract is avoided or if there is a failure of consideration between buyer and seller for which the seller undertook to procure the issue of the performance bond, I do not see why, as between the seller and buyer, the seller should not be unable to prevent a call upon the bond by the mere assertion that the bond is to be treated as cash in hand."[253]

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[251] Kozolchyk, B "Bank Guarantees and Letters of Credit: Time for a Return to the Fold" (1989), 11(1), *University of Pennsylvania Journal of International Law*, at 51.

[252] (1985) 28 BLR 19.

[253] Idem, at 28.

In addition, considering the relationship between an underlying contract and a performance bond, Eveleigh, L.J. in *Potton Homes* stated:

> "[w]hile from the point of view of the bank the underlying contract is irrelevant and the bank's contract with the seller is independent of it, non-the-less as between buyer and seller the underlying contract may not be irrelevant."[254]

4.3.6.1.2 Decision and Summary of Position Established

The *Potton Homes* case is considered to have contributed significantly to the emergence of the breach of a negative stipulation exception in English law jurisprudence.[255] In particular, Everleigh LJ's observation that there could be some circumstances other than fraud where a beneficiary could be restrained from making a demand opened up the door to considering other potential exceptions.[256] The case stopped short of explicitly establishing a specific additional exception to the autonomy principle of demand guarantees in addition to fraud. However, its importance lies in the fact that it opened the door to the possible recognition of additional exceptions to the autonomy principle or grounds for an injunction preventing a beneficiary from calling up a demand guarantee other than fraud.[257]

4.3.6.2 Sirius International Insurance Co (Publ) v FAI General Insurance Ltd and Others

4.3.6.2.1 General Summary

Breach of a negative stipulation was also considered in the context of the autonomy principle in the case of *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd and Others* ("Sirius"),[258] although this case was strictly speaking not an injunction case to prevent a demand or payment as the standby letter of credit had already been called up and the amount drawn down and deposited into an escrow account. In *Sirius*, an express negative stipulation was observed to be uncommon and "a variant of the more typical [case]"[259] but was recognised as a basis upon

[254] Idem, at 26.

[255] See O'Driscoll, *Performance Bonds, Bankers' Guarantees, and the Mareva Injunction*, at 391-393.

[256] *Potton Homes Ltd v Coleman Contractors Ltd* (1985) 28 BLR 19, at 26.

[257] See O'Driscoll, *Performance Bonds, Bankers' Guarantees, and the Mareva Injunction*, at 391-393.

[258] [2003] 1 WLR 87 (first instance); [2003] 1 WLR 2214 (CA) and [2005] 1 All ER 191 (HL).

[259] *Sirius International Insurance Company (Publ) v FAI General Insurance Ltd* & Ors [2003] 1 WLR 2214, paras 27 and 30.

which an injunction enforcing the negative stipulation against the beneficiary could be granted.[260] With reference to the case of *Doherty v Allman*, the Court of Appeal found that restrictions could be placed on a beneficiary's right to call up a documentary credit on the basis of a negative covenant by such beneficiary in an underlying contract.[261]

Interestingly, the court in *Sirius* also opined that an express negative stipulation in an underlying contract that restricted a beneficiary's rights to call on a standby letter of credit made it "less than equivalent of cash".[262] Some commentators have followed this train of thinking by conceding that express and irrevocable consent by a beneficiary not to draw on a documentary credit until certain conditions are met renders the documentary credit itself (and its cash equivalence) conditional and subject to fulfilment of the stipulated conditions.[263]

On appeal, May LJ, with Carnwath LJ and Wall LJ concurring, supported the court *a quo's* stance that if the case had been an injunction one, then an injunction should have been granted to prevent the beneficiary in that case from calling up the demand guarantee in breach of the terms of its agreement with the applicant.[264] In this regard, the court declared:

> "Whilst the principle of autonomy which applied to letters of credit was of vital importance, there was no reason why the law should not give effect to an express agreement that a party would not draw down a letter of credit unless certain conditions were met".[265]

The court in *Sirius* discouraged exaggeration of the importance of the autonomy principle, particularly where a beneficiary had explicitly agreed in an underlying contract with the applicant not to call on the demand guarantee unless certain conditions had been satisfied and the conditions had not been met. In this regard, May LJ stated:

> "There is no authority extending this autonomy of documentary credit for the benefit of the beneficiary of letter of credit so as to entitle him as against the [applicant] to draw the letter of

[260] Idem, para 27.

[261] See *Sirius Insurance Co v FAI General Insurance Ltd* [2003] 1 WLR 2214, para 29.

[262] Ibid.

[263] Alavi, *Contractual Restrictions*, at 83.

[264] [2003] 1 WLR 2214, para 27.

[265] Idem, para 28.

credit when he is expressly not entitled to do so".[266]

Although on initial appeal, it had been decided in *Sirius* that an injunction could be granted to restrain the beneficiary from making a demand for payment in breach of the terms of the underlying contract,[267] this was reversed for that particular case by the House of Lords who found (consistent with the court *a quo*) that the beneficiary was entitled to claim as the relevant conditions in the underlying contract had been satisfied.[268] The House of Lords ruled that the underlying contract conditions had been satisfied, and the Court of Appeal decision was upturned.[269]

4.3.6.2.2 Decision and Summary of Position Established

Sirius is notable for its thought leadership in considering the breach of a negative stipulation exception to the autonomy principle. The court in *Sirius* certainly appeared amenable to accepting a breach of a negative stipulation exception in the sense that a beneficiary may be enjoined from making a demand under a demand guarantee in breach of the contractual terms binding upon them.[270]

4.3.6.3 TTI v Hutchison 3G UK Ltd

4.3.6.3.1 General Summary

In *TTI v Hutchison 3G UK Ltd* ("TTI"),[271] an applicant sought to restrain a beneficiary from calling up or receiving payment under a demand guarantee on, *inter alia*, the basis of a breach of the terms of an underlying contract relating to when a demand could be made under the relevant demand guarantee.

The underlying contract in question expressly provided that payment could only be claimed if the contract was terminated in accordance with clause 35 thereof. As is typical for instruments of that nature, the demand guarantee itself contained no restrictions on the beneficiary's right to make a demand for payment. A dispute subsequently arose between the parties, amidst which the

[266] *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd & Others* [2003] 1 WLR 2214, para 26.

[267] *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd & Others* [2003] 1 WLR 87 (first instance) and [2003] 1 WLR 2214 (CA).

[268] *Sirius International Insurance Company (Publ) (Appellants) v FAI General Insurance* [2004] UKHL 54, para 12.

[269] [2004] UKHL 54; [2004] 1 WLR 3251.

[270] Alawamleh, *Documentary Credits and Independent Guarantees*, at 196.

[271] [2003] EWHC 762 (TCC).

beneficiary notified the applicant of its intention to call up the demand guarantee on the basis of an allegation that the underlying contract had been terminated in accordance with the relevant clause 35. The applicant, however, retaliated by seeking an injunction to restrain the beneficiary from calling up the demand guarantee, with the applicant alleging that the beneficiary had itself breached clause 35. Judge Thornton QC, appearing open to the notion of an injunction on the basis of a breach of a negative stipulation exception, acknowledged that an injunction could be granted by a court where a demand was made in breach of the terms of an underlying contract.[272]

4.3.6.3.2 Decision and Summary of Position Established

Upon consideration of the facts and allegations, the court found that the beneficiary's demand was in accordance with clause 35 and denied the injunction. Commentators on the *TTI* case have, however, expressed confidence that had the court found that there had been a breach of the underlying contract, in that case, it would have ruled differently, which would likely have resulted in an injunction being granted preventing the beneficiary from calling up the demand guarantee.[273] Therefore, this case is largely considered to be important for its support of recognising the breach of a negative stipulation exception.

Another case notable for following in the footsteps of the *Sirius* case is *Permasteelisa Japan KK v Bouvguesstroi and Banca Intesa SpA*. [274]In *Permasteelisa*, a continuation was sought on an injunction which had been granted on an interim basis to prevent the beneficiary, a contractor, from calling on a bond because certain conditions precedent to the calling up of the bond had not been satisfied.[275] The case of *Sirius* was invoked, with Ramsey J reiterating the position established in *Sirius*, being, firstly, that an injunction could be granted against the beneficiary where there is an express term restricting the circumstances in which the beneficiary can call up the bond.[276] Secondly, Ramsey J endorsed the requirement in *Sirius* that an injunction may be granted only where it is positively established that the beneficiary is not entitled to call up the bond, as opposed to there being merely a seriously arguable case to that effect.[277] Having measured the facts of the

[272] Idem, para 46.

[273] Enonchong, *The Independence Principle of Letters of Credits*, at 212.

[274] 2007 EWHC 3508 (TCC).

[275] *TTI v Hutchison 3G UK Ltd* [2003] EWHC 762 (TCC), paras 11, 29, 50 and 52.

[276] Idem, paras 52-52.

[277] Ibid.

case against the requirements as set out in *Sirius*, Ramsey J in *Permasteelisa* concluded, *inter alia*, that only a seriously arguable case was present in this case, which was insufficient to justify continuations of the injunctions and also the balance of convenience was not in favour of the applicant. On the basis of these, among other factors, Ramsey J declined to continue the injunctions and discharged the interim injunctions.

4.3.7 More Recent English Law Cases Relevant to Breach of a Negative Stipulation Exception

4.3.7.1 Simon Carves Ltd v Ensus UK Ltd

4.3.7.1.1 General Summary

A more recent English case, *Simon Carves Ltd v Ensus UK Ltd* ("Simon Carves"),[278] involved a contract for the provision of a process plant to produce bioethanol by the applicant. The applicant furnished a demand guarantee as security for the performance of its obligations under the contract.[279] Clause 3.7 of the contract stipulated that the demand guarantee would be rendered null and void if an "acceptance certificate" was issued by the beneficiary in relation to the work of the applicant. The beneficiary issued the relevant certificate. A dispute subsequently arose between the parties, at which point the beneficiary sought recourse from the demand guarantee. The applicant then approached the court for an injunction to restrain the beneficiary from calling up the demand guarantee. A core question requiring the court's answer was whether it could grant an injunction restraining the beneficiary from calling up the demand guarantee on the basis that such a call constituted a breach of the terms of the underlying contract.

Ackenhead J, although acknowledging the scarcity of jurisprudence in this area of English law, invoked the case of *Sirius* as an authority in this regard.[280] The injunction was granted on the basis of the determination that there was a breach of a restrictive stipulation in the underlying contract, which was contravened by the beneficiary seeking to call up the demand guarantee.

4.3.7.1.2 Decision and Summary of Position Established

With its decision, the court in the *Simon Carves* case realised the application of the law in a manner

[278] [2011] EWHC 657 (TCC).

[279] Idem, para 5.

[280] [2011] EWHC 657 (TCC), paras 29-35.

which had been confined to a mere hypothesis in the case of *Sirius* due to the absence of a suitable set of facts.[281] To this end, Akenhead J boldly pronounced:

> "In my judgement one can draw from the authorities the following: (a)…fraud is not the only ground upon which a call on the bond can be restrained by injunction…; (c) There is no legal authority which permits the beneficiary to make a call on the bond when it is expressly disentitled from doing so; (d) In principle, if the underlying contract, in relation to which the bond has been provided by way of security, clearly and expressly prevents the beneficiary party to the contract from making a demand under the bond, it can be restrained by the Court from making a demand under the bond".[282]

The finding of the court in *Simon Carves* that "fraud is not the only ground upon which a call on a bond can be restrained by injunction"[283] is reminiscent of a similar position supported in *Potton Homes*. This lends support to the position that a court can restrain a beneficiary from calling up a demand guarantee where the underlying contract clearly and expressly restricts the beneficiary from making such a claim.

The *Simon Carves* case is essential to the arsenal of tools supporting the issuance of an injunction restraining a beneficiary from making a demand in breach of an underlying (or arguably any other) contract.[284] The position depicted in *Simon Carves* was adopted in the subsequent cases of *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada*[285] *and MW High Tech Projects UK Limited v Biffa Waste Services Ltd*[286] discussed next.

4.3.7.2 Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada

4.3.7.2.1 General Summary

In *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* ("Doosan"),[287] Doosan (the supplier and applicant) had provided two boilers to the purchaser

[281] Idem, para 28.

[282] Idem, para 33.

[283] Ibid.

[284] See the brief discussion regarding the location of a negative stipulation 4.3.8.2 of this chapter.

[285] 2013 EWHC 3201 (TCC).

[286] 2015 EWHC 949 (TCC).

[287] 2013 EWHC 3201 (TCC).

(beneficiary) for the operation of a power plant. The beneficiary was provided with a performance guarantee in respect of each of the boilers. Upon the occurrence of a dispute, the applicant successfully sought an interim injunction blocking the beneficiary from calling up the performance guarantees, which the beneficiary then sought to have discharged by the court. The applicant argued that the beneficiary's failure to issue taking-over certificates upon taking the boilers into use, which it was obliged to do in terms of the underlying contract, was a breach of contract and disentitled the beneficiary from calling up the demand guarantees. The applicant's contention was that this case fell into the category of cases "where the parties have agreed expressly that the beneficiary's entitlement to make a demand on the guarantee was either qualified or would be extinguished if certain events occurred".[288] The applicant further submitted that to be successful, they only needed to show that they had a realistic prospect of proving that the beneficiary was not entitled to call up a demand guarantee.[289] It was noted that *Simon Carves* is a definite example of such a case.

The beneficiary argued for discharge of the interim injunction on the basis that the applicant had misconstrued the supply contract. In addition to distinguishing the facts of the *Doosan* case and *Simon Carves*, the beneficiary highlighted that there was also a critical distinction between a situation where a party has expressly agreed to have its right to call on the bond restrained and where the court would have to determine underlying contract disputes to assess whether a claim is justified.[290] Additionally, the beneficiary argued that in the absence of a clear case of fraud, the court should refuse to restrain the beneficiary from making a call on the bond in the same way it should refuse to restrain a bank from making a payment in response to a call.[291]

In considering the arguments before it, the court found the approach taken in *Simon Carves* to have been concerned with whether there had been a breach of the underlying contract and to be virtually indistinguishable from the *Doosan* case.[292] Edwards-Stuart, J concluded that,

[288] Idem, para 31.

[289] Idem, para 31.

[290] Idem, para 33.

[291] Idem, para 33.

[292] 2013 EWHC 3201 (TCC), para 35.

> "I accept that this decision has extended the law, but in my view it has done so adopting a principled and incremental approach that does not undermine the general principles applicable to interim injunctions to restrain a party making a call on a bond"[293]

and granted the interim relief sought by continuing the injunction and refusing to discharge it.[294]

The court's decision was based, *inter alia*, on the rationale that a strong case that the beneficiary's failure to issue the taking-over certificates was a breach of contract, and further that the beneficiary sought to take advantage of its breach of contract to derive a benefit in the form of continuing the performance guarantees.[295] Moreover, the applicant was assessed to have a realistic prospect of establishing that the beneficiary's refusal to issue the taking-over certificates on the ground alleged by the beneficiary was not a bona fide position.[296]

4.3.7.2.2 Decision and Summary of Position Established

An important element of the *Doosan* case is that it added to and reinforced the body of authority in firm support of a breach of a negative stipulation exception under English law. Furthermore, it provided insight into the English law approach regarding granting an injunction restraining a beneficiary from calling up a demand guarantee on the basis of an implied negative stipulation. In *Doosan*, the underlying contract did not contain express qualifications on the beneficiary's entitlement to call on the demand guarantees. Therefore, the court's rationale in Doosan can be construed as tantamount to the imposition of an implied restriction by reference to, *inter alia*, the general rule that one should not benefit from one's own wrongdoing.

4.3.7.3 MW High Tech Projects UK Limited v Biffa Waste Services Ltd

4.3.7.3.1 General Summary

Another fairly recent noteworthy case regarding the breach of a negative stipulation is *MW High Tech Projects UK Limited v Biffa Waste Services Ltd.*[297]

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[293] Idem, para 36.

[294] Idem, para 36 and 41.

[295] Idem, para 41.

[296] Idem, para 42.

[297] 2015 EWHC 949 (TCC). See also *J Murphy & Sons Ltd v Beckton Energy Ltd* [2016] EWHC 607 (TCC) in which the court, although ultimately not granting an injunction on the facts of the case, supported established principles that in certain circumstances a call on a demand guarantee could be prevented on the basis that it is a clear breach of the underlying contract.

In *MW High Tech*, the West Sussex County Council and Biffa Waste Services entered a contract for waste management and disposal. Pursuant to the contract, a waste treatment plant was required to be constructed. Contemporaneously, Biffa Waste Services (the beneficiary) entered into a contract with MW High Tech Projects UK (the applicant) for, *inter alia*, the design and construction of the testing plant (the "EPC Contract"). The applicant was required under the EPC contract to provide a retention bond. A condition precedent on calling up the retention bond contained in clause 43.6 of the EPC contract included *inter alia* that,

> "[i]t shall be a condition precedent to the Employer's right to make a call upon either the Performance Bond or the Retention Bond that the Employer has first called upon the Parent Company Guarantee…in respect of the same matter."[298]

Upon a delay of the works, the beneficiary sought to terminate the EPC Contract due to the passing of a long stop date and to recover liquidated damages amounts alleged to be due on account of the delays under the provisions of the contract. This was stymied by notice provisions of the EPC contract, which were argued to render the demand invalid for being served post-termination of the EPC contract. The beneficiary sought to satisfy the condition precedent in accordance with the provisions of the EPC contract by making a demand for the liquidated damages under the parent company guarantee. It then proceeded to make a demand under the retention bond. The applicant challenged the demand on the basis that the condition precedent envisaged a "valid" demand being made to the company, which requirement was allegedly not met.

The Technology and Construction Court, in considering the matter before it, noted the English law position to be that the non-interventionist rule of the courts applied in two instances: where obvious fraud is established or where the beneficiary is precluded from making calling up a demand guarantee under the terms of the underlying contract. This was succinctly put as follows:

> "the only established exceptions to the rule that the Court will not intervene should be where there is a seriously arguable case of fraud, or it has been clearly established that the beneficiary is precluded from making a call by the terms of the contract."[299]

The court highlighted that where a beneficiary is precluded under the underlying contract from calling up a demand guarantee, the default principle is that the preclusion must be in the express terms of the underlying contract. The court, however, also went on to state that there was no reason

[298] *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC), para 6.

[299] Idem, para 34.

why an implied term in a contract could not suffice for the same purpose, noting that what was important was the clarity of the preclusion rather than whether it is in express or implied form.[300]

Regarding the standard required to be met to establish sufficient grounds for an injunction, the court in *MW High Tech* categorically determined that merely having a seriously arguable case that a beneficiary was not entitled to call up a demand guarantee was insufficient. Instead, it was held that one must positively establish that the beneficiary was not entitled to call up a demand guarantee for an injunction to be justified. The court boldly declared that any subsequent decisions deviating from this standard should not be followed.

In response to the applicant's argument that the condition precedent envisaged a "valid" demand, the court expressed the view that the applicant was attempting to extend circumstances justifying an injunction beyond those where there are specific restrictions on the beneficiary's entitlement to claim, to scenarios where a call by a beneficiary is merely shown to have been without sufficient contractual grounds.[301] It was also noted that the applicant sought to imply a qualification into the EPC contract requiring any demands made under the retention bonds to be valid or have an adequate contractual basis.

The *MW High Tech* case is also seminal for providing what can be termed a sample illustration in vivid detail of the challenges to be faced where one seeks to establish a breach of a negative stipulation on the basis of implied terms. It appears that courts have a low appetite for it. In addition, and as noted by the court in *MW High Tech*, the usual tests for the implication of terms under English law, including certainty of scope and necessity of the implication to make the contract work, would need to be satisfied. In *MW High Tech*, these tests were found not to be satisfied.[302] Coulson J stated:

> "Even if the call in this case could be described as 'ill founded', there is no suggestion that it was fraudulent, and there is nothing new or remarkable in calls on guarantees being controversial, objectionable, or misconceived … [, and] imposing any further qualification on the requirement that there be a call on the Parent Company Guarantee … would encourage protracted satellite litigation at short notice to try and establish whether or not the call on the Parent Company Guarantee was not merely controversial, but misconceived …. The notion that there should be a

[300] Idem, para 34.

[301] With reference to cases such as *Sirius International Insurance Company v FAI General Insurance Ltd* [2003] EWCA Civ 470, from which that approach had seemingly found support, the court directly disapproved of it.

[302] See *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC), para 37.

preliminary dispute about whether the underlying demand is justifiable goes directly against the normal approach to on-demand bonds: pay now, argue later."

4.3.7.3.2 Decision and Summary of Position Established

In *MW High Tech*, the Technology and Construction Court expressly noted that recent cases such as *Simon Carves* and *Doosan* had sought to broaden the scope for challenging calls under on-demand securities should not be followed. Moreover, the more accommodating approach adopted in *Doosan* towards implied restrictions was rejected in *MW High Tech*. The court articulated its preferred stance to be that unless it is clear from the relevant contract that a restriction on calling up a demand guarantee was intended by the parties, intervention with demand guarantees is only acceptable where the fraud exception is established to apply. The *MW High Tech* case also made a significant contribution to the body of English law dealing with implied negative stipulations in the context of demand guarantees, as it is considered a case that considered whether an implied term precluded a beneficiary from calling up the bond in question.[303]

It was made clear in *MW High Tech* that an express preclusion is the first preference for courts to consider restraining a beneficiary from making a demand by injunction. The court, however, made it clear that the doors of judicial consideration were not closed to implied terms, subject to the proviso that any terms precluding the beneficiary from making a demand, whether express or implied, must be clear. These measured remarks in respect of implied terms can be seen as still reflecting a preference in the first instance for express preclusions as opposed to implied negative stipulations under English law, especially because it would be manifestly more difficult to evidence the existence of a clear negative stipulation which is implied, compared to an express negative stipulation.

Certain requirements expected to be satisfied to justify implying a term into a contract under English law further complicate matters. Kelly-Louw and Fayers have noted the now-settled position that implying a term into a contract is not part of the process of construction or interpretation of a contract but comes subsequent to this and is determined as a discrete additional aspect.[304] One of the significantly high hurdles to be cleared where a court is to imply a term into a contract that was not successfully cleared in the *MW High Tech* case includes that the implication

[303] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 521.

[304] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 521, citing *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* 2015 UKSC 72 and *Duval v 11-13 Randall Crescent* 2020 UKSC 18.

must be necessary for the contract to work. Kelly-Louw and Fayers aptly and succinctly summarise the position regarding some of the requirements for implied terms as follows:

> "[The court] cannot do so simply because such a term is thought to be fair, or because it considers the parties would have agreed to the term had it been suggested to them. It is because implication is so potentially intrusive that the law imposes stringent conditions, the most important of which are that the additional term is necessary in order to make the contract work and that it must not contradict any express term in the contract."[305]

While *MW High Tech* is consistent with established principles in a broad sense, being that fraud and a clear negative covenant restricting a beneficiary's ability to make a demand are the recognised grounds for court interference with demand guarantees, it sought to distinguish itself from certain previous cases by reference to the standards required to be met in this regard. The *MW High Tech* case seems to be an indictment on previous cases such as *Simon Carves* and *Doosan* referred to therein as examples, that a broader approach than the traditional approach had been accepted to interfere with demand guarantees and the autonomy principle. A particularly significant element of *MW High Tech* is that it halted the perceived creep that earlier cases had started towards broader standards for justifying anti-beneficiary injunctions and reinstated the traditional approach in respect thereof.

4.3.7.4 Shapoorji Pallonji and Company Private Ltd v Yumn Ltd

4.3.7.4.1 General Summary

A further recent and noteworthy case depicting the acceptance of an anti-beneficiary injunction as a remedy against an unjustified demand by English courts is *Shapoorji Pallonji and Company Private Ltd v Yumn Ltd* ("Shapoorji").[306] In *Shapoorji,* it was held that the courts had the power to issue an injunction compelling the beneficiary to withdraw or revoke a demand that the beneficiary had already made.[307] This is all the more pertinent in view of the fact that an applicant is not always given or entitled to prior notice before a beneficiary makes a demand and, therefore, would miss the opportunity to block it in such circumstances. Also, even where

[305] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 522-523.

[306] 2021 EWHC 862 (Comm).

[307] Idem, para 24.

prior notice is provided, an applicant is sometimes unable to take action in time to prevent the demand from being made by the beneficiary.

4.3.7.4.2 Decision and Summary of Position Established

This case seems to support the distinction between the approach of restraining a beneficiary from making a demand and that of restraining a guarantor from making payment. In particular, the fact that the latter interferes with the autonomy principle is underscored by the different attitudes of the courts to the two approaches. In *Shapoorji*, a performance bond had been issued in respect of the completion of a power plant in Rwanda, in respect of which a claim arose to cover liquidated damages due to delays in completing the power plant. An injunction to restrain payment to honour a demand that had been made under a performance bond was sought.

Given the option between restraining a beneficiary or a guarantor where an unjustified demand has already been made, it appears from cases such as *Shapoorji* that courts are firmly disinclined to interfere with the guarantor and/or their payment obligation. Courts are seemingly more likely to enjoin the beneficiary from making a demand in breach of contract and, where such demand has already been made, as confirmed in *Shapoorji*, to go as far as issuing, instead, an injunction compelling a beneficiary to revoke their demand. It is submitted that the courts' marked lack of appetite for interference with the guarantor and/or their payment obligation is based on the correct understanding that it would breach the autonomy principle.

Shapoorji is a case which is noteworthy because, *inter alia*, it provides alternative recourse to applicants where a beneficiary has already made a demand as they can technically not be restrained from doing something they have already done. In reaching a conclusion on the matter, Pelling QC appears to have deliberately refrained from referencing or endorsing the *Simon Carves* and *Doosan* cases and instead invoked the *MW High Tech* case, which espoused higher standards to be met in order for an injunction to be issued blocking a beneficiary's ability to claim. Following this approach, Pelling QC concluded that for an injunction to be granted, it had to be established to an "enhanced merits" standard that contractual conditions to calling up a bond, whether express or implied, had not been satisfied. The presence of potential challenges of seeking to rely on implied terms given the high levels of certainty required to justify an injunction was, however, still reiterated.[308]

The "enhanced merits" standard articulated by Pelling QC in *Shapoorji* seems to suggest a

[308] Idem, para 21.

similarly high bar as Stuart-Smith J's requirement to "positively establish" a breach of a negative covenant in *MW High Tech*. The case of *Shapoorji*, in addition to rebuffing *Simon Carves* and *Doosan* and seemingly endorsing *MW High Tech*, also reiterated that showing on a balance of probabilities that a beneficiary was precluded from making a demand was an insufficient standard. The enhanced evidential standard pursuant to which breach of negative stipulation must be positively established was held in *Shapoorji* to be the prevailing test.[309]

4.3.8 The Scope and Parameters of the Breach of Negative Stipulation Exception Established by Case Law

4.3.8.1 Distinction between Restraining a Beneficiary from Making a Demand and Restraining a Guarantor from Making Payment and their Effect on the Autonomy Principle

It is worth noting that there is a school of thought which dismisses the distinction between seeking an injunction against a bank (guarantor or issuer) and seeking one against a beneficiary in the context of their effect on demand guarantees. Articulating such a view, Staughton LJ in *Group Josi Re (formerly known as Group Josi Reassurance SA) v Walbrook Insurance Co Ltd and Others*[310] stated that:

> "[I]t is argued . . . that the case is altogether different, and the rule [relating to the issuance of injunctions against guarantors/issuing banks] . . . does not apply when an injunction is sought not against the bank but against the beneficiary of a letter of credit. In my opinion that cannot be right. The effect on the lifeblood of commerce will be precisely the same whether the bank is restrained from paying or the beneficiary is restrained from asking for payment."[311]

It is respectfully submitted that this broad-brush approach misses the nuance in the distinction between restraining a beneficiary from making a demand and restraining a guarantor from making payment. One can, in principle, agree with it only in the sense that restraining a beneficiary from claiming and preventing a guarantor from paying have one thing in common. They both lead to the same ultimate result, being non-receipt of funds by the beneficiary, albeit in the former scenario due to non-entitlement to make a demand or enforcement of a negative covenant, and in the latter due to non-payment of funds by the guarantor to the beneficiary in compliance with a court injunction. As enjoining a beneficiary from breach of a negative stipulation has no interaction with

[309] Idem para 21, 23 and 33.

[310] [1996] 1 All ER 791.

[311] Idem, at 801.

and is thus not an exception to the autonomy principle, it is only in this sense that restraining a beneficiary from demanding and restraining a guarantor from paying can be broadly labelled to be "exceptions" in the traditional sense, e.g., similar to the fraud exception.[312]

With regard to restraining a beneficiary from making a demand, the exception is only in the sense that it ultimately results in a derogation from the usual unfettered entitlement of a beneficiary to make a demand and trigger a payment obligation under a demand guarantee. In the case of restraining a guarantor from making payment, a true exception to the autonomy principle is applied. Some scholars have suggested that the perception of the breach of a negative stipulation as a further type of exception should be dispensed with altogether, favouring viewing it as a "distinct type of case which calls for resolution by injunction".[313] Others, like Horowitz, have offered the alternative term along the lines "restricted rights principle" to elucidate the fact that the enforcement of a breach of negative stipulation is not an exception to the autonomy principle.[314]

A further explanation of this distinction which has been highlighted, is that the autonomy principle is confined to the bank and its obligation to pay, and, therefore, a negative covenant relates only to the beneficiary.[315] This view is supported by the *Tetronics* case, where it was stated,

> "The autonomy principle is that the obligation of the bank – the bank itself – is autonomous from the parties' contractual relations between one another. In *Sirius*, the beneficiary sought to put itself in a similar position to the bank itself, and take advantage of that principle. It was not permitted to do so… [The beneficiary] does not stand generally in the position of the bank… The bank is entitled to take advantage of the autonomy principle … [whereas the beneficiary] cannot avail itself of the autonomy principle."[316]

Despite the contrary opinion expressed in *Group Josi*, it is submitted, in light of the above analysis, that there is a significant difference between restraining a beneficiary from making a claim and restraining a guarantor from making payment under a demand guarantee in relation to the

[312] See also Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526-529 for a comprehensive discussion of the autonomy principle in preclusion [of beneficiaries from making a demand in breach of a negative stipulation binding upon them] and fraud cases.

[313] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526.

[314] Horowitz, *Letters of Credit and Demand Guarantees: Defences to Payment*, at 142.

[315] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 527.

[316] *Tetronics (International) Ltd v HSBC Bank Plc* [2018] EWHC 201 (TCC), paras 31, 32 and 34.

autonomy principle. A key parameter which appears to be applied by English courts in respect of breach of a negative stipulation is that it can be a basis for preventing a beneficiary from making a demand, as opposed to preventing a bank from making due payment under a demand guarantee or other documentary credit.[317] The parameter appears to acknowledge that preventing a beneficiary from making a demand on a demand guarantee in contravention of a negative stipulation that they agreed to does not violate the autonomy principle. Rather it arguably achieves the desired effect within the operational parameters and boundaries of the autonomy principle.

Seeking to apply enforcement of a negative stipulation against payment by a bank of a compliant claim made under a demand guarantee would, unlike doing so against a beneficiary, have the effect of interfering with the autonomy principle. It is submitted that such a scenario is what can accurately be considered to fall within the realm of a potential exception to the autonomy principle. From the analysis of English law in this study, it appears that as against a guarantor, recourse cannot be had to a negative exception limiting a beneficiary's entitlement to call up a demand guarantee. This approach is clearly evident in the case of *Simon Carves,* where the court acknowledged the existence of other grounds on which a demand guarantee could be restrained by injunctions. The court implied that the establishment of fraud remains a prerequisite where such an injunction is sought to prevent a guarantor from making payment pursuant to a valid demand. Akenhead J highlighted that a court would not prevent a guarantor from making payment to honour a demand that satisfies the demand guarantee's conditions unless fraud is established.[318] From a consideration of the English law and the cases sampled in this chapter, it can be firmly deducted that breach of a negative stipulation by a beneficiary is not available as a ground upon which a guarantor can be restrained from making payment where a compliant demand has been made under a demand guarantee.

Apart from the obvious interference with the autonomy principle that restricting a guarantor from honouring a compliant demand would give rise to, the non-availability of such recourse is also justified by the fact that such a guarantor would typically not be a party to, and thus not bound by any underlying or other contract between the applicant and the beneficiary. Only the beneficiary who is party to the relevant underlying contract would be bound by it. This is supported by the doctrine of privity of contract, pursuant to which "a contract cannot, as a general rule, confer rights

[317] Alavi, *Contractual Restrictions*, at 74.

[318] See *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC), paras 26-27.

or impose obligations arising under it on any person except the parties to it."[319]

Noting, *inter alia*, its non-interference with the autonomy principle, it seems that enforcement of the underlying contract has been unwaveringly adopted as a unique circumstance where the beneficiary (i.e., just the beneficiary, as opposed to a guarantor, for example) may be restrained by English courts issuing injunctions against the beneficiary to enforce a negative stipulation. This approach is discernible from the cases considered above. For example, in *Doherty*, the court underscored that issuing an injunction to prevent a party (in this case, the beneficiary) from conducting themselves in a way they had covenanted not to is simply the enforcement of performance of a bargain already agreed between the parties. In the context of demand guarantees, it is inconceivable due to the nature of demand guarantee arrangements that a guarantor would be a party to any contract which would fetter its obligation to pay upon receipt of a compliant demand. Such an agreement would compromise the character of the relevant instrument by bringing into question whether it is a demand guarantee at all. With this in mind, enforcement against a beneficiary, as opposed to a guarantor, is what is targeted by the vehement support for enforcement of a negative covenant in *Doherty*.

The injunction sought in *Howe Richardson* was also against the beneficiary, and the position of the bank was expressed to be clearly limited to whether the event had happened upon which its obligation to pay had arisen, which event would, in line with the nature of a demand guarantee, be a compliant demand. Moreover, the interim interdict in *Potton Homes* was to block the beneficiary from calling up the demand guarantee, as opposed to blocking payment by the guarantor/issuer. It appears to be a consistently overriding theme that the autonomy principle itself and the rule it enshrines, i.e., that a guarantor's payment obligation arises upon presentation of compliant documents and may only be blocked by the fraud exception.[320] In accordance with the case law examined, including recent cases such as *Doosan* and *MW High Tech*, it cannot be evaded by reference to extrinsic factors, including the underlying contract, and the position established seems to be that courts will only issue an injunction to prevent a beneficiary from breaching a negative stipulation and not, for instance, also a guarantor. Enforcement of a negative stipulation is thus between an applicant and a beneficiary and is not considered to have any bearing on the autonomy

[319] Treitel, GH *The Law of Contract*, 9 ed, Sweet and Maxwell, 1987, at 454 and Christie RH and Bradfield GB *Christie's The Law of Contract in South Africa*, Lexis Nexis, 2011, at 269.

[320] See for instance *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC), para 29-31 and *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC), paras 1 & 40. See also Horowitz, *Letters of Credit and Demand Guarantees*, at 145.

principle or payment obligation of the guarantor, which crystalises upon presentation of a compliant demand.

In *Simon Carves,* the court cited as authority the position that there was no legal basis permitting the beneficiary to call up a bond when the beneficiary is expressly disentitled from doing so.[321] This once again depicts that enforcement against the beneficiary, as opposed to the issuer or guarantor, is what is contemplated in the characterisation of the breach of a negative stipulation exception and which the English courts apply consistently. It is inconceivable for such an exception to be contemplated in relation to any other party in the context of a true demand guarantee.

It has been highlighted that the enforcement of a negative stipulation to prevent a beneficiary from calling up a demand guarantee in breach of contract terms does not involve or have any bearing on the guarantor or the autonomy principle.[322] Rather, it is noted that the discretion for intervention on the basis of the breach of a negative stipulation exception lies with the courts.[323] Such discretion can be applied within certain defining rules or parameters, such as enforcement against the beneficiary only so as not to interfere with the autonomy principle, an approach seemingly favoured in the case law discussed above. Other elements such as the standard of proof and balance of convenience test are discussed further below.[324]

In practical terms, however, and taking into account timing on a case-by-case basis, an injunction may be granted against a beneficiary after a guarantor has already made the payment to the beneficiary to honour the beneficiary's demand. In such cases, the alternative remedy would be the *Mareva* injunction.[325]

4.3.8.2 Acceptable Form of the Negative Stipulation: Express, Implied, in the Demand Guarantee Itself or in a Separate Agreement

From the case law considered above, for an injunction to be granted restricting a beneficiary from calling up a demand guarantee, English courts seem to have a pronounced preference for an

[321] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC), para 33.

[322] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 89.

[323] Ibid.

[324] See section 4.3.8.3 of this chapter.

[325] See section 4.1.3.2 of this chapter for a brief discussion of the *Mareva* injunction.

express contractual term to that effect at the very least as a standard requirement. Given the way in which demand guarantees are designed to work (i.e., ready recourse/access to funds according to the terms of the relevant demand guarantee), any conditionality upon the beneficiary's entitlement to make a demand must be explicit.[326] Implicit terms purported to restrict a beneficiary from making a claim under a demand guarantee are, therefore, less likely to succeed by a very significant margin compared to expressly stated restrictions.[327]

As for the location of the express restriction, this point does not seem to be belaboured by English courts, and it is submitted that this distinction need not be over-analysed as an express negative stipulation in an underlying contract would be no less binding than one in a separate contract altogether. While negative stipulations appear to be traditionally housed in an underlying contract,[328] cases such as *Sirius*, in which the alleged negative stipulation was contained in a side letter, show that English courts appear to have made allowance for negative stipulations housed in separate agreements from the underlying contract. While a separate contract may be arguably extrinsic to the demand guarantee arrangement to a larger degree than an underlying contract, this distinction seems to have little material consequence as far as the key parameters for a potential breach of a negative stipulation exception are concerned.

Turning back to the matter of express versus implied negative stipulations, in the case of *Deutsche Ruckversicherung Aktiengeslleschaft v Walbrook Insurance Co Ltd*,[329] the court considered it unacceptable to "imply a term into the underlying contract that the beneficiary will not draw on the letter of credit unless payment under the underlying contract is due".[330] In line with this stance, the breach of a negative stipulation exception is supported mainly in the context of an explicit stipulation rather than an implied one. It is worth noting also, as touched upon earlier, that scholars

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[326] Hugo, C "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal Relating to Demand Guarantees" (2014), 4, *TSAR*, 661 (hereinafter "Hugo, *Protecting the Lifeblood of Commerce*"), at 674.

[327] A similar view regarding the difficulties associated with implied negative stipulations is also echoed in the more recent cases of *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC) and *Shapoorji Pallonji & Co v Yumn Ltd* 2021 EWHC 862 (Comm). See also Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 521-523.

[328] It appears that for the most part, as shown for example in *TTI Team Telecom International v Hutchinson 3G* (2003) 1 All ER 914; *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC)*; MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC) and *Shapoorji Pallonji & Co v Yumn Ltd* 2021 EWHC 862 (Comm), matters related to the breach of a negative stipulation have been in respect of a negative stipulation in the underlying contract.

[329] [1995] IWLR 1017.

[330] Ibid, at 1030.

such as Horowitz, although supporting the enforcement of negative stipulations against beneficiaries, have expressed markedly low tolerance for implied negative stipulations.[331] Horowitz seems to contemplate the application of such an exception, specifically in circumstances where there is an explicit term in an underlying contract restricting the situations in which a demand guarantee could be called up for payment.[332]

In *Sirius*, despite it being noted as a "variant of more typical case",[333] the court was focused on an express negative stipulation. The court was unequivocal regarding its focus on express negative stipulations and not implied ones, stating that there was "no reason why the law should not give effect to an express agreement that a party would not draw down a letter of credit unless certain conditions were met".[334] This marked preference for express negative stipulation was also evident from the court's reference in *Sirius* to the express nature of the negative stipulation in question or express contractual restrictions in an agreement.[335] Other case law considered above, which supports recognition of a breach of a negative stipulating exception, is also sufficiently peppered with support for the requirement that a stipulation should be in express terms. For instance, in the *Doherty* case, heavy emphasis is made on a covenant/contract between the parties "with their eyes open". It may be surmised that perhaps an express contract is contemplated here as there is less room for the beneficiary to turnaround and dispute the existence of or their entry into the contract or negative stipulation, let alone with their eyes wide open.

Again, in *Sirius,* the court made clear its view of the enforcement of negative stipulations as against a beneficiary, stating that the autonomy principle did not extend "for the benefit of the beneficiary of letter of credit so as to entitle him as against the [applicant] to draw the letter of credit when he is expressly not entitled to do so".[336] In the cases of *TTI* and *Simon Carves,* the arguments for a breach of a negative stipulation exception hinged on an alleged express negative stipulation stated in a contract clause instead of an implied stipulation. The court was also categorically clear in *Simon Carves* that the application of the breach of a negative stipulation exception applied where

[331] Horowitz, *Letters of Credit and Demand Guarantees*, at 142.

[332] Ibid.

[333] *Sirius International Insurance Corp v FAI General Insurance Co Ltd* [2003] EWCA (Civ) 470, paras 27 and 30.

[334] *Sirius International Insurance Corp v FAI General Insurance Co Ltd* [2003] 1 WLR 87.

[335] Idem, para 28.

[336] *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd & Others* EWCA (Civ) 470, para 26.

a beneficiary was expressly disentitled from making a claim.[337] This view was encapsulated in the following assertion, which was considered in *Simon Carves* by Akenhead J:

> "whilst, as the Court of Appeal indicated in Sirius, a court might grant an injunction where there is an express term restricting the circumstances in which a party can draw on a letter of credit and where it is positively established that the party was not entitled to draw down, the same will not apply where there is only a serious, arguable case to that effect. Otherwise, the commercial effectiveness of letters of credit would be eroded".[338]

In more recent English case law, the position regarding express versus implied negative stipulations has also been reaffirmed. In *Doosan*, the court upheld the continuation of an injunction on the basis of an implied term as the relevant contract did not contain an express negative stipulation. This evidences the fact that implied negative stipulations are not completely cut off from the possibility of enforcement by courts. However, as supported by the majority of the English cases sampled in this thesis, including *MW High Tech and Shapoorji*, it is clear that express negative stipulations are favoured by English courts for their clarity over implied ones when considering whether an injunction can be granted against the beneficiary from making a demand under a demand guarantee which the beneficiary / is not entitled to make. As depicted by *Doosan* and made clear in *MW High Tech*, an implied negative stipulation can in principle be sufficient grounds for an injunction as an express negative stipulation, and it is not impossible for a beneficiary to be injuncted on the basis of an implied negative stipulation. It is, however, eminently more difficult to procure an injunction against a beneficiary on the basis of an implied negative stipulation.

The recognition of breach of a negative stipulation as a ground for an injunction preventing a beneficiary from calling up a demand guarantee under English law seems, for the most part, to require an express stipulation. An implied stipulation could make it infinitely more difficult to meet the requirement to establish that there truly is a binding negative stipulation that the beneficiary has breached. Therefore, implied terms are unlikely to be considered a valid ground for granting an injunction under English law, although they have not been dismissed outrightly.[339] The pronounced preference and endorsement of express negative stipulations under English law,

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[337] Idem, para 33.

[338] [2011] EWHC 657 (TCC), para 35, citing *Permasteelisa Japan KK v Buoyguesstroi and Banca Intesa Spa* [2007] EWHC 3508 (TCC).

[339] Enonchong, *The Independence Principle of Letters of Credits*, at 213.

while grudgingly refraining from excising the possibility of implied negative stipulations forming the basis of a breach of negative stipulations, seems to be in step with the dominant approach in South Africa.[340]

4.3.8.3 Standard of Proof Required for the Breach of a Negative Stipulation Exception and the Balance of Convenience

While English courts seem to have achieved a significant degree of consistency in churning out cases supporting the recognition of a breach of a negative stipulation exception, they have been less than consistent regarding the parameters or standard of proof required to justify injunctions in this regard. The standards for pre-trial judicial intervention with contractual relationships under English law were considered to be well captured in the case of *American Cyanamid Co v Ethicon Ltd*[341] which became so widely accepted a point of reference that the relevant principles were given the moniker "the Cyanamid guidelines".[342] These guidelines required, *inter alia*, that there must be the establishment of "a serious issue to be tried". A special dispensation within the guidelines was developed for demand guarantees following arguments that the "serious issue to be tried" standard was too low a threshold and, therefore, inappropriate, given the important commercial status and nature of such instruments.[343]

A later case touching upon the standard required by English courts in respect of a breach of a negative stipulation injunction against a beneficiary is *Ouais Group Engineering & Contracting v Saipem SPA & Ors*, in which it was stated that:[344]

> "the court must have a high degree of assurance that the beneficiary is not entitled to call on an on demand bond before it will, at an interlocutory stage, restrain payment of the bond. That follows from the very nature of an on demand bond, and the importance which such bonds have in international commerce."[345]

The requirement articulated in the case of *Ouais Group Engineering* and Contracting *v*

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[340] See the consideration of express versus implied negative stipulations as the basis of a breach of a negative stipulation exception under South African law in Chapter 3 of this thesis, particularly sections 3.3.8.3 and 3.4.2 thereof.

[341] 1975 AC 396 (HL).

[342] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 524.

[343] Ibid.

[344] 2013 EWHC (Comm).

[345] Idem, para 45.

Saipem SpA[346] in respect of demand guarantees was that the court must have a "high degree of assurance" that the beneficiary was not entitled to call up a demand guarantee. However, this was not considered sufficiently clear, with some commentators left still wondering, for example, how such a "high degree of assurance" would or should be expressed.[347]

In *MW High Tech*, the case of *Simon Carves*, in which *Akenhead J* enquired into whether a "strong case" had been shown and whether it had been "clearly established", and also the *Doosan*[348] case, were assessed to have been rather on the slack side regarding the parameters justifying an injunction to prevent a call on a demand guarantee.[349] Referring to the standards applied in these cases as suggestive of a "less rigorous" approach,[350] Stuart-Smith J in *MW High Tech subscribed to the higher standard that* "it must be positively established [by the applicant] that [the beneficiary] was not entitled to draw down under the underlying contract".[351]

Some commentators have questioned whether the "enhanced merits test"[352] applied, for instance, in cases of the fraud exception to establish grounds for an injunction against the guarantor, is the appropriate test to apply to injunctions against beneficiaries when enforcing negative stipulations.[353] Pursuant to the "enhanced merits test", it must be "clearly established" that the only realistic inference is that the beneficiary had no honest belief as to their entitlement to make a demand.[354] This question was considered to be addressed by the recent cases of *Salam*

[346] [2013] EWHC 990 (Comm).

[347] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 524.

[348] In *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC), paras 41-42, Edwards-Stuart, J supported the standard of "a serious question to be tried" and further stated that, "a claimant who wishes to restrain a beneficiary from making a demand under a bond must show that it has a strong case".

[349] See *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC), para 34.

[350] Ibid.

[351] Ibid.

[352] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 525 and 526, citing *Alternative Power Solution Ltd* v *Central Electricity Board* 2015 1 WLR 697.

[353] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526.

[354] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 525 and 526, citing *Alternative Power Solution Ltd* v *Central Electricity Board* 2015 1 WLR 697.

Air SAOC v Latam Airlines Group SA[355] and *Shapoorji,* where such injunctions are termed "anti-demand injunctions"[356] or "anti-beneficiary injunctions",[357]respectively.[358]

The abovementioned enhanced merits test question was considered to be answered in the affirmative by Foxton J in *Salam Air,* wherein it was stated that the, "enhanced merits test is not limited to cases in which the fraud exception is relied upon, but also extends to applications to injunct payment on the basis that the preconditions to a call on the instrument have not been satisfied".[359] Despite this apparent clarification that the enhanced merits test is applicable in the context of injunctions against a beneficiary, it has, however, been noted that no specific phrase was provided for use in cases to reflect that the enhanced merits test has been met.[360]

Taking into consideration the *MW High Tech* case, Kelly-Louw and Fayers have proffered the following reverse-hierarchy in order: "real prospect of success"; "good arguable case"; "seriously arguable case"; "strong case", and "positively established"; and "clearly established", which is considered to be substantively similar to or even slightly higher a standard than "positively established".[361] Following on from this proposition by Kelly-Louw and Fayers and with due deference to the nature and utility of demand guarantees, it would seem that the highest standard(s), being that the beneficiary's lack of entitlement to make a demand must be positively or clearly established, would be considered by English courts to be the most appropriate for an injunction to be granted against a beneficiary.

Another factor worth mentioning is that granting an injunction preventing a beneficiary from breaching a negative covenant binding upon them is a discretionary remedy that rides on and that courts will consider in conjunction with the balance of convenience test. Pursuant to the balance of convenience test, the balance of convenience must fall in favour of the injunction being granted.[362] Determining where the balance of convenience lies, which in the context of

[355] 2020 EWHC 2414 (Comm).

[356] *Salam Air SAOC v Latam Airlines Group SA* [2020] EWHC 2414 (Comm), paras 40 and 41.

[357] *Shapoorji Pallonji and Company Private Ltd v Yumn Ltd* 2021 EWHC 862 (Comm), para 22.

[358] See also Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526.

[359] *Salam Air SAOC v Latam Airlines Group SA* [2020] EWHC 2414 (Comm), para 42, and as cited in Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526.

[360] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526.

[361] Ibid.

[362] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526.

demand guarantee-related injunctions is only between the applicant and the beneficiaries, is not clear-cut and can be considered to be a matter of "whichever course seems likely to cause the least irremediable prejudice to one party or the other".[363]

4.3.9 Conclusion: Position of Breach of a Negative Stipulation Exception under English Law

From the above case law and analysis, it would appear settled under the English law that a court may restrain a beneficiary from making a demand under a demand guarantee on the basis of the breach of a negative stipulation. However, English law cannot be said to have decisively established recognition of the breach of a negative stipulation as an exception to the autonomy principle of demand guarantees in a manner that would bring it at par with the fraud exception. However, the trend of decisions by English courts as sampled above seems to be inclined towards firm recognition of the breach of a negative stipulation as grounds for granting an injunction against a beneficiary in breach of their contractual obligations.

A balance needs to be struck between the rigid enforcement of payment of documentary credits upon presentation of a complying demand, leaving the victims of unscrupulous beneficiaries to their own fate, and potentially subjective dishonour of demands on a miscellany of grounds, e.g., defective goods. Fellinger articulates this need for a balance in the statement:

> "A compromise between these two scenarios can be envisioned in which either the issuing bank or, ultimately, a court would balance the desirability of protecting the account party from the effects of fraud, against the benefits derived by ensuring the letter of credit is maintained as a useful commercial instrument and business device"[364]

The breach of a negative stipulation exception finds support from some scholars on the basis of the argument that it plugs gaps in the protection that applicants have available to them in the face of abusive calls on demand guarantees. It also encourages parties in demand guarantee arrangements to deal with each other in good faith. One such scholar, Alawamleh, opines that "English courts are ready now to utilise the underlying contract exception … [and] such an exception is the best existing exception which could tackle the problem of abusive calls."[365]

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[363] Ibid. See also *National Commercial Bank Jamaica v Olint Corp Limited* 2009 UKPC 16, para 19 as cited therein.

[364] Fellinger, G "Letters of Credit: The Autonomy Principle and the Fraud Exception" (1990), 1, *JBFLP*, 4 at 7.

[365] Alawamleh, *Documentary Credits and Independent Guarantees*, at 203.

It is acknowledged that not all gaps can perhaps be plugged by the breach of a negative stipulation exception, particularly noting that not all applicants will have the wherewithal or commercial sophistication to ensure the insertion of relevant conditions into the underlying or a separate contract. However, Alawamleh highlights that this should not deter recognition of the exception as those applicants that can and are disposed to do so will certainly appreciate its availability and take full advantage of it to protect themselves.[366]

Despite limited traction in English courts to date when compared with well-established exceptions like the fraud exception, the premise that an injunction can prevent a beneficiary from making a demand in breach of a contractual term that they bound themselves to, does have some significant support.[367] Concerns around a *laissez-faire* use of such a grounds to injunct beneficiaries from enforcing their rights and detracting from the commercial utility of demand guarantees would be tempered, *inter alia*, by the high standards required to be met to establish a breach of a negative stipulation and the requirement to satisfy the balance of convenience test. Drawing upon the discussion and case law considered above,[368]such standards would entail positively or clearly establishing that the only realistic inference is that the beneficiary had no honest belief as to their entitlement to make a demand and that the balance of convenience falls in favour of the applicant seeking the injunction.

The standard of proof applicable in respect of an injunction to enforce a breach of a negative stipulation, the English law, seems to be developing firmly in favour of the enhanced merits test, which requires the beneficiary's lack of entitlement to make a demand it to be positively or clearly established. Requiring the highest standards of proof to justify an injunction appears, to a significant extent, to counter-balance some of the concerns about injunctions against a beneficiary undermining the autonomy principle of demand guarantees.

A further control around the enforcement of negative stipulations against a beneficiary is found in the English courts' strong inclination to entertain express negative stipulations for their clarity, ahead of implied negative stipulations.[369] It would seem a fair assessment to conclude that breach of a negative stipulation has, subject to requisite controlling requirements, developed a firm footing

[366] Ibid.

[367] See Chapter 5 of this thesis for a full discussion of the recognition of the breach of a negative stipulation exception under Australian law.

[368] See section 4.3.8.3 of this chapter.

[369] See section 4.3.8.2 of this chapter.

as a ground upon which an injunction against a beneficiary to a demand guarantee would be granted under English law.

CHAPTER 5: UNCONSCIONABILITY AND THE BREACH OF A NEGATIVE STIPULATION EXCEPTIONS UNDER AUSTRALIAN LAW

5.1 GENERAL

5.1.1 Introduction

This chapter will examine the Australian law position in respect of unconscionability and breach of a negative stipulation in the underlying contract or another agreement as standalone exceptions to the autonomy principle of demand guarantees. The Australian law position will be evaluated to establish suitable recommendations for South African law in this regard. Aspects such as the recognition, application and parameters of these exceptions, as evidenced by case law, will be covered, together with arguments for and criticisms levelled against the two potential exceptions from an Australian law perspective.

5.1.2 Overview of Key Aspects relevant to both Unconscionability and Breach of a Negative Stipulation as Potential Exceptions to the Autonomy Principle

5.1.2.1 The Importance of the Autonomy Principle

The autonomy principle is well entrenched under Australian law.[1] A key attraction noted from an Australian law perspective of the independence of documentary credits, including in particular demand guarantees, is that the payment obligation owed by an issuer/guarantor is primary in nature, thus discounting considerations such as set-off and counterclaim.[2] The independence of documentary credits from the underlying (and any other) contract is a boon which underpins their commercial efficacy and utility internationally. Documentary credits, due in no small way to their independent nature and the primary obligation they espouse, have been conferred great importance, even being described as the "crankshaft of modern commerce".[3]

Pursuant to the autonomy principle, a thick line is drawn between the demand guarantee and the underlying or any other contract. This was expressed as follows by Barwick CJ noted in *Wood*

[1] In *Wood Hall Ltd v Pipeline Authority* (1979) 24 ALR 385, at 387 the court entrenched the principle of independence.

[2] Dixon, WM "As Good as Cash? The Diminution of the Autonomy Principle" (2004), 32(6), *Australian Business Law Review*, 391-406 (hereinafter, "Dixon, *As Good as Cash?"*), at 4.

[3] Chorley, RST and Holden, JM *Law of Banking*, 6 ed, Sweet & Maxwell, 1974, at 225.

Hall Limited v Pipeline Authority:[4]

> "… there is no basis whatever upon which the unconditional nature of the Bank's promise to pay on demand can be qualified by reference to the terms of the contract between the contractor and the owner. Equally, there is no basis on which the owner's unqualified right at any time to demand payment by the Bank can be qualified by reference to the terms or purpose of that contract."[5]

Like in other jurisdictions, the autonomy principle in Australia also serves to preserve the perception that documentary credits, specifically demand guarantees, are "as good as cash".[6] As considered in a specific jurisdictional context in previous chapters of this thesis, exceptions to the autonomy principle are generally considered to cause a diminution in the utility of documentary credits and their status as a cash equivalent.[7]

In *Wood Hall*, the cash-equivalent aspect of documentary credits and some benefits associated with them in the context of documentary credits were noted. One such benefit is that documentary credits offer the same advantages as cash but without involving loss of actual cash currency or the payment of interest that would undoubtedly be required from an applicant if the applicant borrowed actual cash to advance to a beneficiary, as security or otherwise, in respect of an obligation.[8] Seen in this light, documentary credits do mitigate the costs that an applicant is exposed to, thereby making transactions more cost-effective.

For the beneficiary, the benefit of having immediate recourse or compensation upon demand without being bogged down by arbitration, negotiation or litigation was noted to be advantageous.[9] Moreover, it was acknowledged that the ability to take recourse in the form of unconditional payment obligation simply subject to a demand by a beneficiary may provide the beneficiary with better bargaining power as they can leverage their advantageous position in negotiations.[10] A

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[4] *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443.

[5] Ibid, at 445.

[6] A marked reluctance to interfere with the unconditional nature of documentary credits was also expressed in *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54, 57.

