

**ASPECTS OF SUBSTANTIAL COMPLIANCE AND STRICT COMPLIANCE AS
APPLIED TO DEMAND GUARANTEES**

by

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submitted in accordance with the requirements for

the degree of

MASTER OF LAWS

in the subject of

BANKING LAW

at the

UNIVERSITY OF SOUTH AFRICA

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FEBRUARY 2024

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ACKNOWLEDGEMENT

I would like to thank God the Almighty for the strength and zeal to undertake this study. I am also greatly indebted to my learned supervisor, Adv M.P Makakaba for his invaluable counsel throughout this study. I am also grateful to Dr Tuba for his administrative support throughout this study.

ABSTRACT

Demand guarantees are essential for purposes of commerce and are used to secure the performance of the contractor. South African courts have held that demand guarantees are akin to letters of credit. Despite the independent nature of demand guarantees to the underlying contract, in circumstances where the beneficiary has made a fraudulent claim, the guarantor may dishonour the demand or claim.

South African courts have indicated that if the underlying contract is illegal, courts may intervene by granting an interdict to stop payment under the guarantee. The South African law recognises traditional guarantees (often called suretyship) where the beneficiary, when making a demand or claim, must demonstrate liability on the part of the contractor. There are instances where courts have held that guarantees were of a nature akin to suretyship.

In South Africa, parties entering into a demand guarantee contract are subject to the common law of contract. The Uniform Rules for Demand Guarantees, adopted by the International Chamber of Commerce, are only applied by explicit reference in the demand guarantee failing which such rules do not apply. Non-implementation of these rules has resulted in rigorous litigation in the recent years on this subject-matter.

A demand must be supported by documents and require strict conformity. However, strict compliance with the prerequisites of the demand guarantee has not been applied consistently in South Africa. South African courts have recently been applying substantial compliance, in certain circumstances finding that a term in a guarantee is just directory and not obligatory. Furthermore, on many occasions, courts have deviated from strict compliance holding that a term in a guarantee does not make commercial sense thus such term is not mandatory. In this way, courts apply the most business-sensible interpretation when interpreting demand guarantees.

KEY WORDS

Demand guarantees; documentary letters of credit; performance guarantees; independence or autonomous; underlying contract; employer, contractor, and beneficiary; guarantor; first written demand; fraud and illegality exception; strict compliance; substantial compliance; suretyship, on demand or conditional guarantee; security for performance; and uniform rules for demand guarantees.

LIST OF ACRONYMS

A	Appellate Division
ABLU	Annual Banking Law Update
ACT	African Coal Trading (Pty) Ltd
All SA	All South African Law Report
CILSA	Comparative and International Law Journal of Southern Africa
EWHC Comm	England and Wales High Court (Commercial Court)
ICC	International Chamber of Commerce
ISP98	International Standby Practices 98
JBL	Journal of Business Law
J S Afr L	Journal of South African Law
Lloyd's Rep	Lloyd's Law Reports
MEC	Member of the Executive Council
PER/PELJ	Potchefstroom Electronic Law Journal
SA	South African Law Report
SCA	Supreme Court of Appeal
SA Merc LJ	South African Mercantile Law Journal
TSAR	Tydskrif vir die Suid-Afrikaanse Reg/Journal of South African Law
UCP	International Chamber of Commerce Uniform Customs and Practice for Documentary Credits
URDG	Uniform Rules for Demand Guarantees
ZAGPJHC	South Gauteng High Court, Johannesburg
ZAKZHC	KwaZulu-Natal High Court, Durban

CONTENT OUTLINE

1. DECLARATION	2
2. ACKNOWLEDGEMENT	3
3. ABSTRACT	4
4. KEY WORDS	5
5. LIST OF ACRONYMS	6
6. Chapter One: Introduction and background	9
1.1 Background and problem statement	9
1.2 Point of departure	11
1.3 Main question	11
1.4 Scope and objective	12
1.5 Research methodology	12
1.6 The framework of dissertation	12
7. Chapter Two: Concept and operation of demand guarantees	13
2.1 Introduction	13
2.1.1 Operation of demand guarantees	14
2.1.2 Exceptions to principle of autonomy	19
2.1.2.1 Fraud	19
2.1.2.2 Illegality of guarantees or underlying contracts and other factors	21
2.1.3 Uses of demand guarantees	25
2.2 Critical differences and similarities between letters of credit and demand guarantees	26
2.3 Demand guarantees akin to suretyship	28
2.4 Conclusion	30
8. Chapter Three: International rules on guarantees	32
3.1 Introduction	32
3.2 Uniform Customs and Practice for Documentary Credits	32
3.3 Uniform Rules for Demand Guarantees and application in South Africa	33
3.4 Conclusion	35
9. Chapter Four: Doctrine of strict compliance and substantial compliance as applied to demand guarantees	36
4.1 Introduction	36
4.2 Strict compliance	37
4.3 Substantial compliance	41

4.4 Analysis of case law relating to strict and substantial compliance-----	47
4.5 Conclusion-----	49
10. CONCLUDING REMARKS -----	50
11. BIBLIOGRAPHY-----	52

1. CHAPTER ONE: INTRODUCTION AND BACKGROUND

1.1 Background and problem statement

Demand guarantees are defined as ‘any signed undertaking; however, named or described as providing for payment on presentation of a complying demand’.¹ Whereas a compliant demand is described as ‘a demand that meets the requirements of a complying presentation’.² A compliant presentation is additionally described as ‘a presentation in accordance with the terms and conditions’³ of the guarantee and may be governed by global laws, norms, or practices relating to demand guarantees. Demand guarantees ‘are often used in local and international trade, particularly international sale-of-goods contracts, and construction or engineering projects.’⁴ As a result, the ‘issue of conformity or non-conformity of demands... has been a dominant theme in South African case law over the years.’⁵

Demand guarantees often involve banks and insurance companies. These companies act as guarantors for obligations acquired by the contractor (the principal party) in terms of the underlying contract, for the benefit of the employer (the beneficiary).⁶ Therefore, the guarantor ‘undertakes to pay the beneficiary [on demand] the maximum amount’⁷ demanded in terms of the conditions. The beneficiary has to submit accompanying documents required under the demand guarantee if the principal party defaults. Moreover, demand guarantees are independent of the underlying contract. The guarantor must make payment if the demand complies with the guarantee, except where there is fraud. If the beneficiary has acted fraudulently when submitting a demand, the guarantor has a legitimate right to dishonour the guarantee.⁸

¹ International Chamber of Commerce Uniform Rules for Demand Guarantees (adopted 3 December 2009, entered into force 2010) (hereinafter referred to as ‘URDG’) 1.

² URDG 1.

³ URDG 1.

⁴ Michelle Kelly-Louw, ‘General update on the law of demand guarantees and letters of credit’ [2016] ABLU 44.

⁵ Charl Hugo, ‘Conformity of Demands Submitted under Independent Guarantees’ (2018) 2018 J S Afr L 680, 681.

⁶ Howard Bennett ‘Performance bonds and the principle of autonomy’ [1994] JBL 574, 574.

⁷ Kanya Kali, ‘Demand Guarantees in Construction Contracts: A Comparative of Interpretation of Guarantees and Applicable Law from a Chinese and South African Perspective’ (LLM, Interpretation and Drafting of Contracts, University of Johannesburg 2018) 12.

⁸ Bennett, ‘Performance bonds’ 576.

In South Africa, demand guarantees are regulated under the common law.⁹ It is imperative that the essentialia requirements of a contract are complied with, failure to do so constitute an invalid contract.¹⁰ In most cases, when a court is required to interpret clauses of a demand guarantee, general rules of interpreting contracts would apply; these include, considering the intention of the parties when contracting.¹¹ Disputes often arise when the beneficiary submits a demand, which must be subject to an assessment as to whether it is in conformity with the prerequisites of the guarantee.¹²

Akin to letters of credit, demand guarantees often require documents to be submitted when making a demand.¹³ Guarantors therefore demand strict adherence to the presentation of documentation in regard to a claim for payment under the guarantee.¹⁴ In South Africa, there is still debate on the acceptable level of compliance when making a claim in terms of the demand guarantee.¹⁵ For example, the court had to decide on the applicable standard in *Compass Insurance*. In *casu*, the demand made by the beneficiary did not comply with terms of the guarantee, Lewis JA held that it was 'not necessary to decide whether "strict compliance" is necessary for performance guarantees.'¹⁶

Consequently, in *Compass Insurance*, the court left the legal question unanswered on the applicable compliance standard to demand guarantees.¹⁷ It is for these reasons

⁹ JP Van Niekerk and Wilhem Schulze, *The South African Law of International Trade: Selected Topics* (4th edn, Saga Legal Publications 2016) 248.

¹⁰ Van Niekerk and Schulze *International Trade* 248; See also Wilhem Schulze 'The UCP 600: A New Law Applicable to Documentary Letters of Credit' (2009) 21 SA Merc LJ 228, 229.

¹¹ *Mutual and Federal Insurance Company Limited v KNS Construction (Pty) Limited* (208/2015) [2016] ZASCA 87 (31 May 2016).

¹² *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA) (hereinafter '*Compass Insurance case*'); *State Bank of India v Denel SOC Ltd* 2015 (2) All SA 152 (SCA) (hereinafter referred to as '*State Bank of India v Denel*'); *Nedbank Ltd v Proccrops 60 (Pty) Ltd* 2015 (2) All SA 152 (SCA); *Group Five Construction (Pty) Ltd v MEC for Public Transport, Roads and Works, Gauteng* 2015 (5) SA 26 (GJ); *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* (23125/2014) [2015] ZAGPJHC 264 (20 October 2015) (hereinafter referred to as '*Kristabel*'); *University of the Western Cape v ABSA Insurance Company* (100/2015) [2015] ZAGPJHC 303 (28 October 2015); and *Lombard Insurance Co Ltd v Schoeman and others* 2018 (1) SA 240 (GJ).

¹³ Kelly-Louw, 'General update' 57.

¹⁴ Kelly-Louw, 'General update' 57.

¹⁵ Kelly-Louw, 'General update' 57.

¹⁶ *Compass Insurance case* [13].

¹⁷ *Kristabel* [31].

that this study evaluates whether strict or substantial compliance should apply to demand guarantees. Furthermore, consider principles that courts may apply when adjudicating disputes on demand guarantees.

1.2 Point of departure

In certain disputes concerning demand guarantees and documentary letters of credit, the doctrine of strict compliance has been applied in South Africa.¹⁸ However, there are instances where courts have been confronted with arguments that ‘the standard of compliance that applied to demands and documents submitted in terms of demand guarantees was less strict than the standard that applied to commercial letters of credit’.¹⁹

Since then, courts have not made a definitive finding regarding the applicable compliance standard relating to demand guarantees.²⁰ For instance, in *State Bank of India v Denel*, the court adopted the strict compliance doctrine. Conversely, in the cases of *Compass Insurance* and *Kristabel*, the question on the applicable standard of compliance was deliberately left unanswered. As a result, this inconsistency creates uncertainty in our legal system. It could have been helpful if courts clarified the circumstances under which the doctrine of substantial compliance is applicable, if at all it should be applicable.

