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THE APPLICABILITY OF THE DOCTRINE OF STRICT COMPLIANCE TO DEMAND GUARANTEES: THE SOUTH AFRICAN PERSPECTIVE

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Chapter 1: Introduction

1.1 Introduction to demand guarantee

When people enter into commercial transactions, security for the counterparty’s performance of their obligations is always a necessity. This is more so when the parties are unknown to one another.\(^1\) In case of International business transactions there is heightened amount of risk owing to the cross-border component requiring the concerned parties to have regard to, *inter alia*, security for performance, enforcement of debts, judgements and arbitration awards across borders, the unfamiliarity with the foreign legal system, jurisprudential disputes, political interference, and the complicated procedure for ascertaining the financial standing and capability of business partners.\(^2\) In order to mitigate the risk, the importer would require the exporter to arrange with a financial institution to issue a demand guarantee for the benefit of the importer as security in respect of the exporter’s performance of their obligations.\(^3\)

Before the invention of the demand guarantee, the common practice was to require the furnishing of a cash deposit to serve as a form of security that the counterparty would perform the undertaken obligation. The growing difficulty of using cash as security led to the development of demand guarantees as a form of security which is relatively convenient than cash.\(^4\) Thus, demand guarantees have a cash-replacing effect in that they must be honoured on presentation of certain stipulated documents that complies with the provisions thereof.\(^5\)

While it is generally accepted that demand guarantees are a creature of international trade developed in support of turn-key construction contracts as a substitute for cash deposits required by hard-bargaining state-owned beneficiaries, they are at least as developed in

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\(^1\) Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* (LLD thesis, University of South Africa 2008) 1.

\(^2\) Marxen *Demand guarantees in the construction industry – a comparative legal study of their use and abuse from a South African, English and German perspective* (LLD thesis, University of Johannesburg 2017) 51.

\(^3\) Enonchong *The independence principle of letter of credits and demand guarantees* (2011) 1.

\(^4\) See n 1 above.

\(^5\) See n 1 and n 3 above.
domestic exchanges as well such as, *inter alia*, leasing and engineering.⁶ Accordingly, a demand guarantee may be used to secure any obligation.

However, demand guarantees, particularly in South Africa, are commonly encountered in the construction industry.⁷ The reason for that is that large construction projects provide considerable scope for risk and uncertainties of various kind.⁸ The risk borne by the employer that the contractor may not perform its obligations properly is inherent in any building contract. On the other hand, they may also be used as a security for the benefit of the contractor to secure the performance of the employer's payment obligation.⁹ Prior to the utilisation of the demand guarantee as a security in this regard, the risk used to be covered mainly by the establishment of a retention fund: a percentage of each payment security was withheld from the contractor and paid into a retention fund as a security for the due performance of the contractor’s obligation. This form of security, however, represented at least two limitations. Firstly, it presented limited security during the early stages of the construction. Secondly, it adversely affected the cashflow of the contractor. The majority of cases dealing with demand guarantees have a construction contract as their underlying agreements. In this regard, the construction industry has developed its own standard-form guarantees.¹⁰

Against the background provided above, it is necessary to provide a definition of a demand guarantee. Guarantees are generally defined as "instruments of security in which the guarantor secures the performance of a debtor to a creditor by binding itself to pay the beneficiary a sum of money in the circumstances contemplated in the guarantee".¹¹ There are two types of guarantees, namely demand guarantees and accessory guarantees. A demand guarantee is also known as an independent guarantee, autonomous guarantee or first demand guarantee.¹²

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⁸ See n 2 above.
¹⁰ See n 9 above.
¹¹ Hugo (n 7) 438.
¹² See Chapter 2 for discussion of difference between accessory and demand guarantee.
The International Chamber of Commerce (ICC) Uniform Rules for Demand Guarantees 758 (URDG) defines a demand guarantee as “any signed undertaking, however named or described, providing payment on presentation of a complying demand”.\(^{13}\) The URDG at article 2 further recognises “guarantee” separate from demand guarantee.\(^{14}\) However, no definition of “guarantee” is provided. Instead it refers to the definition of “demand guarantee”. The effect of the foregoing is that the URDG uses the same definition for demand guarantee and guarantee. This does not mean, however, that the definition applies to both demand guarantee and accessory guarantees. The basis for this view is that the URDG applies only to demand guarantees or counter-guarantees.\(^{15}\) This means that the only type of guarantee known to URDG is demand guarantee. The approach of using the same definition for the two appears to have been aimed at demonstrating, in a not so elegant way, that in the context of URDG, guarantee and demand guarantees are synonyms.