[7] Dixon, *As Good as Cash?*, at 9.

[8] Coleman, M "Performance Guarantees", (1990), *Lloyd's Maritime and Commercial Law Quarterly*, 223 (hereinafter, "Coleman, *Performance Guarantees*"), at 230.

[9] Coleman, *Performance Guarantees*, at 230.

[10] Ibid.

further cost-saving afforded by documentary credits was observed to arise from the fact that issuers need not expend time and resources investigating a demand substantively as their role is confined to checking document compliance when a demand is made and going no further.[11]

The autonomy principle and the approach taken in *Wood Hall* received further endorsement in the Supreme Court of Queensland case of *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd,*[12] where it was stated that "unconditional promises of this kind by a bank are not to be qualified by reference to the underlying contract which led to the creation of the bank's instrument."[13]

Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd[14] is another case in which the autonomy principle was re-affirmed, with the court, in this case, invoking earlier cases like *Edward Owen Engineering Ltd v Barclays Bank International Ltd*[15] *and Elian and Rabbath v Matsas*[16] and reiterating the general position regarding documentary credits is that an issuer's obligation to pay upon receipt of a compliant demand is independent of the relevant underlying contract. In *Hortico,* the court acknowledged the role of the autonomy principle as integral to the utility of documentary credits and that while there may be a time to interfere with commercial activities, "more often than not, commercial life is better served by a 'hands off' policy on behalf of the courts".[17] On this basis, it was emphasised that courts would rightly be more reluctant to entertain applications for injunctions seeking to block payment by an issuer in compliance with their obligations under a documentary credit. While accepting the importance of the autonomy principle and the general deference to it in light of the commercial utility it lends to documentary credits, equitable grounds were noted as one of the few instances in which courts may intervene, with fraud and unconscionable conduct being proffered as examples.

Despite its paramount nature, the autonomy principle under Australian law is, similarly to the position in other jurisdictions, not absolute. A balancing act needs to be maintained between the

[11] Ibid.

[12] [1992] 2 QdR 54.

[13] *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54, at 57.

[14] [1985] NSWLR 545.

[15] [1978] QB 159.

[16] [1996] 2 Lloyd's Rep 495.

[17] Ibid, at 553.

competing interests of the autonomy principle, the function it serves and the benefits it carries for documentary credits on one hand, and the need to assert a reasonable measure of mitigation of abuse of documentary credits which may present itself in various guises, the most commonly recognised one being fraud on the other hand. Fraud has largely been addressed internationally by the recognition in several jurisdictions of the fraud exception to the autonomy principle, which is well-recognised in Australia as well.[18] Unconscionable conduct and the breach of a negative stipulation are other forms of abuse in respect of which the Australian law perspective is worth considering, as covered in this chapter. As both common law and statutory law are relevant to these considerations in an Australian law context, exploring the brinksmanship involved in preserving the autonomy principle and guarding against unconscionable conduct and breach of a negative stipulation should take into account both common law and statutory law of Australia, as applicable.

5.1.3 The Freezing Orders/Mareva Injunction under Australian Law

The concept of the *Mareva* injunction (freezing order) was received into and is recognised under Australian law as exemplified in a number of cases. The term *Mareva* injunction under Australian law, in a generally similar fashion to other legal systems like English law, denotes an injunction granted in order to prevent the person it is granted against from removing assets from the jurisdiction, or disposing of or dealing with assets within the jurisdiction in a manner which frustrates execution of a judgment pursuant to proceedings brought or to be brought by the plaintiff.[19] The Australian cases of *Ballabil Holdings Pty Ltd v Hospital Products Ltd*,[20] *Coombs and Barei Construction Pry Ltd v Dynasty Pty Ltd*[21] and *Yandil Holdings Pty Ltd v Insurance Co of North Americathe High Court of New South Wales*[22] exemplify case law supporting the granting of *Mareva* injunctions under Australian law.

The origins of the courts' jurisdiction to grant a *Mareva* injunction under Australian law is the subject of controversy under Australian law, but apart from its origins it is otherwise a widely recognised remedy under Australian law. One school of thought supports the opinion that the

[18] See, e.g., *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545; *NEI Pacific Ltd v Cigna Insurance Australia, Ltd* (Unreported, NSWSC, Mowlem J, 29 August 1991); *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54. See also Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*, Kluwer Law International, 2002 for a comprehensive analysis of the fraud exception and its recognition, including particularly under Australian law.

[19] Spry, ICF "Mareva Injunctions." (1990), 20(1), *University of Western Australia Law Review*, 169, at 169
[20] [1985] 1 NSWLR 155.
[21] [1986] 42 SASR 413.
[22] *Yandil Holdings Pty Ltd v Insurance Co of North America* (1985) 3 ACLC 542.

jurisdiction of courts to grant a *Mareva* injunction in Australia is founded from the court's power to prevent the abuse of its own processes.[23] A further argument raised in addition to this is that the jurisdiction of courts to grant *Mareva* injunctions is derived from statutory provisions such as section 23 of the Federal Court of Australia Act 1976.[24] Some have even viewed it as doctrinal heresy[25] or a special exception of sorts to the general law.[26] Another school of thought is that the courts derive their jurisdiction to grant a *Mareva* injunction from the principles of equity.[27] Whilst the *Mareva* injunction is a widely accepted remedy under Australian law, historically it was initially met with mixed reactions.[28] Although several cases supported granting of the remedy,[29] some cases were not supportive towards it.[30] This ambivalence has been attributed by some to the controversy regarding the basis for courts' jurisdiction to grant the *Mareva* injunction under Australian law.[31]

Despite some ambivalence in the development of freezing orders in Australia, they are a firmly entrenched component in Australian law both under common law and within a more formal framework of statutory rules. Common law recognition of the freezing order under Australian law is further supplemented by incorporation into it a provision for same in statutory frameworks.[32] For example, in Queensland, the Uniform Civil Procedure Rules 1999 provide that the requirements to obtain a freezing order are a good arguable case (for interlocutory orders), and the presence of a danger that a judgement may be wholly/partly unsatisfied due to a respondent absconding or removing his assets from the jurisdiction, or disposing of or diminishing their

[23] Chan, A "LED Builders v. Eagle Homes - Continuing the Development of Mareva Relief in Australia" (1998), 20(3), *Sydney Law Review*, 487, at 487. See also *Jackson v Sterling Industries Limited (*1987*)* 162 CLR 612 and *Cardile* v *LED Builders Pty Ltd (*1999*)* 198 CLR 380.
[24] Chan, A "LED Builders v Eagle Homes - Continuing the Development of Mareva Relief in Australia" (1998), 20(3), *Sydney Law Review*, 487, at 487.
[25] See Heydon, JD, Leeming, JD, and Turner PG *Meagher, Gummow, Lehane's Equity Doctrines & Remedies*, 4 ed, Lexis Nexis, 2002, at 21-430.
[26] *Mercedes Benz AG v Leiduck* [1996] 1 AC 284, at 299.
[27] See, for example, *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298, at 337; *Cardile* v *LED Builders* Pty Ltd *(*1999*)* 198 CLR 380, at 393; *Australian Broadcasting Commission, v Lenah Game Meats Pty Ltd* [2001] HCA 63, para 12.
[28] See Gee, S *Mareva Injunctions and Anton Piller Relief*, 3 ed, Sweet & Maxwell, 1998, at 11.
[29] See, e.g., *Praznousky v Sablyack* [1977] VR 114 (SCV); *J B Barry Pty Ltd v M & E Construction Pty Ltd*, [1978] VR 185 (SCV), *Sanko Steamship Co Ltd v DC Commodities (A'Asia) Pty Ltd*, [1979] WAR 51 (SCWA).
[30] See, e.g., *Pivovaroff v Chernabaeff* (1978) 16 SASR 329.
[31] McGill, I "The Jurisdictional Basis for the Mareva Injunction" (1980), 3(4), *University of New South Wales Law Journal*, 434, at 435.
[32] For instance, in Queensland, freezing or *Mareva* orders are dealt with in Chapter 8 Part 2 Division 2 of the *Uniform Civil Procedure Rules 1999* (Qld).

value.[33] Under common law the requirements are largely similar but are typically broken down, as exemplified by the case of *Pankhurst v Damata*,[34] as follows:

- the applicant must have an enforceable judgment or an existing and justiciable cause of action within the jurisdiction and, for interlocutory orders, a good arguable case;

- the respondent must have assets whether within or outside the jurisdiction;

- there must be a real risk or danger of the respondent removing assets from the court's jurisdiction disposing of them or otherwise dealing with them in a way which would render them unavailable to satisfy any prospective judgment in favour of the applicant; and

- if the freezing order is not granted the applicant would be subject to the risk of a judgment in their favour not being satisfied; the applicant is however not required to prove that the respondent had the intention of depriving the applicant of satisfaction of its judgment, provided that it is the probable effect.

The *Mareva* injunction under Australian law is considered to be a "useful and necessary in practice"[35] which legislature has also sought to preserve.[36] It is indeed very useful for blocking a defendant from pre-emptively defeating a prospective adverse judgment by disposing of their assets outside the court's jurisdiction prior to such judgment.[37] However, in view of the severity of its impact on persons against whom it is granted, the need for courts to grant the *Mareva* injunction with circumspection and a principled flexibility has been expressed under Australian law.[38]

[33] Chapter 8 Part 2 Division 2 of the *Uniform Civil Procedure Rules 1999* (Qld), Rule 260D(2)-(3).
[34] [2008] QSC 28.
[35] Hetherington, CM "Mareva after Thirty Years", (2004), 8, *University of Western Sydney Law Review*, 21, at 53, citing Kessedjian, C "Note on Provisional and Protective Measures in Private International Law and Comparative Law", Hague Conference on Private International Law Judgments, Prel Doc No 10, October 1998.
[36] See McLachlan, C "International Litigation and the Reworking of the Conflict of Laws" (2004), 120, Law *Quarterly Review*, 580, at 592.
[37] Gapes, R "The Development of the Mareva Jurisdiction" (1981), 4(2), *Auckland University Law Review*, 170, at 170.
[38] *Cardile* v *LED Builders Pty Ltd (*1999*)* 198 CLR 380, at 393.

5.2 UNCONSCIONABILITY

5.2.1 Introduction and Background to Unconscionability under Australian Law

5.2.1.1 Definition of unconscionable

There appears to be no single universal definition of unconscionability. According to Clarke *et al.*, unconscionability in equity can be broken down into the following categories: exploitation of vulnerability or weakness; abuse of positions of trust or confidence; insistence upon rights in circumstances which render that insistence harsh or oppressive; inequitable denial of legal obligations; and unjust retention of property.[39]

Historically, the development of unconscionability was underpinned by equitable considerations to provide protection to vulnerable parties, e.g., those with a special disability or constitutional disadvantage.[40] As time progressed, unconscionability evolved some more and became recognised in a broader sense as a concept that could protect any persons, including commercial parties disadvantaged by an inferior bargaining position, also referred to as a situational disadvantage.[41]

The case of *Stern v McArthur*[42] illustrated the role of equity as a tool to mitigate unconscientious bargains, which seemingly supported the school of thought linking unconscionability to the insistence upon a legal right in a manner which takes advantage of another's special vulnerability.[43] In seeking to explain the ambit of unconscionable conduct, the court (*per* Dawson JJ) in *Stern* stated:

> "The general underlying notion is that which has long been identified as underlying much of equity's traditional jurisdiction to grant relief against unconscientious conduct, namely, a person

[39] Philip H Clarke, PH *et al.*, "Notion of Unconscionability" in, Vout, P ed *Unconscionable Conduct, The Laws of Australia*, 2 ed, Thomson Reuters, 2009, at 121; and Parkinson, P *The Principles of Equity, 2 ed*, Thomson Reuters, 2 ed, 2003) at 39-42.

[40] Rodrigo, T "Unconscionable Demands Under On-demand Guarantees: Case of Wrongful Exploitation" (2012), 33(2), *Adelaide Law Review*, 481 (hereinafter, "Rodrigo, *Unconscionable Demands*"), at 482.

[41] Ibid. See also *Australian Competition and Consumer Commission v Samton Holdings* (2002) 117 FCR 301; 189 ALR 76; [2002] FCA 62) regarding situational disadvantage.

[42] (1988) 165 CLR 489.

[43] Idem, at 526.

should not be permitted to use or insist upon his legal rights to take advantage of another's special vulnerability or misadventure for the unjust enrichment of himself".[44]

In support of the position that unconscionability can be a basis for restraining a demand under a demand guarantee, it was held in *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited*[45]and referenced in *Olex Focas Pty Ltd v Skodaexport Co Ltd*[46] and *Boral Formwork v Action Makers,*[47] that, "a person should not be permitted to use or insist upon his legal rights to take advantage of another's special vulnerability or misadventure for the unjust enrichment of himself".[48] In addition to situational disadvantage, e.g., arising from specific features of a relationship between transaction parties,[49] other examples of a special disadvantage contemplated in an Australian law context include that it may be constitutional, deriving from age, illness, poverty, inexperience or lack of education.[50] In addition, the case of *Hurley v McDonald's Australia Ltd,*[51] which was referenced in *Boral Formwork,* explained unconscionable as encompassing conduct which goes against reason and conscience.

5.2.1.2 Unconscionability under Statutory Law

Australian law is unique in that it has a statutory concept of unconscionability, legislated in section 20(1) of the Australian Customer Law, which is largely considered a variation of its predecessor, section 51AA of Trade Practices Act 1974 ("TPA").[52] One of the advantages of a statutory prohibition against unconscionable conduct, as opposed to merely relying on equity under common law, is the availability of legislative remedies against unconscionable conduct. In addition, enshrining such a prohibition in legislation could be argued to be a more effective deterrent of such conduct when compared with common law.

[44] Ibid. See also *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, at 403-404.

[45] *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136.

[46] [1998] 3 VR 380 at 404.

[47] [2003] NSWSC 713, paras 12-14.

[48] See also *Stern v McArthur* (1988)165 CLR 489, at 526-27 and *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited* (2008) 249 ALR 458, at 494.

[49] *Board Solutions Australia Pty Ltd v Westpac Banking Corporation* [2009] VSC 474, paras 51-52.

[50] *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.

[51] (2001) FCA 209.

[52] Trade Practices Act 1974 (Cth) (hereinafter, the "TPA").

Section 20(1) of the Competition and Consumer Act[53] stipulates that "[a] person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law, from time to time".[54] For section 20(1), neither the previous TPA nor the current Competition and Consumer Act that replaced it has been observed to provide a statutory definition or any meaningful explanations of what constitutes unconscionable conduct in a commercial context. Section 20(1) merely refers to unconscionable conduct "within the meaning of unwritten law"[55] or "unwritten law, from time to time, of the States and Territories",[56] being Australian common law.

What constitutes "unwritten law, from time to time, of the States and Territories"[57] has been construed by reference in turn to unconscionability as contemplated in jurisprudence.[58] This understanding is firmly supported by the Explanatory Memorandum to the TPA as amended in 1992 to incorporate section 51AA ("the Explanatory Memorandum"),[59] which provides that:

> "The phrase 'the unwritten law, from time to time, of the States and Territories' denotes the non-statutory law (i.e., the law which is not contained in statutes, instruments under statutes or prerogative instruments) as developed by the courts of common law and equity. Because of the position of the High Court of Australia as the ultimate appellate court for all States and Territories, the 'unwritten law' of the States and Territories is the same."[60]

[53] Competition and Consumer Act 2010 as amended (hereinafter, "Competition and Consumer Act"). The Australian Consumer Law is incorporated/set out in Schedule 2 of the Competition and Consumer Act, 2010.

[54] Competition and Consumer Act, section 20(1).

[55] Competition and Consumer Act, section 20(1).

[56] TPA, section 51AA.

[57] Ibid.

[58] Competition and Consumer Act, section 20(1). Australian Courts also have powers of intervention pursuant to sections 21 and 22 of the Competition and Consumer Act (previously sections 51AB and 51AC of the TPA) which prohibit unconscionable conduct and outline the relevant factors to consider in determining what constitutes unconscionable conduct, respectively. Such powers under sections 21 and 22 of the Competition and Consumer Act are broader than under section 20(1) thereof in that they are not limited by reference to the unwritten law relating to unconscionable conduct.

[59] The TPA was amended in 1992 by introduction of a new Part IVA thereto, titled "Unconscionable Conduct" which incorporated section 51AA of the TPA.

[60] Paragraph 45 of the Explanatory Memorandum in respect of section 51AA of the TPA at 179, cited in *Gregg v Tasmanian Trustees Ltd* (1997) ATPR 41-567, Federal Court of Australia, 28 February 1997. See also the Government of Western Australia Department of Commerce, Explanatory Memorandum, Fair Trading Bill 2010, at 51: "The 'unwritten law, from time to time' is the array of common law and equitable principles that have developed in the Australian courts over many years as they apply and relate to the concept of unconscionable conduct."

This absence of a definition of statutory unconscionability and latching it onto common law determinations made from time to time has been argued to render the whole notion of unconscionability under Australian law something of a moving target.[61] The Explanatory Memorandum, regarding the meaning of unconscionability, seeks to alleviate this somewhat by also indicating that under section 51AA, unconscionable conduct does not encompass conduct which is merely unfair or amounts to a hard bargain.[62] A Draft Guideline on Unconscionable Conduct[63]issued by the Trade Practices Commission was a significant step towards carving out the boundaries of unconscionability and alleviating uncertainty regarding what would amount to unconscionable conduct under section 51AA of the TPA. The guideline explained that unconscionable conduct under section 51AA of the TPA envisaged equitable unconscionability and not conduct such as fraud, breach of a fiduciary, and undue influence.

The Draft Guideline on Unconscionable Conduct[64] reaffirmed the position that to establish unconscionability, the party with an advantage must have been aware of and sought to take advantage of a special disability of the disadvantaged party.[65] Such special disability could relate to the special commercial needs of the particular trade involved, the reasonableness of the conduct in terms of the relationship of the parties, and/or the setting, purpose and effect of the contract.[66] It was further acknowledged in the Draft Guideline on Unconscionable Conduct that unconscionability is markedly harder to prove in a commercial setting, particularly noting that ruthless bargaining is a typical feature of commerce.[67]

In seeking to formulate what is contemplated by unconscionable conduct within the meaning of the unwritten law, Austin J, in the later case of *Australian Competition and Consumer Commission*

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[61] Brown, L "The Impact of Section 51AC of the Trade Practices Act 1974 (Cth) on Commercial Certainty" *(*2004), 28, *Melbourne University Law Review,* 589, at 599-622.

[62] Trade Practices Review Committee, Report to the Minister for Business and Consumer Affairs, 20 August 1976 (hereinafter, "*Trade Practices Review Committee Report*"), at 179.

[63] Trade Practices Commission, Draft Guideline on Unconscionable Conduct under Part IVA of the Trade Practices Act 1974, as cited in Browne, JJ "The Fraud Exception to Standby Letters of Credit in Australia: Does it Embrace Statutory Unconscionability?" (1999), 11(1), *Bond Law Review*, 98 (hereinafter, "Browne, *The Fraud Exception*"), at 111.

[64] Ibid.

[65] Ibid.

[66] Ibid.

[67] *Trade Practices Review Committee Report,* at 181.

v Samton Holdings,[68] denounced the view adopted in *Blomley v Ryan*[69] *and Commercial Bank of Australia Limited v Amadio*,[70] that unconscionable conduct is limited to taking advantage of a special disadvantage of another.[71] Noting that the special disadvantage criterion was inapplicable to that case, Austin J found that another aspect of unconscionable conduct in equity, being the unconscientious reliance on strict legal rights, was more applicable in that case.[72]

According to Bisley and Mok, for an applicant to succeed in establishing unconscionability, they must show "clear and obvious evidence of unconscionable conduct".[73] It would appear that a relatively firm standard is required to establish unconscionability as an exception to the autonomy principle of demand guarantees, and not any perceived misdemeanour will qualify as establishing unconscionability. For instance, in the case of *Minson Constructions Pty Ltd v Aquatec-Maxon Pty Ltd*,[74] a beneficiary making a demand without giving advance notice to the applicant was not considered to be unconscionable, particularly noting that this was not required.[75]

5.2.1.3 Early Case Law, Development and Jurisprudence of Unconscionability under Australian Law

The case of *Amadio* is considered significant for its fairly comprehensive consideration of the concept of unconscionability as applicable under Australian law.[76] In *Amadio*, unconscionability was taken to envisage the unconscientious taking advantage of a weaker party's special disadvantage in circumstances where their "will is so overborne ... that it is not independent and

[68] (2002) 189 ALR 76.

[69] (1956) 99 CLR 362.

[70] (1983) 46 ALR 402.

[71] *Australian Competition and Consumer Commission v Samton Holdings* (2002) 189 ALR 76, at 92.

[72] *Boral Formwork & Scaffolding* (*Pty) Ltd v Action Makers Ltd* [2003] NSWSC 713, para 77.

[73] Masagoes, ML "The Unconscionability Exception – Has Unconscionable Conduct Emerged as an Exception to the Principle of Autonomy in Documentary Letters of Credit in Australia?" (2019), 22, *International Trade and Business Law Review*, 247 (hereinafter, "Masagoes, *The Unconscionability Exception*"), at 265-266.

[74] [1999] VSC 17, as cited in Bisley, M and James Mok, J "Unconscionable Demands Under Letters of Credit, Performance Bonds and Bank Guarantees" (2005), 16, *JBFLP*, 197, at 205.

[75] Ibid. Rodrigo, *Unconscionable Demands*, at 500-510 for a more comprehensive consideration of what constitutes unconscionability, including particularly under Australian law.

[76] *Trade Practices Review Committee Report*, at 178-179.

voluntary"[77] or where the disadvantaged party is unable to "make a worthwhile judgment as to what is in his best interest."[78]

In step with his approach, the court in *Louth v Diprose*[79] endorsed the stance expressed in *Brusewitz v Brown*[80] that individuals are at liberty to make bargains and dispose of their property as they wish and are bound by such bargains even if they are unreasonable, improvident or unjust unless a party seeking not to be bound can prove the presence of vitiating circumstances.[81] Justice Toohey, in *Louth v Diprose* sought to tighten the parameters of application of unconscionable conduct to commercial transactions with the statement:

> "Although the concept of unconscionability has been expressed in fairly wide terms, the courts are exercising an equitable jurisdiction according to recognised principles. They are not armed with a general power to set aside bargains simply because, in the eyes of the judges, they appear to be unfair, harsh or unconscionable. This is in contrast to some legislation which permits the courts to exercise a broad discretion to control harsh, oppressive, unconscionable or unjust contracts."[82]

There seems to be a broad gamut of examples of how a special disadvantage required to establish unconscionability may arise, particularly in the context of the formation of the contract, including poverty, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy, lack of education, lack of assistance or explanation where assistance or explanation is necessary.[83]

[77] Idem, at 461.

[78] Ibid.

[79] (1992) 175 CLR 621.

[80] [1923] NZLR 1106.

[81] *Louth v Diprose* (1992) 175 CLR 621, para 8. See also *Brusewitz v Brown* (1923) NZLR 1106, at 1109.

[82] *Louth v Diprose* (1992) (1992) 175 CLR 621, para 37.

[83] See above *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, at 462, citing *Blomley v Ryan* (1956) 99 CLR 362, at 405.

5.2.2 Unconscionability under Australian Law as a Standalone Exception to the Autonomy Principle or a Variation of the Fraud Exception or Other Common Law Concepts

5.2.2.1 Overlap and Conflation of Unconscionability with Other Common Law Concepts

Unconscionable conduct, which was contemplated to encompass, *inter alia*, dishonest exploitation of a weaker party,[84] fraudulent conduct,[85] undue influence or exploitation of a mistaken belief,[86] was recognised as a ground for court intervention in commercial dealings as far back as 1956 under Australian law.[87] Unconscionability has also been described as a concept that "first seeped, and then flooded" into Australian law since the early 1980s.[88] Actions on the basis of unconscionability under Australian law, particularly section 51AA of the TPA,[89] have been founded and, in some instances, blurred with conduct such as undue influence, economic duress,[90] unilateral mistake,[91] unjust enrichment,[92] and estoppel.[93]

5.2.2.2 Potential Overlap of Unconscionability with Fraud

Fraud is considered to be the first, both in terms of being the earliest widely recognised exception to the autonomy principle and the most well-established exception to the autonomy principle in a number of jurisdictions.[94] Fraud and unconscionable conduct have been interlinked in several

[84] *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.

[85] Ibid.

[86] *Garcia v National Australia Bank Limited* [1198] HCA 48.

[87] *Blomley v Ryan* (1956) 99 CLR 362.

[88] Finn, P "Unconscionable Conduct" (1994), 8, *Journal of Contract Law*, 37, at 37.

[89] Trade Practices Act 1974.

[90] *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 and *Crescendo Management Pty Ltd v Westpac Banking Corp* (1988) 19 NSWLR 40.

[91] *Taylor* v *Johnson* (1982-1983) 151 CLR 422 at 432-433.

[92] *Stern v McArthur* (1988) 165 CLR 489.

[93] *Wahom Stores (Interstate) Ltd* v *Maner* (1988) 164 CLR.

[94] Lipton, JD "Documentary Credit Law and Practice in the Global Information Age" (1998), 22(5), *Fordham International Law Journal*, 1972, at 1979.

cases, including *Logue v Shoalhaven Shire Council,*[95] which considered equitable fraud to be closely associated with if not synonymous with unconscionable conduct.[96]

In the case of *The Inflatable Toy Company v State Bank of New South Wales,*[97] the court's stance was seen as deliberately leaving some room for potential recognition of unconscionability as an exception to the autonomy principle.[98] However, the following statement of Young J, in that case, lends itself to the acknowledgement of the potentially fuzzy boundary between fraudulent and unconscionable conduct:

> "Again, there is a possibility that the fraud exception does extend so far as to allow for a case where there has been complete and utter non-performance of the underlying sale of goods contract".[99]

Where a beneficiary seeks to call up a demand guarantee despite knowing that they are not entitled to do so, this may justify a derogation from the autonomy principle.[100] Such conduct may arguably fall within either or both the ambit of fraudulent conduct or unconscionability.

There have been suggestions from some quarters that unconscionability, rather than being recognised as a standalone exception to the autonomy principle, must be covered within the scope of the existing and already well-established fraud exception.[101] In other words, it is proposed that the fraud exception be extended in scope to address and provide recourse for instances of unconscionable conduct. Such an argument for merging the two concepts, despite the clear recognition of unconscionability in its own right under the common law of Australia[102] and even more notably in statutory law,[103] may perhaps be motivated by an inclination to leverage the

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[95] [1979] 1 NSWLR 537.

[96] Idem, at 553-555.

[97] *The Inflatable Toy Company v State Bank of New South Wales* (1994) 34 NSWLR 243.

[98] Fedotov, A, "Abuse, Unconscionability and Demand Guarantees: New Exception to Independence" (2008), 11(1), *International Trade and Business Law Review*, 49 (hereinafter, "Fedotov, *Abuse, Unconscionability and Demand Guarantees*"), at 70-71

[99] *The Inflatable Toy Company v State Bank of New South Wales* (1994) 34 NSWLR 243, at 256.

[100] Alavi, H "Comparative Study of Unconscionability Exception to the Principle of Autonomy in Law of Letter of Credits" (2016), 12(2), *Acta Universitatis Danubius Juridica*, 94 (hereinafter, "Alavi, *Comparative Study of Unconscionability*"), at 94-121.

[101] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 70.

[102] See *Hortico (Australia) Pty Ltd v Energy Equipment Co. (Australia) Pty Ltd* [1985] 1 NSWLR 545.

[103] See the TPA and Competition and Consumer Act.

already entrenched and less-contentious status of the fraud exception on an international level.

In line with the notion of a fraud exception which encompasses unconscionable conduct as well, prominent cases such as *Olex Focas*, which advanced recognition of the statutory unconscionability exception in respect of commercial transactions under section 51AA of the TPA, have been the target of criticism. Regarding *Olex Focas* in particular, it has been argued that the circumstances of the case could and should have been more effectively addressed via the fraud exception as the beneficiary's conduct in uttering a document to claim an amount it was not fully entitled to do so constituted actual fraud.[104]

It has been further averred that by going the route of recognising the arguably ill-defined notion of unconscionability, the court's decision in *Olex Focas* opened the door to court intervention with documentary credits potentially on the basis of simply a dictionary definition or personal subjective interpretation of the term unconscionability.[105] In *Olex Focas*, a degree of support was expressed for this proposed approach of interpreting statutory unconscionability within the umbrella of the fraud exception or, correspondingly, considering the fraud exception to cover the instances of statutory unconscionability contemplated under section 51AA of the TPA.[106] Pointing to the potential convergence of the fraud exception and unconscionability, Batt J in *Olex Focas* found the fraud exception to the autonomy principle of demand guarantees to be a concept encompassing the statutory unconscionability under section 51AA of the TPA.[107]

Critics of the recognition of the unconscionability exception under Australian law have argued that it unfairly undermines the autonomy principle[108] and noted that its potential to override the autonomy principle may give rise to confusion in relation to the role of issuers of documentary credits. In line with this view, an alternative seemingly favoured by some scholars is broadening the scope of the fraud exception to cover unconscionable conduct.[109] Issuers of documentary credits are traditionally unconcerned with any disputes between the underlying contract parties in line with the autonomy principle. However, it is argued that an unconscionability exception to the

[104] See Buckley, R "Unconscionability Amok, or Two Readily Distinguishable Cases?" (1998), 26, *ABLR*, 323, at 327.

[105] Browne, *The Fraud Exception*, at 116.

[106] Ibid.

[107] Ibid.

[108] Browne, *The Fraud Exception*, at 98

[109] Ibid.

autonomy principle may muddy the waters in this regard and lead to further uncertainty, which in turn would undermine the utility of documentary credits.[110] From this perspective, some commentators have pushed for the narrower and less liberal approach of limiting recognition of unconscionability in relation to documentary credits within the confines of the fraud exception to the autonomy principle.[111]

A further argument advanced in favour of addressing unconscionability within the bounds of the already established fraud exception is that applying the doctrine of unconscionability under section 51AA of the TPA broadly would subsume the fraud exception in its entirety.[112] Despite the conceivable overlap between the fraud exception and the concept of a standalone unconscionability exception and the onslaught of criticism against recognition of the latter, Australian legislators and Australian courts have not been deterred from conferring standalone recognition upon the unconscionability exception under Australian law. The legislative provisions and case law depicting the seemingly unabated recognition of an unconscionability exception are considered further below in this chapter.

5.2.2.3 Intersection of Unconscionability and Bad Faith or Lack of Good Faith in relation to Documentary Credits

Whilst it has been stated that there is no general doctrine of good faith under Australian law,[113] it does not mean that the principle of good faith has played no role and has no contribution in respect of the Australian doctrine of unconscionability. Good faith is a notion that has, over the years, garnered significant traction under Australian law.[114]

Despite variances in the degree of recognition given to good faith considerations in different Australian states, it has been averred that the duty of good faith is an implied duty in certain types

[110] Browne, *The Fraud Exception*, at 117.

[111] Ibid.

[112] Monteiro, F "Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand", *Auckland University Law Review*, 144, at 160. See also Browne, *The Fraud Exception*, at 103.

[113] Viven-Wilksch, J "Good Faith in Contracts: Australia at a Crossroads" (2019), 1, *Journal of Commonwealth Law*, 273, at 273-274.

[114] Sheridan, L *Fraud in Equity: A Study in English and Irish law*, Sir Isaac Pitman & Sons, 1957, at 50.

of contracts.[115] This view is supported by the case of *Vodafone*,[116] in which the court found the duty to perform one's contractual obligations in good faith to be implied even in ordinary commercial contracts unless expressly excluded.[117] However, it is worth noting that in *Vodafone*, the duty of good faith had been expressly excluded under the terms of the contract. What is contemplated by the term good faith was pithily expressed in the case of *Vodafone*,[118] where the court described it as entailing the duty to act honestly and reasonably.[119] Proceeding on the basis of the view expressed in *Vodafone*, one may extend it too to dealings between parties to a demand guarantee arrangement, including the underlying or any relevant contract and the demand guarantee itself.[120]

Good faith has in some quarters been described in connection with fraud, and fraud has been described in the context of demand guarantees as conduct which constitutes abuse and bad faith, such as seeking to call up a documentary credit despite knowing that they are not entitled to payment or that the circumstances that would so entitle them to payment have not occurred.[121] Where fraud has been linked to equitable notions such as good faith, this has been noted to warrant the inference that the concept of fraud in such instances is of a nature intertwined with the concepts of fairness and good faith.[122] Further to this, the presence of bad faith is perceived in some contexts as indicative of unconscionability.[123]

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[115] See, e.g., *Burger King Corp v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558 and *Alstom Ltd v Yokogawa Australia Pty Ltd (No 7)* [2012] SASC 49.

[116] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15.

[117] Idem, paras 125 and 189.

[118] Vodafone *Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15.

[119] Idem, paras 192-193.

[120] The general rules applicable to contracts are considered to be applicable in respect of documentary credits as well, particularly demand guarantees, despite their quasi-contractual nature as discussed in section 2.2.2.2 of Chapter 2 of this thesis.

[121] Bertrams, RF *Bank Guarantees in International Trade: The Law and Practice of Independent (first Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions*, 2 ed, Kluwer Law International, 1996 (hereinafter, "Bertrams, *Bank Guarantees in International Trade*"), at 261.

[122] Horn, N and Wymeersch, E "Bank - Guarantees, Standby Letters of Credit, and Performance Bonds in International Trade" in Horn, N (ed), *The Law of International Trade Finance,* Kluwer, 1989, at 484.

[123] Lupton, CS "*A Comparative Legal Perspective on the Impact of Good or Bad Faith on the Independence of Documentary Credits and Demand Guarantees*", LLM Dissertation, University of Johannesburg, 2018 (hereinafter, "Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*"), at 29.

Proponents of additional exceptions to the autonomy principle, particularly to provide remedies against conduct which would be unconscionable, have also found support in the argument that the demand guarantees are subject to the principles of good faith. Some see this view as unanimous.[124] The importance of good faith was expressed in the case of *Overlook v Foxtel*[125] where Barret J declared, "the implied obligation of good faith underwrites the spirit of the contract and supports the integrity of its character. A party is precluded from cynical resort to the black letter".[126] In this light, a beneficiary seeking to make a claim upon a demand guarantee in an abusive or fraudulent way would be acting contrary to the tenets of good faith, which may arguably then warrant court intervention.[127]

Under section 22(2) of the Competition and Consumer Act, Australian courts have the power to apply equitable concepts of good faith and fair dealing in trade and commerce (i.e., a variety of commercial transactions) to make a determination regarding whether specific conduct is unconscionable. Alluding to the inclusion of bad faith under the ambit of unconscionability, in the case of *Optus Networks Pty Limited v Telstra Corporation Limited*,[128] unconscionability, with reference to the TPA, was described as including "conduct in respect of which a judge in equity would have been prepared to grant relief".[129] The notions of good faith and, conversely, bad faith seem to hold significant sway under Australian law of documentary credits. It is asserted that due to these notions, the concept of unconscionability took hold and became entrenched in statute, including particularly as an exception to the autonomy principle of demand guarantees.[130]

[124] Bertrams, *Bank Guarantees in International Trade*, at 261.

[125] *Overlook v Foxtel* [2002] NSWSC 17, para 67.

[126] Ibid.

[127] Bertrams, *Bank Guarantees in International Trade*, at 261.

[128] *Optus Networks Pty Limited v Telstra Corporation Limited* (2009) FCA 728.

[129] Ibid.

[130] Lupton, *A Comparative Legal Perspective on the Impact of Good or Bad Faith*, at 29.

5.2.3 Statutory Unconscionability

5.2.3.1 Trade Practices Act ("TPA")

Australia's TPA was the first statutory boon for prohibiting unconscionable conduct but has since been supplanted by its successor, the Competition and Consumer Act, which incorporates similar provisions.

While the original version of the TPA in 1974 was devoid of provisions relating to unconscionability,[131]such provisions were incorporated subsequently.[132] Sections 51AA and 51AC of the TPA were central points of reference in the cases of *Olex Focas* and *Boral Formwork* to support the recognition of unconscionable conduct as an exception to the autonomy principle of documentary credits.

Section 51AA of the TPA states that "[a] corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time." The words "in trade or commerce" have been considered to reflect the intention behind judicial intervention, being to provide recourse against unconscionable conduct, specifically in the context of commercial relationships in the unconscionability provision in the TPA.[133] Section 51AA of the TPA, in addition to generally prohibition corporate entities from engaging in unconscionable conduct, also codified the common law meaning of unconscionable conduct.[134]

Section 51AC of the TPA contained a similar prohibition against unconscionable conduct, albeit in relation to unconscionable conduct by a person or corporation against consumers or suppliers in business transactions relating to the actual or possible supply or acquisition of goods and services.[135] The bargaining power of parties, the understanding of the business transaction

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[131] Cecere, C "Australia Section 51AC of the Trade Practices Act: Impact on Franchising Sector" (2003), 1, *International Journal of Franchising Law*, 8 (hereinafter, "Cecere, *Australia Section 51AC of the Trade Practices Act*), at 9.

[132] Section 51AB was first incorporated into the TPA in 1986, section 51AA in 1992 and 51AC in 1998, respectively. See Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010, at 41, para 4.4 and Cecere, *Australia section 51AC of the Trade Practices Act*, at 11.

[133] Baxt, R and Mahemoff, J "Unconscionable Conduct under the Trade Practices Act - An Unfair Response by the Government: A Preliminary View" (1998), 26, *Australian Business Law Review*, 5 (hereinafter, "Baxt and Mahemoff, *Unconscionable Conduct under the Trade Practices Act*") at 15.

[134] The TPA, section 51AA(1). See also *ACCC v Samton Holdings Pty Ltd* (2002) 117 FCR 301, Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010, at 48, para 4.21.

[135] The TPA, section 51AC(1), 51AC(1)-51AC(3).

documents, the presence of undue influence or pressure, and/or whether the parties had conducted themselves in good faith were, inter alia, some of the factors that courts could consider[136]when determining unconscionability under section 51AC.[137]

5.2.3.2 Scope of section 51AA of the TPA: Broad and Narrow Approaches

Section 51AA of the TPA has been construed in one of two ways: the broad sense and the narrow sense. The narrow sense considers section 51AA to be merely an entrenchment of equitable doctrine,[138] and the broad approach extends unconscionability beyond only where there is a special disadvantage or disability of another.[139] The narrow approach has been argued to have the effect of excluding the application of section 51AA to demand guarantees due to the improbability of encountering a commercial entity which can be said to have a special disadvantage of the nature contemplated.[140]

The case in favour of the broad approach was articulated in *Pritchard v Racecage*[141] where the court noted that a wide construction of section 51AA of the Trade Practices Act could not be dismissed as untenable or doomed to failure.[142] The application of this wide approach was further exemplified in the case of *Olex Focas*,[143] which interpreted the equitable principle enshrined in section 51AA to encompass all unconscionable conduct, regardless of whether or not a special disadvantage had been suffered. The court in *Olex Focas* went on to state that "even if one believes, wrongly, that one is acting within one's rights, one can thereby engage in unconscionable conduct"[144] and found that a beneficiary's insistence on enforcing an advance payment demand

[136] See the factors outlined in section 51AC(3) of the TPA.

[137] Trade Practices Act 1974 (Cth) sections 51AC(3)(a), (c), (d), and (k).

[138] See *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 and *Blomley v Ryan* (1956) 99 CLR 362.

[139] Fedotov, *Abuse, Unconscionability and Demand Guarantees,* at 71.

[140] *Ridout Nominees Pty Ltd v Commonwealth Bank of Australia* [2003] WASCA 158 and Fedotov, *Abuse, Unconscionability and Demand Guarantees,* at 73.

[141] (1997) 142 ALR 527.

[142] *Pritchard v Racecage* (1997) 142 ALR 527, at 545.

[143] *Boral Formwork & Scaffolding v Action Makers* [2003] NSWSC 713.

[144] *Olex Focas v Skodaexport* [1998] 3 VR 380 at 49.

guarantee in circumstances where most of the advances had been repaid amounted to conduct against the dictates of conscience.[145]

5.2.3.3 The Competition and Consumers Act 2010

The TPA was rechristened as and/or replaced by the Competition and Consumers Act 2010, which came into operation in January 2011. Analysts of the Competition and Consumers Act have noted that at first glance, it seems to have imported the provisions of the TPA relating to unconscionability.[146] Upon closer scrutiny, however, a key distinction that has been detected is that while the TPA prohibited unconscionable conduct in respect of both corporations and persons, the Competition and Consumers Act seems to do so for persons only, a difference which has been interpreted to exclude corporations from the scope of the prohibition.[147]

In the absence of a categorical statutory definition for the term "person" as used in the Competition and Consumer Act, the term could be understood in line with its commonly understood meaning, being per a lay person's understanding, that it applies to individuals or natural persons, as opposed to corporations or legal persons. However, further analysis taking into account the relevant statutory interpretation rules in the Interpretation Act[148] concluded that "persons" as referred to in the Competition and Consumer Act includes corporations or legal persons too.

The re-codification of the concept of unconscionability in the Competition and Consumer Act in substantially the same form as the corresponding provisions in the TPA seemed to be indicative of parliament's re-affirmation of the unconscionability exception. This view is supported by Austin J's remark in Boral Formwork that the autonomy principle could not override statutory intent, and the unconscionability exception should, therefore, be applied as appropriate.[149] As unconscionable conduct is not defined in the Competition and Consumer Act, the position has been accepted, in

[145] Idem, at 50.

[146] Sections 51AA, 51AB and 51AC of the Trade Practices Act were observed to bear resemblance to sections 20, 21 and 22 of the Competition and Consumers Act 2010 (Cth), sans for the introduction of a pecuniary penalty in the latter.

[147] See the TPA, section 51AC(1), 51AC(2) and the Competition and Consumer Act (Schedule 2 of which is the Australian Consumer Law), section 22(1).

[148] Interpretation Act 1901 (Cth), section 2C.

[149] *Boral Formwork & Scaffolding v Action Makers* [2003] NSWSC 713, para 74.

respect of the meaning of unconscionability, that "it falls to the court to frame the scope and determine the elements of proof for the doctrine."[150]

5.2.4 Recognition of an Unconscionability Exception under Australian Common Law

Despite the development of statutory unconscionability in leaps and bounds under Australian law, it has been argued that a standalone common law unconscionability exception should be firmly accepted under Australian law as a contingency in case the interpretation of section 51AA, which incorporates unconscionability, is later rejected and dispensed with.[151] The 1985 *Hortico* case is considered to have ushered in the first consideration of unconscionability, specifically in the context of documentary credits under Australian law.

Hortico is, therefore, an important case to the consideration of unconscionability from a common law perspective under Australian law. Recognition of unconscionability as a further exception to the autonomy principle of demand guarantees under Australian common law appears to have been notably entertained in *Hortico,* with the court supporting the view that courts could grant equitable relief in the presence of fraud or gross unconscionable conduct.[152] This stance, pursuant to which *Hortico* has been credited with being the originator of the common law concept of unconscionability under Australian law, was clearly depicted in the following statement:

> "It does not seem … that anything short of actual fraud would warrant this Court in intervening, though it may be that in some cases (not this one), the unconscionable conduct may be so gross as to lead to exercise of the discretionary power."[153]

Unconscionability was thus recognised in *Hortico* as a doctrine applicable under the common law of Australia. These remarks have been viewed as indicative of a willingness by Australian courts to embrace recognition of the principles of unconscionable conduct in relation to documentary credits.

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[150] Wooler, G "*Lifting the Veil of Autonomy: Unconscionable Conduct as Grounds for Injunctive Relief in Australia and Singapore – A Study in the Context of Independent Trade Finance Instruments*", PhD thesis, University of Queensland, at 184.

[131] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 82.

[152] In contrast, Batt J, in *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, at 400, expressed strong reservations regarding whether gross unconscionability falling short of actual fraud could be sufficient grounds for an injunction.

[153] *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545, at 554. See also Ulph, J "The UCP600: Documentary Credits in the Twenty-first Century" (2007), 4, *Journal of Business Law*, 355 at 371; and the case of *Inflatable Toy Co v State Bank of NSW* (1994) 34 NSWLR 243.

The court, in the later case of *Olex Focas,*[154] however, seemed only willing to entertain common law unconscionability to the extent that it was tantamount to fraud, as indicated by the court's refusal to "treat gross unconscionability falling short of actual fraud as a ground for an injunction."[155] The later 2008 case of *Clough Engineering Ltd v Oil & Natural Gas Corp,* in contrast, recognised both common law and statutory unconscionability, noting that in addition to the former, section 51AA of the TPA could also be relied upon by a party seeking an injunction.[156]

5.2.5 Consideration of Selective Case Law regarding the Recognition of the Unconscionability Exception under Australian law

5.2.5.1 General Recognition of the Unconscionability Exception by the Australian Courts

Unconscionable conduct was touched upon in the *Logue v Shoalhaven* case, wherein the court, whilst considering equitable fraud, noted that it involved conduct so unconscionable as to invoke the intervention of a court of conscience.[157] The case of *Inflatable Toy Company Pty Ltd v State Bank of New South Wales*[158]is considered a seminal case regarding the fraud exception in the context of documentary credits. What is notable in respect of the *Inflatable Toy Company* case in the context of unconscionability is that it appeared to deliberately leave the door open for the recognition of unconscionability as an additional exception to the autonomy principle of demand guarantees.[159] In *Inflatable Toy Company,* it was noted in relation to unconscionability and the autonomy principle of documentary credits that it was "still wise to keep open the possibility that unconscionable conduct may be an exception."[160]

Unconscionability was also recognised as a defence against payment of demand guarantees in the case of *Olex Focas,* which came more than a decade after *Hortico.* In *Olex Focas,*[161] the Supreme

[154] *Olex Focas Pty Ltd v Skodaexport Co.* Ltd [1996] 134 FLR 331.

[155] Idem, at 354.

[156] *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136, paras 44 and 59-60.

[157] *Logue v Shoalhaven Shire Council*, [1979] 1 NSWLR 537, at *553-555.*

[158] (1994) 34 NSWLR 243.

[159] *Inflatable Toy Co Pty Ltd v State Bank of New South Wales* (1994) 34 NSWLR 243, at 251.

[160] Ibid.

[161] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380

Court of Victoria considered and found unconscionable conduct on the part of the beneficiary to be a sufficient ground for restraining the enforcement of demand guarantees pursuant to section 51AA of the TPA (i.e., the previous version of section 20(1) of the Competition and Consumer Act). *Olex Focas* is considered one of the earliest cases in which unconscionable conduct in respect of commercial transactions was established.[162] In *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd*,[163] the grounds upon which a beneficiary of a demand guarantee could be enjoined included fraud and unconscionable conduct in contravention of section 51AA of the TPA 1974.[164]

The issue of unconscionable conduct in relation to demand guarantees once more came before the courts in *Board Solutions Australia Pty Ltd v Westpac Banking Corporation.*[165] The position re-affirmed in this case was that unconscionable conduct by a beneficiary was a basis upon which a demand on a demand guarantee can be restrained under Australian law. Forrest J found on the evidence adduced that section 51AA of the TPA had been potentially breached.

The erosion of uncertainty in the commercial arena was one of the grounds upon which the provisions regarding unconscionability under section 51AA of the TPA were greatly opposed.[166] The statutory entrenchment of unconscionability was considered to render it a concept that would trump the latter if pitted against the autonomy principle.[167] Australian law, through the TPA, thereby established a mechanism by which the autonomy principle could be overridden.[168]

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[162] It had, however, been given some consideration in *Hortico (Aust) Pty Ltd v Energy Equipment Co (Aust) Pty Ltd* [1985] 1 NSWLR 545.

[163] (1999) 15 BCL 158 at 164-5.

[164] This position was outlined in *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1999) 15 BCL 158 with reference to the cases of *Wood Hall Ltd v Pipeline Authority* (1979) 24 ALR 385 and *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, respectively.

[165] [2009] VSC 474.

[166] See Healey, D "Unconscionable Conduct in Commercial Dealings" (1993), 1, *Trade Practices Law Journal,* 169 (hereinafter, "Healey, *Unconscionable Conduct in Commercial Dealings*"), at 169 and Woods, GD and Stein, PL *Harsh and Unconscionable Contracts of Work in New South Wales: Section 88F of the Industrial Arbitration Act (New South Wales) - A Radical Law,* The Law Book Co, 1972, at 2ff.

[167] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 71.

[168] Ibid.

The leading cases exploring the application of unconscionability exception to the autonomy principle under Australian law include the three cases of *Olex Focas*, *Boral Formwork* and *Clough Engineering*, which will be considered in turn below.

5.2.5.2 Olex Focas v Skodaexport

In this case, Olex Focas, an Australian company (plaintiff/applicant of demand guarantee), a provider of, *inter alia*, power cables and telecommunication equipment, entered into a contract with Skodaexport, a Czech Republic company (defendant/beneficiary of demand guarantee) for the construction of an oil pipeline in India. Olex Focas received two payments from the defendant in order to commence work and furnished two advance payment demand guarantees in return to secure the advances.[169] Following delays by Olex Focas in starting the work, a dispute arose regarding whether, despite the delays, the work carried out by Olex Focas satisfied its obligations. Skodaexport denied that Olex Focas had met its obligations and demanded that Olex Focas should reduce the amount claimed for the work, or else Skodaexport would call up the demand guarantees.[170] Olex Focas countered this by alleging that Skodaexport's conduct was either fraudulent or in breach of the prohibition of unconscionable conduct in the TPA.[171] Moreover, Olex Focas proceeded to seek an injunction against the bank, prohibiting the bank from making payment and the defendant from receiving such payment under the demand guarantees.[172]

Notwithstanding the recognition of the unconscionability doctrine in relation to documentary credits under common law in the case of *Hortico*, the court in *Olex Focas* refused to grant an injunction based on unconscionability under common law. In this regard, it was held that fraud and illegality remained the main recognised exceptions to the autonomy principle under common law and severe unconscionable conduct, which did not amount to actual fraud, is not an exception in equity.[173] It was stated in *Olex Focas* that,

> "with regard to the passing reference in *Hortico* to gross unconscionability in an extreme case, I would not… treat gross unconscionability falling short of actual fraud as a ground for an injunction

[169] *Olex Focas Pty Ltd v Skodaexport Co Ltd* (1996) 134 FLR 331, at 331.

[170] Idem, at 331-332.

[171] Idem, at 344-345.

[172] Idem, at 343-344.

[173] Idem, at 395, 400.

> … [and if unconscionability indeed was] a ground, even allowing for the considerable growth in importance of unconscionability as a sword and a shield in Australian jurisprudence of late one would expect it to have been mentioned in the cases much earlier."[174]

Consideration was given to whether fraud or unconscionability under section 51AA of the TPA was the appropriate ground upon which to grant relief. Relief on the basis of fraud was denied on the facts of this case, noting that no fraud was established as Skodaexport was contractually entitled to make a demand.[175]

In considering unconscionability, it was noted that the term unconscionable is not defined in the TPA, so in addition to other court findings, the Oxford *English Dictionary* definition, being that it is, "showing no regard for conscience; not in accordance with what is right or reasonable"[176] was turned to. Skodaexport's conduct in seeking to enforce its rights under the guarantees despite Olex Focas having largely delivered on the services (i.e., seeking to call up more funds than it knew it was entitled to) was found to be unreasonable when measured against "ordinary human standards",[177] "quite against conscience"[178] and/or unconscionable.[179] On the assessment that Skodaexport was abusing its position of advantage in respect of the demand guarantees, an injunction was found to be justified by the court.[180]

In deliberating on this matter, Batt J acknowledged that threats to call up a demand guarantee were a tool commonly used as leverage by commercial parties to bend negotiations or settlement of a dispute to their will. In line with this, it was remarked that had the beneficiary threatened to call up only the outstanding amount of what had been advanced, such tactics would not have been unconscionable as contemplated under section 51AA.[181] The injunction sought by Olex Focas was, however, granted by the court on the basis of unconscionability as ensconced in the statutory law of Australia.

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[174] *Olex Focas Pty Ltd v Skodaexport Company Ltd* [1998] 3 VR 380, at 400.

[175] Idem, at 398.

[176] Idem, at 356.

[177] [1998] 3 VR 380, at 358.

[178] Ibid.

[179] Ibid.

[180] Ibid.

[181] [1998] 3 VR 380, at 403-404.

5.2.5.3 Implications of the decision in Olex Focas v Skodaexport

Traditionally, unconscionability under section 51AA of the TPA was construed to be applicable in cases where one party was at a special disadvantage or was vulnerable and was pressured on the basis of such disadvantage. While courts had generally been seen to have a standoffish approach in respect of commercial dealings, the words "in trade or commerce" in section 51AA of the TPA appear to reflect an intention supporting the broader approach to interpreting unconscionability depicted in *Olex Focas*.[182] In the case of *Olex Focas,* two large corporate entities, neither of which could be said to have been vulnerable or at a special disadvantage, were involved. *Olex Focas* is, therefore, especially significant for broadening the scope of application given to section 51AA by showing that unconscionability can exist in the absence of a special disadvantage. Thus commercial parties can still be victims of and find recourse against unconscionable conduct under section 51AA.

Furthermore, the *Olex Focas* ruling was considered to be conducive to court interference with documentary credits in any circumstances which, by dictionary meaning or personal and potentially subjective interpretation, could fall within the ambit of the term unconscionability.[183] In *Olex Focas*, section 51AA of the TPA was held to provide sufficient grounds for granting an injunction against payment of a letter of credit. Such an application of section 51AA exemplifies how this legislative provision against unconscionable conduct could be weaponised against the autonomy principle of documentary credits. In *Olex Focas*, it was observed in this regard that this application of unconscionability made "substantial inroads into the well-established common law autonomy of letters of credit".[184] Furthermore, in *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd*,[185] the court did not dismiss or denounce the wider construction of unconscionability. This has been asserted to indicate that the TPA may also embrace the broad concept of unconscionability.[186]

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[182] See Baxt and Mahemoff, *Unconscionable Conduct under the Trade Practices Act,* at 15. See also *Pritchard v Racecage Pty Ltd* (1997) ATPR 41-554.

[183] Browne, *The Fraud Exception*, at 116.

[184] *Olex Focas Pty v Skodaexport Co Ltd,* (1996) 134 FLR 331, AT 358

[185] (2003) 214 CLR 51, paras 44-45.

[186] Dean, N "Cases and Comments - ACCC v Berbatis Holdings (2003) 197 ALR 154" (2004) *Sydney Law Review* 256, at 256.

Some commentators have expressed the concern that the wider scope of unconscionability adopted in *Olex Focas* may open the floodgates to litigation by commercial parties in respect of contracts they entered into freely, simply because it may be of convenience to them.[187] Consistent with this perspective, some scholars have advocated for a reading down of section 51AA to maintain the narrower or limited scope of unconscionability, which requires some special disadvantage for the victim of unconscionability. Failure to do so, it is opined by some, would, in addition to making undesirable inroads into the autonomy principle of demand guarantees, seriously undermine commercial relationships and interfere unjustifiably with certain tenets of contract law.[188] The hope has been expressed that courts will remain appreciative of the importance of preserving the autonomy principle and accordingly facilitate a narrower application of the fraud exception,[189] because using it to capture all types of potentially broad conduct considered to be unconscionable may undermine the utility of documentary credits.

5.2.5.4 Boral Formwork v Action Makers

In the later case of *Boral Formwork*, the court was faced with the challenge of defining the scope of unconscionability and once again determining its application in relation to documentary credits. Based on section 51 AA of the TPA, the court in *Boral Formwork* seemingly favoured the approach taken in *Olex Focas* and granted a temporary injunction.

In *Boral Formwork*, the buyer (applicant) and Action Makers entered into an agreement with Action Makers, the seller (beneficiary), whereby the latter would manufacture and supply scaffolding equipment to Boral. Upon receipt of the equipment, Boral inspected it and assessed it to be defective and falling foul of the supply specifications agreed between the parties. In a letter to the beneficiary, Boral advised it of the defects, the anticipated cost of the rectification, and their preference to rectify the equipment themselves and offset the rectification costs incurred from the invoice amount. Boral went on to remedy the defects at its own expense and further updated the beneficiary by electronic mail that the repairs were almost complete and included the additional costs relating to the repairs.[190]

Further to the supply agreement, an irrevocable standby letter of credit had been provided in favour

[187] See Baxt and Mahemoff, *Unconscionable Conduct under the Trade Practices Act*, at 63.

[188] See Healey, *Unconscionable Conduct in Commercial Dealings*, at 433.

[189] Browne, *The Fraud Exception*, at 11.

[190] *Boral Formwork & Scaffolding (Pty) Ltd v Action Makers Ltd* [2003] NSWSC 713, para 17.

of Action Makers, the beneficiary (seller), who was now in financial difficulties and had had an administrative receiver appointed for it. The administrative receivers, on behalf of the seller (beneficiary), presented a certificate alleging that it was owed a certain amount and then made a demand under the letter of credit for the full amount invoiced for the equipment supplied by the beneficiary when in fact, only some of that amount money was outstanding. Boral applied for an injunction to restrain payment by the issuer (bank) to Action Makers on the ground of unconscionability. The bank settled the amount of the claim which Boral agreed that it owed but withheld the balance, which Boral disputed it owed.