1.3 Main question

The main question of this study is whether the standard of compliance applied to demand guarantees should be less strict than that applied on letters of credit. The following supplementary questions will be taken into account in order to effectively address the main question: To what extent have South African courts applied the doctrine of strict compliance to demand guarantees and letters of credit? To what

¹⁸ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* (5311/2008) [2008] ZAKZHC 50 (30 July 2008); *Grinaker-LTA Rail Link Joint Venture v Absa Insurance Company* (24110/2014) [2015] ZAGPJHC 302 (10 November 2015); *State Bank of India v Denel SOC Ltd* 2015 (2) All SA 152 (SCA); *Group Five Construction (Pty) Ltd v MEC for Public Transport, Roads and Works, Gauteng* 2015 (5) SA 26 (GJ).

¹⁹ Kelly-Louw, ‘General update’ 58.

²⁰ *Compass Insurance* case [13]; and *Kristabel* [31].

extent have courts applied substantial compliance on demand guarantees? What have English courts ruled on strict compliance pertaining to guarantees.

1.4 The scope and objective

The scope and objective of this study is to consider and interpret aspects of strict compliance and substantial compliance as applied to demand guarantees. This will entail critical analysis of domestic case law, international case law and standards on demand guarantees. This study is aimed at providing guidance on the relevant doctrine on demand guarantees whilst creating flexibility and business-sense by South African courts.

1.5 Research method

This study undertakes a desktop research approach which entails literature review, a study of case law, common law, international standards, books, journal articles and reliable internet sources.

1.6 Framework of the dissertation

The outline of this study is organised as follows:

- (i) Chapter One – This chapter includes the introduction and background, problem statement, point of departure and research methodology;
- (ii) Chapter Two – In this chapter, the concept and operation of demand guarantees, and critical differences between letters of credit and demand guarantees, and other forms of security such as surety are discussed;
- (iii) Chapter Three – This chapter briefly sets out international rules on guarantees;
- (iv) Chapter Four – This chapter provides a discussion on the doctrine of strict compliance and substantial compliance as applied in South African law; and
- (v) Concluding remarks.

2. CHAPTER TWO: CONCEPT AND OPERATION OF DEMAND GUARANTEES

2.1 Introduction

Demand guarantees, as previously mentioned, are described by the International Chamber of Commerce as ‘any signed undertaking, however named or described, providing for payment upon presentation of a complying demand’.²¹ Kelly-Louw, however, broadly defines a demand guarantee as—

[S]traightforward 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.²²

Demand guarantees are important for commerce.²³ This is because demand guarantees are normally applied in both local and international trade in respect of various transactions such as construction and procurement of goods.²⁴ There is an inconsistency on the terms of reference associated with demand guarantees, and performance bonds or guarantees.²⁵ Hence, this study uses the term demand guarantees unless the context indicates otherwise. Demand guarantees are issued following an underlying contract; for instance, construction contract.²⁶ Despite the fact that a guarantor such as a bank or an insurer, is not party to the underlying contract, the demand guarantee is informed by an underlying contract between the principal, for whose account a demand guarantee is issued, and the employer (the beneficiary) to whom the guarantee is issued.²⁷ Demand guarantees are independent of the

²¹ URDG 1.

²² Kelly-Louw, ‘General update’ 43.

²³ Schulze, ‘The UCP 600’ 228; see also Bennett, ‘Performance bonds’ 578.

²⁴ Kelly-Louw, ‘General update’ 44.

²⁵ Kelly-Louw, ‘General update’ 44.

²⁶ Kelly-Louw, ‘General update’ 46.

²⁷ Bennett, ‘Performance bonds’ 574.

underlying contract irrespective that demand guarantees are issued centred on an underlying agreement.²⁸ Bennett referencing the URDG submits that:

Guarantees by their nature are separate transactions from the contract(s)...on which they may be based and Guarantors are in no way concerned with or bound by such contract(s)...despite the inclusion of a reference to them in the Guarantee.²⁹

2.1.1 Operation of demand guarantees

A demand must be accompanied by documents. This means that, irrespective of the reason for the default in respect of the underlying contract by the principal, a guarantee may be called, or the guarantor may be required to pay the beneficiary after the submission of a written demand and specified documents.³⁰ The guarantor makes payment based on the documents received. The guarantor shall not be obliged to pay the beneficiary if the demand or documents do not meet the conditions set out in the guarantee. Notably, the guarantor does not have an obligation to verify the authenticity of the documents submitted.³¹

In addition, 'demand guarantees are autonomous'³² in nature. In *Dormell v Renasa*³³ the court had to decide on the enforceability of a building guarantee. The appellant, Dormell Company had started a project to build a shopping centre. Dormell contracted with the second respondent (Synthesis) to build the shopping centre and required a guarantee. Renasa issued a guarantee in favour of Dormell. Dormell was converted into a close corporation; consequently, wanted to rectify the guarantee to reflect the conversion. The High Court refused this relief and found the guarantee had expired thus unenforceable.

²⁸ Bennett, 'Performance bonds' 575, 576; see also Kelly-Louw, 'General update' 46.

²⁹ Bennett, 'Performance bonds' 576; see also Michelle Kelly-Louw, 'Beneficiary Fraud and Demand Guarantees' (2022) 25 PER/PELJ 2.

³⁰ Tinaye Chivizhe 'A Comparative Analysis of the Approach to the Conformity of a Supporting Statement Calling for Payment Under Demand Guarantees' (2022) 25 PER/PELJ 4.

³¹ Kelly-Louw, 'General update' 48.

³² Tiny Musesengwa, 'Unconscionability and a Breach of a Negative Stipulation in the Underlying Contract as Exceptions to the Autonomy Principle of Demand Guarantees in South Africa' (LLD, University of South Africa 2022) 31.

³³ *Dormell Properties 282 CC v Renasa Insurance Company Ltd and Another* 2011 (1) SA 70 (SCA) (hereinafter referred to as '*Dormell v Renasa*').

Nevertheless, Dormell terminated the building contract and subsequently sent the guarantor a demand. Dormell informed the guarantor that the contract had been terminated and the guarantor had to pay. The first respondent raised two defences; namely, the guarantee had expired; and that Dormell was not the 'employer' in terms of the guarantee. During the proceeding, Dormell and Renasa sought to settle the dispute through arbitration. The arbitration concluded that the contractor had not breached the contract. Therefore, the finding of the arbitrator was introduced as new evidence on appeal, which the majority accepted.

In contrast, the appeal court disagreed with the finding of the High Court on the expiry of the guarantee, the appeal court held that the guarantee expired on 28 February 2008.³⁴ The appeal court further pronounced that rectification of the guarantee ought to have been allowed.³⁵ The court considered the enforceability of the guarantee and relied on established principles set out in *Lombard Insurance Co Ltd v Landmark Holdings*; which held that demand guarantees are 'not unlike letters of credit issued by banks'.³⁶ The court also relied on *Loomcraft Fabrics CC v Nedbank Ltd & another*, stating that for a bank to honour a guarantee there must be strict conformity with the requirements.³⁷ In essence, the court found that in light of the arbitration conclusion, Dormell 'lost the right to enforce the guarantee... [t]here remains no legitimate purpose to which the guarantee sum could be applied'.³⁸ In this regard, the majority dismissed the appeal.

Cloete JA differed with the majority on the acceptance of new evidence on appeal, which relates to the arbitrator's findings on breach of contract. Cloete JA outlined different types of legal relationships arising out of the contracts.³⁹ The minority concluded that the appellant made a valid demand.⁴⁰ Cloete JA found that—

It was not necessary for the appellant to allege that it had validly cancelled the building contract due to the second respondent's default. Whatever disputes there

³⁴ *Dormell v Renasa* [31].

³⁵ *Dormell v Renasa* [37].

³⁶ *Dormell v Renasa* [38].

³⁷ *Dormell v Renasa* [38].

³⁸ *Dormell v Renasa* [41].

³⁹ *Dormell v Renasa* [61].

⁴⁰ *Dormell v Renasa* [63].

were or might have been between the appellant and the second respondent were irrelevant to the first respondent's obligation to perform in terms of the construction guarantee.⁴¹

The minority judgment relied on *Edward Owen v Barclays Bank International* which found that banks must honour guarantees according to its terms.⁴² Cloete JA correctly concluded that the only exception to which a bank or insurer may refuse to make payment is when there is proof of fraud. The aforementioned case did not prove fraud on the part of the employer.

Another example is the case of *Coface Insurance*,⁴³ where a construction contract had been concluded between East London Own Haven (respondent) and Construct Construction (contractor) for building works in East London. The beneficiary (respondent) made a demand alleging breach of contract by the contractor. The appellant denied such breach. The court relied on the findings in *Dormell v Renasa* and concluded that the statement by the employer may be 'challenged and the employer may be denied a claim in terms of the guarantee'.⁴⁴ The appellant applied to amend its plea. The court dismissed the application as the guarantee under consideration was enforceable. The only acceptable exception is fraud, any other factor is irrelevant.⁴⁵

On appeal, the court considered the well-founded jurisprudence on demand guarantees.⁴⁶ The court found that '*Dormell* indicated a divergence'.⁴⁷ The court considered subsequent cases following *Dormell v Renasa*. In *Casey v First Rand Bank Ltd*,⁴⁸ the rule relating to autonomy of irrevocable letters of credit was reaffirmed.⁴⁹ In addition, in *First Rand Bank Limited v Brera Investment CC*⁵⁰ the rule relating to

⁴¹ *Dormell v Renasa* [63].

⁴² *Dormell v Renasa* [63].

⁴³ *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA) (hereinafter referred to as '*Coface Insurance*').

⁴⁴ *Coface Insurance* [5].

⁴⁵ *Coface Insurance* [9].

⁴⁶ *Coface Insurance* [11, 13].

⁴⁷ *Coface Insurance* [14].

⁴⁸ *Casey and Another v Firstrand Bank Ltd* 2014 (2) SA 374 (SCA). See *Coface Insurance* [18].

⁴⁹ *Coface Insurance* [18].

⁵⁰ *First Rand Bank Ltd v Brera Investments CC* 2013 (5) SA 556 (SCA). See *Coface Insurance* [19].

autonomy of guarantees was restated. In *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd*,⁵¹ Cloete JA's dissenting views in *Dormell v Renasa* were preferred. *Dormell v Renasa*, according to the court, had allowed banks to raise contractual disputes so as to refuse to honour guarantees and this is what decisions prior to *Dormell v Renasa* sort to avoid.⁵² The court accordingly concluded that *Dormell v Renasa* was incorrect (except the dissenting judgment).⁵³ The court correctly dismissed the appeal.

In the case of *Exxaro Coal Mpumalanga (Pty) Ltd v TDS Projects Construction and Newrak Mining JV (Pty) Ltd and Another*⁵⁴, Exxaro and the first respondent, TDS Projects Construction and Newrak Mining JV (Pty) Ltd (TDS), entered into a construction contract. Absa Bank Ltd (Absa), second respondent, issued in favour of Exxaro, a demand guarantee subject to certain conditions. Exxaro alleged breach of contract by TDS. TDS denied such allegation. Exxaro demanded payment from Absa in terms of the guarantee.

TDS applied for an order declaring the demand by Exxaro as invalid and an interdict against Absa from making payment in terms of the guarantee. TDS argued that certain demands were made fraudulently and in fact did not comply with the terms of the guarantee. The High Court granted the order declaring the demand to be invalid.

On appeal, TDS acceded that a case of fraud was not clearly made out in its founding affidavit.⁵⁵ On this basis, its main argument was that there was non-compliance with the terms of the guarantee by the employer when making a demand. The court found that TDS failed to establish fraud on the part of the employer, thus, there was no prejudice to it.⁵⁶ Furthermore, if Absa were to honour a guarantee that did not comply with its terms, TDS would have a complete defence to a claim by Absa on the basis that Absa honoured a guarantee which it did not have to honour.⁵⁷

⁵¹ *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA). See also *Coface Insurance* [20, 22].