Affaki and Goode, moreover, provide the most explicit definition of a demand guarantee in that their definition succinctly captures the essence of a demand guarantee. They define it as - 

"an irrevocable undertaking issued by the guarantor upon the instructions of the applicant to pay the beneficiary any sum that may be demanded by that beneficiary up to a maximum amount determined in the guarantee, upon presentation of a demand complying with the terms of guarantee".\(^{16}\)

From the above, it is clear that there are various generally accepted definitions and descriptions of demand guarantees. It is also clear that all of them share essential elements, particularly the parties to a demand guarantee transaction and how they relate to one another.

\(^{13}\) article 2.
\(^{14}\) Article 2 contains definitions.
\(^{15}\) URDG article 1.
\(^{16}\) Affaki and Goode (n 6) 1.
1.2 Drafting of demand guarantee contacts
In South Africa, many guarantees are issued subject to one of three approaches, namely in accordance with the construction industry standard-form guarantee, subject to the URDG rules or none of the above. As regards the latter, the interpretation of the guarantee will rest squarely on the provisions of the guarantee itself in accordance with the South African law of contract. This much is evident from the South African case law dealt with below.

1.2.1 URDG 758 based guarantee
The best starting point in explaining the URDG is to explain the International Chamber of Commerce (“ICC”). The ICC was established in 1919 by a group of industrialists, financiers and traders. The ICC describes itself as the world’s largest business organization, representing more than 45 million companies across 100 countries. It describes its core mission as making business work for everyone, every day, everywhere. ICC aims to promote international trade, responsible business conduct and a global approach to regulation, in addition to providing market-leading dispute resolution services through a unique mix of advocacy, solutions and standard setting.17

ICC has presence in South Africa in the form of a South African national committee known as the South African Chamber of Commerce and Industry (SACCI) as well as through the Johannesburg Chamber of Commerce and Industry (JCCI).

The ICC prides itself for having formulated the voluntary rules by which commerce is conducted every day, from internationally recognized Incoterms rules to the Uniform Customs and Practice for Documentary Credit (UCP) (the latest edition being the 600) that are widely used in international trade finance. While the UCP is the set of voluntary rules produced by the ICC to regulate letters of credit, the URDG is its equivalent aimed at regulating demand guarantees.18 The effect of URDG being a voluntary set of

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17 See Hugo “Letters of credit and demand guarantee: A tale of two sets of rules of the International Chamber of Commerce” 2017 TSAR 1 in general for detailed discussion of the ICC.
18 See https://iccwbo.org/about-us/who-we-are/ (accessed on 04 October 2019) for background relating to the ICC.
rules is that it applies to any demand guarantee or counter-guarantee that is expressly subjected to them.\textsuperscript{19} The URDG is not commonly incorporated into demand guarantees in South Africa.\textsuperscript{20} The effect of that is that the URDG plays no role in the interpretation of such demand guarantees. URDG has its standard forms guarantee which parties can adapt to suite their particular circumstances.\textsuperscript{21}

Once the guarantee or counter-guarantee indicates that it is subject to the URDG, the rules bind all the parties to the guarantee or counter-guarantee except so far as the demand guarantee or counter-guarantee modifies or excludes them.\textsuperscript{22}

### 1.2.2 Construction industry standard-form guarantee

One of the consequences of most South African guarantees not subject to URDG is that they do not enjoy the uniformity that URDG provides. That being the case, various bodies in the construction industry have established standard-form guarantee contracts. The effect of the forms is that they bring some uniformity to guarantees. However, the uniformity is not absolute for at least two reasons. The first reason is that utilisation of the forms is voluntary and therefore parties may decide not to use them. In \textit{Minister of Transport and Public Works, Western Cape and Another v Zanbuild Construction (Pty) Ltd and Another},\textsuperscript{23} for instance, parties entered into a guarantee contract the terms of which differed substantially from the applicable standard form despite having an option to use the form. The second reason is that there are few organisations in the industry which have different forms. Joint Building Contracts Committee (JBCC), General Conditions of Contract for Construction Works (GCC) of the South African Institute of Civil Engineering all have different standard forms. Though not widely used, Federation International des Ingenieurs-Counsel (FIDIC) and the New Engineering Contract are also encountered in South Africa.