The matter brought before the court was whether Boral, at odds with the autonomy principle, was entitled to restrain the bank from making payment in respect of the disputed sum. Firstly, Boral contended that the beneficiary was not entitled to the full amount under the underlying contract due to the goods supplied being defective, which in turn caused Boral to incur considerable expense to remedy the defects.[191] Secondly, it was flagged that the beneficiary was on the brink of bankruptcy and the receivers that had been appointed acknowledged if payment under the letter of credit was made, Boral would only have the recourse of an unsecured creditor in respect of any claim on account of the defective goods.[192] It was further noted that there would unlikely be enough funds to pay off unsecured creditors of Action Makers in the event of bankruptcy.[193]

Moreover, Boral supported its arguments on two alternative grounds, one being that there was an implied negative stipulation in the supply agreement restraining a demand for a full amount under the circumstances, the second being sections 51AA or 51AC of the TPA. While the courts dispensed with the first ground, the second ground fared better. Austin J found it appropriate to grant an injunction under section 51AA of the TPA and found the conduct of the administrative receivers (who had made the demand as agents for the beneficiary) to be unconscionable under section 51AC of the TPA.

Austin J found the certificate to be false and misleading and that the demand by the beneficiary under such circumstances was unconscionable within the meaning of section 51AA of the TPA.[194] A key factor rendering the beneficiary's conduct unconscionable was that there was no dispute

[191] Idem, at 5, 11.

[192] Browne, *The Fraud Exception*,13

[193] Ibid.

[194] *Boral Formwork & Scaffolding v Action Makers* [2003] NSWSC 713, para 79.

between the parties regarding the amount owed to the beneficiary, but the beneficiary still proceeded to claim an amount in excess of what was owed.[195] The insistence on strict legal rights by the beneficiary was found to be the category of conduct into which the brand of unconscionability exhibited by the beneficiary fell.[196]

Regarding the court's reasoning in relation to the autonomy principle, Austin J stated:

> "… the presumption of autonomy does not provide an adequate discretionary reason for declining declaratory and injunctive relief on the basis of contravention of section 51AC. The position might have been different if this was simply a case of making a call on the irrevocable instruments to apply pressure to resolve the dispute. But here, the dispute was effectively over and the Disputed Amount was no longer owing, and it was unconscionable for Action Makers to use its rights under the letter of credit by certifying for payment of the whole Invoice Amount in those circumstances."[197]

Relief was seemingly granted particularly under section 51AC of the TPA, as the administrative receivers' (in their capacity as agents for Action Makers) conduct of unconscionably relying on strict legal rights by claiming a full amount it was not entitled to was in contravention of section 51AC of the TPA. Further to the court's ruling, the beneficiary was required to revoke its claim for payment of the disputed sum under the letter of credit and refrain from making any other demand thereunder.[198]

5.2.5.5 Implications of the Decision in Boral Formwork v Action Makers

Some scholars have criticised the ruling in *Boral Formwork* for various reasons, including that it did not give sufficient importance to the autonomy principle.[199] It is further averred that the court in *Boral Formwork* adopted an inappropriately sympathetic stance towards the applicant and effectively laid the consequences of the applicant's deficient risk management skills onto the beneficiary in a manner contrary to the typical risk-allocation intention behind documentary

[195] Idem, paras 82 and 87.

[196] Idem, paras 77-82.

[197] Idem, para 87.

[198] Idem, para 91.

[199] Johns, RJ and Blodgett, MS "Fairness at the Expense of Commercial Certainty: The International Emergence of Unconscionability and Illegality as Exceptions to the Independence Principle of Letters of Credit and Bank Guarantees" (2011), 31, *Northern Illinois University Law Review*, 297 (hereinafter, "Johns and Blodgett, *Fairness at the Expense of Commercial Certainty*"), at 324.

credits.[200] The reliance in *Boral Formwork* on the unconscionability doctrine in accordance with *Olex Focas* was also criticised on the basis that the parameters of unconscionability in *Olex Focas* were nebulous.[201]

Despite the criticisms levelled against it, the *Boral Formwork* case is notable for being the first Australian case to consider the effect of sections 51AA and 51AC of the TPA in relation to letters of credit and, by implication, demand guarantees. Regarding the position of the autonomy principle of letters of credit (also demand guarantees) when pitted against the statutory doctrine of unconscionability in the TPA, Austin J unequivocally stated, "[t]he principle of autonomy, applicable to standby letters of credit, cannot override the statute."[202]

According to Bisley and Mok, the cases of *Olex* and *Boral Formwork* cemented the position that, in addition to fraudulent conduct, unconscionable conduct under the TPA is a basis for judicial interference with the enforcement of documentary credits.[203] Bisley and Mok have also countered the argument that recognising unconscionability as an additional exception to the autonomy principle would undermine the utility of documentary credits. In particular, they point out that it is recognised in a number of jurisdictions but has not undermined the commercial value of such instruments in such jurisdictions, including the United States of America, which construes fraud to incorporate equitable fraud.[204]

The *Boral Formwork* judgment is significant for its clarification that unconscionable conduct could trump the autonomy principle. In addition, some have perceived *Boral Formwork* as a case that brings together the common law doctrine of unconscionability and the provisions of statutory consumer law. The *Boral Formwork* case made it clear that the autonomy principle does not blindly override the statutory provisions against unconscionable conduct in the TPA.[205] The position was explained quite clearly as follows:

> "Even if the conduct is unconscionable, the principle of autonomy is relevant to the exercise of the

[200] Ibid.

[201] Ibid.

[202] *Boral Formwork v Action Makers* [2003] NSWSC 713, para 74.

[203] Bisley, M and Mok, J "Unconscionable Demands Under Letters of Credit, Performance Bonds and Bank Guarantees" (2005), 16(3) *Journal of Banking and Finance Law and Practice*, (hereinafter, "Bisley and Mok, *Unconscionable Demands*") at 197.

[204] Bisley and Mok, *Unconscionable Demands*, at 212.

[205] *Boral Formwork v Action Makers* [2003] NSWSC 713, para 74.

> Court's discretion to grant injunctive relief or leave the plaintiff to other remedies. Here the circumstances, involving as they do a call on the letter of credit on a false basis, are sufficiently special to overcome the hesitation which the principle of autonomy generates."[206]

The *Boral Formwork* case, like *Olex Focas*, seems to have stopped short of establishing a general common law unconscionability exception to the autonomy principle. However, it is notable for its recognition of an exception to the autonomy principle on the basis of unconscionability. According to Johns and Blodgett, *Boral Formwork* is significant for contributing to the interpretation of unconscionability under Australian law by moving away from a rule-based standard which was more protective of the autonomy principle, in favour of a fact-based standard which was influenced by the level (or lack thereof) of judicial tolerance towards unconscionable conduct by a beneficiary.[207]

5.2.5.6 Clough Engineering Ltd v Oil and Natural Gas Corporation Limited

Clough Engineering is another Australian case on the application of the unconscionability exception under the Australian law of demand guarantees.[208] In *Clough Engineering*, the court decided that in addition to the fraud exception, an injunction pursuant to section 51AA of the TPA could be granted on the basis of unconscionability.

In *Clough Engineering*, demand guarantees had been issued to Oil and Natural Gas Corporation Limited (beneficiary), being a customer of Clough Engineering, in relation to the performance of a construction contract. A dispute arose, with the beneficiary alleging that Clough Engineering had breached the terms of the underlying contract. Clough Engineering counter-argued that any breaches on its part were due to earlier breaches by the beneficiary. The beneficiary sought payment by making a demand under the demand guarantees, which Clough Engineering challenged by seeking an injunction against the beneficiary on the basis that the beneficiary's claim on the demand guarantees was unconscionable.

The court expounded on what is meant by unconscionability in the following words:

> "under the unwritten law, which is the common law of Australia, unconscionable conduct will be such conduct as would support the grant of relief on principles set out in specific equitable

[206] Idem, para 94.

[207] Johns and Blodgett, *Fairness at the Expense of Commercial Certainty*, at 324.

[208] *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136.

doctrines. Equity does not provide a remedy in respect of conduct in trade or commerce which is, in the opinion of a judge, unfair."[209]

However, the court in *Clough Engineering* did not find unconscionable conduct to be present based on the facts of the case.

5.2.5.7 Implications of the Decision in Clough Engineering Ltd v Oil and Natural Gas Corporation Limited

The position that the autonomy principle could be supplanted by unconscionable conduct was reaffirmed in *Clough Engineering*, where the court recognised unconscionability as a potential standalone exception to the autonomy principle. In seeking to define the scope of unconscionability, the court indicated that it is based upon equitable notions and stated that equity "has traditionally exercised its jurisdiction to curtail an exercise of a right to terminate if that right is sought to be used arbitrarily, or capriciously or unreasonably or in bad faith."[210]

5.2.5.8 Some Sample Cases under the Competition and Consumer Act

Case law specifically considering and applying the provisions of the Competition and Consumer Act in respect of unconscionability, and particularly in the context of documentary credits, may possibly be limited compared to that under the previous TPA that it replaced due to the Competition and Consumer Act being more recent. There is, however, case law indicating that the advancement and consideration of the principle of statutory unconscionability by courts have continued under the Competition and Consumer Act. This is evident in cases such as *Olde & Ors v Primary Compass Limited ACN*,[211] where unconscionability in violation of s 51AA of the Trade Practices Act 1974, which was noted therein to now be replaced by the Competition and Consumer Act, was recognised as an exception in respect of which a court could grant an interlocutory injunction restraining a beneficiary from calling up a demand guarantee.[212]

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[209] *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited (No 2)* (2008) FCAFC 136 as cited in Alavi, *Comparative Study of Unconscionability*, at 106-107.

[210] *Clough Engineering Ltd V Oil & Natural Gas Corporation Ltd* (2007) ATPR 42-166, Federal Court of Australia, 07 June 2007, para 78.

[211] [2011] NSWSC 845.

[212] Idem, para 10.

Furthermore, in *Swanhill Enterprises Pty Ltd v Qbe Insurance (Australia),*[213] it was sought to restrain the beneficiaries of two respective bonds from calling them up on the basis that the beneficiaries had acted unconscionably under the Competition and Consumer Act by seeking to call up the bonds while not being entitled to do so.[214] Whilst unconscionability was recognised in this case as an exception to the autonomy principle and a statutory remedy which is available to victims of such conduct,[215] it was not determined to be applicable on the fact of the *Swanhill* case.[216] Consideration has been given to the materiality of some apparent distinctions between the TPA and the Competition and Consumer Act. The explicit reference to persons and corporations in the TPA and the absence of reference to corporations in the Competition and Consumer Act, for example, have reference in this regard. On closer analysis, however, the conclusion seems to be that this change was made merely to enhance clarity and the term "persons" in the latter encompasses both individuals and corporations (i.e., both natural and legal persons). Statutory unconscionability thus seems to have continued to be recognised and drawn upon under the Competition and Consumer Act in respect of documentary credits in substantially similar form as it did under the TPA.[217]

5.2.6 Some Arguments Against and In Favour of Recognition of the Unconscionability Exception from an Australian Law Perspective

5.2.6.1 The Autonomy Principle and Recourse to the Unconscionability Exception as a Remedy Within Certain Parameters

A major criticism against the unconscionability exception is the corrosive effect on the autonomy principle.[218] Advocates for recognising unconscionability under common law in Australia have argued that if a broad interpretation of section 51AA of the TPA was ever rejected, then the only recourse for victims of unconscionable conduct in relation to documentary credits would be to turn

[213] [2017] WASC 279.

[214] Idem, para 9.

[215] Idem, para 13.

[216] Idem, para 14.

[217] Masagoes, *The Unconscionability Exception*, at 259; and Wooler, GC, "The New Asplenium Clause Unconscionability Unwound", (2016), 1, *Singapore Journal of Legal Studies*, 169, at 171.

[218] Refer to section 1of this Chapter.

to common law.[219] It has been proposed that the utility of such an exception would lie in its ability to combat unconscionable behaviour by beneficiaries, such as the insistence upon a formal right under a demand guarantee. At the same time, there is no substantive right or entitlement under the underlying contract.[220]

Procedural safeguards that would preserve the risk allocation intended under a demand guarantee have been suggested as a measure to allay concerns that an unconscionability exception would undermine the autonomy principle and utility of demand guarantees.[221] On such procedural safeguard which has been proposed is that in cases where an applicant makes out a strong case that the beneficiary may not be entitled to make the demand they are making, a beneficiary should be required to furnish realisable security which can be realised if the beneficiary turns out to have made an unjustifiable demand.[222]

The presence of case law precedent on conduct which courts would likely consider to be unconscionable is a factor that is considered to favour recognition of the unconscionability exception. The body of relevant cases in this regard is considered to provide a common doctrinal foundation that the courts could tap on for direction.[223]

5.2.6.2 The Pressing Need to Prevent Abusive Calls on Documentary Credits

The success of demand guarantees has been attributed to the autonomy principle. However, despite this, it has been noted that rigid application of the autonomy principle could lead to harsh results when applied without regard to the context or circumstances of individual cases.[224] Moreover, the disadvantages associated with such rigid application of the autonomy principle include that it can be conducive to egregious scams.[225] The game of brinksmanship required to balance the autonomy

[219] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 82.

[220] Idem, at 56.

[221] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 49 and 82.

[222] Idem, at 82.

[223] Ibid.

[224] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 76

[225] Byrne J, "Critical Issues in the International and Domestic Harmonisation of Letter of Credit Law and Practice" (1995), *Commercial Law Annual*, 389 (hereinafter, Byrne, *Critical Issues in the International and Domestic Harmonisation of Letter of Credit Law*"), at 421.

principle on the one hand and, on the other hand, the need to deter abusive tendencies such as fraudulent conduct in relation to demand guarantees is arguably applicable to unconscionability.[226]

5.2.6.3 Public Policy and Equity-based Considerations

Equity-based considerations such as unconscionability under demand guarantee law have gained a firm foothold, a *status quo* conceded in the statement, "[e]quity's place in the law of commerce long resisted by commercial lawyers, can no longer be denied."[227] The policing of good faith in commercial transactions, which goes hand in hand with preventing unconscionable conduct, seems to be gaining increasing influence in the courts of law. The incorporation of anti-unconscionability measures into legislation in the form of section 51AA of the TPA is considered to indicate recognition of the importance of preventing unconscionability.[228] The retention or incorporation of prohibitive provisions in respect of unconscionable conduct in the Competition and Consumer Act further reflects a continuation of this position.[229]

5.2.6.4 Diminishing the Utility of Documentary Credits

A popular argument lodged against recognising additional exceptions other than fraud to the autonomy principle is that a proliferation of such exceptions may diminish the utility of documentary credits. While the autonomy principle does have a crucial role to play and is an intrinsic part of the nature of documentary credits, it is important to note that if documentary credits are left vulnerable to other forms of abusive conduct such as unconscionability with no recourse available for potential victims of this conduct, their utility may be damaged even more. If documentary credits start being perceived as favourable for unscrupulous and dishonest beneficiaries, their utility to applicants, who are also key drivers of the use of these instruments, is also significantly undermined. Therefore, the workings of documentary credits must be tailored in a balanced manner that also provides some protection or recourse against abuse thereof, which in some instances takes the form of unconscionable conduct.[230]

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[226] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 75-76.

[227] Millett P, "Equity's Place in the Law of Commerce" (1998) 114 *LQR* 214 at 216-217.

[228] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 76-77.

[229] See sections 20-22 of the Competition and Consumer Act.

[230] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 77.

5.2.6.5 Potential for Over-weighting the Reputation of Issuers/Guarantors

Although it is conceivable that a financial institution's reputation would likely suffer if it defaulted on its obligations under a documentary credit, the circumstances around this are an important qualifier. If, for instance, a guarantor was faced with a compliant demand for payment under a demand guarantee and, instead of making payment per its obligations, decided on its own determination to descend into the arena of the dispute between the underlying parties, the bank may well suffer reputational damage. Therefore, the argument that the unconscionability exception should be a remedy capable of being applied only by courts[231]lends support to this.

An injunction by a court on the ground of unconscionability, on the other hand, is a judicial act which leaves little room for discretion on the part of a guarantor. In addition, the argument that an unconscionability exception would endanger the reputation of issuers of documentary credits has been debunked on the basis of a lack of empirical data and authority to support it, plus the implausibility of there being a presumption that guarantors are entitled to have their reputations protected.[232] It has been asserted that such an argument must fail in the context of equitable intervention by courts to prevent unconscionable conduct.[233]

5.2.6.6 Possible Over-weighting of the Uncertainty Argument

The uncertainty associated with the unconscionability exception to the autonomy principle is a common criticism against its recognition. However, it has been pointed out that a degree of uncertainty is not unique to instances where unconscionability is recognised and is to be expected in any business relationship, including demand guarantee arrangements. In addition, the uncertainty argument has been challenged, *inter alia*, on the basis that unconscionability is capable of being applied within reasonably certain parameters without reliance on unbridled judicial discretion. This approach was depicted in the case of *Louth v Diprose*[234] where the court remarked,

> "although the concept of unconscionability has been expressed in fairly wide terms, the courts are exercising an equitable jurisdiction according to recognized principles. They are not armed with a

[231] Idem, at 81.

[232] Rodrigo, T "Toward Fairness in the Guarantee Market: The Rationale for Expanding Interventions from Fraud to Unconscionability in the Enforcement of Demand Guarantees" (2013), 16, *International Trade and Business Law Review*, 225, at 249.

[233] Ibid.

[234] *Louth v Diprose* (1992) 175 CLR 621.

general power to set aside contractual bargains simply because in the eyes of the judges, they appear to be unfair, harsh or unconscionable".[235]

The equitable remit of the courts would thus be applied within the confines of recognised principles.[236]

5.2.6.7 Potential of Balancing the Unconscionability Exception with the Preservation of the Risk Allocation Function of Documentary Credits

Although not completely rejecting the admission of remedies against unconscionable conduct within the international documentary credit law framework, some scholars have cautioned that any such remedies should not go so far as to shift the initial allocation of risks agreed between the parties.[237] Essential functions of demand guarantees include the allocation/re-allocation of risks (e.g., litigation and credit risk), liquidity management, ensuring performance by an applicant and cost reduction. The matter of an unconscionability exception potentially scuppering the intended risk allocation function of a demand guarantee is one of the points raised against recognition of the exception. Whilst this is certainly a valid point, the parameters of such risk allocation need not, as the default position, permit conduct bordering on unconscionability from the beneficiary.

It has been submitted that the recognition of unconscionability as an exception to the autonomy principle is not necessarily inimical to these functions. In response to any arguments that the unconscionability exception interferes with the risk allocation function of demand guarantees, it is pointed out that the unconscionability exception does not by design dislocate the credit risk pursuant to the demand guarantee.[238] The argument had been advanced that any ambiguity and perhaps potential challenges relating to demands may be avoided by ensuring that where the risk of a beneficiary acting in what some may perceive to be a commercially driven manner is to be borne by an applicant, this is made clear in an underlying contract. [239]

According to scholars like Fedotov, unconscionability can be tailored around the functions of a demand guarantee so as not to unduly undermine the key functions of the demand guarantee, such

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[235] Ibid.

[236] (1992) 175 CLR 621, at 654.

[237] Fedotov, *Abuse, Unconscionability and Demand Guarantees,* at 67.

[238] Idem, at 80.

[239] Dixon, *As Good as Cash?*, at 29.

as risk allocation.[240] As discussed above,[241] it has been posited that the application of the exception could be tempered by procedural safeguards and application in a manner that does not interfere unjustifiably with the risk allocation agreed between the parties to a documentary credit. In line with this, it has been suggested that where an applicant makes a strong case that a beneficiary may not be entitled to payment, the beneficiary could be required to furnish realisable security.[242]

5.2.7 Conclusion: The Position of Unconscionability under Australian Law

Unconscionable conduct is a well-recognised ground upon which a beneficiary may be restrained from calling up a demand guarantee under Australian law.[243] As depicted in the above analysis, the unconscionability exception is recognised under both the statutory law and common law of Australia. Some scholars have observed that the interaction of the common law doctrine of unconscionability under Australian law and the statutory principle of unconscionability is somewhat murky.[244] The recognition of unconscionability as an exception to the autonomy principle has thus gone down two paths under Australian law: a common-law path and the statutory path under section 51AA of the TPA in respect of demand guarantees.[245]

Unconscionable conduct under the TPA (now replaced by the Competition and Consumer Act in respect of the relevant provisions) is a recognised ground for equitable intervention in commercial dealings, including demand guarantees in particular. Australian courts have illustrated via case law how the boundaries of acceptable exceptions to the autonomy principle have stretched to accommodate unconscionability, both at common law and under statutory law tenets.[246]

It would appear that there are divergent views advanced regarding the scope and application of section 51AA of the TPA in relation to unconscionability, particularly whether the narrow or broad approach is dominant. Australian courts have exhibited seeming reluctance to determine which of

[240] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 77-80.

[241] See section 5.2.6.1 of this chapter.

[242] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at, at 82.

[243] Rodrigo, *Unconscionable Demands*, at 481.

[244] Alavi, *Comparative Study of Unconscionability*, at 107.

[245] Masagoes, *The Unconscionability Exception*, at 264.

[246] *Inflatable Toy Co v State Bank of New South Wales* (1994) 34 NSWLR 243.

the judicial attempts to determine the precise scope of section 51AA of the TPA is correct.[247] No definitive conclusion as to which one is the more correct view seems to have been established by the superior courts of Australia.[248] However, this judicial ambiguity has not deterred some scholars from the perception that the application of the unconscionability exception under Australian law is narrow, with room for future consideration to perhaps expand it.[249]

Moreover, it was confirmed in the Parliamentary speech of the Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010 that the existing Australian case law under the TPA would continue to be relevant to the interpretation and application of the new/corresponding sections under the Competition and Consumer Act.[250] Given the substantial similarity between unconscionability under the TPA and the Competition and Consumer Act, the definitional deficiencies of the former have largely carried over into the latter. It is still worth noting that the latter went further, albeit slightly or arguably negligibly, in trying to lend certainty to the term unconscionability by introducing the current section 22 of the Competition and Consumer Act, which outlines factors to be considered when determining what constitutes unconscionable conduct, an amendment that was introduced pursuant to the Competition and Consumer Legislation Amendment Act 2011.

A wider concept of unconscionability, which encompasses, in the context of demand guarantees, situational disadvantage, e.g., arising from a beneficiary seeking to call up a demand guarantee despite not being entitled to do so, is considered by some commentators to have gained and retained significant traction under Australian law.[251] A case such as *Australian Competition and Consumer Commission v CG Berbatis Holdings* which seems to accommodate a wider notion of unconscionability, is seen by some commentators to support the application of a broad concept of unconscionability under the TPA.[252]

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[247] *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, paras 44-45.

[248] Ibid.

[249] Masagoes, *The Unconscionability Exception*, at 269.

[250] Emerson, C, Commonwealth of Australia Parliamentary Debates, House of Representatives, Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 Second Reading Speech, 17 March 2010, at 2719.

[251] Rodrigo, *Unconscionable Demands*, at 482-483. See also *Australian Competition and Consumer Commission* v *Samton Holdings Pty Ltd* (2002) 117 FCR 301, at 323.

[252] Dean, N "Cases and Comments - ACCC v Berbatis Holdings (2003) 197 ALR 154" (2004) *Sydney Law Review* 256, at 256.

Others, in contrast, have ardently expressed the hope that courts will retain a higher degree of deference to the autonomy principle and accordingly promote a narrower application of the fraud exception.[253] Despite the varied opinions on the nuance of its scope, the position that the doctrine of unconscionability is firmly recognised under Australian law, particularly as a potential exception to the autonomy principle of demand guarantees, is seemingly very clear.[254] The developing body of case law on unconscionability has also been referenced as a useful source of helpful precedents which courts can turn to for guidance in determining examples of conduct which evidences unconscionability and the parameters of applying the unconscionability exception.[255]

5.3 BREACH OF A NEGATIVE STIPULATION

5.3.1 Introduction: General Aspects and Brief Rationale of Negative Stipulations in relation to Demand Guarantees

5.3.1.1 Conflicting Rights Arising in the Context of Breach of a Negative Stipulation

The breach of a negative stipulation exception seems to be understood in Australia in a broadly traditional sense as occurring where a beneficiary has agreed in an underlying (or other) contract that they would not exercise their right to call up a demand guarantee before the realisation of certain conditions or events outlined in the relevant contract but proceeds to call up the demand guarantee contrary to such agreement. Moreover, the argument has been advanced that a breach of a negative stipulation or covenant may render a call on a demand guarantee an abusive call. [256] The breach of a negative stipulation exception is considered to have gained traction since the 1970s under Australian law as the third recognised exception after fraud and unconscionability, respectively.[257]

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[253] Browne, *The Fraud Exception*, at 117.

[254] Alavi, *Comparative Study of Unconscionability*, at 107.

[255] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 82.

[256] Marxen, K "*Demand Guarantees in the Construction Industry: A Comparative Legal Study of their Use and Abuse from a South African, English and German Perspective*", LLD thesis, University of Johannesburg, 2017 (hereinafter, "Marx, *Demand Guarantees in the Construction Industry*"), at 280.

[257] Kelly-Louw, M and Fayers, R "The 'Breach of a Negative Stipulation' as an Exception to the Autonomy Principle in England and South Africa" (2021), 84, *THRHR*, 515, (hereinafter Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*) at 517.

5.3.2 Rationale and Role of The Breach of a Negative Stipulation Exception

5.3.2.1 Reasons for Negative Stipulation Provisions from an Applicant's and a Beneficiary's Perspective

It is acknowledged that given the on-demand/independent nature of demand guarantees, which are designed to necessitate payment by a guarantor merely upon the presentation of a compliant demand by a beneficiary, an applicant in a demand guarantee arrangement may seek to safeguard their interests by alternative means. Such alternative means with increasing commonness have included provisions that restrict the beneficiary's entitlement to call up the guarantee to specific circumstances or fulfilment of conditions.

The reasons why beneficiaries agree to such restrictive provisions vary from case to case. In some jurisdictions, including Australia, these may include higher bargaining power of an applicant or, conversely, the need to dilute the traditionally higher bargaining position of a beneficiary and harsh allocation of risk against the applicant. The need to demonstrate a degree of good faith and build trust with an applicant is another reason why a beneficiary may accept restrictive conditions on calling up a demand guarantee. Moreover, contractual provisions which restrict when a beneficiary may call up a demand guarantee may be a cost-effective alternative to a counter-guarantee. [258]

5.3.3 Arguments in Favour of and Against Recognising Breach of a Negative Stipulation as an Exception to the Autonomy Principle

5.3.3.1 Vulnerability of Demand Guarantees to Abuse

The on-demand nature of demand guarantees is a core element of their utility and how they are intended to function. However, this feature has also been noted to render them vulnerable to abuse and scams of a "particularly vicious" nature.[259] The need to counterbalance demand guarantees' vulnerability to abuse is, therefore, an important factor referenced to support recognition of the breach of a negative stipulation exception.

[258] Alavi, H "Contractual Restrictions on Right of Beneficiary to Draw on a Letter of Credit; Possible Exception to Principle of Autonomy" (2016), 16(2), *ICLR*, 67 (hereinafter, "Alavi, *Contractual Restrictions*"), at 72.

[259] Byrne, *Critical Issues in the International and Domestic Harmonisation of Letter of Credit Law*, at 421.

5.3.3.2 Freedom of Contract and Legitimate Expectations

The legitimate exceptions, which are an intrinsic theme of contractual relations, and the binding nature of contracts in general, have been invoked in support of the breach of a negative stipulation exception. Furthermore, it would seem in line with the principle of freedom of contract that a contractual covenant by a beneficiary not to call up a demand guarantee, except upon the occurrence of certain events or fulfilment of certain conditions, should be enforced.

5.3.3.3 Absence of Discretion in respect of a Negative Covenant

Due to the nature of a breach of a negative stipulation exception, particularly that it entails a prior contractual agreement by a beneficiary to refrain from calling up a demand guarantee except only upon the occurrence of certain events or the fulfilment of specified conditions, it is a remedy which is tantamount to enforcement of a contract. Upon establishing the unequivocal presence of such a negative stipulation or covenant binding upon the beneficiary, the scope for court discretion is somewhat limited. The court's consideration is typically restricted only to establishing the existence of a negative covenant and whether it has been breached, and if so, enforcement of same. It would appear that the extent of court intervention, and indeed all that could be sought from the courts in this regard, is the enforcement of a contractual obligation.

5.3.3.4 Novelty of the Breach of an Underlying or Other Contract Exception

The novelty of breach of a negative stipulation as an exception to the autonomy principle is argued as a factor which contributed to its progressive recognition. This was depicted in the Australian case of *Bachmann Pty Ltd v BHP Power New Zealand Ltd*[260] and in *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty* Ltd,[261] where Rolf J, despite the absence of a negative stipulation applicable in that case, acknowledged that "... [h]ad the construction contract itself contained some qualification upon the [beneficiary's] power to make a demand under a performance guarantee, the position might well have been different."[262]

[260] (1999) 1 VR 420.

[261] *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451, at 457.

[262] *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443, at 459; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451, at 457.

5.3.3.5 Lack of Authority in Outright Opposition to Recognition of the Exception

Some commentators argue that an absence of authority debunking the breach of a negative stipulation exception could indicate the position of a jurisdiction on the exception.[263] For instance, the absence of definitive case law categorically rejecting the breach of a negative stipulation exception under Australian law could at most be indicative of tacit acceptance of the exception in this jurisdiction or, at the very least, indicate that the matter is not yet firmly decided and that the law could progress or swing either way.[264]

5.3.3.6 Relationship of the Breach of a Negative Stipulation Exception to the Autonomy Principle

The need to preserve and not interfere with the autonomy principle is often raised as an argument against exceptions to it, including the breach of a negative stipulation exception. At the same time, it is conceivable that the autonomy principle could be violated in certain circumstances relating to the breach of a negative stipulation, e.g., where a court overstepped in its application of the exception by seeking to restrict payment by a guarantor rather than simply enforcing the relevant restrictive term against the beneficiary. This appears somewhat of a remote scenario, made more unlikely by the fact that it would necessarily require misapplication of the exception by the courts and the disregard of certain contractual principles such as privity of contract. When applied correctly and in line with its nature, the breach of a negative stipulation exception is typically enforceable only against the beneficiary that agreed upon the negative stipulation upon whom the negative stipulation is binding. Any interaction with or undermining the autonomy principle is virtually non-existent, so referring to the breach of a negative stipulation as an exception, without context and within the typical meaning of the term, can be regarded as a misnomer. This position, which has been discussed in more detail in earlier chapters,[265] is submitted to hold under Australian law as it does in other jurisdictions.

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[263] Alavi, *Contractual Restrictions*, at 84.

[264] Ibid.

[265] See the detailed discussion regarding the interaction of the breach of a negative stipulation exception and the autonomy principle from a South African law perspective in Chapter 3 of this thesis. A brief consideration of the English law perspective on this is included in Chapter 4, noting that the scope of this thesis is confined to analysis only from a South African law perspective, and summarising key selective aspects of the position under English and Australian law in order to facilitate, in Chapter 7 of this thesis, comparative analysis of each against the South African law and to reach conclusions and make recommendations arising therefrom.

5.3.3.7 Exacerbation of Uncertainty in Relation to Documentary Credits

Uncertainty, an umbrella term including all the potential interpretational uncertainties of exceptions such as the unconscionability exception, has also been argued to be equally pertinent in the context of the breach of a negative stipulation exception.[266] Issues such as irreconcilable lines of authority and potential inconsistencies in judicial interpretation of contractual wording have been noted to depict a deficiency of certainty in relation to documentary credits and the parties to it.[267] Such uncertainty will undoubtedly multiply where the recognition of a breach of a negative stipulation exception extends to implied negative stipulations. Particularly where the existence of a negative stipulation or the lack thereof is likely to be more open to disputation and hinges on a court's determination. Uncertainty in relation to the breach of a negative stipulation exception is, however, an issue which has been noted to be capable of significant mitigation through the application of specific parameters, dealt with below.

5.3.3.8 Negative Stipulations as a Tool in Contractual Manoeuvring

The recognition of a breach of a negative stipulation exception can be seen as offering applicants a bolt-hole of sorts in respect of demand guarantees. In particular, sufficiently sophisticated parties with relevant bargaining power could negotiate for restrictive terms in an underlying or other relevant contract, with the sole aim of frustrating any demands or reducing the weight of the risk allocation otherwise agreed upon via entry into a demand guarantee arrangement. It is a contractual tool which any sensible and sufficiently knowledgeable or resourced applicant would not hesitate to exploit in their favour. On the face of it, it would seem that such an exception could have the effect of clawing back a good amount of the cash equivalence or utility that a demand guarantee has, to the detriment of the unwitting beneficiary.

However, the beneficiary is equally not restricted from utilising their bargaining power, knowledge or resources to negotiate an underlying or other contract that does not restrict their ability to call up a demand guarantee. A similar view is advanced and expanded upon further by Dixon, who asserts that a beneficiary could require certain provisions to be incorporated in the underlying contract, requiring the applicant to acknowledge, *inter alia*, that:

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[266] Alavi, *Contractual Restrictions*, at 85.

[267] Dixon, *As Good as Cash?*, at 28-29.

- the demand guarantee is an unconditional instrument and risk allocation device reflecting the parties' intention that any litigation or dispute-related risk should be borne by the applicant, who will accordingly be the one out-of-pocket pending the resolution of any dispute; and

- the terms of the contract do not and are not intended to contain any restriction upon the beneficiary's right to make a demand, which the beneficiary is entitled to make regardless of any dispute, in the absence of fraud.[268]

5.3.4 Recognition of Breach of a Negative Stipulation as an Exception under Australian Law

Australia has been said to be the jurisdiction of origin of the breach of a negative stipulation exception.[269] Australian case law is thus considered to overall be reflective of a supportive approach to the breach of a negative stipulation exception[270] Like the prevailing approach under English law and developing South African law, the accepted formulation of the breach of a negative stipulation exception under Australian law is that the exception only operates against the beneficiary (i.e., an anti-beneficiary injunction). The impression that Australian law may have unequivocally embraced the breach of a negative stipulation exception is depicted in the following statement from *Lane-Mullins v Warrenby Pty Ltd:*[271]

> "There is an exception for the principle of autonomy where there is an underlying contract between the applicant for the guarantee and the beneficiary which restricts the beneficiary's power to demand payment under the guarantee".[272]

The breach of a negative stipulation exception can be said to be based on the premise that it is open for an account party or applicant in a demand guarantee context (being the party bearing the burden of proof)[273]to allege that the underlying contract regulates the circumstances upon which a demand

[268] Dixon, *As Good as Cash?, at* 27-28.

[269] Enonchong, N "The Problem of Abusive Calls on Demand Guarantees" [2007] *LMCLQ* 1, 83, at 90.

[270] Alavi, *Contractual Restrictions*, at 77-78.

[271] [2004] NSWSC 817.

[272] *Lane-Mullins v Warrenby Pty Ltd* [2004] NSWSC 817, at [53] and *Clough Engineering limited v Oil and Gas Corporation Limited* [2008] FCAFC 136.

[273] *ADI Ltd v State Electricity Commission of Victoria* (Unreported, Vic Sup Ct, Brooking J, 12 August 1997).

guarantee can be called up.[274]

5.3.5 Selective Cases on the Breach of a Negative Stipulation Exception under Australian Law

Australian case law is generally perceived to fully support the recognition of the breach of a negative stipulation exception, as demonstrated by the selective cases considered briefly below.

5.3.5.1 Wood Hall Ltd v Pipeline Authority

Wood Hall is an early seminal case without which consideration of the breach of a negative stipulation exception as against the beneficiary under Australian law would be incomplete. The court in *Wood Hall* acknowledged that the terms of an underlying contract could, in certain circumstances, qualify a beneficiary's right to call up a demand guarantee.[275]

In *Wood Hall*, a demand guarantee was issued to the beneficiary in connection with a contract for the construction of a pipeline. A dispute occurred, pursuant to which the beneficiary called up the demand guarantee, and the applicant sought an injunction from the court on the allegation that the applicant had not breached the underlying contract and, therefore, the beneficiary's demand was not entitled to make a demand under the demand guarantee. The High Court of Australia ruled in favour of the beneficiary and, quite notably, seemed to re-affirm the autonomy principle by finding that it was not possible to block a payment under a demand guarantee where there is an unconditional demand guarantee placing an obligation upon the guarantor to make payment upon presentation of a compliant demand.[276]

A key element of the *Wood Hall* case which has been cited in relation to the breach of a negative stipulation exception is the acknowledgement by Stephen J that "the position might well have been different"[277]if the underlying contract gave rise to the demand guarantee contained some restrictions on the beneficiary's entitlement to call up the demand guarantee amount, in which case the plausible inference made is that the court could and would indeed have restrained the beneficiary from calling up the demand guarantee in such circumstances. In this case, the position

[274] Dixon, *As Good as Cash?,* at 21.

[275] *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443, at 456.

[276] Enonchong, N *The Independence Principle of Letters of Credits and Demand Guarantees*, Oxford University Press, 2011 (hereinafter, "Enonchong, *The Independence Principle of Letters of Credits and Demand Guarantees"*), at 219.

[277] (1979) 141 CLR 443, at 459.

was, however, not different because there were no express restrictions regarding the independent guarantee in the underlying contract.

The *Wood Hall* case is considered authoritative in supporting judicial intervention in documentary credit arrangements where a demand is made in breach of express terms of an underlying contract.[278] *Wood Hall* is a cornerstone of the position that a beneficiary may be restrained by means of an injunction from calling up a documentary credit in breach of a negative covenant in favour of the person applying the injunction, which position is well-recognised in Australia.[279]

5.3.5.2 Pearson Bridge Pty Ltd v State Rail Authority of New South Wales

Another early and prominent Australian case regarding the breach of a negative stipulation exception is *Pearson Bridge Pty Ltd v State Rail Authority of New South Wales.*[280] In *Pearson Bridge*, the underlying contract provided for security for the performance under the contract, which took the form of a demand guarantee. The underlying contract contained a provision which outlined the circumstances in which the beneficiary could call up the demand guarantee, which provision was considered to constitute a negative covenant.

The court, with reference to supporting Australian case law such as *Wood Hall*,[281] granted an injunction against the beneficiary on the ground that the making of a demand by the beneficiary in breach of the negative stipulation in the underlying contract was a serious issue to be tried.[282] The position that an injunction can be issued to restrain a beneficiary from calling up a demand guarantee in breach of a contractual negative stipulation has found support in several Australian cases.[283]

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[278] See, for instance cases such as *Pearson Bridge (NSW) Pty Ltd v State Rail Authority (NSW*) (1982) 1 Aust Constr LR 81; *Selvas Pty Ltd v Hansen Yuncken (SA) Pty Ltd* (1987) 6 Aust Constr LR 36; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451; and *Lane-Mullins v Warrenby Pty Ltd* [2004] NSWSC 817.

[279] *Selvas Pty v Hansen Yuncken (SA) Pty Ltd* (1987) 6 ACLR 36; *Putney Group Pty Ltd v The Royal Rehabilitation Centre Sydney* [2008] NSWSC 1424; *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2008] FCAFC 136; *Olde & Ors v Primary Compass Limited* [2011] NSWSC 845; and *Ceresola TLS AG v Thiess Pty Ltd v John Holland Pty Ltd* [2011] QSC 115.

[280] [1982] 1 Aust Constr LR 81.

[281] See *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443; *Williamson Limited v Lukey and Mulholland* (1931) 45 CLR 282, and *Ampol Petroleum Limited v Mutton* (1952) 53 SR1 59.

[282] Enonchong, *The Independence Principle of Letters of Credits and Demand Guarantees*, at 219.

[283] See *Selvas Pty v Hansen Yuncken (SA) Pty Ltd* (1987) 6 ACLR 36; *Putney Group Pty Ltd v The Royal Rehabilitation Centre Sydney* [2008] NSWSC 1424; *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2008] FCAFC

5.3.5.3 Bachmann (Pty) Ltd v BHP Power New Zealand Ltd

In *Bachmann (Pty) Ltd v BHP Power New Zealand Ltd*,[284] the matter before the court involved a building contract containing a restrictive term, which read, "A party shall not convert into money security that does not consist of money until the party becomes entitled to exercise a right under the Contract in respect of the security"[285] and was relevant in the context of two standby letters of credit. Brooking JA (Tadgell and Ormiston JJA concurring) found that the contractual provision in question constituted,

> "… an express, albeit qualified, contractual prohibition on the conversion of a security into cash [and could be soundly construed as a] promise as part of the contract under which the security is provided ─ the underlying contract ─ not to do some act in relation to the security except in a certain event."[286]

The court, therefore, agreed as to the existence of an explicit negative covenant in the underlying contract.

Brooking JA went on to state the following position regarding the nature and effect of such a negative covenant:

> "Such a contractual promise is efficacious, not in the sense, when the security is constituted by the obligation of a third person, that the third person can rely by way of defence as against the security-holder on a term of the underlying contract, to which he was not a party, but in the sense that relief can be afforded to the person who procured the security in an action brought against the security-holder on the promise contained in the underlying contract. No principle or rule of law would deny that a promise forming part of the underlying contract is in this sense efficacious …"[287]

The court further highlighted several Australian law cases that adopted or supported this position.[288]

136; *Olde & Ors v Primary Compass Limited* [2011] NSWSC 845; and *Ceresola TLS AG v Thiess Pty Ltd v John Holland Pty Ltd* [2011] QSC 115.

[284] [1998] VSCA 40.

[285] Idem, para 7.

[286] Idem, para 28.

[287] Ibid.

[288] *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443, at 452-454 and 459; *Pearson Bridge (NSW) (Pty) Ltd v State Rail Authority of New South Wales* (1982) Aust Const LR 81; *Washington Constructions Company Pty Ltd v Westpac Banking Corporation* (1983) QdR 179; *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty*

5.3.5.4 Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd

In *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd*[289] Callaway JA was faced with similar issues relating to the effects of a breach of a negative stipulation on a demand guarantee. Notably, the learned judge of appeal gave due consideration to the distinction between restraining a /guarantor of a demand guarantee from making payment and restraining a beneficiary from demanding payment under a demand guarantee. Callway JA first noted the stance taken by the court in the English case of *Group Josi Re v Walbrook Insurance Co Ltd*,[290] where such a distinction was dismissed as irrelevant, and Staughton LJ opined that the effect on the lifeblood of commerce is precisely the same regardless of whether it is the guarantor, restrained from paying or the beneficiary restrained from making a demand under a demand guarantee.[291]

Callaway disagreed, correctly it is submitted, with the view adopted in *Group Josi*, succinctly explaining the distinction thus:

> "There is nevertheless an important difference between restraining a bank from honouring a guarantee and restraining the beneficiary from calling upon it. In the former case the moving party seeks to prevent the bank from performing its contract; in the latter case the moving party seeks to prevent the beneficiary from breaching a provision of the underlying contract. A moment's reflection will show that the beneficiary, unlike the bank, may be restrained if there is an express prohibition in the underlying contract against calling upon the guarantee."

Another important distinction highlighted in Fletcher is between an express negative stipulation and an implied one. Callaway JA acknowledged that, theoretically, an implicit or implied negative stipulation could be just as good but also underscored the difficulties that may arise with establishing its existence.[292] Furthermore, Callaway noted that an additional factor further compounding the difficulty of establishing an implied negative stipulation is that an "implication

Ltd (1985) 1 NSWLR 545; *Tenore Pty Ltd v Roleystone Pty Ltd*, Unreported, Supreme Court of New South Wales, 14 September 1990; *J H Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd*, Unreported, Supreme Court of the Northern Territory, 30 January 1989; *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 Building and Construction Law 210; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451 at 457; *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1993) 11 Building and Construction Law 50; and *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812.

[289] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812.

[290] [1996] 1 WLR 1152.

[291] Idem, at 1161-1162.

[292] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, 826–827, citing *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1161-1162.

cannot be made if it would stultify, or even if it would be inconsistent with, the purpose for which the guarantee was taken".[293]

5.3.5.5 Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd

Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd[294] is another notable Australian case in which breach of a contractual promise not to call on a demand guarantee except upon the occurrence of certain events was recognised as a ground for an injunction to prevent a beneficiary from calling up a demand guarantee. In *Reed Construction*, Austin J noted that while the court would not restrain the guarantor of a demand guarantee from honouring an unqualified promise to pay, in circumstances where,

> "the party in whose favour the bond has been given has made a contract promising not to call upon the bond, breach of that contractual promise may be enjoined on normal principles relating to the enforcement by injunction of negative stipulations in contracts." [295]

These remarks from *Reed Construction* seem to re-affirm the acceptance only of the anti-beneficiary formulation of the breach of a negative stipulation exception. *Reed Construction* thus made it clear that while the courts would not restrain a guarantor from meeting its payment obligations under a demand guarantee on the basis of a contractual restriction on the beneficiary's entitlement to make a demand (i.e., apply a true exception formulation of preventing the guarantor from honouring a demand), nothing precluded the enforcement of the restriction against the beneficiary by way of an injunction under the already existing enforcement framework in respect of contracts.

5.3.5.6 More Recent Cases regarding Breach of a Negative Stipulation Exception under Australian Law

In a more recent Australian Victoria Supreme Court of Appeal case, *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd*,[296] the court, with reference to cases such as *Fletcher Construction*

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[293] Ibid.

[294] (1999) 15 BCL 158.

[295] Idem, at 164. See also *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, at 826-827; *Bachman Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420; [1998] VSCA 40, para 28; *Baulderstone Hornibrook Pty Ltd v Qantas Airways Ltd* [2000] FCA 672, para 10; and *Rejan Constructions Pty Ltd v Manningham Medical Centre Pty Ltd* [2002] VSC 579, para 37.

[296] [2015] VSCA 98.

Australia Ltd v Varnsdorf Pty Ltd,[297] *Clough Engineering Ltd v Oil & Natural Gas Corporation* Ltd,[298] and *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd*[299] highlighted the relevance of determining the commercial purposes of a demand guarantee when interpreting its provisions, including in the context of an alleged breach of a negative stipulation. The purposes of a demand guarantee in *Sugar Australia* were noted to include the provision of security and the allocation of risk, the latter amounting to an agreement of who would be out of pocket pending the resolution of any dispute arising.[300]

In recognition of the potential impact of a negative stipulation in relation to the purpose of a demand guarantee, it was remarked:

> "The fact that a performance bond is intended to operate as a risk allocation device is not, of course, necessarily determinative of the right of a party to have recourse to it. It may be subject to a contractual qualification or limitation upon the circumstances in which recourse may be had."[301]

In the recent 2020 case of *Uber Builders and Developers Pty Ltd v MIFA Pty Ltd*,[302] the Australian position regarding breach of a negative stipulation exception and the standard required to establish it was reiterated by Nichols J as follows:

> "Where the contract does impose a condition on the right to access the security, the party seeking to restrain recourse must establish the existence of a serious question to be tried as to whether the beneficiary has in fact met the contractual requirements."[303]

[297] *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812.

[298] *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd [No 3]* (2008) 249 ALR 458.

[299] *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2010] NSWCA 283.

[300] *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98, paras 19-24.

[301] Idem, para 25.

[302] *Uber Builders and Developers Pty Ltd v MIFA Pty Ltd* [2020] VSC 596.

[303] Idem, para 26; *Dedert Corporation v United Dalby Bio-Refinery Pty Ltd* [2017] VSCA 368, and *Siemens Gamesa Renewable Energy Pty Ltd v Bulgana Wind Farm Pty Ltd* [2019] VSCA 318.

5.3.6 The Scope and Parameters of the Breach of Negative Stipulation Exception Established by Case Law

5.3.6.1 Distinction between Restraining a Beneficiary from Making a Demand and Restraining a Guarantor from Making Payment and their Effect on the Autonomy Principle

Some very pertinent questions have been posed regarding the breach of a negative stipulation exception. These include whether it affects the autonomy principle and whether it is correct to regard it as a true exception to the autonomy principle in the same way that fraud is so recognised.[304] An inevitable further question to be considered in conjunction with these considerations is whether a beneficiary should be allowed to rely on the autonomy principle to justify calling up a documentary credit despite having agreed to terms restricting their entitlement to make a demand under an underlying contract.[305]

There is a strong, consistent line of Australian law precedent cases recognising the position that a beneficiary may be enjoined from calling up a demand guarantee or other documentary credit where it is established that they are not entitled to do so, particularly where they have contractually bound themselves not to do so except upon the occurrence of certain events.[306] Despite this, a number of Australian law cases have also upheld the stance that a beneficiary's entitlement to call up a documentary credit is a broad and overriding one, as long as the claim is not fanciful or specious in nature.[307] These two lines of authority are considered to run parallel in an irreconcilable manner.[308] The divergent judicial views and the deviances in judicial interpretation of contracts they exhibit under Australian law have led some commentators to opine that considering documentary credits as the equivalent of cash under Australian law may be a dangerous

[304] *Alavi*, *Contractual Restrictions*, at 67.

[305] Ibid.

[306] See *Pearson Bridge v State Rail Authority of New South Wales* (1982) 1 ACLR 81; *Tenore Pty Ltd v Roleystone Pty Ltd* (Unreported, NSW Sup Ct, Giles J, 14 September 1990); *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 BCL 210; *Selvas Pty Ltd v Hanson Yuncken Pty Ltd and State Bank of Australia* (1987) 6 ACLR 36; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451; and *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158.

[307] *Hughes Bros Pty Ltd v Telede Pty Ltd* (1992) 7 BCL 210; *Phillips Pty Ltd v Baulderstone Hornibrook Pty Ltd* (Unreported, NSW Sup Ct,Giles J, 26 October 1994); *Ultra Refurbishing and Construction Pty Ltd v John Goubran & Associates Pty Ltd* (Unreported, NSW Sup Ct, Young J, 24 April 1997); *Coby Constructions Pty Ltd v Melbourne Glass Pty Ltd* (Unreported, Vic Sup Ct, Gillard J, 7 April 1998); and *Kennedy Taylor (Vic) Pty Ltd v Baulderstone Hornibrook Pty Ltd* (2000) 16 BCL 374, also referenced in Dixon, *As Good as Cash?*, at 22.

[308] An observation made by Brooking JA in *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] VR 420.

assumption.[309] Critics of the lack of a uniform and clear position under Australian law have scathingly suggested that the cash equivalent status of documentary credits under Australian law is dependent on a myriad of variables such as the judge allocated to make the decision, the subtleties of language in the relevant contract and whether in the judge's opinion the beneficiary has acted unfairly.[310]

Notwithstanding the existence of Australian law cases which have not fallen in line with the recognition of the breach of a negative stipulating exception, including particularly the anti-beneficiary formulation thereof,[311] the presence of a significant body of support for such anti-beneficiary injunctions to prevent the breach of a negative contractual stipulation has been viewed as a clear indication that when it comes to documentary credits an issuer's obligation to pay and a beneficiary's entitlement to claim, "are not simply opposite sides of the same coin".[312] In line with this view, there is an important distinction between the issuer's/guarantor's obligation and the beneficiary's entitlement. It is submitted that despite their corresponding nature, one (e.g., the beneficiary's entitlement to claim) can be excised from the other (the issuer's/guarantor's obligation to pay) and challenged separately without necessarily having any impact on the other.

In the *Wood Hall* case, it was confirmed that a beneficiary was entitled to receive payment under a demand guarantee on demand and that such a demand could not be considered against extrinsic circumstances. It was made clear that in relation to a claim under a demand guarantee, a guarantor cannot look to the underlying contract or transaction between the beneficiary and the applicant or to any transactions between itself and the applicant.[313]

This stance in *Wood Hall* plays well into the argument that any interference with a payment obligation under a demand guarantee would adversely affect the autonomy principle of demand guarantees. Arguably, there is generally or at the very least overwhelming majority consensus that an injunction restricting payment by an issuer of a documentary credit following the presentation

[309] Dixon, *As Good as Cash?*, at 23.

[310] Ibid.

[311] *Hughes Bros Pty Ltd v Telede Pty Ltd* (1992) 7 BCL 210; *Phillips Pty Ltd v Baulderstone Hornibrook Pty Ltd* (Unreported, NSW Sup Ct,Giles J, 26 October 1994); *Ultra Refurbishing and Construction Pty Ltd v John Goubran & Associates Pty Ltd* (Unreported, NSW Sup Ct, Young J, 24 April 1997); *Coby Constructions Pty Ltd v Melbourne Glass Pty Ltd* (Unreported, Vic Sup Ct, Gillard J, 7 April 1998); and *Kennedy Taylor (Vic) Pty Ltd v Baulderstone Hornibrook Pty Ltd* (2000) 16 BCL 374, also referenced in Dixon, *As Good as Cash?*, at 22.

[312] Coleman, *Performance Guarantees*, at 224. See also *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, at 826.

[313] *Woodhall v Pipeline Authority* (1979) 141 CLR 443.

of a compliant demand is inimical to the autonomy principle and raises public policy issues in this regard.[314] By contrast, enforcing a restriction on a beneficiary's entitlement to make a demand is a separate matter not necessarily tethered to the autonomy principle of demand guarantees. It is submitted that the subtext in *Wood Hall* is that the prohibition against considering a demand against extrinsic factors only applies to issuers and not necessarily to applicants when it comes to enforcing the terms of an underlying contract. In the context of breach of a negative stipulation exception, it appears that the applicant can look to the underlying transaction or contract and seek to enforce their rights as a party thereto against the beneficiary.

Some commentators consider and have referred to an injunction against a beneficiary to withdraw a demand or to prevent a future demand as a recognised exception to the autonomy principle.[315] This is based on the postulation that granting an injunction restraining a beneficiary from calling up a documentary credit runs contrary to the application of the independence principle.[316] In spite of this, others have recognised and called out the inaccuracy of referencing the breach of a negative stipulation as an exception and indicated a preference not to describe it as an exception. The school of thought that an injunction preventing a beneficiary from calling up a documentary credit in breach of contractual terms binding upon them does not affect the autonomy principle is submitted to be sound.[317]

The contrast between interference with the autonomy principle and payment obligations of issuers/guarantors on the one hand and restraining enforcing a clear restriction on the beneficiary's entitlement to make a demand, on the other hand, has been stressed by scholars in conjunction with consideration of whether or not the latter can be called an exception.[318] Moreover, in *Boral Formwork*, the view was expressed that an injunction to enforce a negative stipulation and prevent a breach of such negative stipulation does not directly interfere with the autonomy principle but restrains a beneficiary from seeking to invoke an issuer's autonomous obligations.[319]

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[314] Dixon, *As Good as Cash?*, at 15.

[315] Dixon, *As Good as Cash?*, at 21.

[316] Mugasha, A "Enjoining the Beneficiary's Claim on a Letter of Credit or Bank Guarantee" (2004), 5, *Journal of Business Law*, at 515-538.

[317] Ibid.

[318] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 528.

[319] *Boral Formwork & Scaffolding (Pty) Ltd v Action Makers Ltd* [2003] NSWSC 713, para 40.

Additional support for this view has also been depicted in the case of *ALYK (HK) Ltd v Caprock Commodities Trading Pty Ltd*,[320] in which Slattery J said, in respect of breach of a negative stipulation, that it:

> "… is not strictly an exception to the 'autonomy principle'. The negative stipulation in the contract is used to prevent the beneficiary from claiming under the bond rather than the court interfering with a payment which would otherwise be made under the instrument".

Some alternative terminology has been proffered instead, such as the term "over-riding rule", on the basis that the main focus in determining a breach of a negative stipulation is the correct and proper construction of the relevant contract.[321]

The normal workings of a demand guarantee connote and give rise to both the unconditional entitlement of a beneficiary to claim and the obligation for payment by the guarantor. This unconditionality is governed by the autonomy principle pursuant to which the demand guarantee and the underlying contract are completely independent and separate from each other. However, nothing precludes a beneficiary from agreeing to contractual terms under the underlying contract or possibly another standalone contract, which restricts or places conditions upon their entitlement to demand payment. It is submitted that such an agreement crosses paths with neither the guarantor's obligation to pay nor the autonomy principle under the demand guarantee. A beneficiary's entitlement to make a demand can thus be tethered under the terms of an underlying or other contract between the beneficiary and the applicant/principal without affecting the guarantor's payment obligation should he/it receive a compliant demand under the demand guarantee.

5.3.6.2 Acceptable Form of the Negative Stipulation: Express, Implied, In the Demand Guarantee Itself or in a Separate Agreement

The words of Stephen J in *Wood Hall* that had the underlying contract "itself contained some qualification upon the Authority's power to make a demand under a performance guarantee, the position might well have been different"[322] are considered to have given impetus to the "mischief"

[320] 2012 NSWSC 1558, para 84.

[321] See *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158, at 164; *Bateman Project Engineering Pty Ltd v Resolute Ltd* [2000] WASC 284, para 30.