⁵² *Coface Insurance* [24].

⁵³ *Coface Insurance* [54].

⁵⁴ *Exxaro Coal Mpumalanga (Pty) Ltd v TDS Projects Construction and Newrak Mining JV (Pty) Ltd and Another* (169/2021) [2022] ZASCA 76 (27 May 2022) (hereinafter 'Exxaro').

⁵⁵ *Exxaro* [11].

⁵⁶ *Exxaro* [13].

⁵⁷ *Exxaro* [14].

This case demonstrates that a court will not interfere with demand guarantees even if the employer (in this case Exxaro) does not comply with the terms of the guarantee. This is because the contractor will have a complete defence against a claim by a guarantor that has made payment even if it was not obliged to do so.

In the case of *Infiniti Insurance Co Ltd v Inkonka Civils CC and Another*⁵⁸, the applicant, Infiniti Insurance Company Limited, issued a guarantee at the instance of the first respondent, Inkonka Civils CC in favour of a third-party against an indemnity in which the second respondent stood surety. The third-party, namely, the Department of Rural Development and Land Reform Development, called the guarantee and the applicant honoured the guarantee which was then claimed from the respondents.⁵⁹

The respondents contended that the claim by the third-party is invalid because it was not accompanied by a notice of termination of the contract.⁶⁰ The court found that the demand was accompanied by the correspondence to the effect that the underlying contract had been terminated as a result of the respondent's default.⁶¹ In addition, the respondents contended that the applicant relied on the say-so of the third-party and failed to do an enquiry on the matter.⁶²

Mngadi J found that:

In my view, the issue raised by the respondents relates to a dispute between first respondent and the third party. The applicant was not a party to that contract between the first respondent and the third party. The applicant was bound by the terms of the guarantee, the indemnity and the suretyship. Even if the applicant was informed of the dispute it could not take any position relating thereto. See *Cofare South Africa Insurance Co. Ltd vs East London Own Haven t/a Own Haven Housing Association* 2014 (2) SA 382 (SCA) paras 13-16.; *Dormell Properties 282 CC v Renasa Insurance Co. Ltd and Others NNO* 2011 (1) SA 70 (SCA) par 63.⁶³

⁵⁸ *Infiniti Insurance Co Ltd v Inkonka Civils CC and Another* (9841/2021P) [2023] ZAKZPHC 7 (27 January 2023) (hereinafter "Infiniti Insurance").

⁵⁹ *Infiniti Insurance* [3].

⁶⁰ *Infiniti Insurance* [6].

⁶¹ *Infiniti Insurance* [10].

⁶² *Infiniti Insurance* [12].

⁶³ *Infiniti Insurance* [13].

Moreover, the court emphasised that the applicant was obliged to honour the guarantee once presented with a compliant demand.⁶⁴ Furthermore, the court held that the dispute on the termination of the underlying contract was of no relevance in the determination of the applicant's relief in this case.⁶⁵

Accordingly, it is clear that the autonomous principle on guarantees is applied by courts in South Africa.

2.1.2 Exceptions to the principle of autonomy

2.1.2.1 Fraud

The autonomous rule on demand guarantees has limitations. For instance, the guarantor may not pay if fraud is proved or possibly if there is illegality. The well-established exception, in case law, is fraud.⁶⁶ A guarantor may not pay if 'there is evidence of clear fraud on the part of the beneficiary'.⁶⁷ Moreover, the principal 'may also apply for an interdict (injunction) to restrain enforcement of a demand guarantee'⁶⁸ if there is strong evidence suggesting a fraudulent demand by the beneficiary. In *Phillips v Standard Bank*⁶⁹ and *Loomcraft Fabrics v Nedbank*⁷⁰ the exception of fraud was accepted. In *Phillips*, the court recognised fraud as an exception. The court relied on *Sztejn v J Henry Schroder Banking Corporation*⁷¹ as authority which endorsed *Edward Owen Engineering Ltd v Barclays Bank International Ltd*,⁷² which set out that courts should not allow abuses of their processes based on fraud. Albeit the court in *Phillips* found it unnecessary to make a pronouncement on the extent that the exception should be recognised.

⁶⁴ *Infiniti Insurance* [14].

⁶⁵ *Infiniti Insurance* [14].

⁶⁶ Michelle Kelly-Louw 'Limiting exceptions to the autonomy principle of demand guarantees and letters of credit' [2014] Essays in Honour of Frans Malan 196, 200.

⁶⁷ Tshepang Tsotetsi, 'Erosion of the Independence Principle in Letters of Credit: Lessons from Precedent' (LLM Commercial Law, University of Johannesburg 2018) 12.

⁶⁸ Kelly-Louw, (n 54) 201.

⁶⁹ *Phillips v Standard Bank of South Africa Ltd* 1985 (3) SA 301 (W) (hereinafter referred to as '*Phillips*').

⁷⁰ *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 (1) SA 812 (A) (hereinafter referred to as "*Loomcraft case*").

⁷¹ *Sztejn v J Henry Schroder Banking Corporation* [1941] 31 NYS 2d 631.

⁷² *Edward Owen Engineering Ltd v Barclays Bank International Ltd* 1978 QB 159 (hereinafter referred to as '*Edward Owen Engineering Ltd v Barclays Bank*').

In *Loomcraft*, it was held that stopping the guarantor from honouring a demand would require the principal or issuer to prove on a civil liability test that the beneficiary has presented facts that are materially untrue to the guarantor.⁷³ However, a ‘mere error, misunderstanding or oversight, however unreasonable, cannot amount to fraud’.⁷⁴ Kelly-Louw submits that the *Loomcraft* case ‘left many uncertainties regarding the concept of fraud’.⁷⁵ This argument entails the consideration whether fraud assessment should only be limited to the documents (narrow sense), or fraud assessment should extend to the underlying contract (broader sense).⁷⁶

The guarantor’s decision to make payment is only concerned with the documents presented on demand. Expanding the fraud exception to ponder the initial contract may be contrary to how guarantees are applied. This may unnecessarily burden the guarantor to undertake an investigation on the affairs of the underlying contract.

Subsequent cases⁷⁷ demonstrate the application of the fraud exception.⁷⁸ In *Group Five Construction v MEC*⁷⁹, the court had to decide the guarantor’s liability where a guarantee did not comply with the conditions.⁸⁰ The condition was that ‘the building agreement [had to be] cancelled due to the default of the JV contractor’.⁸¹ However, the demand from the beneficiary; namely the MEC, ‘stated that the Agreement had been cancelled due to the contractor’s default’.⁸² The appellant averred: ‘any demand made by the MEC which purport to be on the grounds of cancellation due to the contractor’s default would be “unjustified, unconscionable and could be classified as fraudulent”’.⁸³

⁷³ *Loomcraft* case [817G].

⁷⁴ *Loomcraft* [822G-H]; see also Kelly-Louw, ‘Limiting exceptions’ 202.

⁷⁵ Kelly-Louw, ‘Limiting exceptions’ 202.

⁷⁶ Kelly-Louw, ‘Limiting exceptions’ 202.

⁷⁷ *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA); *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [14, 28].

⁷⁸ Kelly-Louw, ‘Limiting exceptions’ 203.

⁷⁹ *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* 2015 (5) SA 26 (GJ) (hereinafter referred to as ‘*Group Five Construction v MEC*’).

⁸⁰ *Group Five Construction v MEC* [2].

⁸¹ *Group Five Construction v MEC* [38].

⁸² *Group Five Construction v MEC* [38].

⁸³ *Group Five Construction v MEC* [40].

Accordingly, fraud was alleged on the part of MEC because the demand was submitted knowingly 'the contract had not been called due to the default of the JV contractor'.⁸⁴ Satchwell J found that the 'demand incorporates a fraud and that the guarantee should be set aside'.⁸⁵ The court relied on English case law, concluding 'that on the material available, the only realistic inference is that... [the beneficiary] could not honestly have believed in the validity of its demands on the performance bonds'.⁸⁶

2.1.2.2 Illegality of demand guarantees or underlying contracts and other factors

The illegality exception is still unclear. It is common cause that if a contract is illegal, that contract is void *ab initio*.⁸⁷ In terms 'of the maxim *ex turpi causa non oritur actio*'⁸⁸ – a court should not enforce a contract arising from an illegal action.⁸⁹ The common law legality principle stipulate that a contract must not be against any legislation or common law. An illegal contract may not be enforceable, even a court of law may not condone an illegal contract (*par delictum* rule). The *par delictum* principle entails that the 'law should discourage illegality; hence it would be contrary to public policy to render assistance to those who defy the law'.⁹⁰ In the case of *Sasfin (Pty) Ltd v Beukes*,⁹¹ it was held that an agreement that is contrary to public policy is void.

The illegality exception must be viewed from two different perspectives; namely, 'where the guarantee itself is illegal and where the underlying contract'⁹², to which the guarantee is related, is illegal.⁹³ There are circumstances where a guarantee may be tainted with illegality, e.g., if legislation explicitly prohibits demand guarantees.⁹⁴ In addition, where a country is sanctioned thus trading with other countries may be

⁸⁴ *Group Five Construction v MEC* [40].

⁸⁵ *Group Five Construction v MEC* [51].

⁸⁶ *Group Five Construction v MEC* [50].

⁸⁷ Cayle Lupton & Michelle Kelly-Louw 'Emergency of Illegality in the Underlying Contract as an Exception to the Independence Principle of Demand Guarantees' [2020] 53 CILSA 10.

⁸⁸ Musesengwa, 'Unconscionability' 227.

⁸⁹ Lupton & Kelly-Louw, (n 75) 10.

⁹⁰ *Afrisure CC v Watson N.O* 2009 (2) 127 SA (SCA) [39].

⁹¹ *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A); see also *Baart v Malan* 1990 (2) SA 862 (E).

⁹² Grace Kayembe, 'The Fraud Exception in Bank Guarantee' (Thesis, Department of Commercial Law, University of Cape Town 2008) 49.

⁹³ Lupton and Kelly-Louw *Emergency of Illegality* 8, 9.

⁹⁴ Lupton and Kelly-Louw *Emergency of Illegality* 10.

illegal.⁹⁵ Marxen mentions a number of circumstances where an underlying contract may be illegal because of fraud, misrepresentation, corruption, flouting procurement processes among others.⁹⁶ If a demand guarantee is illegal it would be an acceptable defense to dishonour the guarantee. However, Kelly-Louw submits that 'illegality in the underlying contract should be limited solely to those instances where the underlying contract's illegality carries with it a clear criminal element'.⁹⁷

Niekerk and Schulze submit that guarantees tainted with illegality should not be paid.⁹⁸ For example, if the illegality relates to foreign-exchange regulations.⁹⁹ The Johannesburg High Court had an opportunity to adjudicate on the possibility of recognizing an illegality of guarantees as an exception. In *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investment Proprietary Fund Limited and Others*,¹⁰⁰ the underlying contract and guarantee was challenged by the applicant by alleging fraud, misrepresentation and illegality relating to failure to comply with regulations.¹⁰¹

The court outlined the legal principles relating to guarantees. Subsequently, the court acknowledged that guarantees are independent contracts and are akin to letters of credit.¹⁰² Courts may only interfere with these contracts in exceptional circumstances.¹⁰³ The court discussed the well-established exception of fraud and held that the applicant did not establish fraud.¹⁰⁴

With regards to the illegality exception raised by the applicant, the court found 'that the lease [was] not concluded for an illegal purpose'.¹⁰⁵ Furthermore, the alleged illegality was 'not the kind of transgression where the lease and/or the guarantee were entered

⁹⁵ Lupton and Kelly-Louw *Emergency of Illegality* 10.