\textsuperscript{19} See n 15 above.
\textsuperscript{20} Hugo (n 7) 439.
\textsuperscript{21} See n 20 above.
\textsuperscript{22} See n15 above.
The benefit of using standard forms is that the forms are formulated within the industry with the rights of the parties being carefully considered.\textsuperscript{24} Furthermore, the jurisprudence of demand guarantees in South Africa is to some extent informed by JBCC standard-form guarantees since they have dominated the attention of courts.\textsuperscript{25}

It must be mentioned that the utilisation of standard-form guarantees, particularly in the construction industry, is not uniquely South African. Other countries do use them as well.\textsuperscript{26}

\textbf{1.2.3 Ad hoc or Bespoke Guarantee}

Parties may opt to negotiate all the terms of the guarantee from scratch without relying on standard forms or subjecting the guarantee to URDG.\textsuperscript{27} Most South African demand guarantee case laws relates to this position. A sharp example of the case in which the approach was adopted is \textit{Zanbuild} where parties disregarded the standard form and URDG and opted to negotiate the terms of their guarantee afresh.\textsuperscript{28} These guarantees are interpreted in accordance with the law of contract in South Africa, therefore, based solely on the instrument of guarantee.

\textbf{1.3 Introduction to the doctrine of strict compliance}

The doctrine of strict compliance is well-developed in the context of letters of credit rather than in the demand guarantee context.\textsuperscript{29} It entails that the beneficially should submit to the guarantor documents that are specified in the demand guarantee in order for the beneficiary of the guarantee to be entitled to payment.\textsuperscript{30} The doctrine was aptly outlined by the House of Lords in England when it observed that “\textit{[t]here is no room for documents which are almost the same, or which will do just as well}”.\textsuperscript{31}

\begin{thebibliography}{9}
\bibitem{24} Marxen (n 2) 35-38.
\bibitem{25} Hugo (n 9) 159.
\bibitem{26} Marxen (n 2) 40-45.
\bibitem{27} Hugo (n 7) 442.
\bibitem{28} See n 23 above.
\bibitem{29} Hugo “The Law relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks” (LLD thesis, University of Stellenbosch, 1996); Hugo (n 9) 163.
\bibitem{30} See Kelly-Louw “The documentary nature of the guarantee and doctrine of strict compliance (part 1) 2009 \textit{SA Merc LJ} 306 317-321 for discussion of the doctrine.
\bibitem{31} Equitable Trust Company of New York v Dawson Partners Ltd [1926] 27 L1 REP 49 (HL) 52.
\end{thebibliography}
There is much scholarly debate as to what the required standard of compliance is. On the one hand there is a view that the demand must strictly comply with the terms of the guarantee while on the other hand there is a view that holds that strict compliance is not applicable. The former view is further divided into two. One school of thought holds that strict compliance does not require rigid meticulous fulfilment of precise wording in all cases while another holds that the specific requirements must be fulfilled, no matter how trivial some aspects thereto might seem.\(^{32}\)

1.4 Research question
The central question to this research is what the required standard of compliance for payment under a demand in the case of a demand guarantee, is. This question is not entirely new as it has been troubling lawyers and bankers for some time. What keeps it a relevant question, however, is that, overtime, courts and academics had revised their view on same, sometimes taking totally opposite positions from their initial ones.

2 Fundamentals of demand guarantees

2.1 Introductory remarks
This chapter two together with chapter three, serves to provide relevant background against which an analysis of the applicability of the doctrine of strict compliance regarding demand guarantees can be explored.

2.2 Demand guarantees and accessory guarantees
As indicated above, demand guarantees, and accessory guarantees are two known types of guarantees. By virtue of being members of the same family, it stands to reason that they have similarities and differences. The striking similarity is that both are instruments of security in which the guarantor secures performance of the debtor to a creditor (the beneficiary of the guarantee) by binding itself to pay the beneficiary a sum of money in the circumstances contemplated in the guarantee.33

Differentiating between demand guarantee and accessory guarantee is important as the rights and obligations, and legal principles applicable to each are different. In practice this exercise is difficult and sometimes complex, particularly when the guarantee instrument contains ambiguous wording and terms.34 The courts approach in this regard is to read the guarantee as a whole and determine from its clauses whether the parties intended the guarantee to be independent or accessory. In this exercise, the language used in the guarantee is generally conclusive.35 It is interesting to note that the approach differs to the one used by the courts in the People’s Republic of China which rely on a checklist approach to determine the difference.36

The South African courts, however, only consider a guarantee to be a demand guarantee where such an intention is obvious on the proper interpretation of the guarantee as a

35 See n 34 above.
36 Hugo (n 34) 134.
whole.\textsuperscript{37} If there is any ambiguity in the clauses of the guarantee, the courts are more likely to conclude that the parties intended to create an accessory guarantee.\textsuperscript{38}