[322] *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443, at 459.

giving rise to contemplation of a breach of a negative stipulation exception in relation to demand guarantees.[323]

This has been construed as insinuating that the position (i.e., failure to establish the breach of a negative stipulation by the beneficiary in that case) would have been different if the construction contract itself had contained a negative stipulation restricting the beneficiary's power to call up the demand guarantee. Whilst Stephen J's remarks are notable for their recognition that a breach of a negative stipulation exception is possible in the presence of certain facts, they are also particularly noteworthy for their marked contemplation of an express contractual term, as opposed to an implied one. Thus, even in early cases that are seen as the inception of the breach of a negative stipulation exception under Australian law, courts specifically envisaged or strongly preferred an express negative stipulation as the basis for such an exception rather than implied terms.

While an express negative stipulation would be far more likely to be a successful choice when it comes to ease of enforcement from an applicant's perspective, the *Fletcher* case did acknowledge the possibility of a negative stipulation being an implicit or implied one.[324] The parameters within which a breach of a negative stipulation exception will be recognised under Australian law, therefore, seem to include the existence of a clear negative stipulation. Although the preference is for an express negative stipulation, Australian law seems to have a degree of tolerance regarding the position of implied negative stipulations.[325]

Australian law's recognition that the breach of a negative stipulation exception could be established on the basis of an implied or implicit negative stipulation has been the brunt of criticism by some scholars on the ground that it facilitates the permeation of uncertainty and some degree of subjectivity into the documentary credits, thereby affecting their utility internationally.[326] This is, however, considered to be offset to some extent by certain other tighter parameters (e.g., the balance of convenience test and requirement for the applicant to show damages) applied

[323] Dixon, *As Good as Cash?*, at 22-23.

[324] See *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, at 826.

[325] *Australian Winch and Haulage Co Pty Ltd v Walter Construction Group Ltd* [2002] FCA 1181; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158; and *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812.

[326] See the discussion in section 5.3.3.7 of this thesis in this Chapter.

specifically in Australia and not necessarily in other jurisdictions, which in turn have preferred to apply tighter measures in the form of requiring only express negative stipulations.[327]

5.3.6.3 Standard of Proof Required for the Breach of a Negative Stipulation Exception and the Balance of Convenience

Some scholars have traced a distinction between earlier Australian law cases and later ones regarding the standard required for an injunction on the basis of establishing a breach of a negative stipulation exception. Earlier cases in respect of injunctions on the basis of a beneficiary's breach of a negative stipulation have been assessed to require a lower standard of proof, being that there should be "a serious issue to be tried".[328] Later case law, on the other hand, appears to have been observed to raise the bar to the higher standard of a "seriously arguable" case to be shown by the applicant.[329]

Moreover, a balance of convenience test has been applied under Australian law, and the party aggrieved by the beneficiary's demand in contravention of a negative stipulation would be required to evidence loss sustained as a result of the beneficiary's conduct. The balance of convenience test has been incorporated into consideration of injunctions in relation to demand guarantees under Australian law, as depicted in the cases of *Olex Focas*[330] and *Boral Formwork*,[331] where, taking into account the relevant factors and circumstances of the case, the balance of convenience was considered and determined to be in favour of an interlocutory injunction being granted.[332]

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[327] Alavi, *Contractual Restrictions*, at 80.

[328] See, e.g., *Pearson Bridge Pty Ltd v State Rail Authority of New South Wales* (1982) 1 Aust Constr LR 81; *Selvas Pty Ltd v Hansen & Yuncken* (SA) Pty Ltd (1987) 6 ACLR 36; *J H Evans Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (Unreported NT Supreme Court, 30 January 1989); and *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451. However, some later cases seem to have continued in step with this early case law standard by referencing the requirement for a, "serious issue to be tried", for example *Kirfield Ltd v First Trade Consulting Pty Ltd* [2005] WASC 82; *Marson Constructions Australia Pty Ltd v Hillcrest Manor Pty Ltd* (27 February 2000) [2000] VCAT 29; *H Troon v Marysville Hotel and Conference Centre* [2017] VSC 470; and *Siemens v Bulgana* [2019] VSC 771 (27 November 2019).

[329] See, e.g., *Rejan Constructions Pty Ltd v Manningham Medical Center Pty Ltd* [2002] VSC 579; *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2009] NSWSC 439; *Patterson Building Group Pty Ltd v Holroyd City Council* [2013] NSWSC 1484; *Duro Felguera Australia Pty Ltd v Samsung C&T Corporation* [2016] WASC 119; and *Ecap Finance Pty Ltd v Ottoway Engineering Pty Ltd (No 2)* [2017] FCA 237 in which the requirement for a "serious arguable" case or issue was referenced and/or considered.

[330] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404.

[331] *Boral Formwork v Action Makers* [2003] NSWSC 713, paras 12-14.

[332] See, e.g., *Planet Build (NSW) Pty. Limited v Lassgol Pty Limited* [2000] NSWSC 861; *Thiess Pty Ltd v Pacific National (Victoria) Pty Ltd* [2009] VSC 670; *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2009] NSWSC 439;

5.3.7 Conclusion: Position of Breach of a Negative Stipulation Exception under Australian Law

Where a beneficiary has bound themselves contractually not to call up a demand guarantee except upon the occurrence of specific circumstances, it seems that any attempt to turn around and justify a demand in breach of such a negative covenant by invoking the autonomy principle would be considered disingenuous and unacceptable by the courts of Australia.[333] Despite the reservations expressed in some quarters regarding how the recognition of a breach of a negative stipulation exception may adversely affect the autonomy principle, upon in-depth scrutiny, this perception appears to have been set aside, perhaps for its superficiality, in favour of recognition of the exception within certain parameters. To reiterate the point covered in preceding chapters and sections, the term exception in the context of breach of negative stipulation is more of an exception to the typical unencumbered demand guarantee mechanism whereby a beneficiary has an entitlement to claim and receive payment thereunder. In other words, the exception arising is not in the form of a true deviation from the autonomy principle but rather the existence of an extrinsic encumbrance (i.e., a restrictive contractual provision) on the beneficiary's entitlement to make a demand.

Australian law appears to have largely embraced the breach of a negative stipulation exception within, *inter alia*, two key parameters. Firstly, the exception is only recognised as against the beneficiary and not the issuer/guarantor of a demand guarantee, i.e., breach of a negative stipulation in a contract (typically the underlying contract but may extend to a separate contract) can be a ground for issuance of an injunction preventing a beneficiary from calling up a demand guarantee. For the avoidance of doubt it is generally not accepted that such a stipulation can justify interference by injunction or otherwise, with the guarantor's/issuer's obligation to pay upon receipt of a compliant demand under a demand guarantee.

Secondly, whilst Australian law has left some wiggle-room regarding whether a negative stipulation must be express or if it can be implied, it is accepted that the former is not only the more likely one to be entertained by the courts but also the one with greater odds of success.

Heyday5 Pty Ltd v Cockram Constructions NSW Pty Ltd [2015] NSWSC 884; *Duro Felguera Australia Pty Ltd v Samsung C&T Corporation* [2016] WASC 119; and *Kawasaki Heavy Industries, Ltd v Laing O'Rourke Australia Construction Pty Ltd* [2017] NSWCA 291 wherein the balance of convenience was referenced and/or considered in relation to injunctions against calling up relevant documentary credits. See also Enonchong, N *The Independence Principle of Letters of Credits and Demand Guarantees*, Oxford University Press, 2011, at 221.

[333] *Boral Formwork v Action Makers* [2003] NSWSC 713, para 40. See also Alavi, *Contractual Restrictions*, at 85-86 for a more detailed consideration discussion of this analysis.

Although it has been acknowledged that, in theory, an implied or implicit negative stipulation could work just as well as an express one, establishing the existence of an implicit or implied negative stipulation is a course riddled with difficulties.[334] Moreover, as expressed in the *Fletcher* case, "implication cannot be made if it would stultify, or even if it would be inconsistent with, the purpose for which the guarantee was taken".[335] Success in respect of an application for an injunction based on the breach of an implicit or implied negative stipulation would be more difficult to achieve, particularly noting that prior to establishing a breach of a negative stipulation, one has to surmount the hurdle of establishing that there is indeed a negative stipulation to which the beneficiary has bound themselves contractually.

Regarding the standard of proof required to establish a breach of a negative stipulation exception under Australian law, there are cases to support mainly two thresholds: the presence of "a serious issue to be tried" or the presence of "a seriously arguable" case/issue.[336] The latter, which is the higher standard, has been submitted to be the prevailing approach, seems to provide a greater counter-balancing effect against concerns of the breach of a negative stipulation exception becoming too easy to claim and undermining the utility of documentary credits. This counterbalancing effect is further augmented by the application of the balance of convenience test under Australian law, which is required to favour the issuance of an injunction against the beneficiary by evidencing a loss resulting from their breach of a negative stipulation exception.[337]

[334] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, 826-827, citing *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1161-1162.

[335] Ibid.

[336] See section 5.3.6.3 of this thesis above.

[337] Ibid.

CHAPTER 6: SELECTIVE ASPECTS OF THE URDG 758, UCP 600, ISP98, URCG AND THE UNCITRAL CONVENTION RELATING TO THE UNCONSCIONABILITY AND BREACH OF A NEGATIVE STIPULATION EXCEPTIONS

6.1 GENERAL

6.1.1 Introduction

This chapter will examine the relevant provisions in respect of the autonomy principle and exceptions thereto, focusing particularly on, Article 19 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit ("the UNCITRAL Convention").[1] To the extent considered relevant for the consideration of exceptions, international rules issued or endorsed by the International Chamber of Commerce ("ICC"), such as the ICC Uniform Rules for Demand Guarantees ("URDG 758"),[2] ICC Uniform Customs and Practice for Documentary Credits ("UCP 600"),[3] International Standby Practices ("ISP98"),[4] and the ICC Uniform Rules of Contract Guarantees ("URCG")[5] will be discussed. Interpretive guidance can be garnered from these international standards in respect of the unconscionability and breach of a negative stipulation exceptions.

6.1.2 Overview of the Autonomy Principle under the International Rules relating to Documentary Credits and the UNCITRAL Convention

It is trite that a demand guarantee and the payment obligation arising from it are independent of extrinsic factors or documents such as disputes between the parties to the underlying contracts, which must be resolved separately without involving the guarantor. The demand guarantee, by design, is inherently separate or autonomous from the underlying contract between the applicant and the beneficiary and from the contract between the applicant and the guarantor. As shown in previous chapters of this thesis, in addition to full recognition of the autonomy principle in South

[1] United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) (hereinafter, "UNCITRAL Convention").

[2] ICC Uniform Rules for Demand Guarantees, ICC Publication No 758, Paris (2010) (hereinafter "URDG758"). The previous iteration of these rules was the Uniform Rules for Demand Guarantees, ICC Publication No 458 (April 1992) (hereinafter, "URDG 458").

[3] ICC Uniform Customs and Practice for Documentary Credits, ICC Publication No 600, Paris (2006) (hereinafter "UCP600").

[4] International Standby Practices (ICC Publication No 590, Paris (1998) ("hereinafter "ISP98").

5 Uniform Rules of Contract Guarantees (ICC Publication No 325) ("hereinafter "URCG").

Africa,[6]the autonomy principle generally enjoys universal recognition.[7]

Further to its specific consideration in Chapter 2 of this thesis,[8] the autonomy principle is complemented by the documentary nature of documentary credits, pursuant to which determination of payment obligations thereunder must be determined solely on the basis of the documents presented.[9] In this regard, Article 5 of the UCP 600 gives the nod to the autonomy principle by emphasising the documentary nature of documentary credits, categorically stating that "[b]anks deal with documents and not with goods, services or performance to which the documents may relate."[10] Another ancillary element which serves as a bulwark to the operation of demand guarantees is the doctrine of strict compliance.[11] The doctrine of strict compliance is interwoven into provisions of the UCP 600.[12]

A guarantor need only consult the documents presented and examine those against the requirements of the demand guarantee to determine whether to honour a demand. Where the documents are compliant, the guarantor is obliged to honour the demand and must do so without

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[6] See, e.g., *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) 731-732; *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA) paras 19 and 20; *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA) para 39; *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA) para 14; *Firstrand Bank Ltd v Brera Investments* CC 2013 (5) SA 556 (SCA) para 11; *Eskom Holdings v Hitachi Power Africa* (139/2013) [2013] ZASCA 101 (12 September 2013) para 15; *Denel Soc Ltd v Absa Bank Ltd* [2013] 3 All SA 81 (GSJ) paras 30-31; *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA) paras 11-13; *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA) paras 14 and 28; and *Group Five Power International (Pty) Limited v Cenpower Generation Company Limited & Others* (2008/41068) [2018] ZAGPJHC 663 (16 November 2018) paras 88-89. See also Chapter 3 of this thesis.

[7] See URDG758, Article 5(a); UCP 600, Articles 4-5; UNCITRAL Convention, Articles 2-3; URDG458, Article 2(b); ISP98, Rule 1.06(a) and (c). See also Bennett, HN "Performance Bonds and the Principle of Autonomy" (1994) *Journal of Business Law*, 574; Goode, R "Abstract Payment Undertakings in International Transactions" (1996), 22, *Brooklyn Journal of International Law*, 1, at 12; Ali Malek, A and Quest, D *Jack: Documentary Credits: The Law and Practice of Documentary Credits including Standby Credits and Demand Guarantees*, 4 ed, Tottel Publishing, 2009, at 17-18; and Furmston, M and Chuah, J, 2 ed, *Commercial Law*, Pearson, 2013 (hereinafter, "Furmston and Chuah, *Commercial Law*"), at 377. See also section 2.3 in Chapter 2 of this thesis for a focused discussion of the autonomy principle of demand guarantees.

[8] See section 2.3 of Chapter 2 of this thesis.

[9] Ibid. See also Kelly-Louw, M "Must All the Required Documents for a Demand Guarantee be Presented At the Same Time? – *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited*" (2017), 80, *THRHR*, 148; Kelly-Louw, M "The Doctrine of Strict Compliance in the Context of Demand Guarantees" (2016), 49(1) *CILSA* 85 for a more detailed and specific consideration of the documentary nature of demand guarantees.

[10] UCP600, Article 5.

[11] UCP600, Articles 4, 5, 7(a), 7(c), 8(a), 8(c), 15(a), 15(b). See also section 2.8 of chapter 2 of this thesis for a discussion of the requirements in relation to a complying demand and the application of the doctrine of strict compliance in the context of demand guarantees.

[12] Ibid.

allowing itself to get distracted by matters extrinsic to the demand documents and their compliance with the requirements agreed in the demand guarantee, but if they are non-compliant, then the payment obligation does not arise.[13]

This independent nature of demand guarantees and other documentary credits, known as the autonomy principle, is reflected in various international rules applicable to documentary credits and in the UNCITRAL Convention. The relevant provisions are reiterated immediately below.

The autonomy principle is enshrined in UCP Articles 3, 4 and 14, which provide or reiterate that credits are, by nature, transactions which are separate from their underlying transactions, and that payment by the issuer of a credit must be based solely on an assessment of the conformity of the presented documents against the requirements of the credit.[14]

Article 4 of the UCP 600, in particular, incorporates the autonomy principle as follows:

> "A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank".[15]

So as to avoid blurring the independence of documentary credits and other documents or contractual relationships, Article 4(b) of the UCP 600 stipulates that issuing banks must discourage any attempts by an applicant to include documents such as the underlying contract and proforma invoices as integral parts of a credit.[16]

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[13] See, e.g., *Loomcraft Fabrics CC v Nedbank Ltd & Another* 1996 (1) SA 812 (A); *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 (3) SA 688 (SCA); Kelly-Louw, M "Construing Whether a Guarantee is Accessory or Independent is Key", in Hugo, C and Kelly-Louw, M (eds) *Jopie: Jurist, Mentor, Supervisor and Friend - Essays on the Law of Banking, Companies and Suretyship*, Juta, 2017 (hereinafter, "Kelly-Louw, *Construing Whether a Guarantee is Accessory or Independent is Key*"), at 114; Chuah, JCT *Law of International Trade: Cross-Border Commercial Transactions*, 5 ed, Sweet & Maxwell, 2013, at 591; Bertrams, RF *Bank Guarantees in International Trade: The Law and Practice of Independent (First Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions*, Kluwer Law International, 2013, at 3; Furmston and Chuah, *Commercial Law*, at 379.

[14] UCP600 Articles 3, 4 and 14.

[15] UCP 600, Article 4(a).

[16] Ibid.

In the ISP98, the autonomy principle, together with the documentary nature of standby letters of credit, is embodied in Rule 1.06, which provides, *inter alia*, that a "standby is an irrevocable, independent, documentary and binding undertaking when issued and need not so state".[17] Rule 1.06 also includes factors which must have no bearing on an issuer's payment obligation and upon which such payment obligation must not depend under a standby letter of credit.[18] These factors include, without limitation, any references in the standby letter of credit to any reimbursement agreement or underlying transaction or the issuer's knowledge of performance or breach thereunder and/or the beneficiary's right to payment from the applicant.[19] Moreover, Rule 1.07 states that "[a]n issuer's obligations toward the beneficiary are not affected by the issuer's rights and obligations toward the applicant under any applicable agreement, practice, or law."[20]

In the URDG, the autonomy principle is provided for in Article 5, which stipulates, *inter alia*:

> "[a] guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary."[21]

The UNCITRAL Convention entrenches the autonomy principle under its own unequivocal heading; "[i]ndependence of undertaking" under which it is stipulated:

> "an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not: … dependent upon the existence or validity of any underlying transaction, or upon any other undertaking …; or [s]ubject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents or another such act or event within

[17] ISP98, Rule 106(a).

[18] ISP98, Rule 106(c).

[19] Ibid.

[20] ISP98, Rule 1.07.

[21] URDG 758, Article 5. This was also incorporated in Article 2(b) of the URDG 458, which provided that:

"[g]uarantees by their nature are separate transactions from the contract(s) or tender conditions on which they may be based, and Guarantors are in no way concerned with or bound by such contract(s), or tender conditions, despite the inclusion of a reference to them in the Guarantee. The duty of a Guarantor under a Guarantee is to pay the sum or sums therein stated on the presentation of a written demand for payment and other documents specified in the Guarantee which appear on their face to be in accordance with the terms of the Guarantee."

a guarantor/issuer's sphere of operations."[22]

The position that the role of guarantors or issuers of documentary credits is restricted to "one of paymaster rather than investigator"[23] is also re-affirmed in the UNCITRAL Convention. Therefore, the autonomy principle is a focal point of the UNCITRAL Convention. In addition to the exclusion of non-documentary conditions and other factors extrinsic to the documentary credit itself, non-autonomous instruments such as accessory guarantees fall outside the scope of the UNCITRAL Convention. The unequivocal acceptance of the autonomy principle is thus apparent from international rules and standards, as exemplified by the UCP 600, ISP98, and URDG and under international law established by conventions, particularly the UNCITRAL Convention.

6.2 INTERNATIONAL RULES AND THEIR APPROACH TO EXCEPTIONS, PARTICULARLY THE UNCONSCIONABILITY AND BREACH OF A NEGATIVE STIPULATION EXCEPTIONS

6.2.1 General

International rules, such as the URDG 758, UCP 600, ISP98, and the URCG, do not have the force of law and are typically elective or opt-in by nature, such that parties agree to be subject to or governed by such rules by incorporating them into their contracts.

6.2.2 The URDG's Approach to Exceptions in respect of Demand Guarantees

One set of rules which was issued to be bespoke to demand guarantees is the URDG. On the basis of targeted relevance to demand guarantees, the URDG, prepared by the Banking Commission of the International Chamber of Commerce, is an important set of international rules, particularly for the purposes of this study. The URDG apply where parties have incorporated it into their contract. The first version of the URDG was issued in 1992 and is referred to as the URDG 458. A subsequent edition, which is also the latest and current iteration of the URDG, referred to as the URDG 758, was issued on account of, *inter alia*, changes in the demand guarantee industry and came into operation on 1 July 2010.[24]

[22] UNCITRAL Convention, Article 3(a) and 3(b).

[23] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit (hereinafter, "UNCITRAL Convention Explanatory Note"), para 18.

[24] For a comprehensive commentary of the URDG 758 see Affaki, G and Goode, R *Guide to ICC Uniform Rules for Demand Guarantees (URDG 758)*, International Chamber of Commerce, 2011.

The URDG are said to have been strongly influenced by the UCP,[25] but a distinction observed between the UCP and the URDG is that while the former is silent on the subject of exceptions to the autonomy principle, including the well-established fraud exception, the latter has some built-in anti-fraud provisions.[26] Supporting this position, the URDG has been said to incorporate "some constraint on unfair calling of the guarantee without undermining its efficacy as a swift remedy in the event of perceived default".[27]

Article 15 of the URDG 758 exemplifies the anti-fraud tenor of some of the URDG's provisions, such as requiring a beneficiary to present with its demand a written statement alleging default in order to obtain the guaranteed amount under a demand guarantee.[28] Article 15 of the URDG 758 further requires an indication of how the applicant has breached their obligations.[29] Further provisions in Article 15 of the URDG 758 prohibit, *inter alia*, dating the demand and the statement alleging default from being dated before the date on which the beneficiary is entitled to make a demand.[30] Such provisions as Article 15 of the URDG 758 have been noted to potentially discourage improper demands on a demand guarantee and cause "a beneficiary who might not hesitate to make an improper demand [to] think twice before presenting a false written statement".[31]

The URDG has been said to cover only common type characteristics in relation to fraud.[32] Despite being regarded as a notch ahead of the silent UCP when it comes to anti-fraud provisions, the URDG 758 has been found to offer little by way of a practical solution to the problem of fraudulent calls on demand guarantees. Among others, this deficiency may account for the result that only a

[25] Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*, Kluwer Law International, 2002, at 20.

[26] Ibid.

[27] Goode, R and McKendrick, E *Goode on Commercial Law*, 4 ed, Penguin Books, 2010), at 1140.

[28] URDG 758, Article 15(a). Article 15(b) contains corresponding controls in respect of claims under a counter-guarantee. Both Articles15(a) and 15(b) can be excluded by incorporation of specific provisions to that effect in the relevant demand guarantee or counter guarantee, as provided for in Article 15(c).

[29] Ibid.

[30] URDG 758, Article 15(a).

[31] Ellinger, P and Neo, D *The Law and Practice of Documentary Letters of Credit*, Hart Publishing, 2010, at 348.

[32] Nemeikšis, G "Abstract Principle of First Demand Guarantee and its Restrictions" (2014), *Proceedings of the 56th International Scientific Conference of Daugavpils University*, 181, at 185.

minority of demand guarantees issued in the UK are made subject to the URDG.[33] The low uptake of the URDG in the UK is also reflected in the observation by one commentator that "in the UK, URDG 458 is very rarely seen in practice".[34]

The International Standard Demand Guarantee Practice ("ISDGP") [35] is intended to encapsulate best practice in relation to demand guarantees governed by the URDG 758.[36] The ISDGP provides interpretation and application guidance regarding how the URDG applies to demand guarantees governed by the URDG.[37] It should be read in conjunction with the URDG and is not an amendment of the URDG. The ISDGP is not required to be specifically incorporated or referenced in a demand guarantee in order to be utilised or applied.[38] Similarly to the URDG, the ISDGP is subject to the overriding mandatory rules of relevant applicable law in respect of a demand guarantee.[39]

The intentional omission of exceptions to the autonomy principle of demand guarantees, e.g., relating to fraud or abusive demands in the URDG, is reflected clearly in the ISDGP. Article 209 of the ISDGP explains it thus:

> "Improper demands, including fraudulent, illegal and unfair demands, are outside the URDG. Their characterisation and legal implications are a matter for the applicable law."[40]

However, the ISDGP goes further and seems to refer to Article 19 of the UNCITRAL Convention as a worthy and sufficiently authoritative codification of the standard for establishing fraudulent demands or otherwise improper demands in relation to demand guarantees.[41] In particular, the

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[33] Alawamleh, KJA "*Documentary Credits and Independent Guarantees: A Critique of the 'Fraud Exception' Position in English and Jordanian Law*", PhD thesis, University of Central Lancashire, 2013 (hereinafter "Alawamleh, *Documentary Credits and Independent Guarantees*"), at 52.

[34] Jones, R and Gwynne, R "Uniform Rules for Demand Guarantees: URDG 758" (2010), 3(3), *Bank Law*, 4 at 6, as cited in Alawamleh, *Documentary Credits and Independent Guarantees*, at 52.

[35] International Chamber of Commerce, *International Standard Demand Guarantee Practice for URDG 758* (ICC Publication No 814) (hereinafter, "ISDGP").

[36] ISDGP, at 4.

[37] Ibid.

[38] Ibid.

[39] Ibid.

[40] ISDGP, Article 209, at 30.

[41] ISDGP, Article 209, at 30:

ISDGP provides that regard may be had to Article 19 of the UNCITRAL Convention "as an authoritative codification of the standard of fraudulent or otherwise improper demands in guarantees".[42]

The ISDGP also addresses the issue of parties incorporating provisions in a demand guarantee which seek to ouster the effect of a court order. Paragraph 213 of the ISDGP refers to applicable law regarding whether a guarantor must comply with a provisional court order ahead of its obligations to pay under a demand guarantee or *vice-versa*. Terms purporting to place an obligation on a guarantor to make payment under a demand guarantee notwithstanding a court order are firmly discouraged in paragraph 213 of the ISDGP, which also notes that such provisions are at odds with demand guarantee practice and shall be ignored as if they were not stated at all.

Therefore, while submitting to relevant applicable law regarding demand guarantees, the ISDGP certainly seems to acknowledge the role of courts in addressing circumstances which may give rise to an exception to the autonomy principle and justify court intervention in the form of a court order. The reference to applicable law points to a deliberate intention, as also apparent under the URDG, to steer away from specific provisions regarding exceptions to the autonomy principle and leave this area to be governed by the governing law of a demand guarantee. Such governing law can, for example, be national law or international law such as that espoused in the UNCITRAL Convention, particularly Article 19 of the latter, as it covers the topic of exceptions in some detail and is invoked in paragraph 209 of the ISDGP.

6.2.3 The ISP98's Approach to Exceptions in respect of Documentary Credits

Another important set of rules, which, though traditionally and as the name suggests, seems tailored to standby letters of credit but has also been known to be applied to demand guarantees, is the International Standby Practices, the current version of which is referred to as the ISP98. The ISP98[43] was published in 1998 by the Institute of International Banking Law and Practice in the

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"Fraud

209. Improper demands, including fraudulent, illegal and unfair demands, are outside the URDG. Their characterisation and legal implications are a matter for the applicable law. *Regard may be had to article 19 of the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit as an authoritative codification of the standard of fraudulent or otherwise improper demands in guarantees*" (own emphasis).

See also the discussion of Article 19 of the UNCITRAL Convention in section 6.3.3 of this thesis further below.

[42] Ibid.

[43] ICC Publication No 590 (1998).

United States of America, after which it received endorsement from the ICC and was published as an ICC publication.[44] The ISP98, which came into effect in 1999,[45] was tailored specifically for standby letters of credit.[46] While the ISP98 are in some ways drafted along the same lines as the URDG and UCP, the ISP98, unlike the URDG and UCP, expressly excludes, in Rule 1.05, matters relating to due issuance and fraudulent or abusive drawing in relation to standby letters of credit.[47] The matters excluded under this heading include particularly excluding provision for "defenses to honour based on fraud, abuse or similar matters."[48] Rule 1.05 further clarifies its intention that the excluded matters are to be determined within the purview of national/applicable law by stating that such matters "are left to applicable law".[49]

6.2.4 The URCG's Approach to Exceptions and its Relevance to Demand Guarantees

The ICC's Uniform Rules of Contract Guarantees ("URCG") were first issued by the ICC in 1978. The URCG have to date, failed to gain popularity and are considered to be used rarely, perhaps in part due to the perceived ambiguity regarding their application, as some commentators have advanced the view that the URCG are not targeted at demand guarantees but instead seek to address uncertainties or ambiguities in respect of ordinary or accessory guarantees.[50] Another view is that the URCG may have intended to establish rules that unify international practices regarding demand guarantees and ordinary or accessory guarantees, but this is not entirely clear from the URCG itself.[51] The URCG's failure to gain broad acceptance has also been attributed to the perception that it is "too far removed from market practice to be acceptable".[52]

However, in terms of anti-fraud provisions, the URCG seems to have built-in provisions to curtail fraudulent demands. Article 9 of the URCG states that a beneficiary must present a judgment,

[44] Goode, R *Commercial Law*, 3 ed, Penguin Books, 2004, at 952.

[45] Byrne, JE *LC Rules & Laws: Critical Texts for Independent Undertakings*, 7 ed, The Institute of Banking Law and Practice, Inc, 2018, at 33.

[46] Ibid.

[47] ISP98, Rule 1.05.

[48] ISP98, Rule 1.05(c).

[49] ISP98, Rule 1.05.

[50] Alawamleh, *Documentary Credits and Independent Guarantees*, at 52.

[51] Ibid.

[52] Goode, R and McKendrick, E *Goode on Commercial Law*, 4 ed, Penguin Books, 2010, at 1130.

arbitration award, or the principal's written acceptance to claim the guaranteed amount successfully.[53] Some have touted this as the panacea for the problem of fraudulent or abusive claims on demand guarantees.[54] However, due to the onerous nature of these requirements, which does seem at odds with key aspects which characterise the utility of demand guarantees, others have found them to have "virtually turned independent guarantees to accessory [guarantees]."[55] This alludes again to the ambiguity of whether the URCG were targeted at traditional accessory guarantees or demand guarantees and may well be a major factor contributing to the poor uptake of the URCG in the international trade arena.

6.2.5 The UCP's Approach to Exceptions and its Relevance to Demand Guarantees

The first version of the of the Uniform Customs and Practices for Documentary Credits, also referred to as UCP 82, was published in 1933.[56] It has thereafter been amended a number of times to keep in step with ever-evolving international trade norms, and the latest version of the UCP, which is referred to as UCP 600, was released on 1 July 2007. What the UCP sought to achieve was articulated as being a realistic and modest goal: "not to codify all the relevant rules of law, customary or otherwise, but rather to compile international banking customs and other rules that facilitate banking functions."[57]

It seems to have been generally acknowledged that "a set of rules providing regulations of world-wide application has always been necessary for the proper function of the system",[58] a need which the UCP 600 perhaps sought to fulfil. A "credit" is defined in the UCP 600 as "any arrangement, however, named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation."[59] This definition could easily encompass both or either demand guarantees and standby letters of credit.

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[53] URCG, Article 9.

[54] Alawamleh, *Documentary Credits and Independent Guarantees*, at 52-53.

[55] Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*, Kluwer Law International, 2002, at 19-20.

[56] Byrne, JE *LC Rules & Laws: Critical Texts for Independent Undertakings*, 7 ed, The Institute of Banking Law and Practice, Inc, 2018, at 1.

[57] Kozolchyk B, "Letters of Credit" in Ziegel, J, *International Encyclopaedia of Comparative Law*, Vol. 9, Hamburg, 1980, at 146, as cited in Alawamleh, *Documentary Credits and Independent Guarantees*, at 49.

[58] UCP 600, Article 2.

[59] Ibid.

The UCP govern, *inter alia*, the application, issuance, negotiation, reimbursement, and compliance requirements regarding documentary credits. Notwithstanding that the UCP are capable of and were perhaps intended for broad application to both demand guarantees and other documentary credits such as letters of credit, it has been observed that a "majority of the provisions are simply inappropriate",[60]particularly in the context of demand guarantees.[61] For example, the UCP incorporate provisions relating to transport documentarian, insurance and invoices, which are not relevant or applicable in the context of demand guarantee transactions.[62] Despite this, the UCP is regarded as one of the "most successful harmonising measure[s] in the history of international commerce".[63] It is likely in part due to its accommodation of both letters of credit and demand guarantees that the UCP[64] seem to be a popular set of international rules adopted for application to documentary credits.

The UCP are typically incorporated by an express term in international letters of credit instruments. The UCP 600, like the ISP98 and URDG, are non-mandatory rules without the force of law, and they would be applicable where parties have agreed to their incorporation by making provision for it in their contract(s). Application of the UCP to documentary credits is thus at the election of the parties so that it binds parties where parties expressly incorporate it into the relevant contract.[65] This has not detracted from their international acceptance and uses, with the UCP being labelled an international norm.[66] The UCP seem to have attained a level of success in achieving uniformity and a unified interpretation of key documentary credit terms by international commercial parties to such instruments.[67] At one point, the UCP were noted to be adhered to by banks in about 165 countries.[68]

However, other commentators have asserted that the UCPs' wide acceptance and use have

[60] See Goode, R and McKendrick, E *Goode on Commercial Law*, 4 ed, Penguin Books, 2010, at 1059. See also Sifri, JE *Standby Letters of Credit: A Comprehensive Guide* Palgrave Macmillan, 2008, at 3.

[61] See Goode, R and McKendrick, E *Goode on Commercial Law*, 4 ed, Penguin Books, 2010, at 1059.

[62] See for example and without limitation, Articles 19-28.

[63] Goode, R *Commercial Law*, 3 ed, Penguin Books, 2004, at 968.

[64] The latest version is the 2007 revision, known as UCP600.

[65] Alawamleh, *Documentary Credits and Independent Guarantees*, at 49.

[66] Kozolchyk, B "Bernard Spencer Wheble (1904-1998) in Memoriam", (1999) *Annual Survey of Letter of Credit Law and Practice*, 18, at 21.

[67] Alawamleh, *Documentary Credits and Independent Guarantees*, at 49.

[68] Graham, GB and Geva, B "Standby Credits in Canada" (1984), 9(2) *Canadian Business Law Journal* 180, at 186.

conferred the force of law upon it.[69] In line with this view, the UCP have been argued by some to operate under their own force without the requirement for incorporation into a contract by the parties to a documentary credit.[70] Goode, for instance, appears to support this view by opining that the UCP are "directly incorporated by implication into the contract on the basis that their adoption is so much a matter of course that the parties must be taken to have intended to contract with reference to them even if the contract does not state this in terms and even if one of the parties was not aware of the UCP."[71] The nobility of this view taken by Goode has been noted but ultimately dismissed on the basis of the submission that the position of the UCP, particularly under English law, does not constitute a law in the traditional sense of what is understood to be a law.[72] It would indeed seem more accurate to say that the UCP are indeed not a law in the traditional sense. Despite the UCP not quite holding the status of a law, it has been noted that this does not preclude parties from turning to the UCP for guidance on a specific point of law not covered in their contract.[73]

The UCP appear to have taken a deliberately silent approach in relation to the subject of exceptions in relation to documentary credits in general. The UCPs' reticence in respect of the fraud exception, and perhaps other acceptable exceptions such as breach of negative stipulation, has been subject to an onslaught of criticism on the basis that the opportunity for more certain and practicable rules around the fraud exception had been wasted.[74] Incorporating provisions in respect of the fraud exception and prevention of fraudulent conduct, particularly by beneficiaries, have been touted as the solution to address the lack of certainty and international harmonisation around fraud under documentary credits.[75] An alternative yet similar suggestion put forward is that a separate transnational trade law is established to address non-harmonised areas in relation to

[69] Herrmann, G "The UNCITRAL Draft Convention on Independent Guarantees and Stand-by letters of Credit", in *Attorney General's Department and Law Council of Australia Twenty First International Trade Law Conference,* 1994, at 325.

[70] Alawamleh, *Documentary Credits and Independent Guarantees*, at 49.

[71] Goode, R and McKendrick, E *Goode on Commercial Law,* 4 ed, Penguin Books, 2010, at 1077.

[72] *Royal Bank of Scotland Plc v Cassa di Risparmio delle Provincie Lombarde*, Court of Appeal 21 January 1992, unreported case.

[73] See, for example, *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146

[74] Buckley, RP and Gao, X "The Development of the Fraud Rule Letter of Credit Law: The Journey So Far and the Road Ahead" (2002), 23, *University of Pennsylvania Journal of International Economic Law,* 663, at 701.

[75] Kuo-Ellen, L S, "UCP Needs to Change" (2002), 5(3), *Journal of Money Laundering Control*, 231 at 231.

documentary credits, such as fraudulent conduct.[76] However, this suggestion has been dismissed as unrealistic or lacking pragmatism as it would entail the onerous, time-consuming administration of ratification by different nations.[77]

In defence of the UCPs' silence in relation to exceptions such as those associated with fraudulent conduct, ICC authorities have been cited as justifying this approach by pointing to national courts as the bearers of the responsibility when it comes to combatting abusive or fraudulent demands.[78] Furthermore, it seems to be accepted that the rationale for the UCPs' silence on the subject of fraud is to leave this open to being addressed by national or local laws, particularly in light of how the fraud exception is applied with different formulations and parameters in different jurisdictions.[79]

It could then be inferred that attempting to incorporate the fraud exception into the UCP could make a unified approach challenging to arrive at. It could also render the UCP inappropriate and/or unpopular in a number of jurisdictions due to the entrenchment of any specific anti-fraud provisions which are not aligned with those jurisdictions.

This position against the incorporation of the fraud exception into the UCP has found support generally from scholars on the basis of the sensitivity around the fraud exception and differences in how it is dealt with in different jurisdictions.[80] Moreover, the UCPs' approach of leaving issues of fraud and/or other exceptions for national authorities to determine themselves has been lauded as a remarkable success that encourages national authorities to deal with such issues and does not adversely affect the value or market utility of documentary credits.[81] Further reinforcing this view, Goode explains that,

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[76] Rowe, M "Do We Need a Transnational Law on Documentary Credits? Michael Rowe & Bernard Wheble Debate" (1998), 4(2), DCI (ICC), (hereinafter "Rowe, *Do We Need a Transnational Law on Documentary Credits?"*), at 16-17.

[77] Rowe, *Do We Need a Transnational Law on Documentary Credits?*, at 16-17.

[78] See International Chamber of Commerce, *Opinions of the ICC Banking Commission* 1995-1996, ICC Publication No 565, at 22 and "Query: Rights of Recourse to the Beneficiary in the event of Fraud", in "Latest Queries Answered by the ICC Banking Commission'' (1997), 3(2), *DCI (ICC)*, at 7.

[79] See discussion in Alavi, H "Comparative Study of Unconscionability Exception to the Principle of Autonomy in Law of Letter of Credits" (2016), 2016(2), *Acta Universitatis Danubius Juridica*, 94 (hereinafter, "Alavi, *Comparative Study of Unconscionability Exception*"), at 94-121.

[80] See International Chamber of Commerce, *Opinions of the ICC Banking Commission* 1995-1996, ICC Publication No 565, at 22 and "Query: Rights of Recourse to the Beneficiary in the event of Fraud", in "Latest Queries Answered by the ICC Banking Commission'' (1997), 3(2), *DCI (ICC)*, at 7.

[81] Dolan, JF "Commentary on Legislative Developments in Letter of Credit Law: An Interim Report" (2002), 8, *Banking & Fin L Rev*, 53, at 63.

> "the content and explanation of ICC Uniform Rules are influenced by the fact that these uniform rules are rules of best banking practice, not the rules of law…[whereas fraud, on the other hand, is] …the province of the applicable law of the courts of the forum".[82]

For reasons such as those noted above, the neutrality in the UCPs' lack of anti-fraud provisions has been justifiably hailed as a resounding success that has preserved the international marketability of documentary credits.[83]

The failure of international rules such as the UCP, URDG, URCG and ISP98 to deal with the issue of fraud and/or any other widely acceptable exceptions such as breach of a negative stipulation has been noted to be a regrettable state of affairs reflective of a rather lax attitude towards issues of fraud involving documentary credits.[84] It has been correctly observed that in the absence of recourse against fraud which is led by international rules, the responsibility of dealing with fraud in relation to documentary credits governed by such rules lies with the courts.

The formulation and/or definition of fraud required to justify resisting payment under a documentary credit governed only by UCP, ISP98 or URDG is exponentially uncertain by comparison to, for example, the UNCITRAL Convention because, in the absence of any explicit provisions addressing fraud or other exceptions in relation to documentary credits, reliance is placed on national common law and judgments which are prone to inconsistencies and their own uncertainty.

6.3 THE UNCITRAL CONVENTION AND ITS APPROACH TO EXCEPTIONS, PARTICULARLY THE UNCONSCIONABILITY AND BREACH OF A NEGATIVE STIPULATION EXCEPTIONS

6.3.1 Brief Overview of the UNCITRAL Convention

6.3.1.1 Introduction

In what can be considered an early attempt to harmonise documentary credit law internationally, the United Nations Commission on International Trade Law's ("UNCITRAL") established the

[82] Goode, R "Abstract Payment Undertakings and the Rules of the International Chamber of Commerce" (1995), 39, *Saint Louis University Law Journal*, 725, at 727. See also Alavi, H "Remedies to Fraud in Documentary Letters of Credit: A Comparative Perspective" (2016), v(1), *EU Agrarian Law*, at 2.

[83] Buckley, RP and Gao, X "The Development of the Fraud Rule Letter of Credit Law: The Journey So Far and the Road Ahead" (2002), *University of Pennsylvania Journal of International Economic Law* 663, at 676.

[84] Alawamleh, *Documentary Credits and Independent Guarantees*, at 55.

United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, which was adopted by the General Assembly of the United Nations on 11 December 1995 (the UNCITRAL Convention).[85] The UNCITRAL Convention came into force on 1 January 2000 following approval, ratification, acceptance and/or accession by the requisite minimum of 5 nations.[86]

As suggested by its name, the UNCITRAL Convention can be applied to both demand guarantees and letters of credit. One of the key functions of the UNCITRAL Convention was to facilitate the functioning of demand guarantees and standby letters of credit as international trade instruments.[87] Other goals of the UNCITRAL Convention include harmonisation of basic principles and rules applicable to demand guarantees and standby letters of credit and overcoming divergences in taxonomy used to denote similar concepts.[88] The UNCITRAL Convention, therefore, serves to solidify principles and rules which demand guarantees and standby letters of credit have in common on an international platform.[89]

By design, the UNCITRAL Convention takes effect in contracting states[90] and applies with the force of law in jurisdictions which have acceded to it, in line with the rules of private international law.[91] This elective aspect in relation to its application to states has made apparent the observation that the UNCITRAL Convention has received little support and, therefore, appears to be side-lined within the documentary credit arena.[92] The practical importance of the UNCITRAL convention has been said to be limited by the fact that relatively few countries have adopted it.[93] Notwithstanding this, the purpose of the UNCITRAL Convention remains, as articulated by former

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[85] See https://uncitral.un.org/en/texts/payments/conventions/independent_guarantees (accessed on 5 February 2022).

[86] Ibid.

[87] Xiang, G, *The Fraud Rule in Law of the Letters of Credit: A Comparative Study*, Kluwer Law International, 2002, at 125.

[88] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 2.

[89] See in general De Ly, F "The UN Convention on Independent Guarantees and Standby Letters of Credit" (1999), 33, The *International Lawyer*, 831 and Byrne, J "Independent Guarantee Convention" (1999), *Annual Survey of Letter of Credit Law and Practice*, 93.

[90] UNCITRAL Convention, Article 26

[91] UNCITRAL Convention, Article 1(1)(b).

[92] To date, the Convention was ratified/acceded to by the following countries only: Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia. The United States of America has signed the Convention but, to date, has not yet acceded to it. See https://uncitral.un.org/en/texts/payments/conventions/independent_guarantees/status (accessed on 5 February 2022).

[93] Alawamleh, *Documentary Credits and Independent Guarantees*, at 55.

UNCITRAL Secretary Gerold Herrmann as being, "to codify the principle of independence … in a legally binding manner and not merely rely on the non-binding rules of the ICC set out in the UCP 500 or the URDG."[94]

This purpose of the UNCITRAL Convention is further explained by the rationale that the drafters of the UNCITRAL Convention were concerned that "there has been a lack of uniformity internationally in the understanding and recognition of that essential characteristic"[95] of documentary credits. However, the UNCITRAL Convention seems not to have gained much popularity and usage, as a sweeping majority of documentary credits are, by election of the relevant parties, generally governed by the UCP, URDG or ISP98. The UNCITRAL Convention has thus been observed to have had limited effectiveness due to it not being ratified by enough countries to achieve such effectiveness, although the option remains for any parties to elect its application or to incorporate it into their contracts.[96] To date, only eight countries have ratified or acceded to the UNCITRAL Convention.[97]

6.3.1.2 Scope and Application of the UNCITRAL Convention

As expressed in Article 2 of the UNCITRAL Convention and indicated by the reference to demand guarantees and standby letter of credit in its name, the UNCITRAL Convention is intended to apply to independent guarantees and standby letters of credit.[98] The nature of the undertakings to which the UNCITRAL Convention applies is covered in a nutshell by the key characteristics that demand guarantees and standby letters of credit have in common. This view is supported by the words in the official Explanatory Note of the UNCITRAL Convention, which explains that the

[94] Herrmann, G "The UNCITRAL Draft Convention on Independent Guarantees and Stand-by letters of Credit", (1994), *Attorney General's Department and Law Council of Australia Twenty First International Trade Law Conference*, 325, at 326. See also UNCITRAL Convention, Articles 6(c) and 6(e).

[95] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 17 and see also Note 18.

[96] Alawamleh, *Documentary Credits and Independent Guarantees*, at 55.

[97] See footnote 92 above.

[98] See UNCITRAL Convention, Articles 1(1) and 2(1). Article 1(1) of the UNCITRAL Convention states that the UNCITRAL Convention applies to, "an international undertaking referred to in article 2. Article 2(1) in turn states that, "[f]or the purposes of this Convention, an undertaking is an independent commitment known in international practice as an independent guarantee or as a standby letter of credit, given by a bank or other institution or person ("guarantor/issuer") to pay to the beneficiary …". For consideration of the scope of application and form of the instruments to which the UNCITRAL Convention was intended to apply, see also Herrmann, G "Salient Features of the UNCITRAL Bills and Notes Convention", 273, at 273-275. in Effros, RC, *Current Legal Issues Affecting Central Banks*, Volume III, *International Monetary Fund*, 1995.

UNCITRAL Convention, *inter alia*, "solidifies recognition of common basic principles and characteristics shared" by demand guarantees and standby letters of credit.[99] The term undertaking, as contemplated in the UNCITRAL Convention, is defined as:

> "an independent commitment, known in international practice as an independent guarantee or as a standby letter of credit, given by a bank or other institution or person ("guarantor/issuer") to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person."[100]

Internationality is described fairly broadly in Article 4(1) of the UNCITRAL Convention, which provides that an undertaking is considered international if the places of business, as referenced in the undertaking, of any two of the guarantor/issuer, beneficiary, principal/applicant, instructing party or confirmer are in different states.[101]

The UNCITRAL Convention can find application in the dealings of commercial parties primarily in two scenarios. Firstly, where the place of business of the guarantor or issuer is in a Contracting State,[102]and secondly, where in the absence of an exclusion of the UNCITRAL Convention, the rules of private international law lead to the application of the law of a Contracting State.[103] It is acknowledged that parties can elect to exclude the application of the UNCITRAL Convention,[104] an option supported by the Explanatory Note to the UNCITRAL Convention confers upon parties

[99] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 17; see also Note 2.

[100] UNCITRAL Convention, Article 2(1).

[101] See further UNCITRAL Convention, Article 4(2) which expands on Article 4(1) by explaining that for the purposes of the latter, where an undertaking lists more than one place of business for a given person, the relevant place of business is that which has the closest relationship to the undertaking; and where no place of business is specified in an undertaking for a given person, but the undertaking does specify their "habitual residence", that residence is relevant for determining the international character of the undertaking.

[102] The UNCITRAL Convention, Article 1(1)(a).

[103] The UNCITRAL Convention, Article 1(1)(b).

[104] Ibid.

"(f)ull freedom … to exclude completely the coverage of the Convention."[105]

In addition to the two abovementioned scenarios in which the UNCITRAL Convention would apply, under Article 1(2) of the UNCITRAL Convention, parties can by agreement opt-in or elect to have it apply to their transaction. The UNCITRAL Convention could, therefore, be stretched to apply to other international and/or commercial letters of credit further to the provision that the UNCITRAL Convention "applies also to an international letter of credit not falling within article 2 if it expressly states that it is subject to this Convention."[106]

Moreover, Article 1(3) of the UNCITRAL Convention provides for the application of the choice of law provisions in Articles 21 and 22 of the UNCITRAL Convention independently of Article 1(1) thereof. Articles 21 provides that the undertaking (i.e., the guarantee or other documentary credit) is governed by the choice of law stipulated in the undertaking, or demonstrated by the terms and conditions of the undertaking, or agreed elsewhere between the guarantor/issuer and the beneficiary. In the absence of a choice of law as contemplated in Article 21, Article 22 of the UNCITRAL Convention provides for the law of the State where the guarantor or issuer has its place of business at which the undertaking was issued to be the governing law.

Further to Article 1(2) of the UNCITRAL Convention, as referred to in the preceding paragraph, while its name suggests that the UNCITRAL Convention is primarily targeted at demand guarantees and standby letters of credit,[107] the door has not been completely shut on its use or application in respect of commercial letters of credit. In terms of the commentary from the drafters of the UNCITRAL Convention, it has been noted that there exists "broad common ground between commercial and standby letters of credit". Furthermore, parties to commercial letters of credit may, "in their own judgment," utilise the UNCITRAL Convention "in view of the occasional difficulties in determining whether a letter of credit is of a standby or commercial variety".[108]

The scope of this thesis does not include a consideration of whether it would be recommended for South Africa to accede to the UNCITRAL Convention or not, as this falls outside of the focus area of this thesis. However, certain selective aspects of the UNCITRAL Convention may guide how

[105] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 11.

[106] Article 1(2).

[107] UNCITRAL Convention, Articles 1 and 3.

[108] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 16.

South African law may deal with the unconscionability and breach of a negative stipulation exception. For this reason, certain articles in the UNCITRAL Convention considered relevant to a discussion of the unconscionability and breach of a negative stipulation exception, particularly Article 19, will be juxtaposed against the South African law position regarding the same. As this thesis is centred around South Africa and aimed at establishing recommendations in respect of the development of South African law only, the same will not be done for other jurisdictions considered herein (i.e., the UK and Australia) as they, like the UNCITRAL Convention, are looked at for guidance in the context of recommending the development of certain aspects of South African law.

6.3.1.3 The Relationship between the Convention and Rules of Practice

The UNCITRAL Convention enshrines the universal rule that the terms and conditions of an undertaking are the determinants of the rights and obligations arising from an undertaking.[109] In terms of Article 13(2) of the UNCITRAL Convention,

> "[i]n interpreting terms and conditions of the undertaking and in settling questions that are not addressed by the terms and conditions of the undertaking or by the provisions of this Convention, regard shall be had to generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice."[110]

This, it has been said, is a flexible approach by drafters of the UNCITRAL Convention, as it enables it to remain a living instrument and keep in step with developments relating to the UCP, URDG and ISP98.[111] This advantage is exemplified by the fact that the ISP98 was relatively new when the UNCITRAL Convention came into effect but has since developed and grown in usage, with any new developments being automatically incorporated by reference into the UNCITRAL Convention. The Explanatory Note to the UNCITRAL Convention explains it as follows:

> "(the) approach ensures that the Convention will remain a living instrument, sensitive to developments in practice, including future revisions of rules of practice such as UCP and URDG and the development of other international rules of practice."[112]

[109] UNCITRAL Convention Article 13(1).

[110] Ibid.

[111] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 36.

[112] Ibid.

6.3.2 The UNCITRAL Convention and Exceptions Generally

Although both the ICC and UNCITRAL have been acknowledged to be involved in adequately addressing the issue of exceptions on the basis of fraudulent and abusive calls on documentary credits, the only headway made seems to be in the UNCITRAL Convention.[113] Articles 15, 19 and 20 of the UNCITRAL Convention are the key provisions under which exceptions in relation to demand guarantees may be considered. They set out the circumstances in which payment under a documentary credit can be prevented and outline provisional measures which courts can take.[114] While these expressly deal with fraudulent and abusive demands for payment, other exceptions, such as the unconscionability exception and breach of a negative stipulation, which are central to this study, can as considered further below, also be considered within the framework of these provisions of the UNCITRAL Convention despite not being explicitly referenced.

The failure by rules of practice such as the UCP, ISP98, and URDG to address the matter of fraudulent calls and potential exceptions, which would include unconscionability and breach of a negative stipulation, in relation to documentary credits have been criticised as deficiencies of these rules.[115] Under these rules, parties may conceivably struggle to reach a common understanding of what is meant, for example, by fraud in the context of their documentary credit transaction.[116] While the UNCITRAL Convention can be credited with creating a unified international practice standard in respect of fraudulent or abusive calls on documentary credits. It has received praise for addressing major elements in respect of the fraud rule and offering precise and useful guidance in this regard.[117] Apart from fraud, the UNCITRAL Convention, without explicitly referencing those exceptions by name, incorporates elements which may be encompassed under the unconscionability and breach of negative stipulation exceptions.

The praise directed at the UNCITRAL Convention for addressing/not being silent regarding the fraud exception could, to some degree, also apply in respect of how it addresses other exceptions to the autonomy principle. Gao and Buckley have lauded the fraud provisions in the UNCITRAL

[113] Alawamleh, *Documentary Credits and Independent Guarantees*, at 299-300.

[114] Alavi, H "Remedies to Fraud in Documentary Letters of Credit: A Comparative Perspective" (2016), v(1), *EU Agrarian Law*, at 3-4 and 11.

[115] Davidson, A "Fraud and the UN Convention on Independent Guarantees and Standby Letters of Credit" (2010), 1(1), *George Mason Journal of International Commercial Law*, 25, at 29.

[116] Ibid.

[117] Alavi, H "Remedies to Fraud in Documentary Letters of Credit: A Comparative Perspective" (2016), v (1), *EU Agrarian Law*, at 4.

Convention as a positive development and a source of guidance that national courts can turn to for guidance on the application of the fraud rule.[118]

As will be considered in more detail below, Article 19 of the UNCITRAL Convention provides for other exceptions to the autonomy principle, elements of which can fall under or be considered synonymous with, *inter alia*, the unconscionability exception and the breach of a negative stipulation exception. Notwithstanding the limited traction gained by the UNCITRAL Convention, it can be lauded for tackling the issue of exceptions generally in relation to documentary credits. The extent to which the UNCITRAL Convention provides effective guidance or a blueprint for the application of potential exceptions in relation to demand guarantees, particularly the unconscionability exception and the breach of a negative stipulation exception, is a key consideration of this study and will be considered further below.

Notwithstanding its limited traction in terms of being ratified by countries, the UNCITRAL Convention remains uniquely important for being the first international law instrument directly addressing the issue of exceptions to the autonomy principle of documentary credits. Article 19 of the UNCITRAL Convention incorporates a more comprehensive definition of circumstances that could constitute an exception and consequently entitle a guarantor/issuer to withhold payment in good faith from a creditor/beneficiary.[119] In this regard, Article 15 of the UNCITRAL Convention outlines the guidance for beneficiaries in the context of making a demand under documentary credits. It incorporates the following caveat regarding certain instances where a beneficiary can be precluded from making a demand:

> "[t]he beneficiary, when demanding payment, is deemed to certify that the demand is not in bad faith and that none of the elements referred to in subparagraphs (a), (b) and (c) of paragraph (1) of article 19 are present."[120]

In addition, Article 17 of the UNCITRAL Convention, titled "[p]ayment", is expressly subject to the provisions of Article 19 thereof[121] and further stipulates:

> "Subject to article 19, the guarantor/issuer shall pay against a demand made in accordance with the

[118] Gao, X and Buckley, RP, "A Comparative Analysis of the Standard of Fraud Required under the Fraud rule in Letter of Credit Law" (2003), 13, *Duke Journal of Comparative and International Law*, 293, at 333.

[119] UNCITRAL Convention, Article 19(1).

[120] UNCITRAL Convention, Article 15, para 3.

[121] UNCITRAL Convention, Article 17(1).

> provisions of article 15. Following a determination that a demand for payment so conforms, payment shall be made promptly, unless the undertaking stipulates payment on a deferred basis, in which case payment shall be made at the stipulated time."

This seems to go a bit further than just supporting potential exceptions to the autonomy principle and the payment obligation thereunder. It implies that where a guarantor/issuer makes a payment that the beneficiary was not entitled to, in terms of the provisions of Article 15, read together with Article 19, the applicant/principal may have recourse to a claw-back remedy through the courts. Receipt of payment further to a demand by a beneficiary not entitled to payment is, therefore, not conclusive and lacks the finality typified by the design of documentary credits, as it seems potentially vulnerable to challenge pursuant to Article 17. It is submitted that this detracts from the certainty of documentary credits by stripping them of the element of finality, particularly where a compliant demand has been made and the beneficiary has received payment.

It is clear that the UNCITRAL Convention recognises the concept of bad faith. Moreover, the circumstances referred to in Article 19 of the UNCITRAL Convention are vitiating factors regarding the beneficiary's entitlement to make a demand. In other words, it appears that under Article 15, a beneficiary is regarded as certifying their entitlement to make a demand and that there are no factors which would give rise to an exception to the payment obligation under a documentary credit (i.e., the factors outlined in Article 19 as discussed further below).