⁹⁶ Karl Marxen 'Demand guarantees in the construction industry' [2018] *Juta* 183, 184.

⁹⁷ Michelle Kelly-Louw 'Illegality as an exception to the autonomy principle of bank demand guarantees' (2009) 3 *CILSA* 339 381.

⁹⁸ Van Niekerk and Schulze *International Trade* 291.

⁹⁹ Van Niekerk and Schulze *International Trade* 291.

¹⁰⁰ *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investment Proprietary Fund Limited and Others* (2017/36270) [2017] ZAGPJHC 298 (13 October 2017) (hereinafter referred to as '*Mattress House case*').

¹⁰¹ *Mattress House case* [19].

¹⁰² *Mattress House case* [23].

¹⁰³ *Mattress House case* [24].

¹⁰⁴ *Mattress House case* [25].

¹⁰⁵ *Mattress House case* [28].

into for criminal purposes or in furtherance of an unlawful purpose'.¹⁰⁶ Thereby it was said—

It seems to me that at the very least, to receive consideration, the illegality complained of can only be a valid defence where it extends to and directly affects the guarantee. The guarantee must have been entered into for a criminal purpose or in furtherance of an unlawful purpose. Even though I do not purport to set out a general principle, it is conceivable that there may be instances where the nature of the illegality complained of vitiates the guarantee. An example would be where the issuing bank becomes aware of the transaction as part of a money laundering scheme or in the case of a breach of exchange control regulations.¹⁰⁷

On balance, the case demonstrates that courts may accept illegality as an exception. As a result, a court may intervene if there is illegality with respect to the demand guarantee or the underlying contract.

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*¹⁰⁸, the SCA had to determine whether the South African National Roads Agency Soc Ltd (SANRAL), the first respondent, was precluded by the underlying contract to demand payment in terms of a demand guarantee. The demand guarantee was issued in favour of SANRAL by the second respondent, Lombard Insurance Company Ltd as a result of a construction contract entered into by SANRAL and the appellant, the Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH (Joint Venture).

Succinctly, the facts of this case are that the Joint Venture on 30 January 2019 submitted to SANRAL a notice to terminate the construction contract in line with the provisions of the underlying contract. The rationale for the termination was *force majeure*. As such, the Joint Venture would not be required to fulfil its obligations in terms of the underlying contract. On the other hand, SANRAL disputed the existence of *force majeure*. Accordingly, the dispute was referred for arbitration. Pending the

¹⁰⁶ *Mattress House* case [28].

¹⁰⁷ *Mattress House* case [30].

¹⁰⁸ *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) (hereinafter referred to as: '*Joint Venture v SANRAL*').

arbitration, the Joint Venture requested assurance from SANRAL that the demand guarantee will not be called. SANRAL did not provide such assurance. However, SANRAL indicated its intention to demand payment in terms of the guarantee.

The Joint Venture applied to the High Court for an interdict stopping SANRAL from demanding payment from the guarantor pending the finalisation of the arbitration. The High Court dismissed the application on the basis that the Joint Venture failed to make a *prima facie* case that the discontinuance of construction works was as a result of *force majeure*. Nonetheless, the High Court granted leave to appeal to the SCA.

When considering the appeal, Makgoka JA, reiterated the jurisprudence on demand guarantees. In particular, the court emphasised that demand guarantees are autonomous of the underlying contract and guarantors must pay in accordance with the terms of the guarantee.¹⁰⁹ Counsel for the Joint Venture, however, argued that other than fraud:

...our law should be developed to recognise an exception... where the underlying contract restricts or qualifies a beneficiary's right to call up the guarantee, a contractor is entitled to interdict a beneficiary from doing so until the conditions in the underlying agreement have been met.¹¹⁰

The court found that 'there is room in South African law to follow the same path as that taken in Australian and English law' subject to *Kwikspace Modular Buildings Ltd v Sabodala Mining Company Sarl and Another*¹¹¹. The court, however, cautioned that this approach must consider the importance of demand guarantees and international letters of credit for purposes of trade.

The Joint Venture submitted that SANRAL could not terminate the underlying contract because the Joint Venture had filed a notice of cancellation based on *force majeure* and its success in the arbitration process would prohibit SANRAL from cancelling the contract.¹¹² The court dismissed this argument. The court held that the entitlement of SANRAL to cancel the contract was not derived from dispute resolution provisions rather under clause 4.2(d) of the underlying contract.¹¹³ Thereby, 'SANRAL's

¹⁰⁹ *Joint Venture v SANRAL* [7].

¹¹⁰ *Joint Venture v SANRAL* [9].

¹¹¹ *Joint Venture v SANRAL* [17]; and see also *Kwikspace Modular Buildings Ltd v Sabodala Mining Company Sarl and Another* 2010 (6) SA 477 (SCA) [11].

¹¹² *Joint Venture v SANRAL* [21].

¹¹³ *Joint Venture v SANRAL* [22].

entitlement to claim under the performance security is met because there is no dispute that SANRAL claimed to be entitled to cancel the agreement'.¹¹⁴ The court relying on *Dormell* further held that 'the Joint Venture's prospects of success in the pending arbitration is of no moment'.¹¹⁵

The court accordingly concluded that:

... the guarantee is an unconditional one. Its wording is instructive: Lombard was obliged to pay 'on receipt of a written demand' from SANRAL, which could be made if, in SANRAL's 'opinion and ... sole discretion', the Joint Venture had failed and/or neglected to commence the work as prescribed, or if it had failed and/or neglected to proceed therewith, 'or if, for any reason, [it] fails and/or neglects to complete the services in accordance with the conditions of the contract' [italics supplied]. The catch-all provision, viz. 'any reason', is important. The Joint Venture's failure to complete the project, be it due to *force majeure* or otherwise, falls into this category. In other words, the reason for such failure is irrelevant. That the Joint Venture considered itself to have been prevented by *force majeure* is immaterial as far as this provision is concerned.¹¹⁶

In this regard, it was clear that the appellant, the Joint Venture, could not demonstrate or convincingly argue that SANRAL was precluded from demanding payment in terms of the guarantee pending a dispute relating to the underlying contract. While the court stated that there is room to develop South African law to consider other factors in which the contractor may, through a court, interdict the employer from demanding payment pending the fulfilment of a condition in the underlying contract, this finding has the effect of undermining the autonomous principle and strict compliance with the guarantee irrespective of the provisions of the underlying contract. Nevertheless, the court correctly dismissed the appeal.

2.1.3 Uses of demand guarantees

In general, demand guarantees serve as security. That is to say, where there is a default by the contractor or principal, the beneficiary may call or make a written

¹¹⁴ *Joint Venture v SANRAL* [22].

¹¹⁵ *Joint Venture v SANRAL* [23].

¹¹⁶ *Joint Venture v SANRAL* [28].

demand under the guarantee. This legal construct spares the beneficiary ‘the need to resort to legal process[es] to secure financial redress’¹¹⁷, only if there is default on the part of the contractor. As explained by Bertrams, ‘the purpose of a guarantee is to indemnify the creditor/beneficiary for losses resulting from the principal debtor[‘s]...default in the underlying relationship’.¹¹⁸ The guarantor has ‘to pay the beneficiary according to the tenor of the bond [guarantee]’.¹¹⁹ Chivizhe submits that demand guarantees ‘serve as a security mechanism to guarantee the proper performance of any obligation... of the underlying contract’.¹²⁰ Furthermore, Chivizhe submits that demand guarantees operate ‘as a risk allocation device concerning claims relating to a breach of contract between parties to the underlying agreement’.¹²¹ Therefore, this suggests that demand guarantees are meant to ‘secure performance’,¹²² minimise the risk of prolonged court processes and to seek redress for non-performance by the contractor.

2.2 Critical differences and similarities between letters of credit and demand guarantees

In *Edward Owen Engineering Ltd v Barclays Bank*, Lord Denning M.R. found: ‘performance [demand] guarantees stand on a similar footing to a letter of credit’.¹²³ Kelly-Louw, relying on the same authority, highlights that ‘demand guarantees have many similarities to a letter of credit, with which of course we are very familiar’.¹²⁴ Nevertheless, there is a fundamental difference in documentary letters of credit and demand guarantees. Demand guarantees and commercial letters of credit are different with respect to their payment function.¹²⁵ According to Kelly-Louw, ‘letter[s] of credit constitutes a normal mode of payment; the bank demand guarantee does not’.¹²⁶

¹¹⁷ Bennett, ‘Performance bonds’ 574.

¹¹⁸ Roeland Bertrams, *Bank Guarantees in International Trade* (4th edn, Wolters Kluwer Law & Business 2013) 11.

¹¹⁹ Bennett, ‘Performance bonds’ 575.

¹²⁰ Chivizhe, ‘Comparative Analysis’ 2.

¹²¹ Chivizhe, ‘Comparative Analysis’ 2.

¹²² *Eskom Holdings v Hitachi Power Africa* (139/2013) 2013 ZASCA 101 (12 September 2013) [1] (hereinafter referred to as ‘*Eskom Holdings v Hitachi Power Africa*’).

¹²³ Bennett, ‘Performance bonds’ 575.

¹²⁴ Kelly-Louw, ‘Beneficiary Fraud’ 2.

¹²⁵ Michelle Kelly-Louw, ‘Selective Legal Aspects of Bank Demand Guarantees’ (LLD, University of South Africa 2008) 98.

¹²⁶ Kelly-Louw, ‘Selective Legal Aspects’ 98.

Demand guarantees serves as risk mitigation for non-delivery of goods or non-performance; whereas, a letter of credit serves to ensure that the principal delivers required goods failing which the letter of credit may be invoked.¹²⁷ On one hand, commercial letters of credit certify that payment will be made.¹²⁸ On the other hand, a demand guarantee is security for performance, it is not concerned with a payment obligation.¹²⁹

Demand guarantees are always called by the beneficiary if there is a default or breach of contract by the contractor whereas commercial letters of credit are invoked if 'things go right'.¹³⁰ Letters of credit entail the 'presentation of a substantial volume of documents' while demand guarantees may only be limited to the documentation stipulated in the guarantee or just merely a written demand itself.¹³¹

According to Kelly-Louw, demand guarantees, and commercial letters of credit have some common characteristics. These include:

- (a) Abstract payment undertaking – basically meaning that these agreements do not have to conform to the general legal requirements for the validity of a contract;¹³²
- (b) Independent in nature – typically meaning that guarantees are independent of the initial contract; thus, the guarantor has to pay based on documentation received from the beneficiary;¹³³ and
- (c) Documentary in character – meaning payment by the guarantor or issuer is only because of compliance by the beneficiary on the submission of the stipulated documents.¹³⁴

¹²⁷ Kelly-Louw, 'Selective Legal Aspects' 98.

¹²⁸ Kelly-Louw, 'Selective Legal Aspects' 99.

¹²⁹ Kelly-Louw, 'Selective Legal Aspects' 99.

¹³⁰ Kelly-Louw, 'Selective Legal Aspects' 99.

¹³¹ Kelly-Louw, 'Selective Legal Aspects' 100.

¹³² Kelly-Louw, 'Selective Legal Aspects' 97.