The main difference between demand guarantees and accessory guarantees is that in the case of the demand guarantee the guarantee is independent of the underlying relationship while in case of accessory guarantee the guarantor is only liable to pay if the debtor is in default of its obligations towards a creditor. The accessory guarantee is, therefore, akin to suretyship.\textsuperscript{39} Surety may be defined as

"Suretyship is an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and, secondarily that if and so far as the principal debtor fails to do so, he, the surety, will perform it or, failing that, indemnify the creditor."\textsuperscript{40}

Accessory guarantees, just like surety, provide security in the event of compliance with the applicant’s obligations in accordance with the contract and bound the guarantor for the due and faithful performance by the applicant in terms of contact.

In addition, it is to be noted that in the case of accessory guarantees the guarantor may raise any defence against the creditor that would have been available to the debtor whose performance is secured by the guarantee whereas in the case of a demand guarantee the defence that would have been available to the debtor is irrelevant.

The difference between the demand and accessory guarantee was crystallised in the case of \textit{Zanbuild}. The Department of Transport and Public Works ("the department") contracted with Zanbuild to construct two pathology laboratories.\textsuperscript{41} ABSA bank issued two construction guarantees at the behest of Zanbuild.\textsuperscript{42} The guarantee provided that the bank

\begin{itemize}
\item \textsuperscript{37} Kelly-Louw (33) 115.
\item \textsuperscript{38} See n 37 above.
\item \textsuperscript{39} See Hugo (n 7) 440-442. See also Affiki and Goode (n 6) 17.
\item \textsuperscript{40} Forsyth and Pretorious Caney’s \textit{The law of Suretyship in South Africa} (2002) 27-28.
\item \textsuperscript{41} \textit{Zanbuild} (n 23) par 3.
\item \textsuperscript{42} \textit{Zanbuild} (n 23) par 1.
\end{itemize}
reserves the right to withdraw the guarantee after 30 days' notice to the employer of its intention to do so, with the provision that the employer has the right “to recover from the bank the amount owing and due to the employer by the contractor on the date the notice period expires”. Consistent with the aforementioned provision, the bank notified the department on 28 August 2008 that it intends to withdraw from the guarantees and that the guarantees would be cancelled on 28 September 2008. Following certain issues with the work, the department purported to cancel the construction contracts. Zanbuild accepted the cancellation as a repudiation by the department, the contracts therefore coming to an end before the projects could be completed. The department then demanded payment from the bank in terms of the guarantee. The department did not contend that it had an identifiable monetary claim against Zanbuild under the construction contract but maintained that the guarantees stood independent from the construction contracts, in a manner comparable to irrevocable letters of credit. Zanbuild argued that the guarantees were inextricably linked to the construction guarantees in a manner akin to a suretyship agreement. Both the High Court and Supreme Court of Appeal (SCA) found in favour of Zanbuild. Both the High Court and the SCA were swayed by the fact that the department had established no amount due to it by Zanbuild during the currency of the guarantees. The court accepted the reasoning that in the case of conditional bonds (accessory guarantees) the claimant (beneficiary) is required to allege or prove liability on the part of the contractor for the same amount while same is not required in case of demand bonds. In Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association, the Zanbuild reasoning was embraced. In Lombard Insurance Company Limited v Stewart and Others the court also followed the same line of reasoning.

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43 Zanbuild (n 23) par 5.
44 Zanbuild (n 23) par 6.
45 Zanbuild (n 23) par 9.
46 Zanbuild (n 23) par 7.
47 Zanbuild (n 23) par 10.
48 Zanbuild (n 23) par 11.
49 Zanbuild (n 23) par 25
50 Zanbuild (n 23) par 13.
51 (050/2013) [2013] ZASCA 202; [2014] 1 All SA 536 (SCA); 2014 (2) SA 382 (SCA) (2 December 2013).
51 (15923/15) [2016] ZAKZPHC 91 (11 October 2016).
52 (15923/15) [2016] ZAKZPHC 91 (11 October 2016).
In *Mutual and Federal Insurance Company Limited and Another v KNS Construction (Pty) Limited and Another* the court also clarified the difference between accessory and demand guarantees. In this case the distinguishing factor was that the guarantee was not accompanied by any document before payment was demanded. The court held that

"the fact that the guarantee was not accompanied by any document before payment was demanded but depended on breach of the sub-contract by Aqua in either failing to commence, proceed with or complete the project, lends credence to the fact that the guarantee is inextricably linked to the sub-contract and therefore akin to a suretyship".