An option for recourse against certain exceptionable conduct or circumstances in relation to documentary credits which is offered by Article 19(1) of the UNCITRAL Convention, and discussed in the next section of this thesis, is that the issuer/guarantor of a documentary credit has a right to withhold payment. This option is exercisable by a guarantor/issuer on the grounds specified therein. According to the Explanatory Note to the UNCITRAL Convention, this approach of conferring upon an issuer a right, rather than a duty to utilise Article 19 to avoid making an unjustified payment, recognises issuers' concerns regarding the need to preserve the commercial utility and autonomy of documentary credits.[122]

However, should a guarantor/issuer refrain from exercising the right to withhold payment where they are entitled to do so, this may give rise to disputes with the applicant or even a breach of contract. Whilst the issuer has a default obligation to pay under a documentary credit when presented with a compliant demand, this is qualified by the converse obligation to resist making

[122] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 48.

payment and act in the interests of the applicant where an exception, particularly as envisaged under Article 19, is established to be applicable. The UNCITRAL Convention does not negate any rights of the applicant under its contract with the issuer, including the right to refuse reimbursement of amounts paid by the issuer in contravention of that contractual relationship. In this way, it can be said that Article 19 balances the competing interests of the parties to a documentary credit arrangement.

6.3.3 Article 19 of the UNCITRAL Convention

6.3.3.1 Overview of Key Provisions of Article 19

Article 19 of the UNCITRAL Convention tackles the subject of exceptions in relation to documentary credits, including fraudulent conduct and is accordingly titled, "[e]xception to payment obligation".[123] Scholars have praised this aspect of the UNCITRAL Convention in line with the view that any efforts to curtail fraudulent conduct ought to be applauded.[124] Under this heading, Article 19(1) stipulates that the issuer of a documentary credit has a right to withhold payment where it is "manifest and clear" that the document is not genuine or has been falsified;[125] payment is not due on the basis asserted in the demand and the supporting documents,[126] or judging by the type and purpose of the relevant undertaking, the demand has no conceivable basis.[127] The third ground is considered to warrant further expansion, which has been provided in the form of what is meant by "no conceivable basis". Article 19(2) goes on to expand on what is meant by the phrase "no conceivable basis" in respect of a demand, being:

> "(a) [t]he contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materiali[s]ed;
>
> (b) [t]he underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking;
>
> (c) [t]he underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;

[123] UNCITRAL Convention, Article 19.

[124] Alawamleh, *Documentary Credits and Independent Guarantees*, at 306.

[125] UNCITRAL Convention, Article 19(1)(a).

[126] UNCITRAL Convention, Article 19(1)(b).

[127] UNCITRAL Convention, Article 19(1)(c).

(d) [f]ulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary;

(e) [i]n the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter-guarantee relates".[128]

These grounds will be considered in turn further below, particularly in the context of recognised exceptions to which they relate in respect of documentary credits, particularly the unconscionability and breach of a negative stipulation exception.

6.3.4 A Brief Consideration of the Fraud Exception under Article 19 of the UNCITRAL Convention

6.3.4.1 Introduction

As already discussed in earlier chapters, the delineation of the often-blurry boundary between fraud and unconscionability will also be considered further below. Such consideration necessitates an understanding of at least a broad outline of the fraud exception. Of the three grounds for stopping a payment under a documentary credit stipulated in Article 19(1) of the UNCITRAL Convention, the first two paragraphs (any document is not genuine or has been falsified; no payment is due on the basis asserted in the demand and the supporting documents) can plausibly be considered to envisage typical fraudulent conduct cases. Interestingly, the UNCITRAL Convention, despite its seeking to address fraudulent conduct and circumstances which may give rise to an exception, does not expressly use the term fraud in any defined sense. It has been observed that this was likely a deliberate decision to steer away from using the term fraud in light of the different interpretations it can be given in different jurisdictions.[129]

6.3.4.2 Article 19(1)(a): Where the Document is Not Genuine or has been Falsified

Despite the term fraud exception not being used explicitly, the document-focused tone of Article 19(1)(a) is characteristic of the common-law fraud exception on a narrow approach. Where a document is not genuine or has been falsified, it is submitted to be likely that this would fall within the ambit of fraud and the fraud exception to the autonomy principle of demand guarantees.

[128] UNCITRAL Convention, Article 19(2).

[129] Goode, R *Transnational Commercial Law – International Instruments and Commentary*, 1 ed, Oxford University Press, 2004, at 341.

Moreover, it is submitted that Article 19(1)(a) is more targeted at or intended to capture fraud on a narrow approach, being that which entails direct fraudulent conduct in respect of the relevant transaction documents. The fraudulent presentation of documents containing express or implicit material misrepresentation, with knowledge of the same,[130] exemplifies a scenario which could be addressed under Article 19(1)(a) of the UNCITRAL.

6.3.4.3 Article 19(1)(b): Where Payment is Not Due on the Basis Asserted in the Demand and the Supporting Documents

Article 19(1)(b), which envisages a scenario where payment is not due on the basis asserted in the demand and the supporting documents, may go further than the narrow formulation of the fraud exception. It could arguably extend to cover fraud not directly involving the transaction documents but which is perpetrated through a beneficiary's conduct. Conduct which it is submitted may exemplify this type of fraud on the wider approach is where a seller (beneficiary) presents compliant documentation with the knowledge that the merchandise being sold is worthless or non-existent.[131] However, it is further submitted that certain scenarios where payment, as asserted in a demand or supporting documents, is not due, per Article 19(1)(b), could spill over into the unconscionability or breach of a negative stipulation exception. This viewpoint will be considered further below within the context of each of these two exceptions, respectively.

6.3.4.4 Commentary and Criticism regarding the Fraud Exception

The codification of the fraud exception in the UNCITRAL Convention has been commented on as a crucial step in extricating the fraud exception from "the arcane twists of common law jurisprudence and [placing] it on a sound footing which is essential to international commercial law."[132] Such a clear and relatively detailed outline of what can constitute fraud has been praised for rendering it easier to combat fraud in the practice of commerce in relation to documentary credits.[133]

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[130] See, e.g., the fraud on a narrow approach scenario contemplated in *Loomcraft Fabrics CC v Nedbank Ltd & Another* 1996 (1) SA 812 (A).

[131] See Van Niekerk, JP and Schulze, WG *The South African Law of International Trade: Selected Topics*, 4 ed, SAGA Legal Publications CC, 2016, at 291.

[132] *Agritrate International v Industrial & Commercial Bank of China* 1998-3 SLR LEXIS, 211, 1998, as cited in Moens, G and Jones R *International Trade and Business Law Review*, Volume XI, Volume 11, Routledge, 2012.

[133] Nemeikšis, G "Abstract Principle of First Demand Guarantee and its Restrictions" (2014), *Proceedings of the 56th International Scientific Conference of Daugavpils University*, 181, at 185.

Despite this initiative taken by the UNCITRAL Convention and the benefits it has been noted to provide, the UNCITRAL Convention has not been completely above criticism. There are two main criticisms levelled against it. Firstly, the provisions themselves have been considered vague and, therefore, difficult to implement practically.[134] Secondly, it has been argued that the provisions lend themselves to the possibility of different court interpretations, thereby increasing uncertainty and the risks associated therewith in international trade.[135] It is arguable that such criticisms also find application in respect of the other non-fraud related exceptions to the autonomy principle set out under Article 19 of the UNCITRAL Convention.

There is South African case law precedent supporting both the fraud exception on a narrow approach[136] and fraud on the wide approach, the latter being with particular reference to knowledge by a beneficiary that they are not entitled to claim under a demand guarantee.[137] Whilst recognition of the fraud exception under South African law is established, the parameters of the fraud exception remain less than perfectly certain under South African law. Analysis of the fraud exception is beyond the scope of this thesis but, in addition to consideration of its potential overlap with the unconscionability and breach of a negative stipulation exceptions which are central to this thesis, it is worth noting that the UNCITRAL Convention, per Article 19(1)(a) and 19(1)(b), seems to make provision for both the narrow and the wide approach to the fraud exception, despite not explicitly using the term fraud exception.

6.3.5 The Intersection of the Fraud Exception and the Unconscionability Exception under the UNCITRAL Convention

The area of overlap and commonality between unconscionability and fraud makes at least a brief consideration of the fraud exception necessary when considering unconscionability.[138] In trying to

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[134] Dolan, JF "The UN Convention on International Independent Undertakings: Do States with Mature Letter-of-Credit Regimes Need It?" (1997), 13, *Banking & Finance L Rev*,1, at 23.

[135] Lars, G "Draft UNCITRAL Convention on Independent Guarantees" (1996), 2, *LMCLQ*, 42, at 49.

[136] See *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A), para 817 and *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited & Another* [2020] ZAGPPHC 554, paras 13, 22 and 26.

[137] See the cases of *Union Carriage and Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) 730, 735; *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 17; *Scatec Solar SA 163 (Pty) Ltd v Terrafix Suedafrika (Pty) Ltd* (2014) ZAWCHC 63; and *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* [2015] 2 All SA 716 (GJ), paras 25-36.

[138] See section 3.2.6.1 in Chapter 3 of this thesis for a more specific and detailed discussion of the doctrine of unconscionability and the fraud exception particularly from a South African perspective. See also sections 4.2.2.1 in Chapter 4 and section 5.2.2.2 in Chapter 5 for consideration of the potential overlap of unconscionability with fraud under English law and Australian law, respectively.

explain the relationship or interconnectedness of fraud and unconscionability, some commentators have averred that unconscionability covers conduct which falls short of fraud but is also inclusive of fraud.[139]

The potential exception scenarios outlined in Article 19 of the UNCITRAL Convention have been found to extend beyond mere common-law fraud.[140] It has been opined that a common thread between the exceptions envisage under Article 19 is good faith and the prevention of abuse of one's rights.[141] A possible link or similarity has been observed between this and the Australian law formulation of the unconscionability exception.[142] Noting this potential for overlap, equitable notions such as bad faith are observed to be broad enough in scope to support these distinct exceptions. When considered in conjunction with Articles 15(3) and 19(1) of the UNCITRAL Convention, this breadth may also encompass certain conduct within the ambit of the breach of a negative stipulation.

As observed earlier in this thesis,[143] the association of both fraud and unconscionability with public policy related elements such as bad faith, particularly in a South African law context, appears to be a common denominator of the two. This commonality seems to be supported by the reference to bad faith/good faith in Articles 15(3) and 19(1) of the UNCITRAL Convention. According to these provisions, a demand by a beneficiary in the circumstances falling under 19(1) may typify bad faith and, therefore, justify an issuer/guarantor withholding payment in good faith on the basis of, *inter alia*, some grounds closely resembling the unconscionability exception.[144] As already noted above, the same articles in the UNCITRAL Convention seem to embrace the application of

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[139] Woolf, HS "*The Doctrine of Unconscionability as an independent Exception to the Doctrine of Independence in Documentary Credit Practice*" LLM dissertation, University of Johannesburg, 2014 (hereinafter, "Woolf, *The Doctrine of Unconscionability as an Independent Exception*"), at 5.

[140] Fedotov, A "Abuse, Unconscionability and Demand Guarantees: New Exception to Independence" (2008), 11, *Int'l Trade & Bus L Rev*, 49, at 69.

[141] Ibid.

[142] Ibid.

[143] See section 3.2.6.1 in Chapter 3 of this thesis for a more specific and detailed discussion of the doctrine of unconscionability and the fraud exception particularly from a South African perspective.

[144] See section 3.2.6.2 in Chapter 3 of this thesis for a more specific and detailed discussion of unconscionability, bad faith or lack of good faith and whether they constitute a potential standalone exception to the autonomy principle particularly from a South African law perspective. See also sections 4.2.3 in Chapter 4 and 5.2.2.3 in Chapter 5 of this thesis, for consideration of the interaction and/or potential overlap between unconscionability, bad faith or lack of good faith, respectively.

bad/good faith considerations to conduct, which may also fall under the scope of other exceptions, such as a breach of a negative stipulation exception.

There is not yet a settled position regarding the recognition of unconscionability as an exception to the autonomy principle under South African law.[145] The majority judgment in *Dormell,* taking into account the arbitration award finding in favour of the applicant, held that "there was no legitimate purpose to which the guaranteed sum could be applied".[146] The Supreme Court of Appeal explained that if the guarantor was ordered to make payment pursuant to the guarantee, the applicant would be entitled to repayment of the paid sum,[147] which in its view was not practical and would, in turn, give rise to additional cost and inconvenience.[148] On that basis, citing the Supreme Court Act,[149] the Supreme Court of Appeal dismissed the appeal.[150] This ruling faced an onslaught of heavy criticism, and later cases effectively rescinded the position taken in *Dormell*. The significance given to the adverse arbitration finding in favour of the applicant in *Dormell,* to some extent, resonates with Article 19(2)(b) (the underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking).

6.3.6 The Unconscionability Exception and Bad Faith Under the UNCITRAL Convention

6.3.6.1 The Unconscionability Exception: Relevant Provisions Under the UNCITRAL Convention Where No Payment is Due, or the Demand Has No Conceivable Basis

As considered in previous chapters,[151] unconscionability is a potentially nebulous concept and does not have a single universal definition. It has been posited that the concept of unconscionable conduct was historically geared toward protecting one against their own vulnerability, whereas

[145] See generally the discussion of the unconscionability exception under South African law in section 3.2 of Chapter 3 of this thesis.

[146] *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA), paras 40-41.

[147] Idem, para 42.

[148] Idem, para 45.

[149] Supreme Court Act 59 of 1959, section 21A, being the statute in force at the time of this case and has now been replaced by the Superior Courts Act 10 of 2013 which has a similar provision, section 16(2).

[150] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA), paras 45-47.

[151] See the discussion of the unconscionability exception under South African law in section 3.2 of Chapter 3 of this thesis.

nowadays, it seems to be targeted at protecting a person against another's self-interested power.[152] This approach of protecting a party from or against a transactional disadvantage explains why it is plausible for such protection on the basis of unconscionable conduct to apply to a sophisticated party or legal person capable of advancing and protecting its own interests.[153]

According to Article 19(1)(b), a guarantor/issuer may in good faith withhold payment demanded under a documentary credit where payment is not due on the basis asserted in the demand and the supporting documents. While this can be seen as falling under the fraud exception, it is submitted that this may fall under the unconscionability exception in some circumstances or to some degree. In the context of unconscionability, it has been said that the insistence on the right to be paid under the demand guarantee in circumstances where a beneficiary clearly has no substantive right to payment may be a form of unconscionable conduct envisaged under Article 19 of the UNCITRAL Convention.[154] This argument is partly rationalised by the recognised potential overlap between unconscionability and fraud, which has even led some to question whether unconscionability may be a subcategory of fraud rather than a potential standalone exception to the autonomy principle.[155]

In contrast, the case for a standalone unconscionability exception has also been bolstered by the argument that unconscionability and the exception it could give rise to can arise from conduct falling short of fraud. Following this argument, certain conduct can, therefore, be unconscionable without necessarily meeting the standard required to establish the fraud exception. Applying this distinction in the context of Article 19(1) of the UNCITRAL Convention, it could be said that conduct falling short of fraud in relation to the documents as described in Article 19(1)(a) may still be caught within the meaning of unconscionable conduct which could be addressed under Article 19(1)(b). It would, therefore, seem that Article 19(1)(b) could feasibly be interpreted as also resembling an unconscionability exception in certain situations. At the very least, it straddles the admittedly blurry line between fraud on a wide approach and unconscionability.

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[152] Rodrigo, T "Unconscionable Demands Under On-Demand Guarantees: A Case of Wrongful Exploitation" (2012), 33, *Adelaide Law Review*, 481, at 503

[153] Finn, P "Commerce, the Common Law and Morality" (1989), 17, *Melbourne University Law Review* 87, at 94.

[154] Fedotov, A "Abuse, Unconscionability and Demand Guarantees: New Exception to Independence" (2008), 11, *Int'l Trade & Bus L Rev*, 49, at 69.

[155] See section 3.2.2 in Chapter 3 of this thesis for a discussion of whether there is potential synonymity or overlap between fraud, duress, misrepresentation, undue influence, and unconscionability from a South African law perspective. See also sections 4.2.1.1 in Chapter 4 and 5.2.2.1 in Chapter 5 of this thesis which touch on this from an English law and Australian law perspective, respectively.

Article 19(2)(d) of the UNCITRAL Convention includes a beneficiary's demand under a documentary credit where, *inter alia*, the fulfilment of the underlying obligation has clearly been prevented by the wilful misconduct of the beneficiary as having no conceivable basis. A rationale for this may be that where a beneficiary's wilful misconduct is the cause of a principal's failure to meet their obligations under an underlying contract, an attempt by the beneficiary to enforce a documentary credit for such failure could be deemed unconscionable conduct.

A conceptual distinction raised by some commentators between the fraud and unconscionability exceptions is that unconscionability, unlike fraud, is also concerned with the outcome or resultant contract.[156] With this in mind, it would seem that a demand made where no payment is due under the grounds asserted further to the demand portends an unjust outcome or result. This could be argued to fall under the purview of an unconscionability exception on the basis that where a claim under a demand guarantee results in a payment to which a beneficiary is not entitled and can, therefore, not be applied to a legitimate purpose, the criteria for an unconscionability exception is established.[157] In addition to providing recourse against conduct that would fall under the fraud exception under common law, Article 19(1)(b) of the UNCITRAL Convention can thus feasibly be said to cover elements of unconscionable conduct and provide for an unconscionability exception too in the right circumstances.

6.3.6.2 A Brief Comparative Analysis of the Unconscionability Exception under the UNCITRAL Convention against Selective South African Case Law

The South African Supreme Court of Appeal case of *Dormell Properties 282 CC v Renasa Insurance Co Ltd*,[158] is an example of a case that, although later overturned in subsequent Supreme Court cases, was considered to have established a new unconscionability exception to the autonomy principle of demand guarantees under South African law. *Dormell* is flagged as an example at this juncture because certain views articulated in relation to this case bear an uncanny resemblance to the stated elements of what constitutes a demand with "no conceivable basis" under Article 19(2) of the UNCITRAL Convention.

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[156] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, 27.

[157] See also Fedotov, A "Abuse, Unconscionability and Demand Guarantees: New Exception to Independence" (2008), 11, *Int'l Trade & Bus L Rev*, 49, at 69.

[158] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA). See also section 3.2.6.2 in Chapter 3 of this thesis for full consideration of this case.

In *Dormell*, the question arose as to whether the findings of an arbitration award in respect of a construction dispute could be admitted as evidence in relation to non-payment of a claim under a demand guarantee. Article 19(2)(b) of the UNCITRAL Convention envisages a scenario where the underlying obligation of the principal/applicant has been declared invalid by the court or arbitral tribunal. While the facts in *Dormell* are not an exact match of such a scenario, certain contextual similarities are discernible. The effect of the arbitration ruling, which had been made in *Dormell,* was that the relevant underlying contract had been repudiated by the claimant and, therefore, cancelled. The arbitration ruling could thus be said to have created a situation where there was no (longer) a valid underlying obligation of the principal due to the repudiation and cancellation of the agreement.[159] Furthermore, the demand guarantee was found to be unenforceable because of the arbitral tribunal ruling that the underlying contract had been validly cancelled, which was asserted to mean that the beneficiary was "no longer bona fide when it insists on payment of the guarantee [and any] entitlement to call for payment has fallen away."[160] The reference to bona fide further invokes the intertwined relationship of bad faith/lack of good faith and unconscionability.

The majority judgment in *Dormell*, taking into account the arbitration award finding in favour of the applicant/principal, in that case, held that "there was no legitimate purpose to which the guaranteed sum could be applied".[161] According to Hugo, the position upheld in the *Dormell* case, "although not stated expressly in these terms – was clearly that another exception to the independence principle had been recognised by the Supreme Court of Appeal: if the underlying dispute has been finally determined against the beneficiary of the guarantee in arbitration (or litigation) this would provide a defence against liability on the guarantee, or the basis for an injunction preventing payment thereof."[162] A prior adverse finding against a beneficiary/in favour of the principal and/or conduct by the beneficiary that amounts to a repudiation of the underlying contract, which feasibly invalidates the existence of a valid underlying obligation owed to a beneficiary and to which the guaranteed sum could be applied, was seemingly proposed, further

[159] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA), para 20.

[160] Idem, para 25.

[161] Idem, paras 40-41.

[162] Hugo, C "Demand Guarantees in the People's Republic of China and the Republic of South Africa" (2019), 6(2), *BRICS Law Journal*, 4 (hereinafter, "Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*"), at 18-19.

to *Dormell*, as an exception under South African law.[163]

The finding in *Dormell* seems to be arguably congruent with the exception outlined in 19(1)(c) and expanded upon in Article 19(2)(b) regarding the effect that an arbitration ruling in respect of an underlying obligation can establish a defence against payment under a documentary credit. There may also be room to argue for parallels with Articles 19(2)(a) and 19(2)(d), as noted above. However, it is worth noting that the minority judgment in *Dormell* held that the arbitration award did not create a valid defence against payment under the guarantee in the face of a valid claim for payment. Explaining this stance, it was found that the arbitrator's determination (in favour of the contractor/applicant) against the beneficiary in the case was only relevant *vis-à-vis* the applicant and was *res inter alios acta* (i.e., irrelevant) in respect of the issuer or the guarantor, who remained obliged to meet their payment obligations as arising upon presentation of a compliant demand under the demand guarantee.[164] This alternative viewpoint seems to have received later endorsement as the correct position under South African law, as evidenced by the overturning of the majority ruling in subsequent Supreme Court of Appeal cases.

It is worth noting that some commentators focused on such a prior determination as an exception in itself, as opposed to fitting it into the mooted unconscionability exception.[165] This approach seems to be more closely aligned with, for instance, Article 19(2)(b), which refers to a prior determination in the form of a declaration by a court or court or arbitral tribunal without seeking to link it with or make it part of the unconscionability exception. While the beneficiary's pursuit of a claim under the guarantee, presumably with knowledge that there was no legitimate purpose to which the claimed sum could be applied, may be construed to be encapsulated under other exceptions, e.g., the unconscionability exception. Such a scenario could also be considered to constitute no conceivable basis for a claim in the alternative sense that it resonates with Articles

[163] See for instance *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA) para 41: "There is no longer any dispute about the cancellation of the underlying agreement that still has to be resolved. The arbitration has established that Dormell is in the wrong. Its repudiation of the building contract was held to have been unlawful. As a consequence, Dormell has lost the right to enforce the guarantee. There remains no legitimate purpose to which the guaranteed sum could be applied."

[164] 2011 (1) SA 70 (SCA), para 64.

[165] Ibid. See generally Hugo's discussion of non-payment under a demand guarantee on the grounds of a court judgment or arbitral award finding that the party obligated under the underlying transaction is not liable for payment or damages, with reference to "The Provisions of the Supreme People's Court of the People's Republic of China on Several Issues Concerning the Trial of Disputes Over Independent Guarantees" which were released by the Judicial Committee of the Supreme People's Court on 7 July 2016 and came into effect on 1 December 2016, Hugo C, "Demand Guarantees: Insights from the People's Republic of China", in Hugo, C and Kelly-Louw, M (eds) *Jopie: Jurist, Mentor, Supervisor and Friend - Essays on the Law of Banking, Companies and Suretyship*, Juta, 2017, at 129.

19(2)(a) and 19(2)(c) of the UNCITRAL Convention, being where the risk secured against has not materialised or where the obligations owed to the beneficiary have been satisfied, respectively.

The scenarios contemplated in Articles 19(1)(b), 19(2)(a); 19(2)(b) and/or 19(2)(c) of the UNCITRAL Convention, respectively, (i.e., where the contingency/risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialised; the underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal; and/or the underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary), are arguably forms of unconscionable conduct.[166] The same can be said of pursuing a demand under a demand guarantee in circumstances where the non-fulfilment of obligations which give rise to the demand resulting from the beneficiary's wilful misconduct, as contemplated in Article 19(2)(d), or a claim for reimbursement of a payment made in bad faith in the context of a demand guarantee, per Article 19(2)I. Therefore, these scenarios could plausibly be considered to fall under the broad umbrella of an unconscionability exception.

In addition to the considerations regarding Article 19(2)(b), parallels could arguably be drawn between certain elements of the *Dormell* case and the scenarios contemplated under Articles 19(1)(b) (i.e., no payment is due on the basis asserted in the demand or supporting documents); 19(2)(a) (i.e., the contingency/risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialised); and/or 19(2)(c) (i.e., the underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary).

For instance, a point emphasised by the court in *Dormell*, which resonates with Article 19(2)(a), is that a demand guarantee must be enforced for the purpose for which it was issued. The court in *Dormell* noted that the demand guarantee in question had been issued to enable completion of the contract in the event of default by the contractor and highlighted that it was not intended to provide a source of funds for payment of any outstanding amounts due by the principal to the beneficiary.[167] It could also be argued perhaps that Article 19(2)(d) (i.e., where the fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary) is somewhat analogous to the conduct of the beneficiary in *Dormell* of repudiating the underlying contract. A claim by a beneficiary under such circumstances is clearly considered an exception

[166] See consideration of these provisions in section 6.3.5 of this Chapter. See also further discussion of Article 19(2)(b) of the UNCITRAL Convention in section 6.3.6.2 of this Chapter.

[167] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA), para 44.

under the UNCITRAL Convention and may broadly fall within the ambit of unconscionable conduct.

Following on from the averments on potential parallels between the exceptions contemplated in *Dormell* and Articles 19(1)(b), 19(2)(a), 19(2)(b), 19(2)(c) and 19(2)(d) of the UNCITRAL Convention, the likely stance of South African law towards the latter could perhaps be extrapolated from the stance taken regarding the *Dormell* decision. In view of the unequivocal rejection of *Dormell'*s attempt to recognise additional scenarios which could give rise to an exception to the autonomy principle, it is submitted that the exceptions envisaged under Articles 19(1)(b), 19(2)(a), 19(2)(b) and 19(2)(c) would likely be considered too adversarial to the autonomy principle and, therefore, untenable from a South African law perspective. Such an approach would be consistent with the overall non-acceptance of a standalone unconscionability exception to the autonomy principle of demand guarantees under South African law.

Mounting discomfort and dissension with the judgment in *Dormell* were highlighted by commentators[168]and culminated in the endorsement of the minority judgment in *Dormell* and a categorical statement by the Supreme Court of Appeal in the case of *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association,*[169] that the majority judgment in *Dormell* had been wrong.[170] The *Dormell* case was noted in *Coface* to have undesirably resulted in guarantors seeking to introduce contractual disputes to avoid their payment obligations under demand guarantees, with applicants sometimes jumping into the fray.[171] It is submitted, in view of the perceptible similarities noted above in the rationale of the *Dormell* ruling and some of the points considered to constitute a "no conceivable basis" exception under Article 19 of the UNCITRAL Convention, that the latter may be considered to be too liberal an approach

[168] Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*, at 19.

[169] 2014 (2) SA 382 (SCA).

[170] *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 23-25. The fact that the majority ruling in *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 1 SA 70 (SCA) is considered wrong and was overturned is widely acknowledged and referenced in a number of other cases, including *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146, para 23; *Group Five Power International (Pty) Limited v Cenpower Generation Company Limited and Others* ZAGPJHC 663, paras 88-89; *Fast Track Contracting (Pty) Ltd v Constantia Insurance Company Limited and Others* [2018] ZAGPJHC 633, para 5; and *Granbuild (Pty) Ltd v Minister of Transport and Public Works, Western Cape and Another* [2015] ZAWCHC 83, para 24.

[171] *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), para 24.

to exceptions and undermine the autonomy principle from a South African law perspective.

Reversing the *Dormell* decision, the case of *Coface* unequivocally (re)established the position that a prior decision on an underlying contract dispute is neither an acceptable defence against payment obligations pursuant to the autonomy principle of demand guarantees nor a basis upon which an interdict would be granted to prevent payment thereunder. This dismissal of extraneous factors such as underlying dispute court or arbitration rulings may prove to be at odds with certain aspects of Article 19 of the UNCITRAL Convention, particularly those exceptions which are linked to the validity of the underlying obligations or agreement. Article 19(2)(b), which envisages an exception where a court or arbitral ruling declares invalid an underlying obligation of the principal on the basis that the demand by a beneficiary would have no conceivable basis, is one such provision.[172] The exceptions under Articles 19(1)(b), 19(2)(a) and 19(2)(c) to 19(2)(e) also generally refer to extraneous and/or underlying contract related factors in a manner inconsistent with the general operation of the autonomy principle, including from a South African law perspective. This arguably depicts some of the pitfalls which would arise if South African law sought to adopt the UNCITRAL Convention wholesale and South Africa signed up to it.

The key factor to note in relation to the *Dormell* case and the juxtaposition of certain elements thereof with Article 19 of the UNCITRAL Convention is, therefore, that it underscores potential areas in which South African law consensus and the UNCITRAL Convention may find themselves at odds regarding exceptions in relation to demand guarantees. The vehemence with which the *Dormell* case, including in particular its permissiveness regarding consideration of factors which are extraneous to the demand guarantee itself, was opposed and subsequently overridden under South African law, is testament to this point. Consideration of certain elements which are extraneous to the demand guarantee, such as the status of the underlying contract obligations, whether payment is due on the basis asserted in the demand, materialisation of the secured risk/contingency, and bad faith, pursuant to Articles 19(2)(a) to 19(2)(e) of the UNCITRAL Convention would, therefore, likely not be compatible with South African law and jurisprudence in respect of the autonomy principle of demand guarantees. This seems to point to the unsuitability of a wholesale adoption or accession to the UNCITRAL Convention, which, as mentioned earlier in this chapter, assumes the force of law in states which have signed up to it.

[172] See also the discussion of *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 1 SA 70 (SCA) in section 6.3.6.2 of this Chapter.

It is worth noting that there is plausibility in the alternative analysis that Article 19(2)(b) may fit into the context of an illegality of the underlying contract exception which was endorsed in the recent case of *Mattress House (Proprietary) Ltd v Investec Property Fund Ltd.*[173] An exception of this nature has scholarly support for application in very limited circumstances determined to be of sufficient seriousness, e.g., serious illegality of the underlying contract.[174] However, any exception in respect of illegality is beyond the purview of this thesis and is not proposed to be pursued further.

Interestingly, in another South African case, *Transnet SOC Limited v Absa Insurance Company Ltd and Others*,[175]the court seemed dismissive of concerns around the utilisation of the guaranteed amount for the expected or intended purpose and supported the view that generally, a beneficiary is considered to be entitled to utilise the proceeds of payment under a demand guarantee as they see fit.[176] This case and the decision reached have been endorsed to be sound.[177] Further swinging the pendulum away from the *Dormell* case and in favour of the sanctity of the autonomy principle, the case of *Casey and Another v Firstrand Bank Ltd*[178]upheld the position that prescription of the obligation under an underlying contract has no bearing on the beneficiary's entitlement to make a demand and the payment obligation arising from a compliant demand.[179]

Quite rightly, cases such as *Transnet* and *Casey* are considered to strongly support the deduction that factors such as nullity, voidness, cancellation, unenforceability or non-existence of a valid obligation under an underlying contract are not recognised as giving rise to any additional exception to the autonomy principle under South African law, save perhaps where they fall, on the facts of the case, under the established fraud exception.[180] Scholars such as Kelly-Louw further opine that allowing such factors to override the autonomy principle would diminish the utility of demand guarantees and be catastrophic to the point of rendering them equal to suretyship

[173] [2017] ZAGPJHC 298.

[174] See Kelly-Louw, M "Validity of the Underlying Contract and the Independence Principle of Demand Guarantees", 110 in Hugo, C (ed) *Annual Banking Law Update 2021: Recent Legal Developments of Special Interests to Banks*, 2021, Juta, (hereinafter Kelly-Louw, *Validity of the Underlying Contract*) at 113 and 122-124 and the authorities cited therein.

[175] [2019] ZAGPJHC 476, para 13.

[176] Idem, para 13.

[177] Kelly-Louw, *Validity of the Underlying Contract*, at 117.

[178] 2014 2 SA 374 (SCA).

[179] Para 16.

[180] Kelly-Louw, *Validity of the Underlying Contract*, at 124.

agreements.[181] In line with this logic, it is submitted that a prior ruling by a court or arbitral tribunal invalidating the underlying obligation of a principal/applicant per Article 19(2)(b) of the UNCITRAL Convention would not be accepted as an exception to the autonomy principle under South African law.

Precise application or pertinence of the provisions under Article 19 of the UNCITRAL Convention to any case is, however, dependent on the facts of each individual case. While this thesis is not and does not seek to be an exercise in matching Article 19 of the UNCITRAL Convention against the facts of specific cases, this has selectively been touched upon, particularly in respect of *Dormell*, to merely illustrate some commonality between certain exceptions contemplated by the UNCITRAL Convention and those which have come before and been decided upon by South African courts, including under the umbrella of unconscionability.

6.3.6.3 A Brief Comparative Analysis of Bad Faith under the UNCITRAL Convention against Selective South African Case Law

In accordance with Article 19(1)(c) read with Article 19(2)(e) of the UNCITRAL Convention, one of the grounds on which a beneficiary's demand would have no conceivable basis and, therefore, be exceptionable includes, "[i]n the case of a demand under a counter-guarantee, [where] the beneficiary of the counter-guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter-guarantee relates".[182] This, in essence, seems to establish a bad faith exception to the autonomy principle or defence against payment to honour a claim under a counter-guarantee.

Focusing on the bad faith exception element, a South African case already considered earlier in this thesis[183] which comes to mind, is *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*.[184] The *Sulzer Pumps* case is worth mentioning regarding unconscionability under South African law as it endorsed recognition of unconscionability and bad faith as exceptions to

[181] Kelly-Louw, *Validity of the Underlying Contract*, at 124.

[182] Ibid; Article 19(2) of the UNCITRAL Convention.

[183] See generally the discussion of bad faith in conjunction with unconscionability in section 3.2 of Chapter 3 of this thesis.

[184] [2014] ZAGPPHC 695. For a more detailed consideration of the unconscionability exception and good faith under South African law, section 3.2.3 of Chapter 3 of this thesis.

the autonomy principle but has been criticised as manifestly lacking a sound rationale.[185] In *Sulzer Pumps*, an application for the interdict was made on the basis that the beneficiary had, via amendment letters to the demand guarantee, undertaken not to call up the demand guarantee (i.e., a *pactum de non petendo*), prompting the court to, *inter alia*, consider what, in its view, were acceptable exceptions to the autonomy principle. In doing this, one of the things the court highlighted was the importance of good faith with reference to the case of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers Ltd*[186] and appeared to acknowledge that a beneficiary may be prevented from calling upon a demand guarantee where the beneficiary has acted, *inter alia*, in "bad faith".[187]

However, the *Sulzer Pumps* case was criticised on a number of grounds, including that it did not provide sufficient certainty on the role of good faith/impact of bad faith in the law of demand guarantees and that it diverged from settled precedents upholding the supremacy of the autonomy principle under South African law. In addition, the *Sulzer Pumps* judgment was argued not to be well-re asoned given, *inter alia*, the view that up to that point, neither unconscionability nor bad faith had been dealt with or raised as possible exceptions under South African law.[188]

Sulzer Pumps, like *Dormell*, seems to have elicited an overwhelming amount of criticism associated with its divergence from the predominant South African law position on recognised exceptions to demand guarantees. This diminished, if not extinguished, any precedent-setting potential that the *Sulzer Pumps* case could have had. It is submitted that the bad faith exception to the autonomy principle, which is contemplated pursuant to Article 19(1)(c), read with Article 19(2)(e) of the UNCITRAL Convention, may, if ever mooted in a South African law context, find itself shunned for some of the same reasons giving rise to criticism of the *Sulzer Pumps* case.

Bad faith, or the absence of good faith, seems to be recognised by the UNCITRAL Convention as an overarching notion in certain sections thereof. The deemed certification in Article 15(3) of the

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[185] Kelly-Louw, *Validity of the Underlying Contract*, at 112. See also the discussion of the case of *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695 in section 3.2.6.2 of Chapter 3 of this thesis.

[186] 2012 (1) SA 256 (CC).

[187] Kelly-Louw, *Construing Whether a Guarantee is Accessory or Independent is Key*, at 115.

[188] Kelly-Louw, M & Marxen, K "General Update on the Law of Demand Guarantees and Letters of Credit", a paper delivered at the 2015 *Annual Banking Law Update*, 276 (hereinafter, "Kelly-Louw and Marxen, *General Update on the Law of Demand Guarantees*"), at 292. See also Marxen, K "*Demand Guarantees in the Construction Industry: A Comparative Legal Study of their Use and Abuse from a South African, English and German Perspective*" LLD thesis, University of Johannesburg, 2017, at 252.

UNCITRAL Convention by a beneficiary that it is not acting in bad faith and that none of the elements in Article 19(1) is present suggests that the presence of such elements is indicative of bad faith or, conversely, rules out the presence of good faith in relation to the demand. Article 19(1) also refers to good faith, stating that a guarantor/issuer has a right to withhold payment where it is manifestly clear that one of the grounds listed therein is present.

Therefore, bad faith seems to be recognised clearly as a factor that could give rise to an exception to the autonomy principle. It seems to be treated largely as an overarching principle whose presence is usually precipitated by or indicative of one of the exceptions established under Article 19(1). However, Article 19(2)(e) seems to elevate the concept of bad faith to a potentially standalone exception to the autonomy principle on the basis that bad faith in respect of the demand guarantee establishes that a demand has no conceivable basis and, in turn, the issuer/guarantor can in good faith withhold payment. This ambiguity regarding whether bad faith is an overarching notion or a standalone recognised exception to the autonomy principle seems common to both South African law and the UNCITRAL Convention.

The potential crossover between fraud and bad faith was evident in the South African case of *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited & Another*,[189] where consideration was given to whether noncompliance with an interim arbitration ruling was sufficient to establish fraud and/or bad faith.[190] In *Bombardier*, the court ruled that neither bad faith nor the fraud exception was established where a beneficiary made a proper demand for payment in terms of a demand guarantee, despite an (interim) adverse arbitration decision.

The close link or overlap between bad faith and unconscionability has meant that the abstract nature of the notion and role of bad faith in relation to demand guarantees is an attribute that also affects unconscionability. This perhaps renders bad faith a concept to be effected in relation to the law of contract through the uniquely South African constitutional vehicle of public policy instead of a standalone substantive exception to the autonomy principle of demand guarantees. Although the abstract nature of the principle of good faith under South African law is acknowledged, this area is not entirely set in stone, as good faith has been a dominant theme of a number of other South African cases in relation to demand guarantees and standalone exceptions to the autonomy principle. *Group Five Construction Ltd v Member of the Executive Council for Public Transport*

[189] [2020] ZAGPPHC 554.

[190] Idem, paras 25-26 and para 28.

Roads and Works Gauteng[191]exemplifies a case which seemed to recognise bad faith or the absence of good faith as a valid exception to the autonomy principle of demand guarantees. Furthermore, in *Hollard Insurance Co Ltd v Jeany Industrial Holdings (Pty) Ltd*,[192] bad faith was supported as an exception to the principle of autonomy, and again, this decision has courted controversy and vocal rejection from various quarters including prominent scholars.[193]

The abstract nature of bad faith in the context of the UNCITRAL Convention is arguably evident from the fact that under Article 19 of the UNCITRAL Convention, it can underpin more than one exception, i.e., both the fraud exception and the unconscionability exception, respectively.[194] Further to the analysis of the significance of bad faith in relation to demand guarantees under South African law earlier in this thesis,[195]good faith under South African law of demand guarantees generally does not seem to have enough substantive authority behind it to be considered a possible standalone ground giving rise to an exception to the autonomy principle.

While South African common law of demand guarantees can be developed further along similar lines as the UNCITRAL Convention or even replaced by codified law if South Africa was to accede to the UNCITRAL Convention, it seems that this would be a radical shift in approach. The UNCITRAL Convention, when broadly compared to the current South African common law regarding exceptions to the autonomy principle, particularly the unconscionability and breach of a negative stipulation exception, appears to take a much more liberal line towards exceptions. The openness of the UNCITRAL Convention to considering factors which are extraneous to the relevant documentary credit may limit the utility or compatibility of some of the exceptions to the autonomy principle envisaged under Article 19 of the UNCITRAL Convention in respect of the South African law of demand guarantees.

6.3.7 The Breach of a Negative Stipulation Exception under the UNCITRAL Convention

6.3.7.1 Non-materialisation of Contingency or Risk Secured Against

Article 19(2) expands on what is meant by the phrase "no conceivable basis" in respect of a

[191] 2015 (5) SA 26 (GJ).

[192] 2016 ZAGPJHC 175.

[193] Kelly-Louw, *Validity of the Underlying Contract*, at 113.

[194] See generally the discussions in sections 6.3.4 and 6.3.5 of this Chapter.

[195] See section 3.2.3 of Chapter 3 of this thesis.

demand, which includes a situation where: "(a)[t]he contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materiali[s]ed". In view of the autonomous and documentary nature of documentary credits, traditionally, guarantors and issuers require a compliant demand to include or be accompanied by a statement indicating that a default has occurred. Such a statement of default is tantamount to a written statement that the contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly materialised as contemplated in Article 19(2)(a) of the UNCITRAL Convention.

Article 19(1)(c) and Article 19(2)(a) of the UNCITRAL Convention seems to be silent on how an issuer/guarantor should determine that the relevant default or contingency which would justify a demand has/has not materialised. These provisions are thus arguably open to being potentially interpreted as an invitation to a guarantor/issuer to consider factors which are extraneous to the documentary credit to ensure that the contingency or risk secured by a documentary credit has materialised and that a demand is not one which has no conceivable basis. As such, an interpretation would be inimical to the autonomy principle.

The utility of Article 19(2)(a) of the UNCITRAL Convention could, however, be extracted, alternatively, within the framework of the breach of a negative stipulation exception. It is possible that Article 19(2)(a) could be construed in a manner which could also encompass a breach of a negative stipulation exception. This is so because it is not unusual for the contingency or risk against which a documentary credit was issued to secure the beneficiary to be incorporated in an underlying or other standalone contract between an applicant/principal and the beneficiary. It is not unusual for such contracts to purport to outline or restrict the circumstances in which a documentary credit issued thereunder to be called up. Applying Article 19(1)(c) read with Article 19(2)(a) in the context of establishing a breach of a negative stipulation exception thereunder, again implicitly involves guarantors/issuers in underlying/extraneous contract dynamics.

Consideration of an underlying or other contract that is binding between a beneficiary and a principal by a guarantor/issuer who is not a party to it, particularly in the context of determining whether a demand against a documentary credit can be honoured, directly violates the autonomy principle. The UNCITRAL Convention's apparent recognition of a "true exception" formulation of a possible breach of a negative stipulation exception makes the UNCITRAL Convention appear in some ways to take a markedly liberal line in respect of exceptions to the autonomy principle. If such an interpretation is correct or plausible, then the anti-beneficiary formulation of the breach of a negative stipulation exception, which is the baseline for its recognition under South African

law[196](and even English law),[197] is materially different from that which could be envisaged in the UNCITRAL Convention. Apart from trying to fit it into Article 19(2)(a), none of the other provisions of Article 19(1) read with 19(2) of the UNCITRAL Convention seems to significantly cater, or could cater, for a breach of a negative stipulation exception.

6.3.7.2 A Brief Comparative Analysis of Breach of a Negative Stipulation under the UNCITRAL Convention against Selective South African Case Law

The formulation of the breach of a negative stipulation exception which is developing under South African law, despite the taxonomy used, is not considered an exception in the true sense as it does not entail interference with the autonomy principle.[198] Breach of a negative stipulation has in recent times been progressively supported in South Africa as a ground upon which an interdict/injunction may be granted by a court restricting a beneficiary from calling up a demand guarantee. South African cases whose ruling and/or *dicta* which can be considered to pave the way towards firmer, albeit still measured, recognition of a breach of a negative stipulation exception include *Kwikspace Modular Buildings Limited v Sabodala Mining Company*,[199] *Eskom Holdings*, *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*[200] and *Joint Venture between Aveng (Africa) (Pty) Ltd* and *Strabag International GmbH v South African National Roads Agency Soc Ltd and Another*.[201]

Joint Venture, in particular, exemplifies a scenario which may arguably qualify as an exception under Article 19 of the UNCITRAL Convention on the basis of payment not being due or the demand lacking a conceivable basis because the contingency or risk secured against it had not materialised. In this case, the underlying contract stated, *inter alia*, that "[t]he employer [beneficiary] shall not make a claim under the performance security, except for an amount to which the employer is entitled under the contract in the event of: … (d) circumstances which entitle the

[196] See section 3.3 of Chapter 3 of this thesis for an analysis of the current and emerging South African law position on the recognition of the breach of a negative stipulation exception.

[197] See section 4.3 of Chapter 4 of this thesis for an analysis of the current and emerging English law position on the recognition of the breach of a negative stipulation exception.

[198] See section 3.3 of Chapter 3 of this thesis.

[199] [2010] 3 All SA 467 (SCA).

[200] [2014] ZAGPPHC 695.

[201] [2020] ZASCA 146.

employer to termination under sub-clause 15.2 [termination by employer], irrespective of whether notice of termination has been given."[202]

Therefore, the crux of the applicant's argument in *Joint Venture* was that the beneficiary had not met the conditions stipulated in the underlying contract for a demand. Although the matter of whether the breach of a negative stipulation exception was not determined in the ruling, potential support for and a progressive leaning towards the exception can be gleaned from Makhuvele J's remark that if it had been the only issue to consider, the decision would have been made in favour of the principal.[203]

The autonomy principle is not considered to translate to allowing a beneficiary to make a demand in flagrant breach of their contractual obligations.[204] In litigation between an applicant and a beneficiary to enforce the obligations of the latter, the independence of the demand guarantee is not considered to arise.[205]

6.3.8 Potential Remedies Available where Exceptions to the Autonomy Principle are Established under Article 19 of the UNCITRAL Convention

Articles 19(3) and 20 of the UNCITRAL Convention provide the options for recourse available to the aggrieved party, typically the applicant. Such recourse includes seeking an injunction to prevent the issuer from honouring the demand for payment made. Where the right to refrain from honouring a demand guarantee arises under Article 19 of the UCITRAL Convention, an applicant becomes entitled to seek a court injunction blocking payment by the issuer. Article 19(3) states that "[i]n the circumstances set out in subparagraphs (a), (b) and (c) of paragraph 1 of this article, the principal/applicant is entitled to provisional court measures in accordance with article 20".[206]

Article 20, titled "[p]rovisional court measures", proceeds to outline options available in terms of court action. The court may, according to Article 20:

> "(1)(a) [i]ssue a provisional order to the effect that the beneficiary does not receive payment,

[202] Idem, para 19.

[203] Idem, para 6.

[204] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[205] Ibid. See the brief discussion of Hugo's comments and the interaction (or lack thereof) of the enforcement of a negative stipulation preventing a beneficiary from making a demand, and the autonomy principle, in section 3.3.4.4 of Chapter 3 of this thesis.

[206] Article 19(3) of the UNCITRAL Convention.

including an order that the guarantor/issuer hold the amount of the undertaking, or

(b) [i]ssue a provisional order to the effect that the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm.

(2) [t]he court, when issuing a provisional order referred to in paragraph (1) of this article, may require the person applying therefor to furnish such form of security as the court deems appropriate.

(3) [t]he court may not issue a provisional order of the kind referred to in paragraph (1) of this article based on any objection to payment other than those referred to in subparagraphs (a), (b) and (c) of paragraph (1) of article 19, or use of the undertaking for a criminal purpose".[207]

The Explanatory Note of the UNCITRAL Convention outlines minimal evidentiary procedure requirements for such provisional court measures, being mainly that there should be strong evidence of a high probability of creditor's fraudulent or abusive conduct and that consideration should be given to the possibility of serious harm in the absence of the provisional court measures and whether security must be posted.[208]

The circumstances in which provisional court measures are warranted and the requisite standard of proof are outlined in Article 20 of the UNCITRAL Convention. In essence, one is required to show "on the basis of immediately available strong evidence" that there is a "high probability" of the circumstances of fraud or abuse set out in Article 19(1) having occurred.[209]

Furthermore, the court is required to consider whether the applicant would be "likely to suffer serious harm" if they were denied the provisional remedy, and may itself require the applicant to provide security.[210] The provisional court orders for blocking or freezing a payment may also be utilised in cases involving undertakings for a criminal purpose.[211]

Article 20 of the UNICITRAL Convention does not seem to distinguish between injunctions against banks and those against beneficiaries. Such an approach would seem to be in step with the views of Staughton LJ in *Groupe Josi Re v Walbrook Insurance* that: "the effect on the life blood

[207] UNCITRAL Convention, Articles 19(3) and 20.

[208] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 50 and Article 20(3) of UNCITRAL Convention also covers relevant criminal procedure for instances where abusive conduct overlaps with criminality.

[209] UNCITRAL Convention, Article 20(1).

[210] UNCITRAL Convention, Article 20(1)(b).

[211] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 49 and UNCITRAL Convention, Article 20(3).

of commerce will be the same whether the bank is restrained from paying or the beneficiary is restrained from asking payment".[212]

6.4 CONCLUSION

The ICC rules such as URDG, URCG, UCP and ISP98 are generally silent on the issue of fraud and any other potential exceptions affecting payment under demand guarantees. The UNCITRAL Convention, on the other hand, is not silent on the topic of exceptions to the autonomy principle. The fraud exception is catered for in the form of reference to a situation where any document is not genuine or has been falsified in Article 19(1)(a). In addition, whilst not expressly using the term unconscionability, the Convention appears to recognise both the unconscionability exception, including associated or overarching equitable notions such as good faith, in Article 19(1)(b) and Article 19(1)(c) read together with Articles 19(2)(a) to 19(2)(e). The breach of a negative stipulation exception could be interpreted as catered for within the parameters and guises outlined in the relevant provisions, particularly Article 19(2)(a).

Deterring the abuse of documentary credits and preserving the autonomy principle and commercial utility of demand guarantees requires a balancing act of sorts. The admission of additional or new exceptions to the autonomy principle would have profound consequences for South African law. If South African law goes too far in one direction, demand guarantees may become prolifically vulnerable to abusive demands. If it goes too far in the other direction, the utility of demand guarantees, and possibly their inherent nature, would be materially diminished.

The UNCITRAL Convention has not been ratified by South Africa, England or Australia. This, however, does not preclude consideration of the UNCITRAL Convention. Whether there is any guidance, it may have to offer in respect of exceptions to payment under demand guarantees, which has been considered herein in the context, particularly of the unconscionability and breach of a negative stipulation exceptions. By addressing potential exceptions to the autonomy principle or in respect of documentary credits, the UNCITRAL Convention has been seen by some as providing a supportive regulatory framework, particularly when considered against rules such as the UCP, which are silent on the subject.[213] In contrast to the hands-off approach of other rules on the subject of exceptions to the principle of autonomy, the UNCITRAL Convention is remarkable for its

[212] [1996] 1 Lloyd's Rep 345, at 361.

[213] Goode, R *Transnational Commercial Law - International Instruments and Commentary*, 1 ed, Oxford University Press, 2004, at 341.

explicit head-on approach to the fraud exception.[214]

Some scholars have advanced the more measured view that the UNCITRAL Convention took a "middle way" by not ignoring the fraud exception altogether like the UCP, URDG and ISP98, yet at the same time not imposing the arguably onerous provisions to address fraudulent conduct as those to be found in the URCG.[215] This so-called middle way adopted by the UNCITRAL Convention has been averred by some to "constitute a good barometer of international consensus on the topic of fraud".[216] Despite this, the impact of the protections in the UNCITRAL Convention is unfortunately limited by, *inter alia*, the low uptake of the UNCITRAL Convention by countries which may be compounded by compatibility issues, particularly in relation to the autonomy principle.

The UNCITRAL Convention, particularly in Articles 19(1)(b) and 19(1)(c) read together with 19(2)(a) to 19(2)(e), which can be marshalled into the ambit of an unconscionability exception to the autonomy principle of demand guarantees or in the case of 19(2)(a) perhaps the breach of a negative stipulation exception, takes into account factors which are extraneous to the relevant documentary credit. In this regard, Article 19 of the Convention seems diametrically opposed to the general conservatism with which the subject of new exceptions to the autonomy principle is, and quite rightly should, be approached. It is, therefore, unlikely that South African law would adopt recognition of such exceptions to the autonomy principle in the absence of radical development such as acceding to/ratifying the UNCITRAL Convention.

Although Article 19(2)(a) of the UNCITRAL Convention can be construed to espouse a form of the breach of a negative stipulation exception, this seems to consider extraneous factors relating to whether the secured risk has materialised. This approach is inimical to the autonomy principle. Moreover, such a formulation of a breach of a negative stipulation exception is based on a true exception construction in the sense that it directly overrides the autonomy principle and is considered a valid defence which can be relied upon for non-payment of the guaranteed amount even after a compliant demand. This formulation of a breach of a negative stipulation exception is generally not accepted under South African law, English, or Australian law. These three jurisdictions draw a clear distinction between an injunction/interdict against a beneficiary from

[214] Alawamleh, *Documentary Credits and Independent Guarantees*, at 54, with reference to Articles 19 and 20 of the UNCITRAL Convention.

[215] Alawamleh, *Documentary Credits and Independent Guarantees*, at 54.

[216] Mugasha, A *The Law of Letters of Credit and Bank Guarantees*, 1 ed, Federation Press, 2003, at 138.

making a demand and one preventing a guarantor or issuer from making payment upon receipt of a compliant demand.[217]

It is outside the remit of this thesis to assess the pros and cons of and/or to proffer any recommendations on the matter of South Africa signing up to the UNCITRAL Convention. A notable observation, however, which is telling, is the fact that South Africa has not acceded to/ratified the UNCITRAL Convention, which has the force of law once adopted in a jurisdiction, despite the UNCITRAL Convention being in force for more than two decades. Perhaps due to the polarisation of provisions such as Article 19 of the UNCITRAL Convention with the general South African law tenor on exceptions to the autonomy principle of demand guarantees, South Africa has seemingly declined to adopt it. One would then ask the question: what then is relevant and can be gleaned from Article 19 of the UNCITRAL Convention in relation to the unconscionability and breach of negative stipulation exceptions? The answer can be found in the fact that the UNCITRAL Convention espouses an approach of directly dealing with the matter of exceptions and not shying away from it.

Notwithstanding that Article 19 of the UNCITRAL Convention is largely incompatible with the law of demand guarantees and how exceptions in relation thereto are treated under the law of South Africa, perhaps the most relevant exemplary theme emanating from it is that it addresses and seeks to establish a harmonised position on the matter of exceptions in relation to documentary credits.

South African law must not be reticent or fan ambiguity on the topic of exceptions but must continue to enhance certainty and establish a consistent and firm position in this regard. South African law of demand guarantees is based on common law and is not codified. While no view is proffered in this thesis regarding the benefits or lack thereof of codifying the law of demand guarantees, the enhancement of certainty in respect of exceptions under the South African law of demand guarantees is a worthwhile goal that can be extrapolated from Article 19 of the UNCITRAL Convention. An enhanced degree of certainty regarding the South African law position on exceptions in relation to demand guarantees would likely be welcomed by many.

Subject to the recognised fraud exception, and potential wiggle-room for very serious cases of illegality of the underlying contract, the autonomy principle is held as generally inviolable under South African law. Compared to the general approach in the UNCITRAL Convention of

[217] See sections 3.3.8.2, 4.3.8.1, and 5.3.6.1 in Chapters 3, 4 and 5 of this thesis for a discussion of the distinction between a restriction on a beneficiary making a demand and a restriction on a guarantor making payment, and their effect on the autonomy principle under South African, Australian and English law.

recognising a number of (one might even argue several) scenarios constituting exceptions to the autonomy principle, the South African law position is that the autonomy principle of demand guarantees is sacrosanct and that once a compliant demand is made it should be honoured regardless of whether the underlying contract/obligation is null, void, or otherwise unenforceable etc.[218] In agreement with this view, it is submitted that general acceptance of the unconscionability or bad faith related exceptions outlined in Article 19(1)(b) and Article 19(1)(c) read together with Articles 19(2)(a) to 19(2)(e), or perhaps also a breach of a negative stipulation exception in the case of Article 19(2)(a), of the UNCITRAL Convention would be a prelude to the relentless erosion of the autonomy principle and consequently rob demand guarantees of their utility and *raison d'etre*. For this reason, further exceptions falling outside the remit of the recognised exceptions (i.e., fraud or, in special cases, serious illegality in the underlying contract), such as the ones espoused in Article 19 of the UNCITRAL Convention, will likely not find support under the South African law.

Suffice it to say, therefore, that the UNCITRAL Convention is too liberal in its approach to the recognition of exceptions to the autonomy principle, if not in a universal context, then certainly in a South African law context. South Africa is significantly more conservative, with courts being cautioned not to be too open-minded or readily grant interdicts which interfere with the autonomy principle as the adverse effects of doing so would be manifold. Such effects are asserted to include the frustration of the intended nature and operation of demand guarantees, as well as undermining their value, utility and commercial purpose.[219] The UNCITRAL Convention, therefore, offers limited guidance which would be suitable for application in the context of South African law.