¹³³ Kelly-Louw, 'Selective Legal Aspects' 97.

¹³⁴ Kelly-Louw, 'Selective Legal Aspects' 97.

2.3 Demand guarantees akin to suretyship

Suretyship is one of many ways in terms of which security for an obligation may be provided. Forsyth & Pretorius define suretyship as:

[A]n accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), that the principal debtor, who remains bound, will perform his obligation to the creditor and that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor.¹³⁵

Suretyship contracts are often 'referred to as "traditional guarantee" or "conditional guarantee"'.¹³⁶ They require that an employer must establish 'an obligation on the surety to answer for any failure of the original, primary debtor'.¹³⁷ In *Eskom Holdings v Hitachi Power Africa*¹³⁸ the court explained as follows:

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. All that is required for payment is a demand stating the claimant's compliance with the terms of the guarantee.¹³⁹

Kelly-Louw argues that 'distinguishing the demand guarantee from traditional guarantee is a matter of construction'.¹⁴⁰ A demand guarantee would have two important factors; that is, there is an underlying contract which security for performance is being provided by the guarantor; and that the demand is made if there is default by the principal.¹⁴¹ Where there is a promise to make payment to a party and there is no reference to an underlying contract for performance, and there is no indication of under what circumstances a demand may be made; for example, if there

¹³⁵ Christopher Forsyth and Jopie Pretorius *Caney's The Law of Suretyship in South Africa* (6th edn, Juta 2010) 27; see also Georges Affaki and Roy Goode, *Guide to ICC Uniform Rules for Demand Guarantees URDG 758* (ICC 2011) 7.

¹³⁶ Marxen, 'Demand guarantees' 112.

¹³⁷ Marxen, 'Demand guarantees' 112.

¹³⁸ *Eskom Holdings v Hitachi Power Africa* [12].

¹³⁹ *Eskom Holdings v Hitachi Power Africa* [12].

¹⁴⁰ Kelly-Louw, 'General update' 50.

¹⁴¹ Kelly-Louw, 'General update' 50.

is a default, South African courts are likely to assess that promise to pay, as an accessory guarantee akin to suretyship.

When a South African court is required to interpret a commercial contract, it would adopt the modern tools of interpretation of commercial contract; that is to also consider factual matrix (surrounding circumstances).¹⁴² The general rules of contractual interpretation entail that, courts consider the semantic used in that contract.¹⁴³ Simply put, 'words and phrases in a contract are given their grammatical meaning' as it may appear in dictionaries and judicial precedent.¹⁴⁴ This would, in the modern context, include consideration of factual matrix.¹⁴⁵ The well-established rules of interpretation entail consideration of ordinary grammatical meaning of words, the context in which these words are used, and the purpose for which they are used.

The court had to consider whether a guarantee constituted a demand guarantee or suretyship. In *Mutual and Federal Insurance Company Limited v KNS Construction (Pty) Limited*,¹⁴⁶ the court had to determine whether 'a guarantee is a conditional guarantee that is inextricably linked to the underlying contract, and therefore akin to suretyship and not an on demand or call guarantee'.¹⁴⁷ It transpired that after issuing the guarantee, KNS Construction, the first respondent, experienced financial difficulties, as a consequence it was unable to perform in line with the main contract.¹⁴⁸

Aqua Transport & Plant Hire (Pty) Limited, the second appellant, approached the court seeking an interdict against the guarantor.¹⁴⁹ The interdict was accordingly granted. KNS Construction instituted court proceeding demanding payment in terms of the guarantee.¹⁵⁰ Aqua opposed the application. Aqua was of the view that the guarantee was a 'conditional guarantee' thus it was not payable, as Aqua was not in breach of

¹⁴² Kelly-Louw, 'General update' 50.

¹⁴³ Kelly-Louw, 'General update' 51.

¹⁴⁴ Kelly-Louw, 'General update' 51.

¹⁴⁵ Kelly-Louw, 'General update' 52.

¹⁴⁶ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited*.

¹⁴⁷ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [8].

¹⁴⁸ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [3].

¹⁴⁹ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [6].

¹⁵⁰ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [6].

the subcontract.¹⁵¹ The court found for KNS Construction, concluding that the guarantee was payable on demand.¹⁵²

The appeal court had to decide whether ‘the guarantee was “a conditional guarantee” that is inextricably linked to the underlying contract, and therefore akin to suretyship and not an “on demand” or “call guarantee”’.¹⁵³ In making its findings, the court relied on *Minister of Transport and Public Works, Western Cape and another v Zanbuild Construction*,¹⁵⁴ in which case the court found ‘the guarantee gave rise to liability akin to that of a surety’.¹⁵⁵ The court further held that—

The first indicator in that direction is the assertion at the outset that the guarantee provides ‘security for the compliance of the contractor’s performance of obligations in accordance with the contract’. And in the body of the document the bank guarantees ‘the due and faithful performance by the contractor’. This accords with language associated with suretyships.¹⁵⁶

Accordingly, it was held: ‘the guarantee is inextricably linked to the sub-contract and therefore akin to a suretyship’.¹⁵⁷ Therefore, the court held, ‘the guarantee is a conditional guarantee and not a call or demand guarantee’.¹⁵⁸ Kelly-Louw correctly submits that the decision of the court in this case ‘cannot be faulted’.¹⁵⁹

2.4 Conclusion

Demand guarantees are essential for purposes of commerce. Demand guarantees are autonomous. Thus, the guarantor is required to make payment if the demand complies with the guarantee. The autonomous nature of demand guarantees means

¹⁵¹ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [6].

¹⁵² *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [7].

¹⁵³ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [8].

¹⁵⁴ *Minister of Transport and Public Works, Western Cape and another v Zanbuild Construction (Pty) Ltd and another* 2011 (5) SA 528 (SCA) [19].

¹⁵⁵ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [12]; see also Andrew Donnelly, ‘Building Contracts: The Difference Between On-Demand and Conditional Performance Guarantees’ (22 July 2016) <<https://www.lexology.com/library/detail.aspx?g=41581cea-a3bd-4d49-8e00-fd930fae2564>> accessed 26 August 2023.

¹⁵⁶ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [12]; see also Donnelly, ‘Building Contracts’.

¹⁵⁷ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [16].

¹⁵⁸ *Mutual & Federal Insurance Company Limited v KNS Construction (Pty) Limited* [16].

¹⁵⁹ Kelly-Louw, ‘General update’ 55.

guarantees are independent. Consequently, the guarantor may not pay upon demand if there is fraud by the beneficiary. While it remains uncertain whether illegality is a valid exception, a recent decision in a South African court indicated willingness to recognise illegality as an exception. Demand guarantees are an important means for the contractor to provide security for performance. There are two types of guarantees, namely, conditional guarantees and on demand guarantees. In essence, courts are willing to make a finding, if required, that a guarantee is conditional thus akin to suretyship. It is therefore important for parties concluding a demand guarantee to be clear on the nature of the guarantee to avoid unintended consequences.

3. CHAPTER THREE: INTERNATIONAL RULES ON LETTERS OF CREDIT AND DEMAND GUARANTEES

3.1 Introduction

Financial sector legislation in South Africa does not distinctively regulate guarantees.¹⁶⁰ Guarantees issued by banks fall within the ambit of banking law which is mainly informed by English law.¹⁶¹ In addition, letters of credit are often required for international trade; hence, other jurisdictions' laws are considered in the interpretation and application of guarantees.¹⁶² In fact, the general requirements of a valid contract are applicable in the formulation of guarantees.¹⁶³

3.2 Uniform Customs and Practice for Documentary Credits

The International Chamber of Commerce ('ICC') has endeavoured to create uniformity and consistency on letters of credit and demand guarantees in respect of the formulation of the relevant contracts.¹⁶⁴ The ICC is responsible for developing the Uniform Customs and Practice for Documentary Credits¹⁶⁵ ('UCP 600') and Uniform Rules for Demand Guarantees (URDG). Van Niekerk & Schulze submit that—

The UCP is a body of rules that is, by international banking practice and mutual agreement between international bankers, incorporated into all contracts involving letters of credits. It thus governs the rights and duties of all the parties involved in such contracts. The aim of the UCP is to create a framework of basic rules which is compatible with both international banking practice and the municipal laws of states, and so to avoid disputes and facilitate the orderly and efficient conduct of international trade.¹⁶⁶

¹⁶⁰ Van Niekerk and Schulze *International Trade* 248.

¹⁶¹ Van Niekerk and Schulze *International Trade* 248.

¹⁶² Van Niekerk and Schulze *International Trade* 248.

¹⁶³ Van Niekerk and Schulze *International Trade* 248.

¹⁶⁴ Van Niekerk and Schulze *International Trade* 249.

¹⁶⁵ International Chamber of Commerce Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 (adopted 25 October 2006, entered into force 1 July 2007) (hereinafter 'UCP 600').

¹⁶⁶ Van Niekerk and Schulze *International Trade* 249; see also Schulze, 'The UCP 600' 230; Mazwenkosi Cele, 'Demand Guarantees: A Comparative Study Relating to Certain Fundamental

The application of UCP 600, according to Van Niekerk & Schulze, is not by default. Parties in the underlying contract may incorporate these rules by explicit reference that UCP 600 is applicable.¹⁶⁷ The UCP 600 was a technical revision as opposed to a substantial revision of its predecessor, UCP 500.¹⁶⁸ Equally, the UCP 600 has no force of law rather binding to parties who explicitly reference the UCP 600 in their contract.¹⁶⁹ In the South Africa, notwithstanding that no law has been enacted to recognise the UCP 600, they are presumed to apply unless parties expressly or otherwise exclude the UCP 600 from application in their contract.¹⁷⁰

3.3 Uniform Rules for Demand Guarantees and application in South Africa

Akin to UCP 600, parties are bound by the URDG only to the extent that 'the demand guarantee or counter-guarantee modifies or exclude them'.¹⁷¹ However, in South Africa, issuers of demand guarantees often do not subject those guarantees to the URDG.¹⁷² Hugo submits the following reasons which are likely the cause for not subjecting demand guarantees to the URDG in South Africa:¹⁷³

- (a) Demand 'guarantees are issued by banks and insurance companies' thus are a lot of role players who need 'to be convinced of their merit'.¹⁷⁴ Whereas commercial letters of credit are only issued by banks.¹⁷⁵
- (b) Demand guarantees are governed by various international instruments such as the URDG, [International Standby Practices] ISP98 and to a certain extent by the UCP depending on their nature.¹⁷⁶
- (c) Demand guarantees could potentially be required for various transactions not only limited to construction guarantees. Hugo submits that 'any obligation can

Aspects of the Law of South Africa and the Law of The People's Republic of China' (LLM Banking Law, University of Johannesburg 2018) 10; and UCP 600, article 1.

¹⁶⁷ Van Niekerk and Schulze *International Trade* 249.

¹⁶⁸ Schulze, 'The UCP 600' 230.

¹⁶⁹ Schulze, 'The UCP 600' 232.

¹⁷⁰ Schulze, 'The UCP 600' 230.

¹⁷¹ URDG, 1.

¹⁷² Kelly-Louw, 'Selective Legal Aspects' 362.

¹⁷³ Charl Hugo 'Letters of Credit and Demand Guarantees: A Tale of Two Sets of Rules of the International Chamber of Commerce' [2017] J S Afr L 17.

¹⁷⁴ Hugo, 'Letters of Credit and Demand Guarantees' 17.

¹⁷⁵ Hugo, 'Letters of Credit and Demand Guarantees' 17.