2.3 Parties to a demand guarantee transaction

The URDG recommends that all guarantees should specify the applicant, the beneficiary and the guarantor. This is logical as a direct demand guarantee would typically involve three parties, namely the applicant, beneficiary and the guarantor. The three are briefly described hereunder.

The applicant is the party in the guarantee who has the obligation under the underlying relationship supported by the guarantee. The applicant requests the guarantor to issue a guarantee in favour of the beneficiary. In the construction environment the contractor is normally an applicant, save for payment guarantee where the employer is the applicant.

When the applicant makes an application, he does so in favour of the beneficiary. Normally the applicant and the beneficiary would be two parties to the underlying relationship and the applicant would approach the guarantor to issue a guarantee as a form of security in favour of the beneficiary.

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54 *KNS Construction* (n 53) par 16.
55 See n 54 above.
56 URDG article 8.
57 See Kelly-Louw (n1)17 for a discussion on direct and indirect demand agreements.
A guarantor on the other hand is the party which issues a guarantee as security in favour of the beneficiary upon being approached by the applicant. In case the requirements of the demand guarantee have been met, the beneficiary calls up the guarantee by demanding payment from the guarantor. The guarantor would be a financial institution typically, a bank or insurance company.

Beyond the abovementioned indispensable parties, the URDG recognizes other parties, namely counter-guarantor, presenter and advising party. A counter-guarantor is the party which issues a counter-guarantee, whether in favour of the guarantor or another counter-guarantor, and includes parties acting for its own account. Essentially, a counter-guarantor is the party who provides security for the commitments of the guarantor.

The presenter is the defined as a party who makes a presentation as or on behalf of the beneficiary or the applicant. From this definition, it is clear that parties to a guarantee, except for guarantor, may validly act through agents. In University of western Cape v ABSA case the court held that

“When these general principles are applied to the guarantee in question it appears that performance by the employer as stipulated in clause 5 is not of such a personal nature that the guarantor may insist on personal performance. On the contrary, this guarantee appears to be part of a normal business transaction between the applicant as employer and the respondent as guarantor. There is also no indication, neither has it been argued, that representation by an agent acting on behalf of the employer in this case is prohibited by law or that a specific person has been designated.”

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58 See n 14 above.
59 See n 14 above.
60 See n 14 above.
61 (100/2015) [2015] ZAGPJHC 303 (28 October 2015) par 12; agency was also accepted by the court in Phenix Construction Technologies (Pty) Ltd and Another v Holland Insurance Company Limited (10995/2015) [2017] ZAGPJHC 174 (4 May 2017); See also Potchefstroom Stadsraad v Kotze 1960 (3) SA 616 (A) for exceptions.
On the basis of the court’s remarks, it may be said that the attitude of the court is that the utilisation of the representatives may be permitted only if it does not go against the provisions of the guarantee itself.

The URDG defines advising party as “a party that advises the guarantee at the request of the guarantor”. The beneficiary or guarantor may receive advice on any issue relating to the guarantee or counter-guarantee either directly from guarantor or counter-guarantor or through agency.

2.4 Types of demand guarantees

It is not possible to provide an exhaustive list of the types of demand guarantees as demand guarantees can conceivably cover any obligation. They may be used to secure contractual, statutory, regulatory or court-ordered obligations in any industry.

Below, however, are some of the commonly encountered types of demand guarantees.

Performance guarantee

This guarantee has been the subject matter of a number of South African court cases. Performance guarantees assure payment to the employer in the case of the contractor failing to perform its obligation under the construction contract or at all. This covers the employer in case the contractor, for instance, performs sub-standard work or does not do the work at all.

62 See n 14 above.

63 See, for example, Affaki and Goode (n6) 5 for a case where a demand guarantee was used to secure the release of a hostage, a CEO of a company, who was detained in a foreign country in which his company was accused of complicity in the environmental damage. The guarantee issued in that case assured the government of the said country that the company would decommission and clean the polluted site and compensate the injured environment.

64 Hugo (n 7) 443.
**Payment guarantee**

A payment guarantee normally assures payment of the contractor for the work that it has completed in terms of the contract. Therefore, it is applied for by the employer in favour of the contractor.

**Advance payment guarantee**

In case, for instance, the contractor requires advance payment in order to move a heavy machine to the contracting site, the employer might have to make an advance payment against an advance payment guarantee applied for by the contractor in favour of the employer.

**Retention guarantee**

Construction contracts often provide for the retention of some money at the end of construction works which serves as security for the defects that may emerge after the contractor has left the site. Retention guarantees are normally applied for by the contractor in favour of the employer in order for the employer to realize all the moneys due.