[218] Kelly-Louw, *Validity of the Underlying Contract*, at 127. See also Andrle, "Preserving the 'On Demand Payment' Character of Independent Guarantees and Counter-Guarantees in Times of Distress" (2021), 26(6), *Documentary Credit World*, at 24. In addition to the established fraud exception, Kelly-Louw leaves the door a crack open for recognition of, "a serious form of illegality in the underlying contract" to be recognised as an exception to the autonomy principle (Kelly-Louw, *Validity of the Underlying Contract*, at 113 and 127-128). For a comprehensive consideration of the case of *Mattress House (Proprietary) Ltd v Investec Property Fund Ltd* [2017] ZAGPJHC 298 and illegality as an exception to the autonomy principle, see Kelly-Louw, M "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees" (2009), 42(3), *CILSA*, 339 and Lupton, C and Kelly-Louw, M "Emergence of Illegality in the Underlying Contract as an Exception to the Independence Principle of Demand Guarantees". (2020) 53(3) *CILSA*, 1.

[219] Kelly-Louw, *Validity of the Underlying Contract*, at 128.

CHAPTER 7: OVERALL SUMMARIES, CONCLUSIONS AND RECOMMENDATIONS

7.1 SUMMARIES, RECOMMENDATIONS AND CONCLUSIONS

7.1.1 Brief Summary in respect of Demand Guarantees

The definition of a demand guarantee has been expressed in various terms. The URDG 758,[1]being the international rules specifically established for demand guarantees, concisely describe a demand guarantee as "any signed undertaking, however, named and described, providing for payment upon presentation of a complying demand".[2] Various other definitions of a demand guarantee, differing in aspects such as prescriptiveness, granularity and even one or two elements, as illustrated in the sample definitions considered in Chapters 1 and 2 of this thesis, have been established by different authorities and commentators. Despite these variations, the two crucial elements form a common thread that runs through the definitions and are submitted to be the core elements characterising a demand guarantee. These are the autonomy principle and the documentary nature of demand guarantees, as reiterated and summarised further below.

The rationale and purpose of demand guarantees span several functions they serve. In addition to their security function and cash equivalence,[3] demand guarantees are an effective risk allocation device.[4] A number of demand guarantees can be broken down by various classifications on the basis of their usage. The main types of demand guarantees split out by their usage include performance guarantees,[5] tender guarantees,[6] advance payment guarantees,[7]retention guarantees[8] and maintenance guarantees,[9] although they all generally serve a security function in one form or another.

[1] Uniform Rules for Demand Guarantees, ICC Publication No 758, Paris (2010).

[2] URDG 758, Article 2.

[3] See section 2.7.1 of Chapter 2 for a discussion of the security function and cash equivalence of demand guarantees.

[4] See section 2.7.2 of Chapter 2 for a discussion of the risk allocation function of demand guarantees.

[5] See section 2.9.2 of Chapter 2 for a discussion of performance guarantees.

[6] See section 2.9.3 of Chapter 2 for a discussion of tender guarantees.

[7] See section 2.9.4 of Chapter 2 for a discussion of the advance payment guarantee.

[8] See section 2.9.5 of Chapter 2 for a discussion of retention guarantees.

[9] See section 2.9.6 of Chapter 2 for a discussion of maintenance guarantee.

Demand guarantees share many notable similarities with contracts[10] but, at the same time, lack some key *essentialia* required to form a contract, particularly a clear offer and acceptance and consideration for the issuance of the demand guarantee.[11] Despite the contractual elements they lack, there is no universally satisfactory and accepted explanation to rationalise the binding, valid and/or enforceable nature of demand guarantees. Numerous theories have been advanced in this regard, but the settlement of this controversy falls outside the scope of this thesis. In this thesis, the view subscribed to is that, rather than fixating on resolving the rationale for the "contract-esque" status of documentary credits despite their perceived deficiencies from a contract law perspective, what is of ultimate importance is the indubitable fact that they are indeed binding.

7.1.2 Summary of the Autonomy Principle of Demand Guarantees

7.1.2.1 Recognition of the Autonomy Principle Generally and in International Rules and Standards, and the UNCITRAL Convention

The autonomy principle espouses dual independence of the documentary credit from all other contractual relationships or transactions, particularly the underlying contract between the applicant (principal) and the beneficiary on the one hand and the contract (agreement) between the applicant and the issuer (guarantor) on the other.[12] The autonomy principle is distinct in that it creates a primary obligation, in contrast to a conditional/true guarantee or suretyship agreement, which creates a secondary accessory liability that is reliant on a principle or underlying obligation. Unlike conditional/true guarantees or suretyship agreements, demand guarantees do not require the existence of valid underlying obligation and/or actual default by the applicant to be proven for payment to be triggered.

[10] See section 2.2.2 of Chapter 2.

[11] Ibid.

[12] Goode, R "Abstract Payment Undertakings in International Transactions" (1996), 22, *Brooklyn Journal of International Law*, 1 (hereinafter, "Goode, *Abstract Payment Undertakings in International Transactions*"), at 12; Malan, FR "Letters of Credit and attachment Ad Fundandam Jurisdictionem" (1994) *TSAR* 150 (hereinafter "Malan, *Letters of Credit and attachment Ad Fundandam Jurisdictionem*"), at 150-151. See also *Bolivinter Oil SA v Chase Manhattan Bank, Commercial Bank of Syria and General Company of Homs Refinery* 1984 1 Lloyd's Rep 251 (CA) 256-257; *Royal Design Studio Pte Ltd v Chang Development Pte Ltd* [1990] SLR 1116 (HC)*; Bocotra Construction v Attorney-General* [1995] 2 SLR 733, at 737-738; and *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976, at 981.

In addition to full recognition of the autonomy principle in South Africa,[13] England[14] and Australia,[15] as considered in this thesis, the autonomy principle generally enjoys universal recognition under the UNCITRAL Convention[16] and key international rules relating to documentary credits,[17] namely the UCP 600,[18] URDG 758,[19] and the ISP98.[20]

7.1.2.2 Non-absolute Nature and Potential for Exploitation of the Autonomy Principle: Abusive Demands and Recourse to Interdicts/Injunctions

As established earlier in this thesis, while the autonomy principle is not absolute, its near-absolute nature lends itself to exploitation in the form of abusive or unjustified demands made by unscrupulous beneficiaries. The risk asymmetry that is inherent in the nature of demand guarantees, including the autonomy principle, generally skews these instruments in favour of the

[13] See, e.g., *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) 731-732; *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (SCA); *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA) paras 19 and 20; *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others NNO* 2011 (1) SA 70 (SCA) para 39; *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA) para 14; *First Rand Bank Ltd v Brera Investments* CC 2013 (5) SA 556 (SCA) para 11; *Eskom Holdings v Hitachi Power Africa* (139/2013) [2013] ZASCA 101 (12 September 2013) para 15; *Denel Soc Ltd v Absa Bank Ltd* [2013] 3 All SA 81 (GSJ) paras 30-31; *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA) paras 11-13; *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA) paras 14 and 28; and *Group Five Power International (Pty) Limited v Cenpower Generation Company Limited & Others* (2008/41068) [2018] ZAGPJHC 663 (16 November 2018) paras 88-89. See also section 2.4.2 in Chapter 2 and Chapter 3 of this thesis generally.

[14] See section 2.4.3 of Chapter 2 and Chapter 4 of this thesis generally.

[15] See *Wood Hall Ltd v Pipeline Authority* (1979) 24 ALR 385, at 387. See also *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 QdR 54 and *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136. See section 2.4.4 of Chapter 2 and Chapter 4 of this thesis generally.

[16] United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) (hereinafter "UNCITRAL Convention"), Articles 2 and 3.

[17] See URDG758, Article 5(a); UCP 600, Articles 4-5; UNCITRAL Convention, Articles 2-3; URDG458, Article 2(b); ISP98, Rule 1.06(a) and (c). See also Bennett, HN "Performance Bonds and the Principle of Autonomy" (1994) *Journal of Business Law*, 574 (hereinafter "Bennet, *Performance Bonds and the Principle of Autonomy*"); Goode, *Abstract Payment Undertakings in International Transactions*, at 12; Ali Malek, A and Quest, D *Jack: Documentary Credits: The Law and Practice of Documentary Credits including Standby Credits and Demand Guarantees*, 4 ed, Tottel Publishing, 2009, at 17-18; and Furmston, M and Chuah, J, 2 ed, *Commercial Law*, Pearson, 2013 (hereinafter, "Furmston and Chuah, *Commercial Law*"), at 377. See also section 2.3 in Chapter 2 for a focused discussion of the autonomy principle of demand guarantees.

[18] Uniform Customs and Practice for Documentary Credits (ICC Publication No 600, Paris (2006) (hereinafter, "UCP 600"), Articles 4(a), 4(b) and 5.

[19] Uniform Rules for Demand Guarantees, ICC Publication No 758, Paris (2010) (hereinafter, "URDG 758"), 5(a).

[20] International Standby Practices (ICC Publication No 590, Paris (1998) (hereinafter, "ISP98"), Rule 1.06(a) and 1.06(c).

beneficiary.[21] This renders demand guarantees vulnerable to abuse or exploitation as "an oppressive instrument".[22] In its defence, the *status quo* attributed to demand guarantees is asserted to be an inherent aspect of commercial transactions.[23] It is considered a dominant party's prerogative to leverage their "leadership role to manage and distribute risks and benefits, either equitably or opportunistically".[24]

The justification of the *status quo,* inherently part of demand guarantee arrangements, has not stopped disputes stemming from allegations of unjustified or abusive demands from arising and coming before the courts of different jurisdictions. It is conceded that, to some degree, applicants who opt to use such instruments, knowing the nature of the instruments, willingly assume such risk when they agree to issuance in the (beneficiary's) favour.[25] However, this is not to say that parties to documentary credit arrangements are totally without any remedy against certain abusive conduct in respect of a documentary credit, as it is subject to certain exceptions.

In such disputes, injunctions, referred to as interdicts under South African law, are usually sought by an applicant (or principal) to give effect to exceptions as a countermeasure in respect of a demand perceived to be unjustified. Two types of injunction/interdict are typically sought: an injunction to prevent a beneficiary from making a demand under the demand guarantee or an injunction preventing a guarantor from making payment to honour a demand that has already been made under a demand guarantee.[26]

7.1.2.3 Brief Overview regarding Exceptions in relation to Demand Guarantees

Fraud is generally recognised universally as an exception to the autonomy principle, including

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[21] Cowan, K, Paswan, A and Steenburg, E "When Inter-firm Relationship Benefits Mitigate Power Asymmetry" (2015), 48, *Industrial Marketing Management* 140, at 140 and 143.

[22] *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604. See also *In Re Originala Petroleum Corporation* (1984) 39 BR 1003, at 1007 and *Sumatec Engineering and Construction v Malaysian Refining Company* [2012] 3 CLJ, 401

[23] Cowan, K, Paswan, A and Steenburg, E "When Inter-firm Relationship Benefits Mitigate Power Asymmetry" (2015), 48, *Industrial Marketing Management* 140, at 140.

[24] Idem, at 143.

[25] Bennet, *Performance Bonds and the Principle of Autonomy, at 575.*

[26] Two aspects in respect of the autonomy principle were emphasised in the Australian case of *Wood Hall.* Firstly that, "[t]here is no basis whatever upon which the unconditional nature of the bank's promise to pay on demand can be qualified by reference to the terms of the contract between the contractor and the owner" and secondly, "there is no basis on which the owner's unqualified right at any time to demand payment by the bank can be qualified by reference to the terms or purpose of that contract".

under South African,[27] Australian[28] and English law. The illegality of the underlying contract[29] has also been recognised as a defence to payment called up under a demand guarantee, including under South African law as supported by the case of *Mattress House (Proprietary) Ltd v Investec Property Fund.*[30] Unconscionability and the breach of a negative stipulation are potential additional exceptions considered in this thesis in relation to whether they could possibly provide further recourse for applicants with a focus on South African law.

In Australia, the unconscionability exception is recognised statutorily under the Competition and Consumer Act, 2010 and the breach of a negative stipulation exception is largely recognised, as demonstrated by case law referenced in Chapter 5 and the conclusions further below. Under English law, unconscionability has failed to establish a firm foothold, as discussed further below. English courts, like Australian courts, seem to recognise the breach of a negative stipulation exception which recognition is evident as discussed in Chapter 4 and the concluding remarks on the English law position below. The conclusions drawn from the positions adopted under English and Australian law will be covered in more detail further below, with consideration given particularly to key take-aways South African law of demand guarantees can benefit from.

A number of definitions and key elements understood to constitute unconscionability for the purposes of establishing an unconscionability exception have been considered in this thesis. Drawing selectively from these considerations, it is posited that unconscionability is such a nebulous concept that a range of conduct has been envisaged to constitute it. The rather wide spectrum of conduct which could constitute unconscionability includes conduct which is bad, immoral and/or shameful;[31] taking serious advantage of another's special disadvantage, e.g., due

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[27] See, e.g., *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A)*; Union Carriage and Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) 730*; Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA*; Scatec Solar SA 163 (Pty) Ltd v Terrafix Suedafrika (Pty) Ltd* (2014) ZAWCHC 63*;* and *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* [2015] 2 All SA 716 (GJ).

[28] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27 and *Fletcher Construction Australia Ltd v Vransdorf Pty Ltd* [1998] 3 VR 812.

[29] See, e.g., other exceptions such as illegality which have been touched upon by South African courts, with the High Court case of *Mattress House (Proprietary) Ltd v Investec Property Fund* [2017] ZAGPJHC 298.

[30] [2017] ZAGPJHC 298.

[31] See https://www.oxfordlearnersdictionaries.com/definition/english/unconscionable (accessed on 21 February 2021).

to poverty, ignorance, lack of advice,[32] or otherwise in a morally culpable manner and in overreaching and oppressive circumstances;[33] and exploiting another's vulnerability or weakness; abusing positions of trust or confidence; insisting upon rights where doing so is harsh or oppressive; inequitably denying one's legal obligations; and/or unjustly retaining property.[34] Even in Australia, where unconscionability is codified in the Competition and Consumer Act, 2010, it is somewhat telling that there is no statutory definition proffered in the relevant legislation. In trying to consolidate these examples into a concise description of unconscionability, it could be broadly said that unconscionability encompasses inequitable and unfair conduct. This difficulty in distilling unconscionability into a precise meaning is partly why it often overlaps with other concepts which are considered to cover unfair or inequitable conduct, such as fraud and bad faith.[35]

In line with the anti-beneficiary formulation accepted in this thesis as the only viable one, a negative stipulation exception can be described as arising where a negative stipulation is enforced against the beneficiary to prevent the beneficiary from calling up a demand guarantee in breach of an agreement they entered into/are bound by which their entitlement to call up the demand guarantee to only upon the occurrence of a certain event or after compliance with certain requirements (i.e., a negative stipulation). Conclusions regarding the formulation and parameters appropriate in a South African law context, which are drawn from the substantially consistent English law and Australian law approaches to the breach of a negative stipulation exception, are set out further below.

7.1.2.4 Effect of an Interdict/Injunction Restraining a Beneficiary from Making a Demand Under a Demand Guarantee on the Autonomy Principle

The position regarding how or whether an interdict/injunction seeking to block a beneficiary from making a demand affects the autonomy principle has been the subject of some debate. On the one

[32] Trade Practices Commission, Draft Guideline on Unconscionable Conduct under Part IVA of the Trade Practices Act 1974, as cited in Browne, JJ "The Fraud Exception to Standby Letters of Credit in Australia: Does it Embrace Statutory Unconscionability?" (1999), 11(1), *Bond Law Review*, 98 (hereinafter, "Browne, *The Fraud Exception*"), at 111.

[33] *Alec Lobb (Garages) Ltd v Total Oil (Great Britain) Ltd* [1983] 1 WLR 87 (HC), at 94-95.

[34] Clarke, PH *et al.,* "Notion of Unconscionability" in, Vout, P *Unconscionable Conduct, The Laws of Australia*, 2 ed, Thomson Reuters, 2009, at 121; and Parkinson, P *The Principles of Equity*, 2 ed, Thomson Reuters, 2 ed, 2003, at 39-42.

[35] See sections 7.2.2, 7.2.3, 7.4.6, 7.7.3 and 7.7.5 of this Chapter for concluding remarks on the overlap or interaction between unconscionability and both fraud and bad faith, from an English, and Australian law perspective as well as with reference to the UNCITRAL Convention, respectively.

hand, an injunction seeking to interfere with a guarantor's obligation to make payment is argued to have a direct impact on the autonomy principle, thereby undermining the value of demand guarantees.[36] On the other hand, an injunction to prevent a beneficiary of a demand guarantee from making a demand has the effect of ensuring that the guarantor's obligation to pay does not arise and is argued to have no impact on the autonomy principle and/or the effectiveness of demand guarantees.[37]

An injunction against a beneficiary typically prevents a payment obligation arising on the part of the guarantor without affecting the autonomy principle by thwarting the one thing that could give rise to it: a demand. The autonomy principle is not affected by an injunction against the beneficiary. However, as a general rule, courts will still not easily grant an injunction against a beneficiary,[38] and a liberal approach in this regard is firmly discouraged.[39] Therefore, regardless of whether an injunction is sought to either prevent a demand by a beneficiary or to block payment by a guarantor, any form of court interference with the enforcement of a demand guarantee arrangement must be avoided in the first instance and any recourse to it taken only in exigent circumstances.

7.1.2.5 Effect of an Interdict/Injunction Restraining a Guarantor from Making Payment Under a Demand Guarantee on the Autonomy Principle

An injunction restraining payment by a guarantor under a demand guarantee undoubtedly strikes at a core purpose of the autonomy principle and certainty of payment, notwithstanding any disputes between parties to the underlying contract. This may explain why applications for such injunctions have tended to be historically unsuccessful as a general rule.[40] Enjoining a beneficiary from making a demand or receiving payment instead of pursuing an injunction to prevent a guarantor from making payment seems to be the favoured approach, particularly in South Africa, including where

[36] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1997] FCA 27.

[37] Stephen O'Reilly, "Bank Guarantees - Are They Worth the Paper They're Written on?" (2000), 33(72), *Australian Construction Law Newsletter* 30 (hereinafter "O'Reilly, *Bank Guarantees*"), at 31.

[38] It was even depicted in *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443 that the autonomy principle would likely still prevail where a demand made by such a beneficiary verges on being an abusive demand, for example, a demand made by an employer simply to exert pressure on a contractor. See also O'Reilly, *Bank Guarantees*, at 31.

[39] Kelly-Louw, M "*Selective Legal Aspects of Bank Demand Guarantees: The Main Exceptions to the Autonomy Principle*", LLD thesis, University of South Africa, 2008 (hereinafter, "Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*"), at 459

[40] Whitten, *Calling on a Performance Security*, at 13 and *Washington Constructions v Westpac Banking Corporation* [1983] 1 Qd R 179.

traditional exceptions such as fraud or illegality in the underlying contract are involved.[41] An anti-beneficiary injunction, as opposed to an anti-guarantor or anti-payment injunction, is also the recognised formulation by which courts give effect to a breach of a negative stipulation exception.

7.1.2.6 Other Remedies

Given the limited circumstances in which courts would consider issuing an anti-beneficiary injunction, and the reality that a beneficiary sometimes manages to call up a demand guarantee and receives payment prior to the injunction being granted, post-demand/post-payment remedies are an alternative available to aggrieved applicants. Other remedies an applicant can consider where a guarantor has already made payment to a beneficiary include an injunction preventing the beneficiary from utilising or dissipating the funds paid.[42] Such an injunction is/has also been referred to as a freezing order, *Mareva* injunction,[43] or as it is known under the South African law, an anti-dissipation interdict.

In addition, an injunction for repayment of the guarantee amount to the issuing bank in exchange for a new guarantee (i.e., effective reversal of the demand and payment process under the demand guarantee)[44] or a claim for damages could be pursued. It is worth noting that freezing (*Mareva*) orders/injunctions or anti-dissipation interdicts are an effective way to facilitate equitable dispute resolution by maintaining the *status quo* and preserving assets pending settlement of a matter without interfering with the autonomy principle. However, the merits and demerits of these alternative remedies are beyond the scope of this thesis.

7.1.3 Overview of the Documentary Nature of Demand Guarantees

7.1.3.1 General Outline

As already mentioned, demand guarantees are documentary in nature. In line with this, payment

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[41] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 459. See also Kelly-Louw, M "Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit", Visser, C & Pretorius, JT, *(eds), Essays in honour of Frans Malan: former judge of the Supreme Court of Appeal*, 197, at 216.)

[42] See *Bolivinter Oil SA v Chase Manhattan Bank and Ors* [1984] 1 Lloyds Rep 251, at 257 and *Intraco Ltd v Notis Shipping Corporation (The Bhoja Trader)* 1981 2 Lloyd's Rep 256 CA, at 258.

[43] The *Mareva* injunction is named after the *Mareva Cia Naviera SA v International Bulk Carriers SA* [1980] 1 All ER 213, pursuant to which it was recognised under English law. See also cases referenced in section 4.1.3 of Chapter 4 of this thesis.

[44] Whitten, *Calling on a Performance Security*, at 11, See also the Australian case of *Thiess Pty Ltd v Pacific National (Victoria) Pty Ltd* [2009] VSC 670.

obligations under demand guarantees are triggered by presenting a compliant demand with supporting documents, if applicable, as stipulated in the demand guarantee. All demands must thus be compliant with the terms of the demand guarantee to which they relate. This documentary nature of demand guarantees is a trite concept under South African law[45] and is also generally recognised universally, including under English and Australian laws.

7.1.3.2 The Requirement for a Complying Demand and the Doctrine of Strict Compliance

The question of whether a demand made by a beneficiary under a demand guarantee is compliant is the key determinant of whether a payment obligation is triggered. Disputes tend to arise in relation to the degree of compliance. The doctrine of strict compliance requires a demand and any documents required to accompany it to strictly or exactly comply with the terms of the relevant demand guarantee or letter of credit.[46] It is considered an "ally of the principle of autonomy"[47] but may also result in "manifestly unreasonable or absurd results"[48] if applied blindly. The degree of compliance required for a demand to be considered compliant, i.e., whether "strict" compliance or material compliance is required, is dependent on the terms of the demand guarantee itself. However, due to differences in construing/interpreting the terms of the demand guarantee,[49] this remains an area of contention.[50]

The doctrine of strict compliance is considered to have been implicitly adopted for letters of credit

[45] See, e.g., *Phillips v Standard Bank of South Africa* [1985] 4 All SA 66 (W); *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 (3) SA 688 (SCA); *Denel Soc Limited v ABSA Bank Limited* [2013] ZAGPJHC 102, paras, 36 and 51-52; and *Casey and Another v First National Bank Ltd* 2013 4 SA 370 (GSJ), paras 14 and 16.

[46] See, e.g., *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Lloyd's Rep 49, para 52; *English, Scottish and Australian Bank Ltd v Bank of South Africa* (1922) 13 LlLR 21. *Midland Bank Ltd v Seymour* [1955] 2 Lloyd's Rep 147; and *Sztejn v J Henry Schroder Banking Corp* 31 NYS 2d 631 (1941).

[46] *English, Scottish and Australian Bank Ltd v Bank of South Africa* (1922) 13 LlLR 21 and *Sztejn v J Henry Schroder Banking Corp* 31 NYS 2d 631 (1941), at 634.

[47] Chuah, JCT *Law of International Trade: Cross-Border Commercial Transactions*, 5 ed, Sweet & Maxwell, 2013, at 600.

[48] Bertrams, RF *Bank Guarantees in International Trade: The Law and Practice of Independent (First Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions*, 4 ed, Kluwer Law International, 2013, at 140.

[49] See the analysis in *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA), paras 7-13.

[50] See section 2.8.2 of Chapter 2 for a detailed discussion of the degree of compliance and the doctrine of strict compliance.

under South African law[51] but whether the doctrine of strict compliance applies to demand guarantees is an area with less consensus. Whilst some commentators hold that it does, and some that it does not, others adopt the halfway-house approach notion that the doctrine of strict compliance applies to demand guarantees, albeit less stringently than it has been established to apply to letters of credit.[52] Given the uncertainty in this regard, a prudent approach is to focus on adherence to the following two points of general consensus: that a demand must comply with the terms called for in a demand guarantee and that where such terms require it, a demand must strictly comply. Rather than fixating on whether the doctrine of strict compliance applies to demand guarantees, the important issue, as rightly asserted by Kelly-Louw, is whether there has, in fact, been compliance with the requirements stipulated in a demand guarantee or not.[53]

7.1.3.3 Recognition of the Documentary Nature in International Rules and Standards and the UNCITRAL Convention

The UNCITRAL Convention also entrenches the documentary nature of documentary credits by providing, *inter alia*, that they are not subject to any term, condition, future or uncertain act or event except, *inter alia*, "presentation of documents".[54] The documentary character of demand guarantees also clarifies the ambit of the guarantor's obligations.[55]

The documentary nature of documentary credits, being a complementary factor to the autonomy principle, is also generally recognised, including under international rules and the UNCITRAL Convention.[56] The UNCITRAL Convention incorporates the principle that the terms and conditions of an undertaking are the determinants of the rights and obligations arising from an

[51] Kelly-Louw, M "The Doctrine of Strict Compliance in the Context of Demand Guarantees" (2016), 49(1), *CILSA*, 95, at 91. See also *OK Bazaars 1929 Limited v Standard Bank of South Africa Limited* 2002 (3) SA 688 (SCA), para 25 and *Casey and Another v First National Bank Ltd* 2013 (4) SA 370 (GSJ), paras 24 and 26.

[52] *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146, at 159. See also *Denel Soc Limited v ABSA Bank Limited and Others* [2013] ZAGPJHC 102; *Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA); *Kristabel* [2015] ZAGPJHC 264 and *University of the Western Cape v Absa Insurance Company Ltd* [2015] ZAGPJHC 303.

[53] Kelly-Louw, M "General Update on the Law of Demand Guarantees and Letters of Credit", a paper delivered at the 2016 Annual Banking Law Update, at 64.

[54] Article 3(b).

[55] See section 2.5.5 of Chapter 2 regarding the overall contribution of documentary nature of demand guarantees to clarifying the role of issuers/guarantors of documentary credits.

[56] Articles 2 and 3.

undertaking.[57] Both the autonomy principle and documentary nature of demand guarantees are thus widely accepted and entrenched in prominent international rules pertinent to demand guarantees and other documentary credits, particularly UCP 600,[58] URDG 758,[59] and the ISP98,[60]as well as in the UNCITRAL Convention.[61] Furthermore, the doctrine of strict compliance is interwoven into provisions of certain international rules, such as the UCP 600.[62]

7.1.4 Brief Overview of the ICC Rules, ISP98 and the UNCITRAL Convention

Various international rules and customs applicable to various types of documentary credits were established for elective use by the parties to such instruments. As suggested by their name, the URDG applies primarily to demand guarantees and the ISP98 mainly to standby letters of credit. The UCP 600 and perhaps the URCG[63] appear to have been intended for versatile use in relation to various documentary credits, including demand guarantees and standby and commercial letters of credit. While international standards and customs are prominent contributors to the body of rules governing demand guarantees and other documentary credits, they are largely reticent on the topic of exceptions to the autonomy principle or in relation to documentary credits generally.

In the category of international law in relation to documentary credits broadly, the UNCITRAL Convention is significant. Unlike the above-mentioned international rules, the UNCITRAL Convention has the effect of a uniform law or regulation for countries that adopt it and is generally mandatorily applicable in such countries.[64] Another factor which distinguishes the UNCITRAL Convention is that it expressly addresses the subject of exceptions in relation to documentary credits under Article 19. There has been limited uptake of the UNCITRAL Convention. To date, only eight countries are party to this Convention[65] and South Africa, England, and Australia, being

[57] UNCITRAL Convention, Article 13(1).

[58] Articles 4(a), 4(b) and 5.

[59] Articles 5 and 6.

[60] Rule 1.06(a) and 1.06(c).

[61] Articles 2 and 3.

[62] UCP 600, Articles 4, 5, 7(a), 7(c), 8(a), 8(c), 15(a), 15(b).

[63] Uniform Rules of Contract Guarantees, ICC Publication No. 325, Paris (1978) (hereinafter, "URCG").

[64] Gao, X *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*, Kluwer Law International, 2002, (hereinafter "Gao, *The Fraud Rule*"), at 21.

[65] Available at https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-15&chapter=10&clang=_en, (accessed on 27 April 2020).

the jurisdictions central to this thesis, are not parties to the UNCITRAL Convention.

7.2 BRIEF SUMMARY AND CONCLUSIONS IN RELATION TO UNCONSCIONABILITY AS AN EXCEPTION TO THE AUTONOMY PRINCIPLE OF DEMAND GUARANTEES UNDER ENGLISH LAW

7.2.1 Limited Support for the Unconscionability Exception under English Law

A significant number of early,[66] later[67] and more recent[68] English law cases alluded to or seemed to support the recognition of unconscionability as an exception to the autonomy principle. However, a key aspect of these cases is that they singularly and collectively stopped short of establishing a clear position on the matter. As a result of this, the position of unconscionability as an exception under English law is far removed from the unequivocal certainty. Moreover, some English law cases emphasise a more traditional approach of unequivocally recognising fraud alone as an exception to the autonomy principle.[69] By implication, this approach can also be seen as a rejection of unconscionability as an additional exception to the autonomy principle.[70]

The absence of an unequivocal position established by English courts in respect of unconscionability as an exception to the autonomy principle, despite the opportunities presented by numerous cases[71] to do so, appears indicative of a reluctance to recognise it as an exception.[72] As stated by Enonchong, the approach of English courts in relation to the unconscionability exception is a "hands-off" approach.[73] Having concluded that the disadvantages of adopting an

[66] *Earl of Chesterfield v Janssen* (1750) 28 ER 82 Ch; *Elian and Rabbath v Matsas and Matsas* [1966] 2 Lloyd's Rep 495; *RD Harbottle (Mercantile) Ltd v Nat'l Westminster Bank Ltd* [1977] 2 All ER 862; *Edward Owen Engineering Ltd v Barclays Bank International* [1978] 1 All ER 976.

[67] *Potton Homes Ltd v Coleman Contractors (Oversea) Ltd* (1985) 28 BLR 19; *TTI Team Telecom International Limited v Hutchison 3G UK Limited* [2003] 1 All ER 914.

[68] *National Infrastructure Development Co Ltd v Banco Santander SA* [2017] EWCA Civ 27.

[69] *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159; *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 at 725; and *State Trading Corp of India Ltd v ED & F Man (Sugar) Ltd* [1981] Comm L R 235.

[70] *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159; *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 at 725; and *State Trading Corp of India Ltd v ED & F Man (Sugar) Ltd* [1981] Comm L R 235.

[71] See, e.g., *Enka Insaat Ve Sanayi AS v Banca Popolare Dell'Alto Adige SpA* [2009] CILL 2777 (first instance) and *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC).

[72] Hooley, R and Sealy, L *Commercial Law: Text, Cases, and Materials*, Oxford University Press, 4 ed, 2009, at 867.

[73] Enonchong, N *The Independence Principle of Letters of Credit and Demand Guarantees*, Oxford University Press, 2011 (hereinafter Enonchong, *The Independence Principle of Letters of Credit*), at 180.

unconscionability exception outweigh the advantages, English courts' apparent rejection of it has been supported by some scholars as the correct approach.[74]

7.2.2 Concluding Remarks regarding the Overlap between Unconscionability and Fraud under English Law

Notwithstanding the autonomy principle, English courts will not abide fraud and exploitation of the autonomy principle and courts for fraudulent purposes by unscrupulous beneficiaries.[75] Some commonality or overlap can be traced between unconscionability and fraud on a "no honest belief" formulation.[76] The "no honest belief" formulation of fraud, which is premised on a beneficiary seeking to call up a demand guarantee or other documentary credit whilst lacking an honest belief of their entitlement to do so and to receive payment, has been recognised in a number of English cases.[77]

Unconscionability has been asserted to be potentially complementary to the fraud exception to the extent that an unconscionability exception could plug any gaps left by the fraud exception by providing recourse against abusive conduct falling short of fraud but nevertheless warranting a remedy. Another view advanced regarding the relationship between the fraud exception and unconscionability is that the fraud exception has scope for expansion to address instances of unconscionability. This is premised on the understanding that the situation of a beneficiary who unconscionably makes a demand for payment with knowledge of their lack of entitlement to do so may possibly be addressed by recourse to the fraud exception on a wide interpretation. This view would obviate the need for a standalone unconscionability exception, as relevant unconscionable conduct would be substantially covered under the fraud exception.[78]

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[74] Alawamleh, KJA "*Documentary Credits and Independent Guarantees: A Critique of the 'Fraud Exception' Position in English and Jordanian Law*", PhD thesis, University of Central Lancashire, 2013 (hereinafter, "Alawamleh, *Documentary Credits and Independent Guarantees*"), at 192-193.

[75] *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 at 725.

[76] See *TTI Team Telecom International Limited v Hutchison 3G UK Limited* [2003] 1 All ER 914 as referenced in section 4.2.6.2.2 of Chapter 4 of this thesis.

[77] See for instance *Derry v Peek* [1875] 14 App Cas 337; *Edward Owen Ltd v Barclays International Bank* [1978] 1 All ER 976; *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19; *Banque Saudi Fransi v Lear Siegler Services Inc* [2007] 2 Lloyd's Rep 47; *Uzinterimpex JSC v Standard Bank Plc* [2008] EWCA Civ 819; and *Alternative Power Solution Ltd v Central Electricity Board* (2014) UKPC 31. See also section 4.1.5.3 of Chapter 4 of this thesis for a fuller discussion of fraud and the "no honest belief" formulation of fraud generally.

[78] See section 4.2.4.2 of Chapter 4.

7.2.3 Concluding Remarks regarding the Overlap between Unconscionability and Bad Faith under English Law

Some scholars consider bad faith and unconscionability to be substantially similar.[79] The concept of bad faith has been described as encompassing any conduct that breaches the boundaries of a reasonable party's acceptable conduct in a commercial transaction but falls outside the scope of the fraud exception (under both English law and South African law).[80] There is English case law supporting the view that bad faith may justify overriding the autonomy principle, particularly to prevent the occurrence of irrevocable or irretrievable injustice.[81] On the basis of such law, it could be argued that English law has the capacity to embrace exceptions to the autonomy principle on equitable notions, such as the unconscionability exception. Despite the synonymous use and apparent overlap of bad faith and unconscionability, or perhaps because of it, universal clarity on the precise definition and scope of the unconscionability exception has remained elusive.

7.2.4 Recap of Reasons Advanced For and Arguments Against Recognition of the Unconscionability Exception

Reasons advanced in favour of recognising unconscionability as an exception to the autonomy principle, particularly from an English law perspective, include the historical support for recognition of unconscionability in English Law;[82] the potential complementary relationship between the unconscionability exception and the fraud exception;[83] the flexibility afforded by an unconscionability exception to the autonomy principle;[84] the recognition of unconscionability in other jurisdictions;[85]and the potential for over-weighting the reputation of issuers.[86]

Arguments raised against recognising the unconscionability exception include the independence

[79] Lupton, CS, "*A Comparative Legal Perspective on the Impact of Good or Bad Faith on the Independence of Documentary Credits and Demand Guarantees*", LLM Dissertation, University of Johannesburg, 2018, at 20.

[80] Idem, at 37.

[81] Idem, at 498.

[82] See section 4.2.4.1 of Chapter 4.

[83] See section 4.2.4.2 of Chapter 4.

[84] See section 4.2.4.3 of Chapter 4.

[85] See section 4.2.4.4 of Chapter 4.

[86] See section 4.2.4.5 of Chapter 4.

of documentary credits and the need to support the reputation of issuers;[87] the uncertainty and vagueness of unconscionability;[88] the potential proliferation of litigation and injunctions;[89] the entanglement of issuers/guarantors in underlying or other contractual disputes;[90] and injunctions against receipt of payment.[91]

7.2.5 Overall Rejection of the Unconscionability Exception under English Law

The case of *Earl of Chesterfield v Janssen*,[92] which referenced unconscionability but did not foray any further to address questions such as the role of unconscionability in relation to documentary credits and the autonomy principle, exemplifies the uncertainty and perhaps lack of will to embrace unconscionability as an exception to the autonomy principle. A "hands-off" approach[93] has thus far been the prevailing approach under English law when it comes to the matter of unconscionability as an exception to the autonomy principle.

The prevailing position under English law seems to be that there was never any general consensus from courts, scholars and relevant industry participants and commentators to recognise unconscionability as an exception to the autonomy principle or confer upon it similar status as the fraud exception under English law. English courts appear on the whole to be reluctant to recognise unconscionability as an exception to the autonomy principle. The absence of an unequivocal position established by English courts in respect of unconscionability as an exception to the autonomy principle despite numerous opportunities provided by various cases is telling.[94] The English courts' low appetite for unconscionability as an exception to the autonomy principle is evident from the fact that several cases relating to documentary credit disputes have come before English courts, but only a few cases mentioned or considered the possibility of unconscionability

[87] See section 4.2.5 of Chapter 4.

[88] See section 4.2.5.2 of Chapter 4.

[89] See section 4.2.5.3 of Chapter 4.

[90] See section 4.2.5.4 of Chapter 4.

[91] See section 4.2.5.5 of Chapter 4.

[92] *Earl of Chesterfield v Janssen* (1750) 28 ER 82 Ch.

[93] Enonchong, *The Independence Principle of Letters of Credit*, at 180.

[94] Hooley, R and Sealy, L *Commercial Law: Text, Cases, and Materials*, Oxford University Press, 4 ed, 2009, at 867.

as an exception to the autonomy principle.[95]

The matter of an unconscionability exception to the autonomy principle has also been considered by some prominent scholars under English law, with Enonchong, for example, rendering the verdict that the case against recognition of the unconscionability exception is much stronger than that advocating for recognition thereof.[96] It may be inferred from the dithery approach of English case law on this subject that the odds are assessed to be currently stacked against recognition of an unconscionability exception to the autonomy principle. Perhaps the disadvantages of an unconscionability exception outweigh the advantages thereof, noting that English courts' reluctance to embrace it has received scholarly support.[97] In line with this, it seems to be the case that while English law acknowledges some public policy reasons which may favour recognition of unconscionability as an exception to the autonomy principle, it also recognises, perhaps more so, the cogent reasons against it.[98]

7.2.6 Some Residual Uncertainty in the English Law Position Regarding the Unconscionability Exception to the Autonomy Principle

The question of whether unconscionability is a recognised exception to the autonomy principle of demand guarantees is mired in jurisprudential and perhaps some judicial indecisiveness under English law. Although English courts seem to have a clear leaning towards not recognising the unconscionability exception, it has remained a floating question on the documentary credit agenda, which has never been answered absolutely.

Some English cases lend themselves to the interpretation that English law is slowly but inexorably moving towards recognising the unconscionability exception to the autonomy principle.[99] Despite this, the continued reticence of the courts on whether unconscionability can ever attain full recognition like the fraud exception has left unconscionability far from being at par with the fraud

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[95] See, e.g., *Enka Insaat Ve Sanayi AS v Banca Popolare Dell'Alto Adige SpA* [2009] CILL 2777 (first instance) and *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC).

[96] "[The] policy reasons against recognition of the exception outweigh the reasons in favour of recognition and, therefore, English law should not adopt the exception" (Enonchong, *The Independence Principle of Letters of Credits*, at 169).

[97] Alawamleh, *Documentary Credits and Independent Guarantees,* at 192-193.

[98] Alavi, H "Comparative study of unconscionability exception to the principle of autonomy in law of letter of credits" (2016), 12(2), *Acta Universitatis Danubius Juridica*, 94 (hereinafter, "Alavi, *Comparative Study of Unconscionability Exception*"), at 112-113.

[99] See section 4.2.7 of Chapter 4.

exception[100] and may be contributing to the rejection of the notion of an unconscionability exception.

However, it is plausible that the English courts' pointed reticence toward an unconscionability exception is a deliberate and considered position intended to convey a stance on the matter. If this is the case, the stance, however subtle, is one of resistance against recognising an unconscionability exception. Perhaps a better enunciation by English courts of its position regarding the unconscionability exception or a bolder rejection thereof would serve as a cue for South African law in view of how English law has long been recognised as a significant influence on certain aspects of South African law.

Given the seeming ambivalence towards the unconscionability exception, it is proposed that the prudent approach is to construe the absence of clear acceptance as rejection. In other words, the nature of demand guarantees and the centrality of the autonomy principle to their commercial utility justifies the equivalent of a rebuttable presumption against recognition of new exceptions to the autonomy principle as the default position. Unless the unconscionability exception is categorically welcomed into the fold of recognised exceptions to the autonomy principle under the two main sources of legal developments being common or case law or statutory law, then unconscionability is not recognised as an exception to the autonomy principle of demand guarantees. The failure to date of the more mature English law of demand guarantees to definitively tackle the question of the unconscionability exception could also be pointed to as a reason why it may be prudent for South African law to steer clear of further encroachments upon the autonomy principle of demand guarantees, particularly via recognition of an unconscionability exception.

7.3 BRIEF SUMMARY AND CONCLUSIONS REGARDING THE BREACH OF A NEGATIVE STIPULATION EXCEPTION IN RELATION TO DEMAND GUARANTEES UNDER ENGLISH LAW

7.3.1 Overall Acceptance of the Breach of a Negative Stipulation Exception under English Law

The breach of a negative stipulation exception arises when a beneficiary seeks to call up a demand guarantee in breach of a contractually binding agreement entered into by a beneficiary stipulating restricted circumstances in which that beneficiary is entitled to make a demand under the demand

[100] Alavi, *Comparative Study of Unconscionability Exception,* at 102.

guarantee. In accordance with the formulation thereof emphasised in this thesis and reiterated further below in this section, the breach of a negative stipulation puts the beneficiary's right to make an autonomous demand free from the impact of underlying contractual disputes against the applicant's contractual right to enforce an agreed negative stipulation and restrain the beneficiary from breaching it. Under English law, the legal basis for granting an injunction on the ground of a negative covenant was explored in a number of early cases[101] and further endorsed with increasing, although not quite absolute certainty, in later[102] and also in more recent[103] cases. In terms of the English court cases sampled in this thesis, it would appear to be settled under the English law that a court may restrain a beneficiary from making a demand under a demand guarantee on the basis of the breach of a negative stipulation. However, English law cannot be said to have decisively established recognition of the breach of a negative stipulation as an exception to the autonomy principle of demand guarantees in a manner that would bring it at par with the fraud exception. However, the trend of decisions by English courts analysed appears to be inclined towards firm recognition of the breach of a negative stipulation as a ground for granting an injunction against a beneficiary in breach of their contractual obligations.

7.3.2 Recap of Reasons Advanced For and Arguments Against Recognition of the Breach of a Negative Stipulation Exception

Some of the arguments supporting the recognition of the breach of a negative stipulation include that the autonomy principle cannot be applied blindly, particularly in "the very special case"[104] where a beneficiary has expressly agreed not to make a demand unless certain conditions were met.[105] Moreover, rather than undermining the utility of demand guarantees, the breach of a negative stipulation could actually augment the commercial utility of demand guarantees by

[101] *Doherty v Allman* [1878] 3 App Cas 709; *Howe Richardson Scale Ltd v Polimex-Cekop and National Westminster Bank Ltd* [1978] 1 Lloyd's Rep 161.

[102] *Potton Homes Ltd v Coleman Contractors Ltd* (1985) 28 BLR 19; *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd and Others* [2003] 1 WLR 87 (first instance); [2003] 1 WLR 2214 (CA) and [2005] 1 All ER 191 (HL); *TTI v Hutchison 3G UK Ltd* [2003] EWHC 762 (TCC); and *Permasteelisa Japan KK v Bouvguesstroi and Banca Intesa SpA* 2007 EWHC 3508 (TCC).

[103] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC); *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC); *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC); and *Shapoorji Pallonji and Company Private Ltd v Yumn Ltd* 2021 EWHC 862 (Comm).

[104] See *Sirius Insurance Co v FAI General Ltd* [2003] 1 WLR 2214, para 9.

[105] Ibid.

making them less vulnerable to abuse.[106]

In contrast, some of the key arguments raised against recognition of the breach of a negative stipulation exception include that in addition to diminishing the cash equivalence and commercial utility of documentary credits, it would undermine the autonomy principle and make the position and role of guarantors in relation to demand guarantees unclear.[107]

While the autonomy principle is important, a beneficiary cannot hide behind it to break contract and evade their contractual obligations.[108] This is even more so, because entering into a contract with a negative stipulation is elective on the part of the beneficiary. Moreover, the view that the breach of a negative stipulation exception would cause uncertainty regarding the role of guarantors is rebutted by the fact that guarantors need not be affected in any way by an investigation into the underlying contract, as such a task lies solely within the remit of the courts. Guarantors remain confined to their documentary analysis in line with the autonomy principle.[109]

7.3.3 The Rationale for Recognition of the Breach of a Negative Stipulation Exception

The breach of a negative stipulation exception can be justified from both the applicant and beneficiary's perspectives. A key compelling propellant of recognising the exception is the need for recourse against abusive demands by beneficiaries. Pursuant to the breach of a negative stipulation exception, such recourse is provided contractually by means of enforcement of a negative stipulation.[110] From a beneficiary's perspective, agreeing to negative stipulations in respect of calling up a demand guarantee may be driven by the desire to show good faith, avoid protracted negotiations, and/or being requested for reciprocal assurance in the form of a counter-guarantee.

7.3.4 Concluding Remarks regarding the Overlap between a Breach of a Negative Stipulation and Fraud under English Law

It has been argued by some that a demand in breach of a negative stipulation by a beneficiary with

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[106] Enonchong, N "The Problem of Abusive Calls on Demand Guarantees" (2007), 1, *Lloyd's Maritime and Commercial Law Quarterly*, 83 (hereinafter, "Enonchong, *The Problem of Abusive Calls on Demand Guarantees*"), at 94.

[107] See section 4.3.3.1 of Chapter 4.

[108] Enonchong, *The Independence Principle of Letters of Credits*, at 224.

[109] Bridge, M, *Benjamin's Sale of Goods*, 8 ed, Sweet & Maxwell, 2010, at 23.

[110] Todd, P *Maritime Fraud and Piracy*, 2 ed, Lloyd's List, 2010, at 129.

no honest belief that they are entitled to make such a demand may be caught within the scope of the fraud exception.[111] This is a conceivable intersection between the breach of a negative stipulation exception and the fraud exception because a beneficiary that makes a demand knowingly in breach of a negative stipulation clearly lacks an honest belief that they are entitled to make the demand. Despite this overlap, there is significant case law supporting a clear distinction between the fraud exception and the breach of a negative stipulation exception under English law.[112]

In addition, when dealing with fraud, the key question is whether a beneficiary lacked an honest belief in their entitlement to make a claim, whereas the issue with the breach of a negative stipulation exception is whether a beneficiary's demand is in breach of the terms of the underlying or another contract.[113] Another key factor of the dichotomy between the fraud exception on a no honest belief formulation and the breach of a negative stipulation is the nature of the exception and the remedy it gives rise to. The former exception is a true exception to the autonomy principle (i.e., grounds for an anti-guarantor or anti-payment injunction). In contrast, the latter exception has no interaction with the autonomy principle and merely takes the form of an anti-beneficiary injunction. The recognised formulation of the breach of a negative stipulation exception is summarised further below.

English law has not decisively recognised the breach of a negative stipulation as an exception to the autonomy principle of demand guarantees in quite the same manner or to the same level as it recognises the fraud exception.[114] Despite this limited traction when compared with well-established exceptions like the fraud exception, the premise that only a beneficiary can be prevented by an injunction from making a demand in breach of a negative stipulation in the underlying contract or another contract does have significant support.[115]

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[111] *Themehelp Ltd v West and Others* [1995] 4 All ER 215. See also *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19, where it was touched upon although not conclusively decided upon, and Alavi, H "Contractual Restrictions on Right of Beneficiary to Draw on a Letter of Credit; Possible Exception to Principle of Autonomy" (2016), 16(2), *ICLR*, 67 (hereinafter, "Alavi, *Contractual Restrictions*"), at 73.

[112] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC), para 34.

[113] Kelly-Louw, M and Fayers, R "The 'Breach of a Negative Stipulation' as an Exception to the Autonomy Principle in England and South Africa" (2021), 84, *THRHR*, 515 (hereinafter, "Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*"), at 527.

[114] See *RD Harbottle (Mercantile) v National Westminster* Bank [1977] 2 All ER 862.

[115] Australian case law on this includes the following: *Selvas Pty v Hansen Yuncken (SA) Pty Ltd* (1987) 6 ACLR 36; *Putney Group Pty Ltd v The Royal Rehabilitation Centre Sydney* [2008] NSWSC 1424; *Clough Engineering Ltd v Oil*

It, therefore, seems settled under the English law that a court may restrain a beneficiary from making a demand under a demand guarantee on the basis of the breach of a negative stipulation. This recognition of the breach of a negative stipulation, as depicted by several English law cases to that effect, has been praised as a much-needed measure to deal with abusive calls on demand guarantees,[116]particularly when the abuse is so gross as to constitute a breach of contract. Concerns such as the exception itself potentially being too liberally applied or abused and undermining the commercial utility of demand guarantees are somewhat allayed by the development of key parameters within which it is applied. One such parameter is that the formulation of the breach of a negative stipulation exception which is accepted under English law is firmly that of an anti-beneficiary injunction with no impact on the autonomy principle.

7.3.5 Recap and Outline of the Key Parameters within which the Breach of a Negative Stipulation Exception is Recognised under English Law

7.3.5.1 Distinction between Seeking an Injunction against a Guarantor and Seeking an Injunction against a Beneficiary

There is a school of thought which dismisses the distinction between seeking an injunction against a guarantor and seeking one against a beneficiary in relation to their effect on demand guarantees.[117] However, this approach is submitted to suffer from a lack of soundness, particularly because it is blind to the material distinction that enjoining a beneficiary from breach of a negative stipulation has no interaction with the autonomy principle and is thus not an exception to the autonomy principle, whereas enjoining a guarantor from payment would infringe the autonomy principle.[118] It is submitted that the only formulation of the breach of a negative stipulation exception recognised under English law is that of an anti-beneficiary injunction, as opposed to an anti-guarantor injunction.

& Natural Gas Corporation Ltd [2008] FCAFC 136; *Olde & Ors v Primary Compass Limited* [2011] NSWSC 845; and *Ceresola TLS AG v Thiess Pty Ltd v John Holland Pty Ltd* [2011] QSC 115.

[116] See the discussion in section 4.3.9 of Chapter 4.

[117] *Group Josi Re (formerly known as Group Josi Reassurance SA) v Walbrook Insurance Co Ltd and Others* [1996] 1 All ER 791.

[118] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 89. See also Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526-529.

7.3.5.2 Enhanced Merits Standard and the Balance of Convenience Test Required to Establish the Breach of a Negative Stipulation Exception

To a significant extent, it can be said that the requirement for the highest standard of proof to justify an injunction appears to counter-balance some of the apprehensions about the breach of a negative stipulation exception undermining the commercial utility of demand guarantees. Concerns around a *laissez-faire* use of such grounds to injunct beneficiaries from enforcing their rights and a potentially adverse impact on the commercial utility of demand guarantees are tempered, *inter alia*, by the high standards required to be met to establish the breach of a negative stipulation exception as well as the requirement to satisfy the balance of convenience test.

Regarding the standard of proof applicable in respect of an injunction to enforce a breach of a negative stipulation, the English law seems to be developing firmly in favour of the enhanced merits test, which requires the beneficiary's lack of entitlement to make a demand to be positively or clearly established.[119] This is supported by the English case law considered in this thesis,[120] according to which it must be established positively or clearly that the only realistic inference is that the beneficiary had no honest belief as to their entitlement to make a demand and that the balance of convenience falls in favour of the applicant seeking the injunction.

7.3.5.3 Express Negative versus Implied Negative Stipulations

A further control around the enforcement of negative stipulations against a beneficiary under English law lies in the preference of the requirement for express negative stipulations, which are clear and unambiguous[121] instead of implied negative stipulations.[122]

It seems only fair to conclude that a breach of a negative stipulation, preferably an express one, subject to requisite parameters and control requirements (e.g., enhanced merits standard and balance of convenience), has established a firm foothold in English law as a ground upon which

[119] *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC). See the more detailed discussion of the standard of proof required for a breach of a negative stipulation exception in section 4.3.8.3 of Chapter 4.

[120] See section 4.3.8.3 of Chapter 4.

[121] Hugo, C "Protecting the Lifeblood of Commerce: A Critical Assessment of Recent Judgments of the South African Supreme Court of Appeal Relating to Demand Guarantees" (2014), 4, *TSAR*, 661 (hereinafter "Hugo, *Protecting the Lifeblood of Commerce*"), at 674.

[122] See section 3.3.8.3 of Chapter 4. See also *Deutsche Ruckversicherung Aktiengeslleschaft v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 and Horowitz, D *Letters of Credit and Demand Guarantees: Defences to Payment*, Oxford University Press, 2010 (hereinafter, Horowitz, *Letters of Credit and Demand Guarantees*"), at 142.

an injunction against a beneficiary to a demand guarantee would be granted under English law.

7.4 BRIEF SUMMARY AND CONCLUSIONS IN RELATION TO UNCONSCIONABILITY AS AN EXCEPTION TO THE AUTONOMY PRINCIPLE OF DEMAND GUARANTEES UNDER AUSTRALIAN LAW

7.4.1 Recap of the Development of Unconscionability and Equitable Notions under Australian Law

As depicted by a number of early cases,[123]equity had a role to play in respect of bargains and contractual relations from an early stage under Australian law. Unconscionability under Australian law was historically premised on equitable principles and the protection of vulnerable parties, e.g., parties with a special disability or constitutional disadvantage.[124] It then evolved progressively to a broader concept that was available to protect any persons, including commercial parties, disadvantaged by an inferior bargaining position or a situational disadvantage.[125]

7.4.2 Recap of Reasons Advanced For and Arguments Against Recognition of the Unconscionability Exception

Although the matter of unconscionability is firmly settled, including particularly by statute under Australian law, some arguments have been raised in opposition to recognising unconscionability as an exception to the autonomy principle of demand guarantees. These include, without limitation, its corrosive effect on the autonomy principle, the adverse effect that defaulting on a payment obligation could have on financial institutions and the need to preserve the intended risk-allocation underpinning demand guarantees and uncertainty that would likely be infused into the law of demand guarantees by an unconscionability exception.[126] Some of these arguments and rationales have been countered on the basis of the view that procedural safeguards could be utilised to lessen

[123] *Stern v McArthur* (1988) 165 CLR 489; *Olex Focas v Skodaexport* [1998] 3 VR 380; *Boral Formwork v Action Makers* [2003] NSWSC 713*; Hurley v McDonald's Australia Ltd* (2001) FCA 209; *Brusewitz v Brown* [1923] NZLR 1106; and *Louth v Diprose* (1992) 175 CLR 621.

[124] Rodrigo, T "Unconscionable Demands Under On-demand Guarantees: Case of Wrongful Exploitation" (2012), 33(2), *Adelaide Law Review*, 481 (hereinafter, "Rodrigo, *Unconscionable Demands*"), at 482.

[125] Ibid. See also *Australian Competition and Consumer Commission v Samton Holdings* (2002) 117 FCR 301; (2002) 189 ALR 76; [2002] FCA 62 regarding situational disadvantage.

[126] See section 5.2.6.1 of Chapter 5 regarding the autonomy principle and recourse to the unconscionability exception as a remedy withing certain parameters.

any adverse impact on the autonomy principle.[127]

Considerations which have been raised to support the recognition of an unconscionability exception under Australian law include the pressing need to prevent abusive calls on documentary credits,[128]public policy and equity-based considerations[129] and the alternative perspective that an unconscionability exception promotes the utility of the credits by making them less susceptible to abuse.[130] The possibility that factors like the potential adverse impact an unconscionability exception could have on the reputation of issuers of documentary credits and the uncertainty of such an exception being given too much weight have also been raised to support recognition of the unconscionability exception.[131] Moreover, it is proposed that an unconscionability exception could be applied in a manner which balances it with the preservation of the risk allocation function of documentary credits.[132]

7.4.3 Recognition of Unconscionability under Australian Law Generally

Unconscionable conduct is firmly established as a basis upon which a beneficiary may be restrained from calling up a demand guarantee under Australian law.[133] The unconscionability exception is recognised under both the statutory law and common law of Australia. The recognition of unconscionability as an exception to the autonomy principle under Australian law has, therefore, followed two paths: a common-law one and one via the statutory law under section 51AA of the Trade Practices Act 1974 (Cth).[134] However, the interaction of the common-law doctrine of unconscionability under Australian law and the statutory principle of unconscionability is still fairly unclear.[135] Australian case law depicts how unconscionability has been embraced as an

[127] Fedotov, A "Abuse, Unconscionability and Demand Guarantees: New Exception to Independence" (2008), 11, *Int'l Trade & Bus L Rev*, 49 (hereinafter, "Fedotov, *Abuse, Unconscionability and Demand Guarantees*), at 49 and 82.