¹⁷⁶ Hugo, 'Letters of Credit and Demand Guarantees' 17.

conceivably be backed by a guarantee'.¹⁷⁷ On the other hand, commercial letters of credit are specific to payment for goods imported.¹⁷⁸

In South Africa, demand guarantees have in the recent past been subjected to rigorous litigation, likely because the URDG are not implemented. In this regard, Hugo relies on *Minister of Transport and Public Works, Western Cape v Zanbuild Construction*¹⁷⁹; this case relates to the interpretation of two construction guarantees.¹⁸⁰ The department had demanded payment.¹⁸¹ The principal, Zanbuild, approached the High Court (Western Cape) for an interdict against Absa, the guarantor. The court granted the interdict.

On appeal, the court had to decide whether the guarantee was an “on demand” guarantee, or a “conditional bond” (suretyship). Leading to its decision, the court indicated that ‘our law is familiar with the distinction’.¹⁸² The court relied on *Dormell v Renasa and Lombard Insurance v Landmark Holdings*, and ruled that those construction guarantees were “on demand” guarantees.¹⁸³ Whereas, in *Basil*¹⁸⁴ it was held that the construction of the guarantee was similar to that contemplated in a suretyship.¹⁸⁵

The court found the guarantees ‘do not constitute “on demand” bonds, but that they give rise to liability on the part of Absa akin to suretyship’.¹⁸⁶ The court reasoned that the words: ‘Provide security for the compliance of the contractor’s performance of obligations in accordance with the contract [and] the due and faithful performance by the contractor’, amounted to language associated with suretyships.¹⁸⁷ Accordingly, the appeal was dismissed. Hugo correctly submits that—

¹⁷⁷ Hugo, 'Letters of Credit and Demand Guarantees' 17.

¹⁷⁸ Hugo, 'Letters of Credit and Demand Guarantees' 17.

¹⁷⁹ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction*.

¹⁸⁰ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [1].

¹⁸¹ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [2].

¹⁸² *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [14].

¹⁸³ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [14].

¹⁸⁴ *Basil Read (Pty) Ltd v Beta Hotels (Pty) Ltd & others* 2001 (2) SA 760 (C) (hereinafter referred to as 'Basil').

¹⁸⁵ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [14].

¹⁸⁶ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [19].

¹⁸⁷ *Minister of Transport and Public Works, Western Cape v Zanbuild Construction* [19].

If the guarantee had been issued subject to the URDG and the parties had applied their minds to this incompatibility [with article 5 and 8 of the URDG], the guarantee would never have been accepted by the employer in this form, and the dispute could have been avoided.¹⁸⁸

In *Nedbank Ltd v Procprops*,¹⁸⁹ the appeal court had to determine whether the guarantee envisaged more than one payment and more than one demand. The court concluded that only one demand was envisaged as the guarantee was clear and unambiguous in that respect. Accordingly, Nedbank had discharged its obligations by paying the lesser amount.¹⁹⁰ Hugo submits that the guarantee 'failed to serve its commercial purpose'¹⁹¹ because it did not apply article 17 of the URDG.

3.4 Conclusion

There is no legislation in South Africa specifically dealing with guarantees. Therefore, law of contract applies. South Africa should consider incorporating international rules relating to guarantees into domestic law.

¹⁸⁸ Hugo, 'Letters of Credit and Demand Guarantees' 18.

¹⁸⁹ *Nedbank Ltd v Procprops* (108/13) [2013] ZASCA 153 (20 November 2013).

¹⁹⁰ Hugo, 'Letters of Credit and Demand Guarantees' 19.

¹⁹¹ Hugo, 'Letters of Credit and Demand Guarantees' 19.

4. CHAPTER FOUR: DOCTRINE OF STRICT COMPLIANCE AND SUBSTANTIAL COMPLIANCE AS APPLIED TO DEMAND GUARANTEES

4.1 Introduction

The general rule is that: ‘documents presented must “strictly comply” with those that have been called for documentary credit’.¹⁹² The rule is well-established under English law in relation to commercial letters of credit. Comparably, the principle has also been adopted in South Africa.¹⁹³ The URDG, in terms of article 6, provides: ‘Guarantors deal with documents and not with goods, services or performance to which the documents may relate’.¹⁹⁴ In addition, article 15a provides—

A demand under the guarantee 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. This statement may be in the demand or in a separate signed document accompanying or identifying the demand.¹⁹⁵

Article 15a imposes a requirement that for a demand to be honoured, it must be accompanied by specified documents. However, in South Africa, the law is not settled as to which standard applies, that is, strict or substantial compliance.¹⁹⁶ Under English law, it is not clear if strict compliance is necessary in demand guarantees.¹⁹⁷ Hugo correctly submits that the issue of conformity or non-conformity of demands insofar as demand guarantees are concerned, has been a dominant theme in case law over the years.¹⁹⁸

¹⁹² Kelly-Louw, ‘General update’ 57.

¹⁹³ Van Niekerk and Schulze *International Trade* 273.

¹⁹⁴ URDG 5.

¹⁹⁵ URDG 9.

¹⁹⁶ Kelly-Louw, ‘General update’ 57.

¹⁹⁷ Kelly-Louw, ‘General update’ 57.

¹⁹⁸ Hugo, ‘Conformity of demands’ 684.

4.2 Strict compliance

In South Africa, various cases have been adjudicated by courts where strict compliance was applied. In *Stefanutti & Bressan (Pty) Ltd v Nedbank Limited and another*,¹⁹⁹ the court had to decide whether, for the guarantor to pay, the demand should meticulously conform with the guarantee. The prerequisite was that the original credit guarantee must accompany the first written demand.²⁰⁰ The court stated: ‘a bank is obliged to conform strictly to the terms of the guarantee’.²⁰¹ The court relied on *OK Bazaars (1929) Limited v Standard Bank of SA Limited*,²⁰² with reference to *Midland Bank Ltd v Seymour*²⁰³ and found that it is imperative that a ‘bank must conform strictly to the instructions which it receives.’²⁰⁴

In addition, while relying on *Loomcraft*,²⁰⁵ the court found that payments should only be made if the documents presented firmly conform with the prerequisite of the guarantee.²⁰⁶ The guarantor must be served with a demand from the beneficiary accompanied by the original copy of the guarantee and letters of amendment thereto.²⁰⁷ At paragraph 46, the court reiterated its findings that ‘a bank is liable to honour the credit to the beneficiary, in the absence of fraud, on presentation... of documents specified... strictly conform[ing]’ with the guarantee.²⁰⁸

In *Grinaker LTA Rail Link Joint Venture*,²⁰⁹ applicant sought ‘an order directing the first respondent (Absa Insurance) to make payment of’²¹⁰ a specified amount under an ‘on-demand’ construction guarantee. The guarantee was unconditional and irrevocable. The main contention by the first respondent was that the demand did not conform with

¹⁹⁹ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another*.

²⁰⁰ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* [3].

²⁰¹ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* [16].

²⁰² *OK Bazaars (1929) Limited v Standard Bank of SA Limited* 2002 (3) SA 688 (SCA) [697H – 698A-C].

²⁰³ *Midland Bank Ltd v Seymour* [1955] 2 Lloyd’s Rep 147.

²⁰⁴ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* [16]; see also *Transnet SOC Limited v Absa Insurance Company Ltd and Others* (08853/2016) [2019] ZAGPJHC 476 (24 October 2019) [11].

²⁰⁵ *Loomcraft* case [815].

²⁰⁶ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* [18].

²⁰⁷ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* [18].

²⁰⁸ *Stefanutti & Bressan (Pty) Limited v Nedbank Limited and Another* [46].

²⁰⁹ *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others*.

²¹⁰ *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others* [1].

the prerequisites; hence respondent was not obliged to pay.²¹¹ The court had to decide as to whether the guarantor could escape liability if the demand was non-compliant with guarantee.²¹²

The court found that 'strict compliance with the terms of the guarantee is required'.²¹³ If a guarantor is called to pay, the guarantor must do so. As one would expect, the court relied on *OK Bazaars (1929) Limited v Standard Bank of SA Limited; Edward Owen Engineering Limited v Barclays Bank International Limited*; and *Lombard Insurance Co Limited v Landmark Holdings (Pty) Ltd*, to conclude that applicant was not entitled to receive payment if the demand did not comply with prerequisites of guarantee.²¹⁴ Consequently, the application was dismissed.

In *Compass Insurance*, the court had to decide whether a demand by the beneficiary, namely, Hospitality Hotel Developments conformed with the prerequisites of the demand guarantee.²¹⁵ There was a guarantee issued by Compass Insurance for work to be performed by the subcontractor.²¹⁶ The subcontractor defaulted and was provisionally wound up in terms of a court order.²¹⁷ The beneficiary wanted payment from the guarantor, but omitted to annex the court order provisionally winding up the subcontractor.²¹⁸

The demand guarantee entered into by the guarantor and beneficiary stipulated that the guarantor is to pay the beneficiary on first written demand.²¹⁹ The demand must state that the subcontract was cancelled as a result of default by the subcontractor.²²⁰ In addition, if the subcontractor is liquidated, a court order must be annexed to the written demand by the beneficiary.²²¹

²¹¹ *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others* [5].

²¹² *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others* [13].

²¹³ *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others* [14].

²¹⁴ *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others* [18].

²¹⁵ *Compass Insurance* case [1].

²¹⁶ *Compass Insurance* case [2].

²¹⁷ *Compass Insurance* case [3].

²¹⁸ *Compass Insurance* case [3].

²¹⁹ *Compass Insurance* case [4].

²²⁰ *Compass Insurance* case [4].

²²¹ *Compass Insurance* case [4].

The main argument by the beneficiary in the appeal court was that there is no requirement for strict compliance. Notwithstanding that the Supreme Court of Appeal has held: '[that the] performance guarantee in question was not unlike an irrevocable letter of credit'.²²² The court mentioned Kelly-Louw who argues '[that] courts in South Africa will also apply to demand or performance guarantees the same standard of strict documentary compliance as they do to letters of credit'.²²³ However, the court found that it was 'not necessary to decide whether strict compliance is necessary for performance guarantees [since] there was in fact no compliance, let alone strict compliance'.²²⁴ The court concluded that while it may transpire that certain guarantees may be construed as a traditional guarantee or accessory obligation (suretyship) but in this case the guarantee was independent in nature thus had to be fulfilled according to its prerequisites.²²⁵ In this regard, the appeal was upheld.

In *State Bank of India v Denel*,²²⁶ respondent (Denel SOC) concluded a contract with the government of India to supply weaponry.²²⁷ Denel was required to provide a guarantee from an Indian bank. Subsequently, Absa provided counter-warranty guarantees on the terms that the guarantees would be paid on first written demand. A written demand was submitted to Absa on grounds of default by Denel. Absa did not want to pay. Nonetheless, Absa changed its stance and informed Denel of its intention to pay the beneficiary.²²⁸ Denel applied for an interdict against Absa. The main argument by Denel was that Indian banks acted fraudulently, and there was non-compliance with the counter-warranty guarantees.²²⁹

The court started by stating the well-established principles in relation to demand guarantees, *inter alia* '[that] banks [must] honour the obligations they have assumed in terms of guarantees issued by them'.²³⁰ The court further underscored that 'the

²²² *Compass Insurance* case [8].

²²³ *Compass Insurance* case [12].

²²⁴ *Compass Insurance* case [13].

²²⁵ *Compass Insurance* case [15].

²²⁶ *State Bank of India v Denel*.