**Warranty guarantee**

The construction contract normally provides for the retention of a part of the contract price for a period after completion of the contract to provide security against emerging defects. The money retained may be released in case the contractor applies for maintenance guarantees in favour of the employer.

**Tender guarantee**

It is normally required that the bidders for a tender apply for a tender guarantee in favour of the employer to cover a situation where the bidder withdraws his bid or is awarded a contract but fails to enter into a contract.

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65 Kelly-Louw (n 1) 28.
66 Hugo (n 7) 444.
67 Kelly-Louw (n 1) 29.
68 Affaki and Goode (n 6) 3.
69 Kelly-Louw (n 1) 27.
Counter-guarantee
URDG defines a counter-guarantee as

“any signed undertaking, however named or described, that is given by the counter-guarantor to another party to procure the issue by another party of a guarantee or another guarantee, and that provides for payment upon the presentation of a complying demand under the counter-guarantee issued in favour of that party.”

From the definition of counter-guarantees it is plain that it is possible for a guarantee to trigger a string of counter-guarantees. This is because a counter-guarantee may well be the subject of another counter-guarantee.

Customs guarantee
This instrument is usually encountered in cross border trade. They are issued to the customs authority to cover any duty liable that may become payable when imported goods or equipment that would be exempted from duty if exported within a specified time are not in fact re-exported within that time.

Credit enhancement guarantee
It allows a better-rated financial institution to undertake to pay security holders should the lesser-rated securities issuer default.

Reinsurance guarantee
This type of demand guarantee is conceptually similar to a risk participation guarantee. They are used by reinsurers to spread the insured risks among several insurers, by arranging for guarantees to be insured in favour of the insurer instead of having to deposit funds against their coverage obligations.

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70 See n 14 above.
71 Affaki and Goode (n 6) 3.
72 Affaki and Goode (n 6) 3.
73 Affaki and Goode (n 6) 3.
Guarantee issued by multilateral financial institution

This covers the payment risk that borrowers from developed economies take in borrowing money in developing economies. This is done in order to encourage them to engage in local financing with a view to fostering growth in the local economy and transferring credit know-how to local banks.

2.5 Major doctrines: the principle of independence and the doctrine of strict compliance

Demand guarantee shares foundational legal principles with letters of credit. The first is the principle of independence and the second the doctrine of strict compliance. This work concerns itself with the doctrine of strict compliance ("the doctrine") which is dealt with in chapter 4. However, it is important, for completeness, to deal with the independence principle.

The principle of independence is comprehensively outlined in the URDG as follows:

"A guarantee is by its nature independent of the underlying relationship and the applicant and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claim of defences arising from any relationship other than a relationship between a guarantor and the beneficiary."  

The principle of independence dictates that, provided that the payment is demanded strictly in accordance with the provisions of the guarantee, the guarantor must pay irrespective of any dispute arising from either the underlying contract or the contract of mandate between the applicant for the guarantee and the guarantor. This essentially gives effect to what is known as the “pay first – argue later” rule which holds that the

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74 Affaki and Goode (n 6) 4.
76 See n 14 above.
77 Hugo (n 7) 445-446.
78 Bertrams Bank Guarantees in International Trade (2013) 73.
beneficiary can expect payment as soon as it is able to tender the documents stipulated in the demand guarantee, irrespective of any dispute emerging from the underlying contract. This rule therefore contributes to legal certainty as all disputes relating to breach of the underlying contract are put on hold to be dealt with at a later stage.

The principle of independence as it applies to letter of credit law is well established. In *Phillips v Standard Bank of South Africa* the court applied the principle of independence. The *Philips* case is the first South African case in which the court had to consider the legal effect of the and consequences of the letter of credit. In taking that decision, the court was influenced by American case *Sztejn v J Henry Schroder Banking Corporation* and the English case *United City Merchants (Investments) Ltd v Royal Bank of Canada*. The *Phillips* case, like *Sztejn* and *United City Merchants*, recognised the fraud as an exception to the principle of independence. The South African courts commitment to principle of independence was reinforced by the *Ex parte Sapan Trading (Pty) Ltd* which also implemented the principle and also recognised fraud as the only exception.