[128] See section 5.2.6.2 of Chapter 5

[129] See section 5.2.6.3 of Chapter 5.

[130] See section 5.2.6.4 of Chapter 5.

[131] See sections 5.2.6.5 and 5.2.6.6 of Chapter 5.

[132] See section 5.2.6.7 of Chapter 5.

[133] Rodrigo, *Unconscionable Demands*, at 481.

[134] Masagoes, LM "The Unconscionability Exception - Has Unconscionable Conduct Emerged as an Exception to the Principle of Autonomy in Documentary Letters of Credit in Australia?" (2019), 22, *International Trade and Business Law Review*, 247 (hereinafter, "Masagoes, *The Unconscionability Exception*"), at 264.

[135] Alavi, *Comparative Study of Unconscionability*, at 107.

acceptable exception to the autonomy principle, both in common law[136] and under statutory law.[137]

7.4.4 Recognition of an Unconscionability Exception under Australian Common Law

Proponents of the recognition of a standalone common-law unconscionability exception under Australian law have had a number of supporting case law to draw from, which seems to support such recognition in common law.[138] A well-developed body of case law reflects the unequivocal recognition of the unconscionability exception to the autonomy principle generally under Australian law.[139] This availability of a significant plethora of cases from which courts can draw guidance and direction on the doctrinal foundation of the unconscionability exception and reasonable parameters within which to apply it in an Australian law context is considered to further justify recognition of the unconscionability exception.[140]

7.4.5 Statutory Recognition of Unconscionability under Australian Law

Under the Trade Practices Act 1974 (Cth) ("TPA")[141] (now replaced by the Competition and Consumer Act 2010 in respect of the relevant provisions), unconscionable conduct is recognised as a ground for equitable intervention by courts in commercial dealings, including demand guarantees. The TPA was rechristened and/or replaced by the Competition and Consumer Act 2010 (Cth), which came into operation in January 2011. While some distinctions have been picked up between the TPA and the Competition and Consumer Act, the two statutes bear significant similarities, which are particularly relevant to demand guarantees or other documentary credits.[142]

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[136] See selective cases considered in section 5.2.4 of Chapter 5.

[137] *Inflatable Toy Co v State Bank of New South Wales* (1994) 34 NSWLR 243. See also section 5.2.3 of Chapter 5.

[138] See, e.g., *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* [1985] 1 NSWLR 545; *Olex Focas Pty Ltd v Skodaexport Co Ltd* No 6282, 1996 VIC LEXIS 1245, at 59; *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136.

[139] *Logue v ShoalhavenShire Council* [1979] 1 NSWLR 537; *Inflatable Toy Company Pty Ltd v State Bank of New South Wales* (1994) 34 NSWLR 243**;** *Olex Focas Pty Ltd v Skodaexport Co Ltd* No 6282, 1996 VIC; LEXIS 1245; *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1999) 15 BCL 158; *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136; *Board Solutions Australia Pty Ltd v Westpac Banking Corporation* [2009] VSC 474 (4 November 21009); and *Boral Formwork & Scaffolding v Action Makers* [2003] NSWSC 713.

[140] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 82. Also see selective cases considered in section 5.2.5 of Chapter 5.

[141] Hereinafter "the TPA".

[142] Sections 51AA, 51AB and 51AC of the TPA were observed to bear resemblance to sections 20, 21 and 22 of the Competition and Consumers Act 2010 (Cth), sans for the introduction of a pecuniary penalty in the latter.

Section 20(1) of the Competition and Consumer Act[143] stipulates that "[a] person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law, from time to time".[144] However, no statutory definition of unconscionable conduct is provided, and unconscionable conduct is referenced in the Competition and Consumer Act to be "within the meaning of unwritten law"[145] or "unwritten law, from time to time, of the States and Territories",[146] being Australian common law. In the absence of a statutory definition of unconscionable conduct in the Competition and Consumer Act, it has fallen to the courts to "frame the scope and determine the elements of proof for the doctrine."[147] Attempts to pin down a solid definition of unconscionable conduct as contemplated by statute have led to reliance on jurisprudence and common law determinations,[148] which arguably detracts from the certainty of the concept under Australian law.[149]

The TPA, being the earlier version or predecessor of the Competition and Consumer Act, particularly regarding statutory unconscionability, provides useful foundational insights into the rationale and legislative intent behind the Competition and Consumer Act. Case law which laid the groundwork for interpretation of the TPA, has found relevance and application under the Competition and Consumer Act, noting that the provisions relating to unconscionability in the two statutes are significantly similar, with the Competition and Consumer Act having largely retained and built upon the framework developed under the TPA. It seems, however, that there are divergent views regarding the scope and application of section 51AA of the TPA in relation to unconscionability, particularly the question of which approach, between the narrow or broad

[143] Competition and Consumer Act 2010 – Schedule 2, (hereinafter, "Competition and Consumer Act"). The Competition and Consumer Act replaced the TPA.

[144] Competition and Consumer Act, section 20(1).

[145] Ibid.

[146] The TPA, section 51AA.

[147] Wooler, G "*Lifting the Veil of Autonomy: Unconscionable Conduct as Grounds for Injunctive Relief in Australia and Singapore – A Study in the Context of Independent Trade Finance Instruments*", PhD thesis, University of Queensland, 2017, at 184.

[148] Competition and Consumers Act 2010, section 20(1). Australian courts also have powers of intervention pursuant to sections 21 and 22 of the Competition and Consumers Act 2010 (previously sections 51AB and 51AC of the TPA) which are not confined to the unwritten law relating to unconscionable conduct and are thus broader than those conferred under section 20(1) of the Competition and Consumers Act 2010. See also *Australian Competition and Consumer Commission v Samton Holdings* (2002) 189 ALR 76*; Blomley v Ryan and Commercial Bank of Australia Limited v Amadio* (1983) 46 ALR 402; and *Minson Constructions Pty Ltd v Aquatec-Maxon Pty Ltd* [1999] VSC 17.

[149] Brown, L "The Impact of Section 51AC of the Trade Practices Act 1974 (Cth) on Commercial Certainty" (2004), 28, *Melbourne University Law Review*, 589, at 599-622.

approach, is the prevailing one.[150] Australian courts have shown a marked reluctance to determine conclusively which of the judicial attempts to delineate the precise scope of section 51AA of the TPA.[151] A broad and a narrow approach have been considered the key approaches to applying the TPA in relation to unconscionability. According to the narrow approach, unconscionability under section 51AA is merely an entrenchment of equitable doctrine, whereas the broad approach extends unconscionability to broader application beyond only where there is a special disadvantage or disability of another.[152] It, therefore, seems that no definitive conclusion has been reached or established by the superior courts of Australia regarding whether the narrow or the broad approach is dominant.[153] Even though there is some case law supporting the broad approach,[154] this judicial ambiguity, however, has not deterred some scholars from the perception that the application of the unconscionability exception under Australian law is narrow, with room for future consideration of its expansion.[155]

Despite the differing opinions on the scope of the doctrine of unconscionability, it is clearly and firmly recognised as an exception to the autonomy principle of demand guarantees.[156] Australia has developed and continued to develop a body of case law precedents on unconscionability from which courts can glean guidance and further build upon regarding unconscionability, including particularly as an exception to the autonomy principle and its parameters.[157]

7.4.6 Concluding Remarks regarding the Overlap between Unconscionability and Fraud under Australian Law

Fraud, which is recognised internationally as an exception to the autonomy principle, is well-

[150] See the discussion in section 5.2.3.2 of Chapter 5 on the scope of section 51AA of the TPA regarding the broad and narrow approaches.

[151] *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, paras 44-45.

[152] See the discussion in section 5.2.3.2 of Chapter 5 on the scope of section 51AA of the TPA regarding the broad and narrow approaches.

[153] Ibid.

[154] *Pritchard v Racecage* (1997) 142 ALR 527 and *Olex Focas v Skodaexport* [1998] 3 VR 380.

[155] Masagoes, *The Unconscionability Exception*, at 269.

[156] Alavi, *Comparative Study of Unconscionability*, at 107.

[157] Fedotov, *Abuse, Unconscionability and Demand Guarantees*, at 82.

recognised in Australia as well.[158] Australian law has, however, not entirely shaken off the potential confusion and overlap between the precise scope of the well-established fraud exception and unconscionability, as depicted by these concepts being interlinked in some cases.[159] The same may be said regarding unconscionability and bad faith or the absence of good faith.[160] If, however, unconscionable conduct can be addressed under the fraud exception a reasonable inference given factors such as uncertainty that militate against recognition of an unconscionability exception is that a standalone unconscionability exception is more trouble than it is worth and, therefore, unnecessary.

7.5 BRIEF SUMMARY AND CONCLUSIONS REGARDING THE BREACH OF A NEGATIVE STIPULATION EXCEPTION IN RELATION TO DEMAND GUARANTEES UNDER AUSTRALIAN LAW

7.5.1 Rationale for Recognition of the Breach of a Negative Stipulation Exception

Some reasons for entering into contracts with negative stipulations in respect of demand guarantees from an applicant's and beneficiary's perspective under Australian law vary on a case-to-case basis. From an applicant's perspective, it includes wanting to dilute the traditionally superior bargaining power of the beneficiary and the corresponding harsh risk allocation against the applicant. From the beneficiary's perspective, it includes the need to demonstrate good faith and build trust with an applicant and is a cost-effective alternative to a counter-guarantee. [161]

7.5.2 Recap of Reasons Advanced For and Arguments Against Recognition of the Breach of a Negative Stipulation Exception

Arguments against recognition of the breach of a negative stipulation exception include the issue of uncertainty. The uncertainty that would be injected into the realm of demand guarantees by any additional exceptions in relation to demand guarantees has generally been touted as one of the factors against recognition of the breach of a negative stipulation exception. All the potential

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[158] See, e.g., *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545; *NEI Pacific Ltd v Cigna Insurance Australia, Ltd* (Unreported, NSWSC, Mowlem J, 29 August 1991); and *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54. See also Gao, *The Fraud Rule* for a comprehensive analysis of the fraud exception and its recognition, including particularly under Australian law.

[159] *Logue v Shoalhaven Shire Council* [1979] 1 NSWLR 537; *The Inflatable Toy Company v State Bank of New South Wales* (1994) 34 NSWLR 243; and *Olex Focas v Skodaexport* [1998] 3 VR 380.

[160] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15; *Overlook v Foxtel* [2002] NSWSC 17; and *Optus Networks Pty Limited v Telstra Corporation Limited* (2009) FCA 728.

[161] Alavi, *Contractual Restrictions*, at 72.

interpretational uncertainties applying to other exceptions, such as unconscionability, have been argued to be equally pertinent to the breach of a negative stipulation exception. However, uncertainty in relation to the breach of a negative stipulation exception is capable of significant mitigation through the application of specific parameters.[162]

The recognition of a breach of a negative stipulation exception can, from one perspective, be perceived as a bolt-hole allowing applicants an avenue for evasion of their obligations under a demand guarantee by negotiating restrictive terms into an underlying or other relevant contract with the beneficiary. However, this view is countered by the fact that a beneficiary is equally not precluded from utilising, *inter alia*, their bargaining power to resist the incorporation of restrictive provisions in an underlying or other contract and negotiate an unrestricted position on their part.[163]

Several compelling arguments have been raised in support of the recognition of the breach of a negative stipulation exception. These include the vulnerability of demand guarantees to abuse,[164] the need to promote/allow freedom of contract and recognise legitimate expectations,[165] the absence of discretion in respect of a negative covenant,[166] the novelty of the breach of an underlying or other contract exception,[167] the lack of authority in outright opposition of recognition of the breach of a negative stipulation exception,[168] and the non-interventionist relationship of the breach of a negative stipulation exception to the autonomy principle.[169]

7.5.3 Overall Recognition of Breach of Negative Stipulation as an Exception under Australian Law

Australian law seems to have unequivocally embraced the breach of a negative stipulation

[162] See section 5.3.3.7 of Chapter 5.

[163] See section 5.3.3.8 of Chapter 5.

[164] See section 5.3.3.1 of Chapter 5.

[165] See section 5.3.3.2 of Chapter 5.

[166] See section 5.3.3.3 of Chapter 5.

[167] See section 5.3.3.4 of Chapter 5.

[168] See section 5.3.3.5 of Chapter 5.

[169] See section 5.3.3.6 of Chapter 5.

exception, as depicted in case law.[170] Such is the maturity of a breach of a negative stipulation exception in Australia that Australia has been averred to be the jurisdiction of origin of the breach of a negative stipulation exception.[171] More recent cases supporting the breach of a negative stipulation exception under Australian law re-affirm consistent recognition of the exception from early case law to more current cases.[172]

7.5.4 Recap and Outline of the Key Parameters within which the Breach of a Negative Stipulation Exception is Recognised under Australian Law

7.5.4.1 General

On the whole, Australian law appears to have embraced the breach of a negative stipulation exception within, *inter alia*, the key parameters as outlined below.

7.5.4.2 Distinction between Restraining a Beneficiary from Making a Demand and Restraining a Guarantor from Making Payment and their Effect on the Autonomy Principle

The breach of a negative stipulation exception is only recognised as a ground to prevent payment against the beneficiary and not the guarantor of a demand guarantee. The breach of a negative stipulation in an underlying or other contract is a ground for an injunction preventing a beneficiary from calling up a demand guarantee. It is not accepted as a justification for interference, by injunction or otherwise, with the guarantor's obligation to pay upon being presented with a compliant demand under a demand guarantee. This parameter has the effect of ring-fencing the autonomy principle from the workings of the breach of a negative stipulation exception so that the

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[170] See, e.g., *Lane-Mullins v Warrenby Pty Ltd* [2004] NSWSC 817; *Clough Engineering limited v Oil and Gas Corporation Limited* [2008] FCAFC 136; *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443; *Pearson Bridge Pty Ltd v State Rail Authority of New South Wales* [1982] 1 Aust Const LR 81; *Wood Hall Ltd v Pipeline Authority* [1979] HCA 21; (1979) 141 CLR 443, at 452-454 and 459; *Pearson Bridge (NSW) (Pty) Ltd v State Rail Authority of New South Wales* (1982) Aust Const LR 81; *Washington Constructions Company Pty Ltd v Westpac Banking Corporation* (1983) Qd R 179; *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545; *Tenore Pty Ltd v Roleystone Pty Ltd* (Unreported, Supreme Court of New South Wales, Giles J 14 September 1990); *J H Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (Unreported, Supreme Court of the Northern Territory, Kearney J, 30 January 1989); *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 Building and Construction Law 210; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451 at 457; *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1993) 11 Building and Construction Law 50; *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812; *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812; *Bachmann (Pty) Ltd v BHP Power New Zealand Ltd* [1998] VSCA 40; and *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1999) 15 BCL 158.

[171] Enonchong, N "The Problem of Abusive Calls on Demand Guarantees" [2007] *LMCLQ* 1, 83, at 90.

[172] *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98 and *Uber Builders and Developers Pty Ltd v MIFA Pty Ltd* [2020] VSC 596.

latter has no impact on the autonomy principle.

The Australian position appears to be that where a beneficiary has agreed contractually not to call up a demand guarantee except upon the occurrence of certain events, any attempt to turn around and justify a demand in breach of such negative covenant by invoking the autonomy principle would be rejected by Australian courts.[173] There is a strong, consistent line of Australian case law recognising the position that a beneficiary may be enjoined from calling up a demand guarantee or other documentary credit where they are contractually bound not to do so except upon the occurrence of certain events.[174] There are a number of Australian law cases supporting the potentially divergent stance that a beneficiary's entitlement to call up a demand guarantee is a broad and overriding one as long as the claim is not fanciful or specious in nature.[175] Despite the existence of such cases, recognition of the breach of a negative stipulation exception appears to be the dominant position.

A pertinent aspect regarding the breach of a negative stipulation exception is its non-interventionist position relative to the autonomy principle. Although some commentators view or refer to breach of a negative stipulation as a recognised exception to the autonomy principle,[176] the position that an injunction preventing a beneficiary from calling up a demand guarantee in breach of contractual terms binding upon them does not affect the autonomy principle is submitted to be the correct construal.[177] If anything, the term exception in relation to breach of negative stipulation is only true in the sense that a negative stipulation disrupts the typical unencumbered workings of a demand guarantee arrangement whereby a beneficiary is free to make a demand and receive payment thereunder. In other words, the exception arising is not in the form of a deviation from

[173] *Boral Formwork v Action Makers* [2003] NSWSC 713, para 40.

[174] See *Pearson Bridge v State Rail Authority of New South Wales* (1982) 1 ACLR 81; *Tenore Pty Ltd v Roleystone Pty Ltd* (Unreported, NSW Sup Ct, Giles J, 14 September 1990); *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 BCL 210; *Selvas Pty Ltd v Hanson Yuncken Pty Ltd and State Bank of Australia* (1987) 6 ACLR 36; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451; and *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158.

[175] *Hughes Bros Pty Ltd v Telede Pty Ltd* (1992) 7 BCL 210; *Phillips Pty Ltd v Baulderstone Hornibrook Pty Ltd* (Unreported, NSW Sup Ct,Giles J, 26 October 1994); *Ultra Refurbishing and Construction Pty Ltd v John Goubran & Associates Pty Ltd* (Unreported, NSW Sup Ct, Young J, 24 April 1997); *Coby Constructions Pty Ltd v Melbourne Glass Pty Ltd* (Unreported, Vic Sup Ct, Gillard J, 7 April 1998); and *Kennedy Taylor (Vic) Pty Ltd v Baulderstone Hornibrook Pty Ltd* (2000) 16 BCL 374, also referenced in Dixon, *As Good as Cash?*, at 22.

[176] Dixon, *As Good as Cash?*, at 21.

[177] Dixon, *As Good as Cash?*, at 21. See also Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 528 and case law such as *Boral Formwork & Scaffolding* (*Pty) Ltd v Action Makers Ltd* [2003] NSWSC 713, para 40 and *ALYK (HK) Ltd v Caprock Commodities Trading Pty Ltd* 2012 NSWSC 1558, para 84

the autonomy principle but rather the existence of an extrinsic encumbrance (i.e., a restrictive contractual provision) on the beneficiary's entitlement to make a demand. There is thus an important distinction between restricting the guarantor's/issuer's obligation to pay upon being presented with a compliant demand, which would violate the autonomy principle and restricting the beneficiary's entitlement to make such a demand, which is submitted to have no bearing on the autonomy principle.[178] The breach of a negative stipulation exception supports this distinction because it is premised on the latter being challenged separately without any impact on the former (that is, on the autonomy principle).

7.5.4.3 Express Negative Versus Implied Negative Stipulations

Another key parameter governing the breach of a negative stipulation exception as recognised under Australian law relates to the distinction between an express negative stipulation and an implied one. Although Australian law has left some wiggle room regarding whether a negative stipulation must be express or if an implied one may also be permissible, it is accepted that an express negative stipulation is not only more likely to be considered by the courts but also has greater odds of success.

Whilst, in theory, an implied negative stipulation may suffice for the purposes of a breach of a negative stipulation exception,[179] establishing the existence of an implied negative stipulation poses a significant challenge.[180] It could be argued that Australian law's recognition of the breach of a negative stipulation exception established on the basis of an implied negative stipulation may cause uncertainty. However, this seemingly lax approach may be offset to some extent by the application of certain tighter parameters (e.g., the balance of convenience test and the requirement for the applicant to show damages) applied specifically in Australia and not necessarily in other jurisdictions which in turn have preferred to apply tighter measures in the form of requiring only express negative stipulations.[181] Moreover, as succinctly stated in the case of *Fletcher*

[178] An exemplary case in which this distinction was highlighted is the seminal case of *Woodhall v Pipeline Authority* (1979) 141 CLR 443.

[179] *Australian Winch and Haulage Co Pty Ltd v Walter Construction Group Ltd* [2002] FCA 1181; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158; and *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812.

[180] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, 826-827, citing *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1161-1162.

[181] Alavi, *Contractual Restrictions*, at 80.

Construction Australia Ltd v Varnsdorp Pty Ltd, "implication cannot be made if it would stultify, or even if it would be inconsistent with, the purpose for which the guarantee was taken".[182] The likelihood of success is significantly reduced where an application for an injunction is based on the breach of an implied negative stipulation, particularly noting that for there to be a breach of a negative stipulation, the existence of the negative stipulation must first be established.

The Australian law standard required for an injunction on the basis of a breach of a negative stipulation exception has evolved over time. Earlier cases seemed to require the relatively lower standard of "a serious issue to be tried",[183] while later cases required the higher standard of a "seriously arguable" case to be shown by an applicant.[184] The balance of convenience test has also been applied under Australian law,[185] and there has been a requirement for a party seeking recourse against the breach of a negative stipulation by a beneficiary to show evidence of the loss sustained as a result of the beneficiary's conduct. Such standards and requirements can be said to facilitate the application of the breach of a negative stipulation exception within reasonable parameters and impede its use in an abusive or specious manner.

The balance of convenience test has been incorporated into consideration of unconscionability under Australian law, as depicted in the cases of *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404 and *Boral Formwork v Action Makers* [2003] NSWSC 713, paras 12-14 where, taking into account the relevant factors circumstances of the case, the balance of convenience was determined to be in favour of an interlocutory injunction being granted. See Alavi, *Contractual Restrictions*, at 85-86 for a more detailed consideration discussion of this analysis.

[182] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, 826–827, citing *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1161-1162.

[183] See, e.g., *Pearson Bridge Pty Ltd v State Rail Authority of New South Wales* (1982) 1 Aust Constr LR 81; *Selvas Pty Ltd v Hansen & Yuncken* (SA) Pty Ltd (1987) 6 ACLR 36; *J H Evans Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (Unreported NT Supreme Court, 30 January 1989); and *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451. However, some later cases seem to have continued in step with this early case law standard by referencing the requirement for a, "serious issue to be tried", for example *Kirfield Ltd v First Trade Consulting Pty Ltd* [2005] WASC 82; *Marson Constructions Australia Pty Ltd v Hillcrest Manor Pty Ltd* (27 February 2000) [2000] VCAT 29; *H Troon v Marysville Hotel and Conference Centre* [2017] VSC 470; and *Siemens v Bulgana* [2019] VSC 771 (27 November 2019).

[184] See, e.g., *Rejan Constructions Pty Ltd v Manningham Medical Center Pty Ltd* [2002] VSC 579; *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2009] NSWSC 439; *Patterson Building Group Pty Ltd v Holroyd City Council* [2013] NSWSC 1484; *Duro Felguera Australia Pty Ltd v Samsung C&T Corporation* [2016] WASC 119 and *Ecap Finance Pty Ltd v Ottoway Engineering Pty Ltd (No 2)* [2017] FCA 237 in which the requirement for a "serious arguable" case or issue was referenced and/or considered.

[185] See, e.g., *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404 and *Boral Formwork v Action Makers* [2003] NSWSC 713, paras 12-14.

7.6 INTERNATIONAL RULES AND THEIR APPROACH TO EXCEPTIONS, INCLUDING THE UNCONSCIONABILITY AND BREACH OF A NEGATIVE STIPULATION EXCEPTIONS

7.6.1 International Rules and their Approach to Exceptions

7.6.1.1 General

International rules, such as the URDG 758, UCP 600, ISP98, and the URCG, do not have the force of law and would typically apply on an elective basis. As summarised below, the ICC rules such as URDG, UCP and ISP98 have taken a generally silent stance on the topic of fraud and any other potential exceptions affecting payment under demand guarantees. The URCG includes specific measures that may be fraud-deterrent, albeit not mentioning "fraud" by its name.

7.6.1.2 The URDG's Approach to Exceptions in respect of Documentary Credits

The URDG seems to have adopted an intentionally silent approach to the topic of exceptions to the autonomy principle of demand guarantees. This is explained as follows in the International Standard Demand Guarantee Practice[186] ("ISDGP"):[187]

> "Improper demands, including fraudulent, illegal and unfair demands, are outside the URDG. Their characterisation and legal implications are a matter for the applicable law."[188]

7.6.1.3 The ISP98's Approach to Exceptions in respect of Documentary Credits

The ISP98 expressly excludes matters relating to "defenses to honour based on fraud, abuse or similar matters",[189] which matters are expressed to fall within the purview of national/applicable law by stating that such matters "are left to applicable law".[190]

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[186] International Chamber of Commerce, *International Standard Demand Guarantee Practice for URDG 758,* ICC Publication No 814E (2021) (hereinafter, "ISDGP").

[187] Article 209 of the ISDGP

[188] ISDGP, Article 209.

[189] ISP98, Rule 1.05(c).

[190] ISP98, Rule 1.05.

7.6.1.4 The URCG's Approach to Exceptions in respect of Documentary Credits

The URCG has built-in anti-fraud provisions in the form of a requirement for a beneficiary to present a judgment, arbitration award or the principal's written acceptance in order for a claim of the guaranteed amount to be successful.[191] While this approach may be seen as an effective way to curtail fraud,[192] others have criticised it for being onerous to the point of converting independent guarantees into accessory guarantees.[193] This aspect has also brought into question whether the URCG intends to cover traditional accessory guarantees or demand guarantees.

7.6.1.5 The UCPs' Approach to Exceptions in respect of Documentary Credits

The UCP are silent on the subject of exceptions in relation to documentary credits in general and has been criticised for this as it is seen as a missed opportunity to establish certain and practicable rules relating to exceptions, such as the fraud exception.[194] ICC authorities have, however, justified this approach by pointing to national courts as the appropriate authorities to address abusive or fraudulent demands.[195] In the absence of recourse against fraud which is led by international rules, the responsibility of dealing with fraud in relation to documentary credits governed by such rules seems left to the courts of the different jurisdictions to take up.

7.7 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS IN RESPECT OF THE UNCONSCIONABILITY EXCEPTION UNDER SOUTH AFRICAN LAW WITH REFERENCE TO ENGLISH LAW AND AUSTRALIAN LAW

7.7.1 Conclusion regarding the Overlap between Unconscionability and Concepts such as Fraud, Duress, Misrepresentation, and Undue influence

A key aspect of considering any concept, including unconscionability in the context of exceptions to the autonomy principle of demand guarantees, is determining its definition. The word "unconscionable", according to the Oxford dictionary, connotes conduct which is "so

[191] URCG, Article 9.

[192] Alawamleh, *Documentary Credits and Independent Guarantees*, at 52-53.

[193] Gao, *The Fraud Rule*, at 19-20.

[194] Buckley, RP and Gao, X "The Development of the Fraud Rule Letter of Credit Law: The Journey So Far and the Road Ahead" (2002), 23, *University of Pennsylvania Journal of International Economic Law,* 663, at 701.

[195] See International Chamber of Commerce, *Opinions of the ICC Banking Commission* 1995-1996, ICC Publication No. 565, (1997), at 22 and "Query: Rights of Recourse to the Beneficiary in the event of Fraud", in "Latest Queries Answered by the ICC Banking Commission'' (1997), 3(2), *DCI (ICC)*, at 7.

bad, immoral, etc. that it should make [one] feel ashamed".[196] Unconscionability, as illustrated by a number of South African cases, is linked to principles relating to equity and fairness under South African law, including bad faith and public policy considerations under the Constitution of the Republic of South Africa.[197]

According to the South African Consumer Protection Act ("CPA"),[198] unconscionable means "having a character contemplated in section 40; or (b) otherwise unethical or improper to a degree that would shock the conscience of a reasonable person".[199] The elements described in section 40 of the CPA as referenced in the definition of unconscionable include, without limitation,

> "physical force against a consumer, coercion, undue influence, pressure, duress or harassment, unfair tactics or any other similar conduct, …[taking] advantage of the fact that a consumer was substantially unable to protect the consumer's own interests because of physical or mental disability, illiteracy, ignorance, inability to understand the language of an agreement, or any other similar factor."[200]

This is further complemented by other provisions in the CPA, which espouse the right to fair, just and reasonable terms and conditions.[201] The apparent shortcoming is threading its way through the various attempts at defining unconscionability, with the South African law experience being no exception, subjectivity, which undermines certainty. It seems fair to say that unconscionability has proved as nebulous a concept under South African law as it has elsewhere.[202]

The merger of fraud, duress, misrepresentation, undue influence and unequal bargaining power under the umbrella of unconscionability has been argued by some to be plausible. However, the observation that concepts such as fraud, duress, misrepresentation, and undue influence are established with considerable certainty under South African law, while unconscionability is

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[196] https://www.oxfordlearnersdictionaries.com/definition/english/unconscionable (accessed on 21 February 2021).

[197] Act 108 of 1996.

[198] Consumer Protection Act 68 of 2008 (hereinafter "the CPA").

[199] Section 1 of the CPA (Definitions).

[200] Section 40(1) and 40(2) of the CPA.

[201] See part G of the CPA and section 48(1) of the CPA. Also see section of Chapter 3 of this thesis for a fuller consideration of the contributions of the South African Law Reform Commission and the Consumer Protection Act of 2008 to the development of the concept of unconscionability under South African law.

[202] See sections 7.2 and 7.4 and of this chapter for concluding summaries on the status and issues surrounding the precise definition of unconscionability under English law and Australian law, respectively.

plagued by uncertainty in terms of both its definition and application, also distinguishes these different legal concepts.[203]

Viewed broadly, it is acknowledged that there may indeed be circumstances in which such overlap may be realised. However, seeking to conflate fraud, duress, misrepresentation, undue influence, and unequal bargaining power with unconscionability would be a disingenuous approach. The fact that courts have continued to wrestle with unconscionability, fairness, public policy and/or good faith considerations, despite the existence of fraud etc., as alternative options for recourse support this distinction.

7.7.2 Summary and Conclusion on the USA Approach under the UCC as potentially relevant to South African Law and Contract Law Considerations

Although this thesis did not discuss the position under the United States of America[204] ("USA") law, brief attention was given to selective aspects of this jurisdiction in how it deals with the concept of "unconscionability". For instance, in the USA, unconscionability was historically regarded as an abstract concept which could be tied into concepts such as fraud, duress, misrepresentation, undue influence and unequal bargaining power. South African law has been argued to have, by virtue of its "hybrid legal heritage",[205] incorporated a position similar to that in the USA regarding unconscionability being an abstract concept. The USA, however, later codified the concept of unconscionability,[206] thus begging the question of whether South African law is due for a similar development.

Despite codification of unconscionability generally in the USA's Uniform Commercial Code ("UCC")[207] in respect of general contract law, the USA seems to have declined to extend such recognition to exceptions to the autonomy principle of standby letters of credit (or similar instruments like demand guarantees or commercial letters of credit). The UCC expressly

[203] See section 3.4.1 of Chapter 3.

[204] Hereinafter "the USA".

[205] Berat, L "South African Contract Law: The Need for a Concept of Unconscionability", (1992) 14, *Loyola of Los Angeles International and Comparative Law Review*, 507 (hereinafter, "Berat, *South African Contract Law: The Need for a Concept of Unconscionability*"), at 508.

[206] Section 2-302 of the Uniform Commercial Code Uniform Commercial Code, Revised UCC Article 5, Letters of Credit, 1995 (hereinafter, "UCC").

[207] Hereinafter "the UCC".

recognises only fraud as an exception to the autonomy principle.[208] It is arguable that upon an analysis of the pros and cons of establishing unconscionability as a standalone exception to the autonomy principle of demand guarantees, a similar conclusion would be reached under South African law as the disadvantages may outweigh the advantages thereof. Moreover, the definition of unconscionability is not provided in the UCC and remains nebulous and, in some instances, subjective, as illustrated by USA case law.[209] Given how documentary credits derive a large portion of their utility from certainty, compared to general contracts, this distinction may further justify the non-recognition of unconscionability as an exception to the autonomy principle in the USA, which stance holds equal validity from a South African law perspective.[210]

Under South African law, a contract with all the relevant *essentialia* may be affected by vitiating factors which would render it voidable.[211] Such factors include fraudulent or non-fraudulent misrepresentation, duress, and undue influence.[212] There is South African case law which lends itself to the view that unconscionability could overlap with such vitiating factors, e.g., undue influence.[213] Following on from this view, it is possible to argue that the unconscionable conduct is already substantially covered by existing South African contract law remedies, which address these vitiating factors. This argument erodes the utility of a standalone unconscionability exception to the autonomy principle of demand guarantees, more so when weighed against the disadvantages thereof.[214]

[208] UCC Section 5-109.

[209] See, e.g., *Stiefler v McCullough* 174 NE 823 (Ind Ct App 1931), as discussed in section 3.2.2.1 of Chapter 3.

[210] See section 3.2.2.1 of Chapter 3 for a detailed comparative consideration of the USA approach under the UCC regarding the codification of unconscionability generally in relation to contracts and the fraud exception regarding letters of credit.

[211] See Berat, *South African Contract Law: The Need for a Concept of Unconscionability*, at 508.

[212] See section 3.2.2.1 of Chapter 3.

[213] See the discussion of *Preller and Others v Jordaan* 1956 (1) SA 483 (A) in section 3.2.2.2 of Chapter 3.

[214] See generally 3.2 of Chapter 3 which prologues the comprehensive consideration of various views and arguments regarding unconscionability and the unconscionability exception to the autonomy principle under South African law, including in particular the disadvantages or shortcomings of such a notion. See also the consideration of same in section 4.2.5 in Chapter 4 and section 5.2.6 of Chapter 5 from an English law and Australian law perspective, respectively.

7.7.3 Summary on the Interaction of Unconscionability, Good Faith and Broader Public Policy Considerations under South African Law

7.7.3.1 Good Faith and the Rise and Fall of the Exeptio Doli Generalis

Unconscionability is considered by some to be substantially similar and to overlap with the concept of bad faith (or lack of good faith). Roman law and Roman-Dutch law were originating influences of the concept of bad faith under South African law. The Roman law approach, founded on strict formalism and adherence to procedure, was prone to injustices and gave rise to the need for equitable concepts such as fairness and reasonableness to address this. From this development, the e*xceptio doli generalis* (i.e., the Roman law defence of bad faith in the general form)[215] was born.[216] The notion of good faith as received in the Netherlands, became known as Roman-Dutch law. Equitable notions gained traction, as evidenced by a substantial body of early case law.[217]

Despite several cases supporting it,[218] some breakaway cases departed from the party line[219]and found equitable principles to be only enforceable where they had been authoritatively incorporated and recognised as rules of positive law.[220] The vacillation of the South African law position was further depicted by the landmark case of *Bank of Lisbon and South Africa Ltd v De Ornelas and Another*,[221] which categorically renounced the *exceptio doli generalis* as a part of South African law. In the absence of certainty regarding the *exceptio doli* generalis as a remedy, contractual

[215] Hutchinson, D, Pretorius, CJ, *et al*. *The Law of Contract in South Africa*, Oxford University Press Southern Africa, 2009, at 450.

[216] Idem, at 39.

[217] See *Mills and Sons v The Trustees of Benjamin Bros* (1876) 6 Buch 115; *Judd v Fourie* (1881) 2 EDC 41; *Burger v Central South African Railways* 1903 TS 571; *Trustee, Estate Cresswell and Durbach v Coetzee* 1916 (AD) 14; *Neugebauer and Co v Herman* 1923 AD 564; and *Rand Rietfontein Estates Ltd v Cohn* 1937 (AD) 317. Other early South African cases supporting the application of the principle of good faith/bona fides to contracts prior to it being dispensed with include, *Paddock Motors (Pty) Ltd v Igesund* 1976 (3) SA 16 A; *Meskin NO v Anglo American Corporation of SA Ltd and Another* 1968 (4) SA 793 (W); *Savage and Lovemore Mining (Pty) Ltd v International Shipping Co (Pty) Ltd* 1987 (2) SA 149 (W); and *Tuckers Land and Development Corporation (Pty) Ltd v Hovis* 1980 (1) SA 645 (A).

[218] 1947 (1) SA 514 (A). See also *Paddock Motors (Pty) Ltd v Igesund* 1976 (3) SA 16 (A).

[219] *Weinerlein v Goch Buildings Ltd* 1925 AD 282.

[220] 1925 AD 282, at 295.

[221] 1988 (3) SA 580 (A).

parties were left to turn to constitutional principles for recourse.[222]

However, the *Bank of Lisbon* case did not mark the demise of equitable notions under South African law altogether. Equitable notions in the guise of public policy considerations continued to dominate in later cases such as *Sasfin (Pty) Ltd v Beukes*.[223] Perhaps attempting to clarify the status of equitable considerations under South African law, *Brisley v Drotsky*[224] held that equitable notions such as good faith did not carry the clout to independently scupper the enforceability of a contract. Residual uncertainty and the need for it "sooner rather than later"[225] remains in this area.[226]

Some scholars have taken the apparent renaissance of notions of good faith under South African law to signal a more liberal attitude by the courts towards exceptions to the autonomy principle of demand guarantees on the basis of such notions.[227] This could be interpreted as an increased likelihood of recognition of equity-based exceptions to the autonomy principle, such as unconscionability.

Uncertainty, however, remains an issue, noting that certainty is even more imperative in the context of demand guarantees compared to contracts generally. However, notwithstanding the absence of universal agreement and clarity on the role of good faith in relation to contracts under South African law, it is clear that good faith is a recognised underlying value which does have some role to play in informing the rules or principles of the law of contract. It may also find expression in public policy considerations. Several South African cases with reference to bad faith or lack of good faith have considered the matter of intervention with demand guarantees on the

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[222] Stewart, T, "*Unreasonable, Unconscionable and Oppressive Contract Terms in South African and Western Australian Law*", LLM dissertation, University of Johannesburg, 2015 (hereinafter "Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*"), at 16.

[223] 1989 (1) SA 1 (A). See also *Jajbhay v Cassim* 1939 AD 537 and *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 (4) SA 302 (A).

[224] 2002 (4) SA 1 (SCA). See also *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA) and *South African Forestry Co Ltd v York Timbers Ltd* 2007 (5) SA 323 (CC) which supported the same approach. See also *Botha v Rich* 2014 (4) SA 124 (CC) and *Bredenkamp v Standard Bank of SA Ltd* 2009 (5) SA 304 (GSJ) and on appeal, 2010 (4) SA 468 (SCA).

[225] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers* 2012 (1) SA 256 (CC), para 22.

[226] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC).

[227] Hugo, C "Demand Guarantees in the People's Republic of China and the Republic of South Africa" (2019), 6(2), *BRICS Law Journal,* 4 (hereinafter, "Hugo, *Demand Guarantees in the People's Republic of China and the Republic of South Africa*), at 30-31.

grounds closely resembling or alleged to constitute unconscionability.[228]

7.7.3.2 Public Policy Considerations and Ubuntu in the Constitutional Era

Ubuntu is a cardinal value of South Africa's constitution, which encapsulates, *inter alia*, social justice and fairness.[229] Unconscionability has also been explained with reference to public policy considerations enshrined in the Constitution of the Republic of South Africa.[230] The question of whether the Constitution, including particularly the Bill of Rights, has any place in relation to the law of contract is a contentious one but seems to have been answered in the affirmative by case law.[231] The contemplation of both notions of fairness and equity on the one hand and freedom of contract on the other, under the umbrella of public policy, seems to add the complication of trying to reconcile these potentially conflicting notions.[232]

Unconscionability, being a concept inextricably linked to the notions that constitute public policy,[233] particularly fairness, justice and reasonableness, may well be encapsulated in public policy in South African law.[234] It seems to be the case that unconscionable conduct in relation to the law of contract and demand guarantees could be addressed by invoking public policy considerations. If a demand guarantee is found to be unconscionable in a manner constituting an infringement of public policy, then similarly to how public policy can fetter the enforceability of a contract, recourse against enforcement of that demand guarantee could be sought on public policy grounds. The restraint that courts have already noted should be applied to interference with

[228] Refer to the cases considered and/or referenced in section 3.2.3 of Chapter 3, including for example *Group Five Construction (Pty) Ltd and Others v Member of the Executive Council for Public Transport Roads and Works Gauteng and Others* [2015] 2 All SA 716 (GJ), para 50 and *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA), para. 65.

[229] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC), para 71.

[230] Act 108 of 1996.

[231] *Du Plessis v De Klerk* 1996 (3) SA 850 (CC) and *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC).

[232] See *Preller and Others v Jordaan* 1956 (1) SA 483 (A).

[233] See section 3.2.4 of Chapter 3 for a fuller discussion of public policy considerations and ubuntu in the constitutional era.

[234] See, e.g., *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Other* 2020 (5) SA 247 (CC); *Magna Alloys & Research (SA) (Pty) Ltd v Ellis* 1984 (4) SA 874 (A); *Citibank NA v Thandroyen Fruit Wholesalers CC and Others* 2007 (6) SA 110 (SCA); *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A); *Preller and Others v Jordaan* 1956 (1) SA 483 (A); *Napier v Barkhuizen* 2006 (4) SA 1 (SCA); and also *Barkhuizen v Napier* 2007 (5) SA 323 (CC).

contracts on public policy grounds,[235] which would, in the context of demand guarantees, curtail any abuse of this remedy in a manner that would corrode the autonomy principle to an unacceptable degree.

7.7.4 Summary of Unconscionability under the Consumer Protection Act of 2008 of South Africa

The CPA has contributed to the development of unconscionability under South African law in general.[236] The CPA incorporates specific provisions to curtail and provide recourse against conduct which is unconscionable, unjust, unreasonable or unfair.[237] Despite this, it is considered by some commentators to be short of "the desirable point of certainty one would have hoped for" in this regard.[238] This approach of codifying unconscionability into consumer protection legislation is similar to the Australian law approach, which incorporates unconscionability in the Australian TPA.[239] In some ways, such as the degree of uncertainty, the South African CPA has been assessed to be conservative and less developed than the Australian TPA,[240] perhaps because the Australian Competition and Consumer Act has developed several years ahead of its South African counterpart, the CPA.[241]

The concept of unconscionability in the CPA is beleaguered by uncertainty, especially due to some key terms such as "unfair contract terms"[242] lacking a clear definition. Uncertainty generally regarding the role of good faith in the South African law of contract exacerbates this issue. These deficiencies of certainty in relation to contract law generally would be even more pronounced in the context of certainty-dependant demand guarantees. Notwithstanding this, the CPA is credited with making headway in facilitating greater recognition of equitable considerations in the law of

[235] See *Trustees, Oregon Trust v Beadica* 2019 (4) SA 517 (SCA) and *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA).

[236] See section 3.2.5 of Chapter 3 for more detailed consideration of the contributions of the South African Law Reform Commission and the CPA to the development of the concept of unconscionability under South African law.

[237] See section 48(1) and 48(2) of the CPA.

[238] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 31 and 39.

[239] This is discussed further in Chapter 5 of this thesis.

[240] Ibid.

[241] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 39.

[242] Stewart, *Unreasonable, Unconscionable and Oppressive Contract Terms*, at 34.

contract in South Africa.[243]

A common factor between Australian law and South African law is the incorporation or codification of unconscionability into statute. The relevant statutes in both jurisdictions also consider unconscionability statutorily within the broader ambit of consumer laws. However, a key distinction is that the Australian statutory concept of unconscionability clearly applies and has been implemented as demonstrated by case law in relation to documentary credits. In contrast, statutory unconscionability under South African law is mainly confined to a consumer protection context under the CPA.

7.7.5 The Doctrine of Unconscionability and the Fraud Exception

The parameters of unconscionability have sometimes been articulated with reference to fraud,[244] in line with the contention that unconscionability covers conduct that falls short of fraud but also includes fraud.[245] The fraud exception has been categorised by two forms of interpretation. One is the narrow approach, e.g., fraudulent presentation of documents containing express or implicit material misrepresentation, with knowledge of the same (i.e., "documentary fraud").[246] The second is the wider approach, e.g., a beneficiary presents compliant documentation with the knowledge that the merchandise being sold is worthless or non-existent (i.e., fraud not relating to the documents presented in terms of the documentary credit).[247] There are South African cases which lend themselves to support of both the narrow[248] and wide[249] approaches to the fraud exception. South African courts are generally more accepting of fraud in the wide sense when it concerns a

[243] Van der Sijde, E "*The Role of Good Faith in the South African Law of Contract*", LLM Dissertation, University of Pretoria, 2012, at 37.

[244] See generally Woolf, HS "*The Doctrine of Unconscionability as an independent Exception to the Doctrine of Independence in Documentary Credit Practice*" LLM dissertation, University of Johannesburg, 2014 (hereinafter, "Woolf, *The Doctrine of Unconscionability as an Independent Exception"*).

[245] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, at 5.

[246] *United City Merchants (Investments) Ltd v Royal Bank of Canada* (1983) 1 AC 168, para 83F-G.

[247] Van Niekerk, JP and Schulze, WG, *The South African Law of International Trade: Selected Topics*, 4 ed, SAGA legal Publications CC, 2016.

[248] See, e.g., *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812; *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA); *Hollard Insurance Co Ltd v Jeany Industrial Holdings (Pty) Ltd and Others* [2016] ZAGPJHC 175; and *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited & Another* [2020] ZAGPPHC 554.

[249] See, e.g., *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) and *Scatec Solar SA 163 Ltd v Terrafix Suedafrika Ltd* [2014] ZAWCHC 63.

demand guarantee.[250]

While notable cases concerning letters of credit seemed to favour the narrow approach to the fraud exception,[251] subsequent cases dealing with demand guarantees appeared more aligned with the wide approach and with particular reference to knowledge by a beneficiary that they are not entitled to claim under a demand guarantee.[252] To date, it seems that South African case law has yet to take an unequivocally declaratory stance regarding the acceptance of the wide interpretation of fraud. Therefore, the parameters of the fraud exception remain less than perfectly certain under South African law, but the recognition of the fraud exception itself is trite.

Under English law, where fraud is also an established exception to the autonomy principle,[253] there is also some overlap and uncertainty on the precise boundaries between fraud on a "no honest belief" formulation[254] and unconscionability.[255] Fraud is also well-recognised as an exception to the autonomy principle in Australia as well.[256] Australian law has also not entirely shaken off the potential confusion and overlap between the precise scope of the well-established fraud exception[257] and unconscionability, as depicted by these concepts being interlinked in some

[250] See, e.g., *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* 2015 (5) SA 26 (GJ).

[251] See *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A), para 817 and *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA).

[252] See the cases of *Union Carriage and Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) 730, 735; *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 17; *Scatec Solar SA 163 (Pty) Ltd v Terrafix Suedafrika (Pty) Ltd* (2014) ZAWCHC 63; and *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* [2015] 2 All SA 716 (GJ), paras 25-36.

[253] *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 at 725.

[254] See, e.g., *Derry v Peek* [1875] 14 App Cas 337; *Edward Owen Ltd v Barclays International Bank* [1978] 1 All ER 976; *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19; *Banque Saudi Fransi v Lear Siegler Services Inc* [2007] 2 Lloyd's Rep 47; *Uzinterimpex JSC v Standard Bank Plc* [2008] EWCA Civ 819; *Alternative Power Solution Ltd v Central Electricity Board* (2014) UKPC 31. See also section 4.2.2.3 of Chapter 4 for a fuller discussion of fraud and the "no honest belief" formulation of fraud generally.

[255] See *TTI Team Telecom International Limited v Hutchison 3G UK Limited* [2003] 1 All ER 914 as referenced in section 4.2.6.2.2 of Chapter 4.

[256] See, e.g., *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545; *NEI Pacific Ltd v Cigna Insurance Australia, Ltd* (Unreported, NSWSC, Mowlem J, 29 August 1991); and *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54. See also Gao, *The Fraud Rule* for a comprehensive analysis of the fraud exception and its recognition, including particularly under Australian law.

[257] See, e.g., *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545; *NEI Pacific Ltd v Cigna Insurance Australia, Ltd* (Unreported, NSWSC, Mowlem J, 29 August 1991); *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54. See also Gao, *The Fraud Rule* for a comprehensive analysis of the fraud exception and its recognition, including particularly under Australian law.

cases.[258] Unconscionability and bad faith or the absence of good faith to some degree suffer from the same conundrum under Australian law.[259]

Unconscionable conduct has been generally considered to include behaviour falling short of fraud and, unlike fraud, is also concerned with the outcome or resultant contract.[260] A beneficiary calling up a demand guarantee with the knowledge that there is no entitlement to do so or any legitimate purpose for the proceeds claimed could therefore meet the criteria for an unconscionability exception. However, the ongoing absence of a clear demarcation on the scope of concepts such as the fraud exception and good faith and unconscionability under the laws of more mature jurisdictions when it comes to exceptions to the autonomy principle like Australia only highlights its nebulous nature further. Regrettably, this militates against recognising the unconscionability exception under South African law. Adopting or attempting to build upon an iteration of the unconscionability exception, which is not sufficiently solid, would arguably be tantamount to replicating and perpetuating the same challenges and deficiencies under South African law.

Although there are instances where the same conduct which constitutes unconscionable conduct could also constitute fraud, fraud and unconscionability are distinct concepts. Moreover, given the potential breadth of what counts as unconscionable conduct, it could be argued that all instances of fraud would likely constitute unconscionable conduct to some degree. In contrast, not all cases of unconscionability would meet the requirements for the fraud exception. Notwithstanding this, a notable portion of unconscionable conduct, particularly the most egregious cases thereof, could be caught and effectively addressed under the fraud exception wide approach. Furthermore, other existing contractual remedies (e.g., duress, undue influence and misrepresentation) and/or public policy considerations applicable specifically under South African law could potentially provide alternative recourse where appropriate.

7.7.6 General Recommendations

The legal landscape and general context supporting the recognition of an unconscionability exception to the autonomy principle in jurisdictions like Australia may not be applicable or

[258] *Logue v Shoalhaven Shire Council* [1979] 1 NSWLR 537; *The Inflatable Toy Company v State Bank of New South Wales* (1994) 34 NSWLR 243; and *Olex Focas v Skodaexport* [1998] 3 VR 380.

[259] *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15; *Overlook v Foxtel* [2002] NSWSC 17; and *Optus Networks Pty Limited v Telstra Corporation Limited* (2009) FCA 728.

[260] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, 27.

appropriate in a South African context for the reasons outlined below.

The inherent uncertainty of the term unconscionability under South African law causes it to be understandably perceived as "an elusive concept to apply.[261] It has also been observed that even in jurisdictions where it is recognised, it generally seems to cover a wide scope and parameters.[262] Others have sought to clothe this aspect of unconscionability as a potential advantage by arguing that it facilitates "judicial manoeuvring in the interest of justice".[263] A degree of uncertainty has also been noted to be an inevitable element of legal concepts, pointing out that few legal concepts, including fraud itself, are certain enough for mechanical application.[264]

As highlighted in cases such as *Sulzer*,[265] the precise role of good faith in the context of South African law of contract is not universally agreed upon. Perhaps partly because of the uncertainty of its status, good faith lacks enough substantive authority behind it to be considered a possible standalone ground giving rise to an exception to the autonomy principle under South African law. Given the established connection and substantial overlap between unconscionability and bad faith or lack of good faith, unconscionability is tainted by the same considerations, especially a lack of substantive certainty. Despite its apparent recognition in *Sulzer*, unconscionability, like bad faith, seems to be largely an abstract concept. Unconscionability should perhaps rather be confined under South African law to application through the vehicle of public policy to the extent that other contract law remedies or recognised exceptions to the autonomy principle like fraud are inapplicable.

The statutory recognition of unconscionability in respect of contracts under the CPA may be considered to be a potential stepping stone towards a broader concept of unconscionability under the South African law of contract. Following on from this view, one could plausibly argue that the concept of statutory unconscionability under the CPA could in future be built upon and extended

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[261] Mugasha, A "Enjoining the Beneficiary's Claim on a Letter of Credit or Bank Guarantee" (2004), *The Journal of Business Law,* 515, at 518. See also Lee, A "Injuncting Calls on Performance Bonds: Reconstructing Unconscionability" (2003), *Singapore Academy of Law Journal*, 30, at 31.

[262] Woolf, *The Doctrine of Unconscionability as an Independent Exception*, at 4-5.

[263] Hutchison, D and Pretorius, CJ *et al., The Law of Contract in South Africa*, 3 ed, Oxford University Press, (2012) (hereinafter "Hutchison and Pretorius, *The Law of Contract in South Africa*"), at 22.

[264] Loi, KCF "Two Decades of Restraining Unconscionable Calls on Demand Guarantees" (2011), *Singapore Academy of Law Journal*, 504, at 512.

[265] See the discussion of the development and role of good faith in the South African law of contract in section 3.2.3 of Chapter 3.

beyond a consumer law context to apply to the law of demand guarantees as an exception to the autonomy principle. On the other hand, it could be argued that deficiencies such as uncertainty, which have so far prevented unconscionability from extending beyond codification under consumer law and being applied broadly to contracts generally in South Africa, would be more detrimental in relation to demand guarantees. The boundaries of unconscionability are notoriously difficult to define. It is submitted that demand guarantees would be prone to more damaging consequences than contracts generally if the concept of unconscionability is shoehorned into the South African law of demand guarantees.

The CPA offers some recourse against unconscionable conduct, albeit in a consumer protection context, and the unconscionability-related considerations therein.[266] This is, however, limited to a consumer protection context and does not stretch enough to cover typical demand guarantee scenarios, which typically involve sophisticated commercial parties. This is arguably because the consumer demographic has a more compelling need for such recourse compared to the usually sophisticated commercial parties to a demand guarantee arrangement.

It is submitted to be fair that sophisticated parties are held to the *pacta sunt servanda* doctrine, with less room for potential derogation from the autonomy principle in the context of a demand guarantee. Moreover, commercial parties in respect of demand guarantees, could, where applicable and/or where the fraud exception cannot be utilised, take their recourse from other existing contractual remedies such as those existing for duress, misrepresentation and undue influence etc. Furthermore, demands made with knowledge of lack of entitlement may possibly be countered by recourse to the fraud exception on a wide interpretation. The availability of other potential remedies to effectively address conduct which may otherwise fall within the ambit of an unconscionability exception erodes the need for such a standalone unconscionability exception, particularly noting the radically adverse impact it could have on the autonomy principle.

Also, unconscionable conduct falling foul of public *mores* could also be extinguished on public policy grounds under South African law, as applicable. There seems to be no cogent reason why sufficient recourse cannot be obtained against unconscionable conduct from public policy considerations by the participants in a demand guarantee arrangement, which option could materially obviate the need for a standalone unconscionability exception. The potential argument

[266] See section 3.2.5 of Chapter 3 for a discussion of the contributions of the South African Law Reform commission and the CPA to the development of the concept of unconscionability under South African law.

that recognition of the fraud exception was driven in part by public policy considerations and, therefore, the unconscionability exception can be recognised on a similar basis is acknowledged. However, arguing that due to recognition of the fraud exception having been supported by public policy considerations, unconscionability, which can also be supported on similar grounds, can, therefore, also be recognised, seems disingenuous. The fraud exception and the concept of an unconscionability exception to the autonomy principle are not so similar as to blindly warrant similar treatment.

The recognition of the fraud exception seems to be supported by reasonably discernible definitional parameters and uniformity of international recognition as an exception to the autonomy principle. Unconscionability, on the other hand, has been shunned as an exception to the autonomy principle under more mature legal systems in relation to demand guarantees, such as under English law. Even where it has been categorically recognised by statutes, such as under Australia's Competition and Consumer Act, legislators seem to have shied away from proffering a firm legislative definition of unconscionability or unconscionable conduct.[267] The difficulties of defining unconscionability, and its rather amorphous nature, render it an almost abstract notion without standalone status for the purposes of vitiating contracts and the like. Unconscionability seems to share a lot in common with the overarching equitable concept of bad faith/lack of good faith.

Definitive circumstances which may constitute bad faith or lack of good faith are challenging to exhaustively define, which issue also plagues the concept of unconscionability. This difficulty in establishing a firm definition has likely contributed to the uncertain status and role of bad faith or the absence of good faith under South African law. Bad faith or lack of good faith under South African law has been opined not to constitute an independent substantive rule that can justify intervention with contractual relationships but to be an abstract value which performs certain creative, informative and controlling functions through the established rules of the law of contract. In a similar vein, perhaps unconscionable conduct is best addressed within the existing frameworks of contractual and constitutionally underpinned public policy remedies instead of being recognised under South African law as a standalone exception to the autonomy principle.

Furthermore, the stringent requirements for establishing a public policy violation to justify court intervention with a contract or demand guarantee seem to be a reasonable median between a *laissez*

[267] See the discussion in sections 5.2.1.2 and 5.2.3 of Chapter 5 of this thesis regarding the recognition of statutory unconscionability in under Australian law and the absence of a clear statutory definition thereof.

faire recognition of an unconscionability exception on the one hand and a complete lack of recourse against unconscionable conduct on the other. More importantly, such an approach defers to the autonomy principle of demand guarantees. Considering this, addressing unconscionable conduct within the already-existing public policy framework instead of further eroding the autonomy principle by introducing a standalone unconscionability exception may be prudent.

All these options considered as a whole and considered against the backdrop of disadvantages of an unconscionability exception significantly erode the justification for a standalone unconscionability exception. It is submitted that the question of whether there would be sufficient value in recognising a standalone unconscionability exception to outweigh its inherent flaws cannot at this point be answered in the affirmative from a South African law perspective.