²²⁷ *State Bank of India v Denel* [1]; see also Michelle Kelly-Louw and Karl Marxen, 'General update on the law of demand guarantees and letters of credit' [2015] ABLU 276, 277.

²²⁸ *State Bank of India v Denel* [4].

²²⁹ *State Bank of India v Denel* [5].

²³⁰ *State Bank of India v Denel* [6].

guarantee must be paid on demand'.²³¹ It is important to note that banks are only obliged to make payment if the demand accords with the prerequisites of the guarantee.²³² Nonetheless, it is also dependent on the interpretation of the guarantee as to whether the conditions are met.²³³ Generally, South African courts may only interfere with demand guarantees if fraud is established. However, 'mere error, misunderstanding or oversight, however unreasonable, would not amount to fraud'.²³⁴

The court found that the beneficiary's written demand did not meet the prerequisites of the counter-warranty guarantees insofar as '[the demand was] premised on a failure by Denel to comply with contractual obligations'²³⁵; whereas, the demand should have been premised on the 'failure to comply according to the warranty obligations under the contract'.²³⁶ The court nonetheless found that one of the guarantees fell exclusively within the jurisdiction of Indian courts. Thus, the High Court should have not granted an interdict in that respect.²³⁷ This case is a clear example of strict compliance on demand guarantees. Kelly-Louw & Marxen are of the opinion that 'it is unfortunate that the court did not express any views' on the applicable standard with respect to demand guarantees.²³⁸

However, despite the fact that the court did not pronounce on the applicable standard, it does appear from the findings of the court that strict compliance applies.²³⁹ Albeit Kelly-Louw & Marxen concur with the findings of the court, they submit that the court should have not considered whether the demand under the primary guarantee was compliant or not because that would totally undermine the autonomy principle.²⁴⁰ The court should have confined its consideration only to the demands in terms of the counter-guarantees and made a finding based on those demands. Moreover, Kelly-

²³¹ *State Bank of India v Denel* [8].

²³² *State Bank of India v Denel* [9].

²³³ *State Bank of India v Denel* [9].

²³⁴ *State Bank of India v Denel* [10].

²³⁵ *State Bank of India v Denel* [17].

²³⁶ *State Bank of India v Denel* [17].

²³⁷ *State Bank of India v Denel* [22].

²³⁸ Kelly-Louw and Marxen, *General update* 285.

²³⁹ Kelly-Louw and Marxen, *General update* 285.

²⁴⁰ Kelly-Louw and Marxen, *General update* 286.

Louw & Marxen submit that 'it was completely unnecessary for the courts to look at facts beyond the counter-guarantees and the demand made under them'.²⁴¹

4.3 Substantial compliance

South African courts have applied substantial compliance in few instances. In *Kristabel*, the beneficiary neglected to include the underlying contract's cancellation notice as required by the guarantee's terms.²⁴² Nevertheless prior to submission of demand, the cancellation notice was delivered to the guarantor.²⁴³ The guarantor claimed that, because the beneficiary did not attach the letter of cancellation, the demand did not meet the prerequisites of the guarantee.²⁴⁴ While the beneficiary counterargued that strict compliance is not a requirement and in any event the required notice was submitted to the guarantor before the demand was made, which could be deemed as compliance.²⁴⁵

Based on *Compass Insurance*, the court did not determine whether strict or substantial compliance is the appropriate standard of compliance. The court, however, held: 'the presentation of the cancellation by applicant to respondent...instead of contemporaneous presentation with the demand constitutes, in these circumstances, compliance with the guarantee'.²⁴⁶ The court made an order in favour of the beneficiary instructing the guarantor to pay the guaranteed amount.

In *University of Western Cape v Absa Insurance Company Ltd*,²⁴⁷ applicant sought an order compelling respondent (Absa) to pay. The respondent's defence was that there was no compliance, and the conduct of applicant was tainted by impropriety.²⁴⁸ In this case, the contractor had commenced the building project; however, failed to complete the project. As a consequence, the applicant cancelled the building contract and

²⁴¹ Kelly-Louw and Marxen, *General update* 287.

²⁴² *Kristabel* [19].

²⁴³ *Kristabel* [23].

²⁴⁴ *Kristabel* [24].

²⁴⁵ *Kristabel* [24].

²⁴⁶ *Kristabel* [39].

²⁴⁷ *University of the Western Cape v Absa Insurance Company Ltd*.

²⁴⁸ *University of the Western Cape v Absa Insurance Company* [1].

indicated its intention to call up the guarantee.²⁴⁹ Thereafter, the applicant through an agent made a demand at the respondent's address as required by the guarantee. A copy of the guarantee and a notice of cancellation of the underlying contract were annexed by the applicant to the demand.²⁵⁰

The respondent contended non-compliance by applicant on the basis that the demand was submitted by an agent not the applicant as required by the guarantee. The respondent also claimed that because the contractor was not in default, the demand had not been made in *bona fide*. The court considered the guarantee insofar as it required a demand to be made by the employer (applicant) at the address of guarantor (respondent). Evidence of cancellation was required to demonstrate that the underlying contract was breached. Clause 8 stipulated that 'in the event of a call on this Guarantee Payment will only be made against return of this original Guarantee by the Employer or the Employer's duly authorised agent'.²⁵¹

The respondent cited the *Compass Insurance* case to support the claim that strict compliance is required. In this instance, the principal agent of the applicant made the demand instead of the applicant. Most importantly, the court had to decide whether a demand by an agent should be deemed as compliance. The court considered the agency legal notion in South Africa's law and concluded that it is generally accepted and applied.²⁵² The court held that there was no express prohibition of representation or agency in the guarantee. In that respect, the court correctly concluded: 'the act of representation should be regarded as the act of the principal as if it had been performed by the principal itself'.²⁵³

The court considered the second defence by the respondent that the cancellation was *mala fide*. The court relied on *Dormell v Renasa*,²⁵⁴ finding that the appellant had 'lost the right to enforce the guarantee and that there remained no legitimate purpose to

²⁴⁹ *University of the Western Cape v Absa Insurance Company* [2].

²⁵⁰ *University of the Western Cape v Absa Insurance Company* [3].

²⁵¹ *University of the Western Cape v Absa Insurance Company* [6].

²⁵² *University of the Western Cape v Absa Insurance Company* [10].

²⁵³ *University of the Western Cape v Absa Insurance Company* [12].

²⁵⁴ *Dormell v Renasa*; see also *University of the Western Cape v Absa Insurance Company* [16].

honour the guarantee'.²⁵⁵ Conversely, the minority judgment reinforced the independence rule.²⁵⁶ The court concluded that a consideration of whether 'the applicant was entitled to cancel the contract is irrelevant'.²⁵⁷

The court finally considered the fraud allegation on the part of the applicant. The court held that failure to produce evidence of fraud rendered the respondent's defence flawed and accordingly had to be dismissed. The application was upheld, and the respondent was ordered to pay the beneficiary.

In *Lombard v Schoeman*,²⁵⁸ the legal question was whether the guarantee's conditions had been followed 'where the beneficiary's demands for payment were made to the guarantor at its address, rather than at the address of the beneficiary'.²⁵⁹ The court, using well-established interpretation tools, determined that the intention of the guarantee was to protect Sasol from any default by Golden Sun.²⁶⁰ It was said that the guarantee was 'an independent, autonomous contract' wherein other contractual arrangements had no bearing to the guarantor.²⁶¹ The court in reaching its conclusion relied on *MUR Joint Ventures BV v Compagnie Monegasque De Banque*.²⁶² In *MUR Joint Ventures*, the guarantee required that a demand must be sent to the guarantor via registered mail, however, it was sent via email, fax and courier. The argument was that there had been no valid demand since it was not sent via registered mail. The English court concluded that the 'requirement in clause 1 is directory, and not mandatory'.²⁶³ In that regard, the presentation of the first demand was deemed effective. Equally, the court came to a similar conclusion that despite that the demand was presented at the address of the guarantor, while the guarantee required that the demand be presented at the premises of the beneficiary, there was an effective

²⁵⁵ *University of the Western Cape v Absa Insurance Company* [16].

²⁵⁶ *University of the Western Cape v Absa Insurance Company* [16].

²⁵⁷ *University of the Western Cape v Absa Insurance Company* [18].

²⁵⁸ *Lombard Insurance case*.

²⁵⁹ *Lombard Insurance case* [22].

²⁶⁰ *Lombard Insurance case* [24].

²⁶¹ *Lombard Insurance case* [24].

²⁶² *MUR Joint Ventures BV v Compagnie Monegasque De Bank* [2016] EWHC 3107 (Comm); see also *Lombard Insurance case* [27].

²⁶³ *Lombard Insurance case* [28].

presentation of the demand.²⁶⁴ The requirement on the address of presentation in this case was 'directory and not mandatory'.²⁶⁵

According to Affaki and Goode, 'a presentation [of the demand] must be to the guarantor at the place specified in the guarantee'.²⁶⁶ One wouldn't expect that a presentation of a demand would be made in any other place except the guarantor's premises. In this case, the court deviated from the strict compliance doctrine.

In *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd*,²⁶⁷ the court had to interpret a demand guarantee. The applicant, Uitspan Colliery, sought payment from the respondent, Lombard Insurance. When the beneficiary presented a demand, the guarantor dishonoured the demand 'because it was not accompanied by written consent from the mine owner, African Coal Trading (Pty) Ltd ("ACT")'.²⁶⁸

The court had to determine 'whether the applicant's demand for payment under the guarantee complied with the requirements of the guarantee'.²⁶⁹ The court relied on *Compass Insurance*, and found that the guarantee was an independent guarantee thus required fulfilment in accordance with its terms.²⁷⁰ If the prerequisites of a guarantee are met, the guarantor may not enquire whether there is liability (no consideration of merits).²⁷¹ The court had to interpret the guarantee using the established interpretation approach outlined in the case of *Natal Joint Municipal Pension Fund v Endumeni Municipality*.²⁷²

The guarantor argued that written consent is a requirement of the guarantee.²⁷³ The beneficiary argued that the list in clause 2 of the guarantee is disjunctive; thus, each category would trigger the guarantor's obligation to pay otherwise any other

²⁶⁴ *Lombard Insurance case* [29].

²⁶⁵ *Lombard Insurance case* [29].

²⁶⁶ Affaki and Goode, (n 114) 95.

²⁶⁷ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* (24814/2020) [2022] ZAGPJHC 389 (25 May 2022).

²⁶⁸ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [12].

²⁶⁹ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [13].

²⁷⁰ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [14].

²⁷¹ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [16].

²⁷² *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) [18].

²⁷³ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [21].

interpretation would be “uncommercial and insensible”.²⁷⁴ The court found that the written consent requirement did not constitute a requirement for a valid demand.²⁷⁵ The court went on to find that to interpret the stipulation of written consent as mandatory would be incorrect.²⁷⁶ Therefore, the court construed the written consent requirement as ‘directory and not peremptory’.²⁷⁷ So, to interpret it as ‘peremptory would lead to an insensible or unbusinesslike result and undermine the apparent purpose of the guarantee’.²⁷⁸ In its finding, the court remarked that—

To sum up, on a contextual interpretation that promotes the purpose of the guarantee, it is not a mandatory requirement of the guarantee that the applicant's demand must be accompanied by the written consent of ACT. Accordingly, the applicant has complied fully with the terms of the guarantee and is entitled to judgment in terms of the notice of motion.²⁷⁹

The court ordered that the guarantor to pay beneficiary in accordance with the guarantee.