The position relating to demand guarantees was not always very clear – but now is. In *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* the court South African court expressly embraced the independence principle in the context of demand guarantee and held that-

“The guarantee …is not unlike irrevocable letter of credit issued by banks and used in international trade, the essential feature of which is the establishment of a contractual obligation on the part of a bank to pay the beneficial (seller). This obligation is wholly independent of the underlying contract of sale and assures the seller of paying of the purchase price before he or she parts with the goods being sold. Whatever disputes may subsequently arise between buyer and seller is of no moment insofar as the

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79 1985 (3) SA 301 (W).
80 Hugo (n 7) 424.
81 (1941) 31 NYS 2d 631.
83 1995 (1) SA 218 (W).
84 *Ex parte Sapan Trading* (n 83) par 224.
bank’s obligation is concerned. The bank’s liability to the seller is to honour the credit. The bank undertakes to pay provided only that the conditions specified in the credit are met."\textsuperscript{85}

In the case of \textit{Fast Track Contracting (Pty) Ltd v Constantia Insurance Company Limited and Others}\textsuperscript{86} the court observed that “The autonomy of letters of credit, demand guarantees, performance bonds and similar documents is well recognised and it is only where fraud is involved that the issuing institution may decline liability”.\textsuperscript{87} The aforesaid remarks of the court do not only reflect undoubted position of the principle of independence in relation to the demand guarantee, they also recognise the fact that the principle is not absolute. Fraud on the part of the beneficiary is a universally accepted exception to the principle. In the \textit{United City Merchants} the court made the following observations about fraud as an exception –

“The exception of fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur action or, if plain English is to be preferred, ‘fraud unravels all’. The courts will not allow their process to be used by a dishonest person to carry out fraud”\textsuperscript{88}

In \textit{Group Five Construction (Pty) Limited and others v Member of the Executive Council for Public Transport Roads And Works Gauteng and Others}\textsuperscript{89} the court declared the demand invalid and unenforceable on ground of fraud.\textsuperscript{90} In \textit{United Trading Corporation SA v Allied Arab Bank} the court in setting the standard for determining the presence of fraud held that “on material available, the only realistic inference is that ...[the beneficiary] could not honestly have believed in the validity of its demands for on the performance bonds”.\textsuperscript{91} This test was quoted with approval in \textit{Group Five}.\textsuperscript{92}

\textsuperscript{85} 2010 (2) SA 86 SCA par 20.
\textsuperscript{86} (22474/2018) [2018] ZAGPJHC 633 (14 December 2018)
\textsuperscript{87} \textit{Fast Track Contracting} (n 86) par 85.
\textsuperscript{88} \textit{United City Merchants} (n 82) par 183-4.
\textsuperscript{90} \textit{Group Five} (n 89) par 56b.
\textsuperscript{91} [1985] 2 Lloyd’s Rep 554 (CA) par 561
\textsuperscript{92} \textit{Group Five} (n 89) par 50.
Limited v Raubex Construction (Pty) Limited\(^93\) the court held that onus of proving the exception of fraud rests on party who is alleging it.\(^94\)

Though not universally recognised as fraud, absence of good faith as an exception to independent guarantee is gaining traction.\(^95\) As the court observed in *Group Five* case, courts are begging to recognise absence of good faith more and more.\(^96\)

### 2.6 Non-documentary and documentary conditions

The demand guarantee is documentary in character. This means that the amount and the duration of the duty to pay, the conditions of payment and the termination of the payment obligation depends exclusively on the terms of the guarantee itself, and the presentation of a demand and such other documents, if any, may be stipulated in the guarantee.\(^97\) The demand guarantee in the construction context may require the demand for payment to be accompanied by documents such as, inter alia, written statement asserting breach of contract by the applicant, original copy of the demand guarantee itself, judgement or arbitral award confirming the breach of contract, notice of cancelation of the underlying contract, and a certificate by an expert attesting to a certain fact (for example, the amount outstanding). It is also possible for the guarantee to require only bare demand to trigger payments - a written demand not accompanied by other documents.\(^98\) The duty of the guarantor to pay only arises when the specified documents are presented within the stipulated time.\(^99\) The guarantor has no duty to authenticate the documents submitted.\(^100\)

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93 (13787/2015) [2017] ZAGPJHC 373 (8 December 2017) [23]
94 *Bryte* (n 93) par 23
95 See n 92 above.
96 See n 92 above; Supreme Court of Appeal in the minority judgment of Cloete JA in *Dormell Properties 282 CC v Renasa Insurance Company Ltd and Others* 2011 (1) SA 70 (SCA); as also in *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA); *Scatec Solar SA 163 (Pty) Ltd and another v Terrafix Suedafrika (Pty) Ltd* [2014] ZAWCHC 24; *Cargill International SA and Another v Bangladesh Sugar and Food Industries Corp* [1996] 4 All ER 563 (QBD); and Kelly-Louw and Marxen “General Update on the Law of Demand Guarantee and Letter of Credit” 2015 Annual banking law update (ABLU) 276 292 for an argument that absence of good faith is not an exception.
98 Marxen (n 2) 88-90.
99 See n 97 above.
100 Kelly-Louw “The doctrine of strict compliance in the context of demand guarantees” 2016 XLIXX *CILSA* 85 89.
The guarantor is not expected to investigate external factors, such as the principal’s default in performance of the underlying contract or the amount of loss actually suffered by the beneficiary as a result of default.\textsuperscript{101}