7.7.7 Recommendation on the Recognition of an Unconscionability Exception with Reference to the Australian Law Position

Although Australia, an interesting outlier on this topic, has incorporated an unconscionability exception which has been applied in respect of demand guarantees, it does not necessarily follow that the circumstances giving rise to such an approach in Australia apply uniformly and would yield the same benefits in a South African law context. It is submitted that in a South African context, the benefits of recognising an unconscionability exception to the autonomy principle of demand guarantees do not outweigh the disadvantages thereof. In respect of recognising the unconscionability exception to the autonomy principle, it would be prudent if South African law were to resist any urge to jump enthusiastically onto the bandwagon.

In the abstract, it is certainly agreed that parties that are guilty of unconscionable conduct in relation to demand guarantees should not be allowed to walk away unscathed. However, the unconscionability exception's inherent lack of clarity, coupled with the fact that it is a direct affront to the autonomy principle, is in the best interests of neither the beneficiary, the applicant and demand guarantee industry stakeholders generally. Overall, the cost-benefit analysis on the unconscionability exception under South African law does not seem to yield results favouring recognition of a standalone unconscionability exception to the autonomy principle of demand guarantees under South African law. To sum up, it is not recommended that South African law adopt the Australian law approach of recognising unconscionability as an exception to the autonomy principle, as the benefits thereof do not seem to outweigh the disadvantages it could bring from a South African law perspective. A significant portion of unconscionable conduct and at least the most serious cases thereof could be and perhaps already are caught and effectively

addressed by other already available remedies such as the fraud exception, applied broadly, contractual remedies (e.g., duress, undue influence and misrepresentation) and/or public policy considerations applicable specifically under South African law.

7.7.8 Recommendation on the Recognition of an Unconscionability Exception with Reference to the English Law Position

English law has long been an important reference point and plays an influential role in respect of South African law.[268] The position under English law seems to be a lack of general consensus among courts, scholars, relevant industry participants, and commentators regarding recognising unconscionability as an exception to the autonomy principle. This lack of unequivocal development and judicial will to do so one way or the other has left the unconscionability exception confined to the shadows of uncertainty, but even more importantly, no clear recognition at all. The English courts' have exhibited a low appetite for unconscionability as an exception to the autonomy principle, as evident from sparse consideration of unconscionability as an exception to the autonomy principle in the numerous cases in relation to documentary credits which have come before English courts.[269]

By declining or simply failing to unequivocally admit the unconscionability exception into the arena of recognised exceptions to the autonomy principle, English law seems to have rendered the verdict that the case against recognition of the unconscionability exception is much stronger than that advocating for the recognition thereof.[270] Further to looking to English law and its "hands-off" approach[271] for a cue on whether to recognise the unconscionability exception to the autonomy principle, South African law should go one step further and better by rather addressing the matter of unconscionability as an exception head-on when the opportunity presents itself, for example in the form of a case where the courts can make a firm declaration on the matter.

Rather than adopting the English law approach, which is open to potentially ambiguous interpretation and resultantly leaves some room to entertain an unconscionability exception, South

[268] Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 516.

[269] See, e.g., *Enka Insaat Ve Sanayi AS v Banca Popolare Dell'Alto Adige SpA* [2009] CILL 2777 (first instance) and *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC). See also Hooley, R and Sealy, L *Commercial Law: Text, Cases, and Materials*, Oxford University Press, 4 ed, 2009, at 867.

[270] "[The] policy reasons against recognition of the exception outweigh the reasons in favour of recognition and, therefore, English law should not adopt the exception" (Enonchong, *The Independence Principle of Letters of Credits*, at 169). See also Alavi, *Comparative Study of Unconscionability Exception*, at 112-113.

[271] Enonchong, *The Independence Principle of Letters of Credit*, at 180.

Africa could rather adopt a firm position when faced with an opportunity to decide whether or not unconscionable conduct constitutes or should constitute an exception. To date, a case in this regard has not been served before the South African courts. If it were to, South Africa should seize the opportunity to show global leadership on this issue, particularly by taking a clearer stance regarding the non-recognition of the unconscionability exception to the autonomy principle and the reasons thereof, which considerations this thesis seeks to contribute to.

7.8 CONCLUSIONS AND RECOMMENDATIONS IN RELATION TO THE BREACH OF A NEGATIVE STIPULATION EXCEPTION UNDER SOUTH AFRICAN LAW WITH REFERENCE TO ENGLISH LAW AND AUSTRALIAN LAW

7.8.1 Breach of a Negative Stipulation Exception as it has Developed So Far under South African Law

In line with the autonomy principle, it is correct that guarantors should not concern themselves with any dispute arising out of any possible breach of the underlying (or any other) contract.[272] A guarantor must be undeterred in meeting its payment obligations upon receipt of a compliant demand by a beneficiary and need not verify the validity of a demand or the existence or lack thereof of a breach of a contract by the principal. An interdict preventing a guarantor from honouring a demand is justified only where recognised true exceptions to the autonomy principle under South African law like fraud and illegality in an underlying contract are established.

The breach of a negative stipulation exception in the context of demand guarantees pits the terms of the underlying contract against the terms of the demand guarantee and the autonomy principle thereunder. Notwithstanding the entitlements conferred upon a beneficiary of a demand guarantee by virtue of the autonomy principle, sometimes a beneficiary may still agree to contractual terms in an underlying contract or elsewhere restricting their ability to call upon a demand guarantee. Typically, such a contract will outline specific circumstances or conditions that must be met in order for a beneficiary to be entitled to call up the relevant demand guarantee.

The breach of a negative stipulation exception questions whether a beneficiary who makes the informed decision to agree (whether in an underlying contract or otherwise) to contractual terms which fetter their right to draw on a demand guarantee should be permitted to make an about-turn by breaching those same terms in the name of autonomy principle. The premise upon which the

[272] Schulze, WG "Attachment *Ad Fundandam Jurisdictionem* of the Rights Under a Documentary Letter of Credit - Some Questions Answered, Some Questions Raised" (2000), 63, *THRHR*, 672, at 674.

breach of a negative stipulation exception is based, and rightly so, is that the answer to this question is no.

Applicants may insist on such restrictive terms to neutralise the bargaining power advantage of the beneficiary. A beneficiary may agree to such terms for several reasons, including incentivising the applicant to agree to the provision of a demand guarantee as a show of good faith and/or to avoid having to provide certain reciprocal assurances to an applicant, e.g., a counter-guarantee.[273] The autonomy principle should not be exploited as a refuge for unscrupulous beneficiaries seeking to avoid contractual terms to which they unequivocally agreed under any jurisdiction's laws, particularly South African law.

Despite heavy reliance on Australian law precedent by South African courts, as depicted in their remarks and findings, in key cases such as *Kwikspace Modular Buildings Limited v Sabodala Mining Company* (where the guarantees themselves were governed by South African law, but Australian law regulated the underlying contract),[274] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*,[275] *Eskom Holdings Soc Limited v Hitachi Power Africa (Pty) Ltd & Another*[276] and *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another*,[277] South African courts seem to recognise that the provisions of an underlying contract may qualify a beneficiary's right to call on a demand guarantee.[278]

As a general rule, courts would be disinclined to interfere with a demand guarantee or blithely make the decision to prevent a beneficiary from calling upon a bank guarantee. However, circumstances where a beneficiary has "made a contractual promise not to call upon the guarantee"[279] appear to be considered as an exception to this rule, particularly where the promise

[273] See section 3.3.3 of Chapter 3 which considers the rationale and role of the breach of a negative stipulation exception from both an applicant and a beneficiary's standpoint from a South African perspective.

[274] [2010] 3 All SA 467 (SCA).

[275] [2014] ZAGPPHC 695.

[276] [2013] ZASCA 101.

[277] 2021 (2) SA 137 (SCA).

[278] See *Eskom Holdings Soc Ltd v Hitachi Power Africa* [2013] ZASCA 101; *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695; and *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* 2021 (2) SA 137 (SCA).

[279] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 42.

is clear and express.[280] South African courts have lent impetus to the development and recognition of the breach of a negative stipulation as a ground to interdict the beneficiary from making a demand by establishing relatively consistent and discernible parameters regarding this via case law.

In line with the caveat noted, for instance, in *Kwikspace* and *Joint Venture* (i.e., that restrictive terms in the underlying contract must not be readily interpreted as conferring a right to restrain a beneficiary from making a demand on the basis that such a demand would be in breach of the underlying contract), courts would not, and indeed should not, lightly grant an interdict restricting the beneficiary from calling up a demand guarantee unless the negative stipulation and/or the breach thereof is undoubtedly clear from the relevant agreement. Therefore, only clear and express restrictions in a contract would likely be entertained by South African courts when considering whether a breach of a negative stipulation is a sufficient basis on which to grant an interdict preventing the beneficiary from making a demand.

Despite the significant strides made towards recognising a breach of a negative stipulation exception under South African law, it is still at a fledgling stage of development, and some uncertainty remains. A key question deficient of certainty is whether the breach of a negative stipulation has acquired enough traction and carries enough merit in a South African law context to be recognised definitively as a ground upon which courts will grant an interdict preventing a beneficiary from calling up a demand guarantee.

Cases such as *Joint Venture,* a recent leading South African law case, have raised some questions and/or left existing ones unanswered. It was recognised in *Joint Venture* that a clear express restriction in an underlying contract might be grounds for an interdict restraining a beneficiary from making a demand. However, the court did not, for instance, sufficiently clarify or explore whether such a scenario represents a true exception to the autonomy principle of demand guarantees.

While it may be a stretch to say that the recognition of the beach of a negative stipulation exception has fully matured in South Africa, South African law has progressed inexorably in the direction of fully recognising it. This position in favour of the exception is evident from the growing body of

[280] See *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture*, [2014] ZAGPPHC 695, para 42 and Kelly-Louw, M "Construing Whether a Guarantee is Accessory or Independent is Key", in Hugo, C and Kelly-Louw, M (eds) in *Jopie: Jurist, Mentor, Supervisor and Friend - Essays on the Law of Banking, Companies and Suretyship*, (eds), Juta, 2017, at 115.

case law supporting recognition of the breach of a negative stipulation exception.[281] Certain parameters of the breach of a negative stipulation exception appear to have expressly or implicitly been accepted by South African courts.

Whilst the South African case law as considered in this thesis hints at an outline of what recognising the breach of a negative stipulation exception would look like in South Africa, more defined guidance can be drawn from relevant jurisdictions such as Australia and England. The dependence on foreign law precedents by the Supreme Court of Appeal, as evidenced in the cases considered above, particularly Australian and English law, is further indicative of the need for greater certainty on the South African law position. This thesis, having taken into account the approaches adopted under English law and Australian law, draws on these laws to recommend the approach and parameters outlined below for the development of South African law in respect of the breach of a negative stipulation exception.

The impetus for recognition of the breach of a negative stipulation exception under South African law can be gleaned from Australian law, which has developed a prolific body of case law supporting this exception.[282] Similarly, English law appears to have embraced a breach of a negative stipulation exception and overall has consistently established a discernible position on this from early cases[283] through to later[284] and more recent[285] cases. Therefore, the answer to the question of whether a breach of a negative stipulating exception can plausibly and should be recognised under South African law can, with reference to Australian and English law, be

[281] See section 3.3 of Chapter 3 for a detailed analysis of South African case law on breach of negative stipulation exception.

[282] See *Pearson Bridge v State Rail Authority of New South Wales* (1982) 1 ACLR 81; *Tenore Pty Ltd v Roleystone Pty Ltd* (Unreported, NSW Sup Ct, Giles J, 14 September 1990); *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 BCL 210; *Selvas Pty Ltd v Hanson Yuncken Pty Ltd and State Bank of Australia* (1987) 6 ACLR 36; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451 and *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158.

[283] See *Doherty v Allman* [1878] 3 App Cas 709 and *Howe Richardson Scale Ltd v Polimex-Cekop and National Westminster Bank Ltd* [1978] 1 Lloyd's Rep 161.

[284] *Potton Homes Ltd v Coleman Contractors Ltd* (1985) 28 BLR 19; *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd and Others* [2003] 1 WLR 87 (first instance); [2003] 1 WLR 2214 (CA) and [2005] 1 All ER 191 (HL); *TTI v Hutchison 3G UK Ltd* [2003] EWHC 762 (TCC); and *Permasteelisa Japan KK v Bouvguesstroi and Banca Intesa SpA* 2007 EWHC 3508 (TCC).

[285] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC); *Doosan Babcock Limited v Comercializadora de Equipos y Materiales Mabe Limitada* 2013 EWHC 3201 (TCC); *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC); and *Shapoorji Pallonji and Company Private Ltd v Yumn Ltd* 2021 EWHC 862 (Comm).

answered in the affirmative.

Australia and England, being common-law jurisdictions with comparatively more matured laws in this regard, appear to have successfully implemented and continue to develop this exception in a manner that South African law can also do. It is submitted that keeping in stride with international laws regarding recognition of the breach of a negative stipulation exception puts South African law of demand guarantees at par with and not in danger of being left behind by other jurisdictions. The identification and plugging of loopholes such as an untenable degree of vulnerability of demand guarantees to abusive demands seems to be part of a natural evolution of demand guarantee law. Applicants, together with beneficiaries, are key parties that drive the use of demand guarantees. It stands to reason that, from an applicant's perspective, a demand guarantee governed by laws which recognise and curtail the potential for abuse of demand guarantees could prove more attractive.

While beneficiaries do not stand to benefit necessarily from recognition of the breach of a negative stipulation, and guarantors, though their position should be agnostic on the matter, would still prefer certainty generally, the breach of a negative stipulation exception arguably offsets or counter-balances key concerns from these quarters. For instance, signing up to a negative stipulation is elective on the part of a beneficiary, and the guarantor's role is totally unaffected by the enforcement of a negative stipulation as they are neither party/privy to it nor expected to derogate from the autonomy principle, which is also unaffected. The utility of demand guarantees in South Africa could well be reinforced by providing balanced recourse against abusive demands, which also constitute breach of contract, which recourse is provided by the breach of a negative stipulation exception.

Moreover, it is submitted that the pros and cons considered and assessed to ultimately justify recognition of a breach of a negative stipulation exception under both English law[286] and Australian law[287]are generally equally cogent in a South African law context. While these reasons, already included earlier in this thesis, are not repeated at this juncture, some key factors supporting and rationalising why recognising breach of a negative stipulation exception is compatible with and would complement instead of disrupt the current South African law of demand guarantees are explained below.

[286] See section 4.3.3 of Chapter 4.

[287] See section 5.3.3 of Chapter 5.

Moreover, the rules and parameters within which a breach of a negative stipulation exception can be implemented to optimise its benefits whilst buffering any potential adverse effects on demand guarantees. The factors that underpin their utility are outlined below with reference to English law and Australian law. South African courts have already commenced borrowing and gleaning guidance from some foreign law cases,[288] and the guidance drawn from Australia and England in this regard is a call to formalise and officially establish South African law tenets in relation to the breach of a negative stipulation exception.

7.8.2 Key Factors Rationalising and Supporting Recognition of the Breach of a Negative Stipulation Exception under South African Law

While the sanctity of the autonomy principle is well-established and should be respected, consideration of such conduct by a beneficiary has culminated in the emergence of a firm view that the autonomy principle should not be blindly applied or abused, particularly where it is qualified by agreed restrictive stipulations in the underlying contract or other contract terms by the beneficiary. The inappropriateness of such conduct by a beneficiary is further compounded by the fact that the breach of a negative stipulation exception has very little to do with the autonomy principle. As correctly asserted by Hugo, any litigation resulting from an applicant applying for an interdict against a beneficiary who has clearly agreed to meet certain conditions under the terms of a contract prior to calling up a demand guarantee has no bearing on the principle of independence.[289] The mischaracterisation of breach of a negative stipulation is thus perpetuated by regarding it as an exception to the autonomy principle.

It is submitted that the enforcement of a restrictive clause in an underlying contract (or perhaps elsewhere) against a beneficiary is neither inimical to nor a derogation from the autonomy principle. Rather, the enforcement of a negative stipulation lends itself to the application within the framework of the autonomy principle. Although a contractual restriction on a beneficiary calling up a demand guarantee has been given the moniker breach of a negative stipulation exception or even referred to as an exception to the autonomy principle, strictly speaking, it is submitted that this is a misnomer. As it is not an exception to the autonomy principle, referring to it as such (i.e., with reference to the autonomy principle) is simply incorrect.

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[288] See, e.g., *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695 and *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA).

[289] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

To most people, the term "exception", when used in the context of demand guarantees, conjures a contemplation of a derogation from the autonomy principle, but in the context of the breach of a negative stipulation exception, this is not the case. However, the breach of a negative stipulation can be argued to be a *quasi*-exception in the sense that it essentially wields power to short-circuit the mechanism by which the payment obligation of the guarantor under the demand guarantee is ultimately triggered. Even though it does not interfere with the autonomy principle, it can plausibly, and for the sake of uniform taxonomy and familiarity of terminology built by common usage, be referred to as a breach of a negative stipulation exception (as opposed to breach of a negative stipulation exception to the autonomy principle). This terminology can also be justified on the technicality that it is an exception to the beneficiary's entitlement to lodge a demand that triggers the guarantor's payment obligation under the demand guarantee pursuant to the autonomy principle.

Furthermore, the breach of a negative stipulation exception is aligned with the constitutional right to contract freely. It is submitted to be in alignment with the *pacta sunt servanda* principle in the sense that where a beneficiary exercises their freedom to enter into a contract restricting their entitlement to call up a demand guarantee, then freedom of contract must be upheld in the same way it would for any contract. A beneficiary is free to enter into any contract, including one which fetters his right to call up a demand guarantee and must not be permitted to flout the terms of such a contract with impunity. Noting that the enforcement of a negative stipulation is firmly in step with freedom of contract (including any restrictive contracts that a beneficiary may agree to), courts should recognise that a beneficiary's right to call on a demand guarantee may be restricted under the terms of an underlying or other contract the beneficiary has entered into freely. The courts appear to have started doing so already.

It is acknowledged that there may be circumstances in which the breach of a negative stipulation plausibly overlaps with or is subsumed by the fraud exception.[290] Fraud and breach of a negative stipulation can, for instance, intersect where there is fraudulent breach of contract.[291] Despite these limited circumstances of intersection, fraud and breach of a negative stipulation are typically

[290] See section 3.3.2 of Chapter 3 for a full discussion of the potential overlap and divergence of fraud and breach of a negative stipulation.

[291] See *Union Carriage and Wagon Co Ltd v Nedcor Bank* 1996 CLR 724 (W), and contrast with *Phillips v Standard Bank* 1985 (3) SA 301 (W) and *ZZ Enterprises v Standard Bank of South Africa Ltd* 1995 CLD 769 (W) regarding innocent breach of contract not constituting fraud.

distinct from each other.[292] The breach of negative stipulation warrants consideration as a standalone ground for an interdict preventing a beneficiary from calling up a demand guarantee under South African law.

7.8.3 Conclusions and Recommendations on the Appropriate Approach and Parameters for the Development of the Breach of a Negative Stipulation Exception under South African Law

The significantly more mature recognition of the breach of a negative stipulation exception in English and Australian law provides insight into what the future South African law of demand guarantees could look like. It also shows where South African law of demand guarantees in respect of a breach of a negative stipulation may converge with or diverge from these leading common-law jurisdictions. Key areas of particular note are set out below.

7.8.3.1 Position and Recommendation regarding the Distinction between Restraining a Guarantor and Restraining the Beneficiary

Two possible approaches can be considered in respect of breach of a negative stipulation by South African courts. A breach of a negative stipulation may be considered as a defence or ground upon which a guarantor can be prevented from rendering payment under a demand guarantee. Alternatively, breach of a negative stipulation may be considered as simply a ground for an interdict blocking a beneficiary from making a demand, which has no interaction *per se* with the autonomy principle.

Therefore, a key distinction is drawn between restraining a guarantor from honouring a demand guarantee and restraining the beneficiary from calling upon it. The former entails restraining the bank from complying with its payment obligations in terms of the demand guarantee. The latter is where an applicant/principal seeks to prevent the beneficiary from breaching a provision of a contract (i.e., a negative stipulation), typically the underlying contract,[293] which restricts the entitlement of a beneficiary to call up the demand guarantee, e.g., by making it subject to certain conditions. Restraining a beneficiary from calling upon a demand guarantee to enforce a negative stipulation agreed to by the beneficiary is perceived as giving effect to a contract entered into by

[292] See section 3.3.2 3.2.2 of Chapter 3 and in particular the *Phillips v Standard Bank* 1985 (3) SA 301 (W) and *ZZ Enterprises v Standard Bank of South Africa Ltd* 1995 CLD 769 (W) cases.

[293] *Kwikspace Modular Buildings Limited v Sabodala Mining Company* [2010] 3 All SA 467 (SCA), para 9, citing *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, at 826.

and binding upon the beneficiary. It is not considered to have an adverse impact, or indeed any impact, on the autonomy principle. In contrast, an interdict preventing a guarantor from making payment under a demand guarantee, on the other hand, is considered to be a direct affront to the autonomy principle.[294] Although South African courts have yet to make an unequivocal pronouncement on this matter, it is submitted that the latter approach has a more feasible legal rationale.

This approach is further supported and applied under English law where it is recognised that enjoining a beneficiary from breaching a negative stipulation has no impact on the autonomy principle, whereas enjoining a guarantor from payment would breach the autonomy principle.[295] Similarly, under Australian law, the breach of a negative stipulation exception is only recognised as against the beneficiary and not the issuer of a demand guarantee, and it is not accepted as a justification for interference, by injunction or otherwise, with the issuer's obligation to pay upon being presented with a compliant demand under a demand guarantee. The Australian formulation of a breach of a negative stipulation exception also contemplates that a beneficiary (as opposed to a guarantor) may be enjoined from calling up a demand guarantee or other documentary credit where they are contractually bound not to do so except upon the occurrence of certain events.[296] This English law and Australian law formulations of the breach of a negative stipulation exception, which both espouse an anti-beneficiary injunction, as opposed to an anti-guarantor injunction, are submitted to provide a blueprint of the appropriate approach for South African law. In summation, it is recommended that South African law should not accept a breach of a negative stipulation as an exception to the autonomy principle (i.e., a true exception) that would operate against the guarantor meeting its payment obligations under a demand guarantee. Should an applicant raise the breach of a negative stipulation as a ground for an interdict injunction against a guarantor to prevent the payment from being made under a demand guarantee, such an argument must fail, and a compliant demand honoured.

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[294] Hugo, *Protecting the Lifeblood of Commerce*, at 672.

[295] Enonchong, *The Problem of Abusive Calls on Demand Guarantees*, at 89. See also Kelly-Louw and Fayers, *The Breach of a Negative Stipulation*, at 526-529.

[296] See *Pearson Bridge v State Rail Authority of New South Wales* (1982) 1 ACLR 81; *Tenore Pty Ltd v Roleystone Pty Ltd* (Unreported, NSW Sup Ct, Giles J, 14 September 1990); *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 BCL 210; *Selvas Pty Ltd v Hanson Yuncken Pty Ltd and State Bank of Australia* (1987) 6 ACLR 36; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451; and *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158.

7.8.3.2 Recommendations regarding the Difference between an Express Negative Stipulation Exception and an Implied Negative Stipulation

Another significant distinction recognised in relation to breach of a negative stipulation exception is between express restrictions on a beneficiary's right to draw on a demand guarantee and implied restrictions. In addition to being significantly more difficult (not impossible, though, it would seem) to establish, the latter would likely not be enforced by South African courts where they would be inconsistent with the purposes of the relevant demand guarantee. However, implied or tacit restrictions have not been outrightly dismissed.[297] However, the circumstances in which courts may consider implicit/tacit restrictions on a beneficiary's entitlement to call up a demand guarantee as grounds for an interdict are unclear.

The recognition of a breach of a negative stipulation exception under English law is mainly premised on and strongly prefers express negative stipulations which are clear and unambiguous[298] instead of implied negative stipulations.[299] Despite the marked preference for express negative stipulations and increased difficulty of establishing the breach of a negative stipulation exception on the basis of an implied negative stipulation, the latter has not been dismissed outrightly under English law and may, in some instances, suffice to establish the exception.[300] Australian law has adopted a similar stance regarding express versus implied negative stipulations. The preference under Australian law is for an express negative stipulation, while the implied stipulation is recognised to be significantly more difficult to establish for the exception[301] but also acknowledged, in theory, to be potentially sufficient in certain circumstances.[302] The South African case of *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture*[303] seems to indicate the gravitation of South African law towards adopting a similar approach as

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[297] *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* [2014] ZAGPPHC 695.

[298] Hugo, *Protecting the Lifeblood of Commerce*, at 674.

[299] See section 3.3.8.3 of Chapter 4. See also *Deutsche Ruckversicherung Aktiengeslleschaft v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 and Horowitz, *Letters of Credit and Demand Guarantees*, at 142.

[300] *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC), para 37.

[301] *Fletcher Construction Australia Ltd v Varnsdorp Pty Ltd* 1998 3 VR 812, 826-827, citing *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1161-1162.

[302] *Australian Winch and Haulage Co Pty Ltd v Walter Construction Group Ltd* [2002] FCA 1181; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158; and *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812.

[303] [2014] ZAGPPHC 695.

under English and Australian law.

However, it is submitted that a more cautious or conservative approach should be considered when it comes to implied negative stipulations. The pitfalls of implied terms in the law of contract generally include, in particular, uncertainty and the potential proliferation of litigation. Such pitfalls would likely apply equally but are felt more sharply in respect of demand guarantees, given that certainty is one of the lifelines to their commercial utility. In this regard, South Africa has an opportunity to forge its own pathway by applying the breach of a negative stipulation exception within more restricted and certain parameters, which may prove more effective for the South African law of demand guarantees.

This could be avoided by restricting the recognition of a breach of a negative stipulation exception under South African law to express negative stipulations. In addition to alleviating concerns around uncertainty which are triggered in any considerations relating to an additional exception in relation to demand guarantees, the requirement for an express negative stipulation may encourage parties to be explicit and clear as to their intentions, thereby lessening the interpretive burden and opportunities to trip up in inconsistencies, on the courts.

7.8.3.3 Recommendations regarding the Document in which the Negative Stipulation is Located

It seems to be more typical for a negative stipulation to be incorporated into an underlying contract as opposed to elsewhere. However, it appears to be generally accepted that a negative stipulation restricting a beneficiary from calling on a demand guarantee can be located in either the underlying contract (i.e., the contract giving rise to the demand guarantee or the obligations secured by the demand guarantee) or in a separate contract/agreement. The distinction between a negative stipulation housed in an underlying contract and one which is in a separate agreement or elsewhere is seemingly not one belaboured by South African courts. It appears to also be the case under English law and Australian law. However, this may simply be because the majority of restrictions in cases considered by the courts so far were generally incorporated in the underlying contract.

It is submitted that generally, an express negative stipulation in any contractually binding document would suffice for purposes of the breach of a negative stipulation exception. For implied negative stipulations, if they are accepted, despite the earlier recommendation not to do so, the matter of the location of the stipulation is arguably too abstract to be of much consequence. The material factors are merely ascertainment that there is indeed a negative stipulation which is binding on the beneficiary and that the beneficiary is in breach of it. It should, however, be

cautioned that if a negative stipulation were to be included in the demand guarantee itself, it would have the effect of converting the demand guarantee into a conditional guarantee or other instrument such as a suretyship agreement, which would fall outside the focus of this thesis.[304]

7.8.3.4 Recommendation regarding the Standard of Proof required for the Breach of a Negative Stipulation Exception under South African Law

The requirement for the highest standards of proof and satisfaction of the balance of convenience test to justify an interdict/injunction against a beneficiary in the implementation of a breach of a negative stipulation exception is an effective way to, *inter alia*, counter-balance some concerns regarding a *laissez-faire* application of the exception eroding the commercial utility of demand guarantees. The balancing of competing interests, such as the need to keep in step with the progressive development of international demand guarantee laws and initiatives introduced to combat abuse of demand guarantees and the preservation of the autonomy principle of demand guarantees, is important. Without such a balance being maintained, demand guarantees may lose their status as a bastion of international trade.

The precise standard of proof required for South African courts to grant an interdict to restrain a beneficiary from calling up a demand guarantee on the basis of a restrictive stipulation is a *lacuna* yet to be hashed out by the courts. The standard of proof required to establish the breach of a negative stipulation exception is an area that remains devoid of certainty.[305] Some hold the view that the balance of probabilities standard applied in civil cases is sufficient,[306] while others contend that a stricter standard than this is requisite or more appropriate for the breach of a negative stipulation exception.[307] It is submitted that the argument for a stricter standard of proof is more aligned with the nature of demand guarantees and their enhanced need to be governed within a

[304] See *Eskom Holdings Soc Limited v Hitachi Power Africa (Pty) Ltd & Another* [2013] ZASCA 101 and *Minister of Transport and Public Works, Western Cape, & Another v Zanbuild Construction (Pty) Ltd & Another* 2011 (5) SA 528, which cases, although not involving a negative stipulation in the relevant instrument or guarantee, underscore the distinction between a demand guarantee (primary obligation) and a conditional guarantee or suretyship (accessory liability) and the importance of language in the document itself in determining the true nature of an instrument. See also *Minister of Transport and Public Works, Western Cape, and Another v Zanbuild Construction (Pty) Ltd and Another* 2011 (5) SA 528 (SCA); *Mutual and Federal Insurance Company Limited and Another v KNS Construction (Pty) Limited and Another* [2016] ZASCA 87; and *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd & Others* 2001 (2) SA 760 (C).

[305] Oelofse, AN *The Law of Documentary Letters of Credit in Comparative Perspective,* 1 ed, Interlegal,1997, at 480.

[306] *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA), para 18.

[307] Kelly-Louw, *Selective Legal Aspects of Bank Demand Guarantees*, at 252.

framework of as much certainty as possible.

English law seems to favour the enhanced merits test, which requires the beneficiary's lack of an honest belief as to their entitlement to make a demand to be positively or clearly established.[308] It is also required that the balance of convenience is established to be in favour of the applicant seeking the injunction. The enhanced merits test endorsed under English law seems to, quite rightly, recognise the obvious requirement of a higher standard of proof when it comes to the breach of a negative stipulation case concerning demand guarantees. In addition to the balance of convenience test[309]and the requirement of evidence regarding the loss sustained as a result of the beneficiary's conduct, which have been applied under Australian law, the standard of proof required for an injunction on the basis of a breach of a negative stipulation exception has evolved over time. Earlier Australian law cases seem content with "a serious issue to be tried",[310] while later cases require the higher standard of a "seriously arguable" case.[311] Such standards and requirements can be said to facilitate the application of the breach of a negative stipulation exception within reasonable parameters and impede its use in an abusive or specious manner. South Africa may be able to take a lesson from this. Adopting a similarly enhanced standard for breach of a negative stipulation exception in relation to guarantees may be the most appropriate course in which to develop the South African law standard of proof in this regard.

In respect of the breach of a negative stipulation exception, South Africa can, therefore, learn from England and Australia and co-opt the best elements from each of these jurisdictions for its own optimum application of the exception. Beneficiaries should not be allowed to effectively press-

[308] *MW High Tech Projects UK Limited v Biffa Waste Services Ltd* 2015 EWHC 949 (TCC). See the more detailed discussion of the standard of proof required for the breach of a negative stipulation exception in section 4.3.8.3 of Chapter 4.

[309] See, e.g., *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404 and *Boral Formwork v Action Makers* [2003] NSWSC 713, paras 12-14.

[310] See, e.g., *Pearson Bridge Pty Ltd v State Rail Authority of New South Wales* (1982) 1 Aust Constr LR 81; *Selvas Pty Ltd v Hansen & Yuncken* (SA) Pty Ltd (1987) 6 ACLR 36; *J H Evans Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (Unreported NT Supreme Court, 30 January 1989); and *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451. However, some later cases seem to have continued in step with this early case law standard by referencing the requirement for a, "serious issue to be tried", for example *Kirfield Ltd v First Trade Consulting Pty Ltd* [2005] WASC 82; *Marson Constructions Australia Pty Ltd v Hillcrest Manor Pty Ltd* (27 February 2000) [2000] VCAT 29; *H Troon v Marysville Hotel and Conference Centre* [2017] VSC 470; and *Siemens v Bulgana* [2019] VSC 771 (27 November 2019).

[311] See, e.g., *Rejan Constructions Pty Ltd v Manningham Medical Center Pty Ltd* [2002] VSC 579; *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2009] NSWSC 439; *Patterson Building Group Pty Ltd v Holroyd City Council* [2013] NSWSC 1484; *Duro Felguera Australia Pty Ltd v Samsung C&T Corporation* [2016] WASC 119; and *Ecap Finance Pty Ltd v Ottoway Engineering Pty Ltd (No 2)* [2017] FCA 237 in which the requirement for a "serious arguable" case or issue was referenced and/or considered.

gang the autonomy principle into helping them in carrying out abusive conduct in relation to demand guarantees. Failure to develop and maintain South African law of demand guarantees in line with international developments, e.g., the solution of an anti-beneficiary injunction to the problem of unscrupulous beneficiaries seeking to evade their contractual obligations, may leave the door open for exploitation of demand guarantees, and undermine their utility under South African law. With this in mind, unequivocal recognition of the breach of a negative stipulation exception under South African law would likely be welcomed by many.

7.9 CONCLUSIONS AND RECOMMENDATIONS IN RELATION TO UNCONSCIONABILITY AND A BREACH OF A NEGATIVE STIPULATION EXCEPTION UNDER SOUTH AFRICAN LAW WITH REFERENCE TO THE UNCITRAL CONVENTION

7.9.1 UNCITRAL Convention: Brief Overview, Interaction with relevant International Rules and Approach to Exceptions

7.9.1.1 Overview

The UNCITRAL Convention came into force on 1 January 2000 following approval, ratification, acceptance and/or accession by the requisite minimum of 5 nations.[312] It can apply to both demand guarantees and letters of credit[313]and takes effect in contracting states.[314] The UNCITRAL Convention codifies, *inter alia*, the autonomy principle in a legally binding manner.[315] However, the UNCITRAL Convention seems to have had limited effectiveness due to not being ratified by enough countries,[316] although the option remains for any parties to elect its application to their

[312] See https://uncitral.un.org/en/texts/payments/conventions/independent_guarantees (accessed on 5 February 2022).

[313] See UNCITRAL Convention, Articles 1(1) and 2(1). For consideration of the scope of application and form of the instruments to which the UNCITRAL Convention was intended to apply, see also Herrmann, G "Salient Features of the UNCITRAL Bills and Notes Convention", 273, at 273-275, in Effros, RC, *Current Legal Issues Affecting Central Banks*, Volume III, I*nternational Monetary Fund*, 1995.

[314] UNCITRAL Convention, Article 26.

[315] Herrmann, G "The UNCITRAL Draft Convention on Independent Guarantees and Stand-by Letters of Credit", (1994), *Attorney General's Department and Law Council of Australia Twenty First International Trade Law Conference*, 325, at 326. See also UNCITRAL Convention, Articles 6(c) and 6(e).

[316] To date, the Convention was ratified/acceded to by the following countries only: Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia. The United States of America has signed the Convention but, to date, has not yet acceded to it. See https://uncitral.un.org/en/texts/payments/conventions/independent_guarantees/status (accessed on February 2022).

instruments.[317] Neither England, Australia, nor South Africa has ratified or acceded to the UNCITRAL Convention.

7.9.1.2 The Relationship between the Convention and Rules of Practice

Article 13(2) of the UNCITRAL Convention provides that generally accepted international rules and usage of demand guarantees or standby letters of credit practice could be turned to for interpretive guidance for matters not covered in the relevant instrument or the UNCITRAL Convention.[318] The inclusion of such provisions has been lauded as a flexible approach which enables the UNCITRAL Convention to keep in step with developments in the UCP, URDG and ISP98.[319]

7.9.1.3 Key provisions in Article 19 of the UNCITRAL Convention and Exceptions Generally

Articles 15, 19 and 20 of the UNCITRAL Convention are the key provisions addressing exceptions in relation to demand guarantees by outlining the circumstances in which payment under a documentary credit can be prevented and provisional measures that can be taken.[320] Exceptions to the autonomy principle which are recognised under the UNCITRAL Convention fall into three main categories: where it is "manifest and clear" that the document is not genuine or has been falsified;[321] where payment is not due on the basis asserted in the demand and the supporting documents;[322] or judging by the type and purpose of the relevant undertaking, the demand has no conceivable basis.[323] The term "no conceivable basis" is further explained, broadly speaking, to cover scenarios ranging from non-materialisation of events secured against the demand guarantee; invalidity of the underlying obligation or alternatively satisfactory fulfilment or nonfulfillment thereof caused by the beneficiary's conduct; or, in respect of counter-guarantees, payments made

[317] Alawamleh, *Documentary Credits and Independent Guarantees*, at 55.

[318] Ibid.

[319] Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 36.

[320] Alavi, H "Remedies to Fraud in Documentary Letters of Credit: A Comparative Perspective" (2016), v(1), *EU Agrarian Law*, at 3-4 and 11.

[321] UNCITRAL Convention, Article 19(1)(a).

[322] UNCITRAL Convention, Article 19(1)(b).

[323] UNCITRAL Convention, Article 19(1)(c).

in bad faith by the beneficiary of a counter-guarantee.[324]

The association of both fraud and unconscionability with public policy related elements such as bad faith indicates common ground between the two, which seems to also be supported by the reference to bad faith/good faith in Articles 15(3), 19(1) and 19(2)(e) of the UNCITRAL Convention. There are bad/good faith considerations in the UNCITRAL Convention, which may possibly also encompass a breach of a negative stipulation exception in certain circumstances, e.g., fraudulent breach of contract. Only fraudulent demands for payment are implicitly covered therein by reference to falsified or ingenuine documents, but other exceptions, unconscionability and breach of a negative stipulation exception, may also be considered within the framework of these provisions. Despite not using the terms unconscionability exception and/or breach of a negative stipulation exception (or underlying contract exception) expressly, the UNCITRAL Convention could be argued to recognise both the unconscionability exception, including associated or overarching equitable notions such as good faith and the breach of a negative stipulation exception, within the parameters outlined in Article 19.

7.9.2 Summary of the Breach of a Negative Stipulation Exception Considered within the Framework of the UNCITRAL Convention and from a South African Law Perspective

The breach of a negative stipulation exception is not referenced explicitly in the UNCTRAL Convention. However, Article 19 incorporates some elements which may, in practice, constitute the breach of a negative stipulation exception as summarised above.[325] Article 19(2) of the UNCITRAL Convention outlines what is meant by the phrase "no conceivable basis" in respect of a demand and includes a situation of non-materialisation of the contingency or risk secured against it.[326] This could be construed to encompass a breach of a negative stipulation exception as it is not unusual for the contingency or risk against which a demand guarantee is issued to secure to be ensconced in an underlying or other contract whose terms restrict a demand from being made unless the stipulated contingency or risk has materialised.[327] This ties in with the rather common

[324] Article 19(2).

[325] See section 6.3.7 of Chapter 6.

[326] UNCITRAL Convention, Article 19(2)(a).

[327] See, e.g., the South African case of *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* 2021 (2) SA 137 (SCA), in which *obiter* remarks

requirement for a demand to include or be accompanied by a statement indicating that a default has occurred. Such a statement of default is akin to a declaration that the contingency or risk secured against it has materialised as contemplated in Article 19(2)(a) of the UNCITRAL Convention.

An aspect of Articles 19(1)(c) and 19(2)(a) of the UNCITRAL Convention which attracts critical scrutiny is the issue of how an issuer/guarantor is expected to determine that the relevant default or contingency secured against it has not materialised for the purposes of establishing an exception. The UNCITRAL Convention is silent as to the person upon whom the duty falls to establish whether or not the secured risk has occurred, and this could be construed as an invitation for guarantors to meddle with underlying contract matters. The onus seems to be placed on an applicant to look beyond the demand guarantee and investigate extraneous circumstances to establish the occurrence of the default giving rise to a claim. Such an approach would be contrary to the well-established autonomy principle of demand guarantees and the manner in which it is understood and applied, including under South African law.

The possible breach of a negative stipulation exception formulation under the UNCITRAL Convention is notably in the form of a true exception, being one which would be seen to justify an anti-guarantor or anti-payment injunction. This is diametrically opposed to the traditionally recognised quasi-exception formulation of the exception (i.e., based on an anti-beneficiary or anti-demand injunction), which is also the formulation emerging and arguably maturing towards recognition under South African law. Due to material differences such as these, the approach of the UNCITRAL Convention to exceptions, including any exceptions resembling a breach of a negative stipulation exception, is submitted to be incompatible with South African law of demand guarantees. The approach of the UNCITRAL Convention directly overthrows the autonomy principle and is incompatible with the formulation of the breach of a negative stipulation exception under South African jurisprudence. The formulation of a breach of a negative stipulation exception, which is emerging and is endorsed for broad general adoption under South African law in this thesis, seems to largely agree with the view that the enforcement of a negative stipulation has no bearing on the autonomy principle.[328]

indicated support for a breach of a negative stipulation exception where the conditions stipulated in the underlying contract for a demand had not been met.

[328] Hugo, *Protecting the Lifeblood of Commerce*, at 674. See the brief discussion of Hugo's comments and the interaction (or lack thereof) of the enforcement of a negative stipulation preventing a beneficiary from making a demand, and the autonomy principle, in section 3.3.4.4 of Chapter 3 of this thesis.

7.9.3 Summary of Unconscionability and Bad Faith Considered within the Framework of the UNCITRAL Convention and from a South African Law Perspective

Although it does not expressly use the term unconscionability, Article 19 of the UNCTRAL Convention incorporates some grounds for an exception to the autonomy principle, which may meet the criteria for and constitute unconscionable conduct. Certain provisions under Article 19 of the UNCITRAL Convention could easily fit under the umbrella of unconscionability exception. An example of this is making a demand where no payment is due on the basis asserted in the demand and supporting documents, per Article 19(1)(b). Moreover, a beneficiary making a demand which has no conceivable basis as contemplated in Article 19(1)(c) of the UNCITRAL Convention[329] may also constitute unconscionable conduct. Article 19(2) further breaks down circumstances in which a demand is considered to have no conceivable basis, including, without limitation, where, subject to the terms of the undertaking, the underlying obligation of an applicant has been declared invalid by a court or arbitral tribunal, and where the beneficiary's wilful misconduct prevented the fulfilment of the underlying obligation.[330]

Some of the points considered to constitute a "no conceivable basis" exception under Article 19 of the UNCITRAL Convention, e.g., invalidation of an underlying obligation via litigation or an arbitration ruling, depict a line of thought that, with selective reference to some South African cases, seems to have been rejected under South African law.[331] Certain exceptions under Article 19 of the UNCITRAL Convention may be incompatible with South African law as they seem to align with approaches pondered and dismissed in South African cases, such as whether an adverse arbitral ruling against a beneficiary can justify this non-payment under a demand guarantee.[332]

In certain provisions of the UNCITRAL Convention, bad faith, or the absence of good faith, seems to be recognised by the UNCITRAL Convention as an overarching notion[333] that usually indicates

[329] UNCITRAL Convention, Articles 19(1)(c).

[330] See Article 19(2)(b) and 19(2)(d) of the UNCITRAL Convention. See also section 6.3.6 in Chapter 6 of this thesis for a fuller consideration of unconscionability exception in the context of Article 19 of the UNCITRAL Convention.

[331] See section 6.3.6.1 of Chapter 6 of this thesis for a comparative consideration of the unconscionability exception under the UNCITRAL Convention and selective South African case law.

[332] Refer to *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA), paras 23-25. See also other cases referenced in section 6.3.6 of Chapter 6 of this thesis which roundly oppose, or support rejection of, the majority ruling in *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 (1) SA 70 (SCA).

[333] See Articles 15(3) and 19(1) of the UNCITRAL Convention.

one of the exceptions to the autonomy principle established under the UNCITRAL Convention.[334] For instance, Article 19(2)(e) of the UNCITRAL Convention seems to elevate the concept of bad faith to a potentially standalone exception to the autonomy principle on the basis that it shows that a demand has no conceivable basis. This ambiguity regarding whether bad faith is an overarching notion or a standalone recognised exception to the autonomy principle is a phenomenon which is present in both South African law and the UNCITRAL Convention. The UNCITRAL Convention, however, could possibly be seen to lean more towards treating bad faith as a potential standalone exception.

The UNCITRAL Convention's seeming openness to recognising bad faith as a standalone exception to the autonomy principle of demand guarantees[335] is at odds with the status of bad faith under South African law of demand guarantees, which is, for the most part, that of an abstract notion and has not been encouraged as a standalone exception to the autonomy principle.[336] Where bad faith was mooted as a potential exception to the autonomy principle in South Africa, it has generally not received a warm reception.[337] Critics have pointed to a lack of certainty on the role of good faith/impact of bad faith in the law of demand guarantees and that recognition thereof as an exception to the autonomy principle is inconsistent with the supremacy of the autonomy principle under South African law.[338]

While South Africa's common law of demand guarantees can be developed further along similar lines as the UNCITRAL Convention, or alternatively overridden by application of the UNCITRAL Convention codified law if South Africa was to accede to it, this may entail too radical a change in a manner ill-suited to the South African context as discussed in previous chapters and summarised in this chapter.[339] The UNCITRAL Convention, when broadly compared to the

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[334] Article 19(1).

335 Article 19(2)(e) of the UNCITRAL Convention. See also Article 15(3) of the UNCITRAL Convention.

[336] See the consideration and criticisms against, for instance the *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695 case in section 3.2.6 of Chapter 3.

[337] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695. For a more detailed consideration of the unconscionability exception and good faith under South African law, see section 3.2.6 of Chapter 3.

[338] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695. For a more detailed consideration of the unconscionability exception and good faith under South African law, section 3.2.6 of Chapter 3.

[339] See section 6.3.6.1 of Chapter 6 of this thesis for a comparative consideration the unconscionability exception under the UNCITRAL Convention and selective South African case law and consideration of areas of divergence between Article 19 of the UNCITRAL Convention and selective South African case law. See also Chapter 3 generally

current South African common law regarding exceptions to the autonomy principle, particularly in relation to conduct which may be unconscionable or in bad faith, appears to take a much more liberal line towards exceptions. This, it is submitted, limits the utility and compatibility of the UNCITRAL Convention's framework for exceptions in relation to the law of demand guarantees in a South African law context.

7.9.4 Brief Summary regarding Potential Remedies Available where Exceptions to the Autonomy Principle are Established under Article 19 of the UNCITRAL Convention

Articles 19(3) and 20 of the UNCITRAL Convention provide the options or provisional court measures for recourse available to the aggrieved party, typically the applicant. These include a provisional order preventing payment by the issuer/guarantor from honouring the demand for payment, blocking the proceeds paid to the beneficiary on the basis of the grounds outlined in Article 19 of the UNCITRAL Convention, as well as cases involving undertakings for a criminal purpose.[340] When considering a provisional order, the court is required to consider whether the applicant would be "likely to suffer serious harm" if it was denied, and where the court determines it appropriate, security may be required from the person applying for the provisional order.[341] Article 20 of the UNICITRAL Convention seems agnostic to the distinction between injunctions against banks and those against beneficiaries. [342]

7.9.5 Recommendations and Some Key Take-Aways in respect of the UNCITRAL Convention and Exceptions to the Autonomy Principle

Despite not referring to the unconscionability exception and/or the breach of a negative stipulation

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for a full discussion of the South African law position on the unconscionability and breach of a negative stipulation exceptions as demonstrated by case law. The incompatibility between the UNCITRAL Convention's approach to exceptions to the autonomy principle and that under South African law is also referenced and concluded upon in this Chapter.

For a more detailed consideration of the unconscionability exception and good faith under South African law, see section 3.2.3 of Chapter 3.

[339] *Sulzer Pumps (South Africa) (Proprietary) Ltd v Covec-MC Joint Venture* [2014] ZAGPPHC 695. For a more detailed consideration of the unconscionability exception and good faith under South African law, see section 3.2.6 of Chapter 3.

[340] UNCITRAL Convention, Articles 19(3), 20(1) and 20(3); and Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, Note 49.

[341] Ibid; and see Article 19(2) of the UNCITRAL Convention.

[342] See also *Groupe Josi Re v Walbrook Insurance* [1996] 1 Lloyd's Rep 345.

exception (or underlying contract exception) expressly, the UNCITRAL Convention could be said to recognise some guises of these exceptions within the parameters outlined in Article 19. In the case of the unconscionability exception, the notion of its recognition in the UNCITRAL Convention is especially supported by references to associated or overarching equitable notions such as good faith in the UNCITRAL Convention.

Neither England, Australia, nor South Africa has ratified or acceded to the UNCITRAL Convention. The UNCITRAL Convention is, however, still worth considering for any guidance it may have to offer in respect of exceptions to payment under demand guarantees and other documentary credits. By addressing potential exceptions to the autonomy principle, the UNCITRAL Convention provides a laudable regulatory framework, particularly when compared to rules such as the UCP 600, which are silent on the subject.[343] Diverging from the hands-off approach of other rules on the subject of exceptions to the autonomy principle, the UNCITRAL Convention adopts an explicit head-on approach to the fraud exception.[344] Some commentators have taken a more measured position, asserting that the UNCITRAL Convention took a "middle way" by not ignoring the topic of exceptions altogether but not imposing the arguably onerous provisions to address matters like fraudulent conduct such as the provisions in the URCG.[345] The approach adopted by the UNCITRAL Convention has been averred to "constitute a good barometer of international consensus on the topic of fraud".[346] However, the impact of the protections in the UNCITRAL Convention is limited by its low uptake by countries.

Approaches that can be taken under South African common law of demand guarantees regarding the UNCITRAL Convention include development to bring common law more in line with the UNCITRAL Convention, subject to modifications as considered necessary to suit a South African law context. Another option would be to consider codifying South African law altogether, but as that was not the focus of this thesis, further exploration of this falls well beyond the scope of this thesis. In this thesis, attention was directed at considering only a few provisions of the UNCITRAL convention, centralised around how it deals with selective exceptions to the autonomy principle. The thesis did not focus on the UNCITRAL Convention as a whole, so to recommend an adoption

[343] Goode, R *Transnational Commercial Law - International Instruments and Commentary*, 1 ed, Oxford University Press, 2004, at 341.

[344] Alawamleh, *Documentary Credits and Independent Guarantees*, at 54, with reference to Articles 19 and 20 of the UNCITRAL Convention.

[345] Alawamleh, *Documentary Credits and Independent Guarantees*, at 54.

[346] Mugasha, A *The Law of Letters of Credit and Bank Guarantees*, 1 ed, Federation Press, 2003, at 138.

of the Convention would thus be premature.

Despite the availability of various options regarding the acceptance of exceptions to the autonomy principle in the UNCITRAL Convention, it is, however, submitted that attempts to align South African law with the UNCITRAL Convention, even with clear distinctions, may prove too radical for the South African context, due to the very broad allowance of an array of exceptions in terms of the Convention. South Africa has a markedly more conservative approach in accepting exceptions to the autonomy principle that cannot easily be harmonised with the too lenient an approach in the UNCITRAL Convention. Instead, it is suggested that South Africa develop and/or retain its own tailored approach regarding exceptions to the autonomy principle of demand guarantees, which considers the nuanced aspects that are unique to South African law mores and the Constitutional principles underpinning it.

The aspect in which South African law should perhaps glean guidance from the UNCITRAL Convention is the drive to introduce certainty regarding exceptions to the autonomy principle instead of being silent on the topic as has been done generally under the relevant ICC international rules.[347] However, the exceptions encapsulated in Article 19 of the UNCITRAL Convention are of limited utility and not conducive to a South African law context as they are too wide, in contrast to the traditionally conservative lines along which South African law of demand guarantees is developing. In addition to the prudence of its consistency with the more mature English law regarding demand guarantees, the conservative-leaning South African law approach is endorsed to be the correct approach which engenders an appropriate degree of deference to the autonomy principle.

7.9.6 Summary, Conclusion and Recommendation on whether Breach of a Negative Stipulation May be Covered by Fraudulent Conduct or Unconscionable Conduct

7.9.6.1 The Interaction between Unconscionability and the Breach of a Negative Stipulation Exception

Given the comprehensive discussion of the unconscionability exception and breach of a negative stipulation exception, respectively, in this thesis, it is worth touching upon the interaction between them as part of these concluding remarks. The broadly amorphous concept of unconscionability, which has been considered one of the central topics in this thesis, may similarly be argued to

[347] See section 6.2 of Chapter 6.

possibly encompass the breach of a negative stipulation exception. After all, it is no stretch to consider the breach of a negative stipulation to constitute unconscionable conduct in a broad sense. An exploration of this potential overlap between the unconscionability exception and the breach of a negative stipulation exception has however not been proposed to be undertaken in comprehensive detail as part of this thesis.

This is largely due to the firm distinction between the two concepts, which distinctions are clear from the detailed consideration of each of these exceptions in this thesis. Key elements in this regard include the uncertainty which is prevalent in respect of unconscionability as a concept, which renders it a challenge to implement as an exception to the autonomy principle. Given the failure of unconscionability to stand on its own feet within an ascertainable definition and parameters, which has contributed to its ambiguous position or tacit rejection in jurisdictions such as England, it is unlikely to have the capacity to effectively carry any other sub-type of exception within its remit. Any enmeshment of an unconscionability exception and breach of a negative stipulation exception would likely only yield the undesirable effect of sullying the parameters of the latter to the point where it would just be as uncertain as unconscionability and, therefore, unviable for recognition as an exception to the autonomy principle.

Unconscionability, if it were to be accepted as an exception, is also a true exception which infringes upon the autonomy principle. In contrast, the breach of a negative stipulation exception, per the recognised formulation endorsed in this thesis, has no impact on the autonomy principle. This fundamental distinction in the formulation of unconscionability exception and a breach of a negative stipulation exception further shows the absurdity of attempting to cover a firm concept based on the law of contract under unconscionability, which is a fluid and rather abstract notion whose status is uncertain. It is submitted that a breach of a negative stipulation exception is far too distinct from unconscionability in formulation, certainty and development generally to merit the argument that it could be rendered redundant by an unconscionability exception.

7.9.6.2 Conclusion on Whether a Standalone Breach of a Negative Stipulation Exception Could be Obviated by a Broad Application of the Fraud Exception

It has been argued and is conceded that breach of a negative stipulation and fraud can, in some circumstances, overlap with each other.[348] This begs the question of whether the notion of a

[348] See *Union Carriage and Wagon Co Ltd v Nedcor Bank* 1996 CLR 724 (W) and *Phillips v Standard Bank* 1985 (3) SA 301 (W). Other examples of cases where considerations around the potential overlap of the fraud and breach of a

standalone breach of a negative stipulation exception is superfluous as a breach of a negative stipulation could also be covered under the fraud exception. In the case of *Union Carriage and Wagon Co Ltd v Nedcor Bank*,[349] remarks supported the view that where a beneficiary and principal agree in the underlying contract that a letter of credit cannot be called up before the occurrence of a certain event, a demand by the beneficiary prior to the occurrence of the agreed events would constitute fraud.[350]

While it may be true that a fraudulent breach of a negative stipulation by a beneficiary may be addressed under the fraud exception, the fact that a breach of contract often occurs in the absence of fraud vindicates the notion of a standalone breach of a negative stipulation.

Instances of "innocent breach of contract"[351] without any fraud on the part of the beneficiary being involved demonstrate the reality of cases where fraud and the breach of contract or a negative stipulation are distinct from each other. Where the breach of contract involves fraud by the beneficiary, such a scenario may possibly fall within the ambit of the wide formulation of the fraud exception,[352] but barring such cases where they may intersect, each is a distinct type of exception. The intrinsic nature of and operation of the remedy offered by the fraud exception and breach of a negative stipulation exception also differs materially in that the former is a true exception while the latter is a *quasi*-exception. In other words, the fraud exception is an anti-guarantor or anti-payment type of remedy which interferes with the autonomy principle, while the negative stipulation exception is an anti-beneficiary remedy with no bearing on the autonomy principle.

A remedy which curtails abuse of demand guarantees without adversely affecting the autonomy principle is advantageous compared to one that interferes with the autonomy principle. It is thus submitted that cases of fraudulent breach of contract may present a choice for parties to pursue a fraud exception or a breach of a negative stipulation exception, with the latter's non-interventionist relationship with the autonomy principle being the more favourable option. It may be more

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negative stipulation exceptions were raised include the English law cases of *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19 and *Themehelp Ltd v West and Others* [1995] 4 All ER 215.

[349] 1996 CLR 724 (W).

[350] Idem, at 735.

[351] *Phillips v Standard Bank* 1985 (3) SA 301 (W), para 303I-304A. See also *ZZ Enterprises v Standard Bank of South Africa Ltd* 1995 CLD 769 (W).

[352] See Hugo, CF "*The Law relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks*", LLD Dissertation, University of Stellenbosch, 1996, at 322.

expedient to effect the breach of a negative stipulation exception, which merely enforces a contract under the normal law of contract, rather than establishing circumstances to justify the fraud exception. Any potential overlap between the fraud exception and breach of a negative stipulation exception does not detract from the reasons supporting the latter's recognition under the South African law.

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