In the case of *Millenium Aluminium and Glass Services CC and Others v Group Five Construction (Pty) Ltd and Another*²⁸⁰, the court had to determine whether a demand complied with the requirements of a guarantee. The first respondent, Group Five Construction (Pty) Ltd (Group Five Construction), claimed payment from the second respondent, Constantia Insurance Company Limited (Constantia) and the first appellant, Millenium Aluminium and Glass Services CC (Millenium), in terms of the guarantee.²⁸¹

Constantia requested the court to enjoin Mr Mohanlall Bridgenun, the second appellant, and Fast Track Contracting Africa (Pty) Ltd (Fast Track), the third appellant,

²⁷⁴ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [22].

²⁷⁵ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [24].

²⁷⁶ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [29].

²⁷⁷ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [30].

²⁷⁸ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [30].

²⁷⁹ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [33].

²⁸⁰ *Millenium Aluminium and Glass Services CC and Others v Group Five Construction (Pty) Ltd and Another* (693/2021) [2022] ZASCA 180 (14 December 2022) [1] (hereinafter referred to as ‘*Millenium case*’).

²⁸¹ *Millenium case* [1].

as parties to the proceedings because of the indemnity and the deed of suretyship signed by these parties in favour of Constantia.²⁸²

In May 2015, Group Five Construction was appointed as a building contractor.²⁸³ Group Five Coastal (Pty) Ltd (Group Five Coastal), acting as an agent of Group Five Construction, appointed Millenium as a subcontractor.²⁸⁴ The subcontractor was required to provide demand guarantees in favour of Group Five Construction.²⁸⁵

Group Five Construction instituted proceedings in the High Court seeking payment in terms of the guarantee.²⁸⁶ Millenium opposed the application on the basis, *inter alia*, that the terms of the guarantee were not met. The High Court, however, held that Group Five Construction had complied with the requirements of the guarantee.²⁸⁷ On appeal in the SCA, Millenium submitted that the High Court was incorrect in its findings as the payment advice and the guarantee did not refer to Group Five KZN or its registration number. In addition, strict compliance is required in respect of demand guarantees.

The court, relying on *Schoeman v Lombard*, dismissed the argument by Millenium. The court found that at the heart of the—

issue is ... the interpretation of the demand guarantee and whether there was compliance with the guarantee in circumstances where an entity which made a demand on guarantee is not the same as an entity that issued a payment certificate and the reconciliation statement.²⁸⁸

In addition, the court was of the opinion that ‘Constantia was in no doubt about the identity of the Contractor, because that was easily ascertainable from the guarantee itself which it had issued’.²⁸⁹ Millenium also contended on appeal that Group Five Construction submission of a copy of the guarantee did not meet the requirements of the guarantee. The court found no merit in such a submission.²⁹⁰ The court stated that:

²⁸² *Millenium case* [2].

²⁸³ *Millenium case* [6].

²⁸⁴ *Millenium case* [6].

²⁸⁵ *Millenium case* [7].

²⁸⁶ *Millenium case* [10].

²⁸⁷ *Millenium case* [12].

²⁸⁸ *Millenium case* [16].

²⁸⁹ *Millenium case* [17].

²⁹⁰ *Millenium case* [19].

... Millenium is however opportunistic to argue that the high court should not have granted relief to Group Five Construction because the guarantee on which it made a demand was a copy and not the original. Millenium was aware of the reason why Group Five Construction did not submit the original guarantee to Constantia. The original guarantee that was reissued after the expiry of the initial one was returned by Mr Rakesh Chunilall, Millenium's director and the deponent to Millenium's answering affidavit, to Constantia for cancellation, purportedly on the basis that the project was practically complete. Thus, Group Five Construction never had in its possession the reissued original guarantee and could not be blamed for having submitted a copy of the guarantee to Constantia.²⁹¹

Notwithstanding that Five Construction presented a copy not the original guarantee when it made its demand to Constantia, the court still found the demand being properly presented. This is a departure from the strict compliance doctrine. The appeal was, however, correctly dismissed.

4.4 Analysis of case law relating to strict and substantial compliance

English courts have indicated in *Siporex Trade SA v Banque Indosuez*²⁹² that a demand guarantee and a letter of credit may be different. In *MUR Joint Ventures BV v Campagnie Monegasque De Banque*,²⁹³ the court was called upon to decide whether a demand that was not submitted through a registered mail was compliant with the prerequisites of the guarantee.

The Judge found that—

[T]he principle of strict compliance does not necessarily apply to demand guarantees. In *IE Contractors v Lloyd's Bank* [1990] 2 Lloyd's Rep 496, Staughton LJ said that, generally speaking, demand guarantees were conditional on the presentation of documents rather than upon the actual existence of the facts those documents asserted, since bankers can check documents but do not have the means or inclination to check facts. He continued at pp 500-501²⁹⁴

²⁹¹ *Millenium* case [20].

²⁹² *Siporex Trade SA v Banque Indosuez*²⁹² [1986]2 Lloyds Rep 146 [159].

²⁹³ *MUR Joint Ventures BV v Campagnie Monegasque De Banque* [2016] EWHC 3107 (Comm).

²⁹⁴ *MUR Joint Ventures BV v Campagnie Monegasque De Banque* [26].

“The question is ‘What was the promise which the bank made to the beneficiary under the credit, and did the beneficiary avail himself of that promise?’ The degree of compliance required by a performance bond may be strict, or not so strict. It is a question of construction of the bond.”²⁹⁵

It was held that ‘in my view this requirement in clause 1 is directory, not mandatory... [t]hat is because the guiding principle is one of effective presentation of a demand’.²⁹⁶ This judgment specifies that there may be a distinction on the applicable standard with respect to demand guarantees. Satchwell J, in *Kristabel*, relied on these authorities from the English court, denoting that South Africa follows English courts.²⁹⁷

Kelly-Louw, relying on *Frans Maas (UK) Ltd v Habib Bank AG Zurich*,²⁹⁸ suggests that ‘South African courts will also apply the same standard of strict documentary compliance to demand guarantees’.²⁹⁹ Nevertheless, this submission from Kelly-Louw is not finding favour in South African courts in light of various decisions such as *Kristabel*, *Lombard Insurance*, *University of Western Cape* and *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd*. Substantial compliance is increasingly finding favour, supported by the ‘facts matrix’ interpretation.

South African courts are now more willing to ensure that these contracts are executed for their true purpose; that is to provide security to the beneficiary. However, courts are unwilling to enforce, from a commercial perspective, an insensible guarantee requirement. For example, in *Lombard Insurance*, it was held that the requirement on the address of presentation was merely directory and not mandatory. Similarly, in *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd*, it was held that ‘it is not a mandatory requirement of the guarantee that the applicant's demand must be accompanied by the written consent of ACT’³⁰⁰ albeit it was prescribed on the guarantee. What is common with these judgments is that there was no strict

²⁹⁵ *MUR Joint Ventures BV v Campagnie Monegasque De Banque* [26].

²⁹⁶ *MUR Joint Ventures BV v Campagnie Monegasque De Banque* [43].

²⁹⁷ *Kristabel* [30].

²⁹⁸ *Frans Maas (UK) Ltd v Habib Bank AG Zurich* [2001] Lloyd's Rep Bank 14.

²⁹⁹ Kelly-Louw, ‘Selective Legal Aspects’ 69; see also *Compass Insurance* [12]; and Hugo, ‘Conformity of demands’ 287.

³⁰⁰ *Uitspan Colliery (Pty) Ltd v Lombard Insurance Company Ltd* [33].

compliance whatsoever by beneficiaries; however, those guarantees were paid according to the terms of the guarantees notwithstanding non-compliance.

From *Lombard Insurance*, it appears that the principle that may be extracted is that there was effective presentation of the demand. In *Kristabel*, a deviation from strict compliance was observed. Kelly-Louw submits that the correctness of the decision in *Kristabel* is “debatable”.³⁰¹ From a strict compliance perspective, Kelly-Louw is correct, there was no compliance with the guarantee.

Legal scholars who argue for the strict compliance with respect to demand guarantees may only be absolved by courts when it is opportune for a decision to be made on the applicable standard. The Supreme Court of Appeal missed an opportunity in *Compass Insurance* and subsequently in *State Bank of India v Denel*, to make a definite finding on the compliance standard. The decisions by courts following the latter cases have applied the doctrine of substantial compliance wherein the beneficiary does not have to strictly conform with the prerequisites of the guarantee. It follows therefore that, courts are keener to ensure that the beneficiary receives payment according to the guarantee, if a valid presentation is made, except where there is fraud or possibly illegality.

4.5 Conclusion

It remains unclear which standard of compliance is applicable in respect of demand guarantees while it is well-established with letters of credit that strict compliance is the applicable.³⁰² It appears that, as in the English courts, the standard of compliance applicable to demand guarantees and that is applicable to letters of credit is not the same, and South African court are following this distinction.

³⁰¹ Kelly-Louw, (n 4) 63.

³⁰² Kelly-Louw, ‘General update’ 57. See also *OK Bazaars (1929) Ltd v Standard Bank of South Africa Limited* [25]; *Lombard Insurance Holdings (Pty) Ltd v Landmark Holdings*; *Loomcraft case* [815G].

5. CONCLUDING REMARKS

Demand guarantees and letters of credit are important for commercial purposes. These contracts are autonomous of the underlying contract. It has been reiterated on numerous occasions that demand guarantees are similar to documentary letters of credit. In addition, courts have accepted that fraud is one of the exceptions to the autonomous rule. Moreover, courts have indicated that illegality may be a valid exception. Furthermore, guarantees serve an important purpose in providing security for performance. Employers have more certainty that contracts they enter into are guaranteed performance, failing which the employer may call up the demand guarantee.

South African courts make a distinction between conditional guarantees and on demand or unconditional guarantees. If there is an obligation for the employer to demonstrate liability on the part of the contractor, the court may find that that type of a contract is akin to suretyship (conditional guarantee). There are cases where courts have found guarantees to be suretyship. This is where the recognition and application of the URDG becomes imperative. If parties apply these rules by explicit reference in their guarantees; ambiguity and unintended consequences may be avoided. These international rules require wider application in South Africa. It is for these reasons that legal scholars have sounded the call on many occasions that South Africa needs to consider incorporating international rules in national legislation and even on a principles-based approach, i.e., outlining the principles and courts apply those principles.

In South Africa, strict compliance has not been applied consistently. Whereas it remains undisputed that strict compliance applies to documentary letters of credit. However, there has been a deviation on demand guarantees, English courts finding that the compliance standard on demand guarantees may not be as strict as documentary letters of credit. Furthermore, English courts have held that in certain circumstances terms set out in the guarantee are merely directory and not mandatory.

South African courts, which follow English law on demand guarantees, have also been inconsistent on the application of strict compliance and have found favour in the factual

matrix interpretation approach. This approach entails considering surrounding circumstances and the purpose of the guarantee. In that way, courts have allowed beneficiaries to successfully obtain judgment in their favour arguing that certain terms do not make commercial sense or applying those terms would defeat the purpose of demand guarantees. On numerous occasions courts have deviated from strict compliance.

South African courts need to make a definitive finding sooner rather than later on whether strict or substantial compliance applies to demand guarantees. This will ensure legal certainty. In order to decide whether strict or substantial compliance applies, the court may consider the construction of the guarantee i.e., words are given their ordinary grammatical meaning; the context, purpose, and intention of the parties, reflected in the guarantee; and the factual matrix i.e., consider surrounding circumstances, to determine the most business-sensible interpretation of the demand guarantee.

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