A non-documentary condition is a condition which does not specify any document to be presented in compliance with it.\textsuperscript{102} The problem with the non-beneficial conditions is that they may draw the bank into the underlying contract between the guarantee applicant and beneficiary.\textsuperscript{103} This may lead to violation of independence principle.

The URDG states that

“A guarantee should not contain a condition other than a date or lapse of a period without specifying a document to indicate compliance with the condition. If the guarantee does not specify and such document and the fulfilment of the condition cannot be determined from the guarantor’s own record or from an index specified in the guarantee, then the guarantor will deem such condition as not stated and will disregard it except for the purpose of determining whether data that may appear in a document specified in and presented under the guarantee do not conflict with data in the guarantee”\textsuperscript{104}

It is clear from the above quoted provision that the URDG only recognises the non-documentary condition for secondary purposes as opposed to primary purposes and only when it does not conflict with data in the guarantee.

2.7 Conclusions

This chapter was aimed at providing background as regards the fundamentals of demand guarantees. It has been established that demand guarantees are to be distinguished from accessory guarantees given that they are fundamentally different. In this regard, demand guarantees have two founding legal principles namely, the principle of independence and the doctrine of strict compliance, whereas accessory guarantees, however, are not autonomous in nature. Although different in nature, the letter of credit and demand

\textsuperscript{101} See n 97 above.
\textsuperscript{102} See n 67 above.
\textsuperscript{103} Kelly (n 67) 313-313.
\textsuperscript{104} article 7.
guarantee have a close relationship, especially in relation to the founding legal principles. Chapter three will consider the letter of credit and its relation to the demand guarantee, and it will also discuss the applicability of the doctrine of strict compliance as regards letters of credit.
Chapter 3: Relationship between the letter of credit and demand guarantee

3.1 Introductory remarks
Given the fact that demand guarantees and letters of credit rest on similar legal foundations, this chapter will briefly provide a definition of letters of credit and will contrast it to demand guarantees. Furthermore, the doctrine of strict compliance as it relates to letters of credit will be evaluated.

3.2 The similar nature of the letter of credit and demand guarantee
The close relationship between the letter of credit and the demand guarantee is well-documented. The South African courts, mainly influenced by the English courts, have emphasized this point on various occasions.

In international trade, the demand guarantee serves the purpose of protecting the importer. In contrast, the letter of credit serves the purpose protecting the exporter. The letter of credit allows the exporter to reduce the risk of the importer failing to pay the contract price of the goods shipped by the exporter. Viewed from this perspective, letters of credit and demand guarantees are like two sides of the same coin that performs a vital function in the financing of international trade. Naturally, therefore, the two are regarded as the “lifeblood of commerce”. The fact that the ICC issued guiding rules for both of these instruments, namely, UCP 600 for letters of credit and URDG for demand guarantees, fortifies the strong impact that these two instruments have in international trade. In Intraco v Notis Shipping Corporation (Bhoja Traders) the court cautioned against undue blockages in the flow of commercial transactions if the courts intervene and thereby adversely impacting the mercantile practice of treating the rights thereunder as being equivalent to cash at hand.

105 See chapter 4 below.
106 Enonchong (n 3) 1.
107 Enonchong (n 3) 2.
108 The expression was first used in the English case of RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd 1977 2 All ER 862 (QB) 870b and was subsequently adopted by our court in Ex parte Sapan Trading (n 83).
109 1981 2 Lloyd’s Rep 256 CA 257. See also Hugo (n 75) 661.
The Uniform Customs and Practice for documentary credit (UCP 600) defines a letter of credit as any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.\footnote{UCP 600 article 2.}

In \textit{Loomcraft Fabrics CC v Nedbank Ltd and Another} the court, when describing the letter of credit, held that

“its essential feature is the establishment of a contractual obligation on the part of a bank to pay the beneficiary under the credit (the seller) which is wholly independent of the underlying contract of sale between the buyer and the seller and which assures the seller of payment of the purchase price before he parts with the goods forming the subject-matter of the sale.”\footnote{(70/94) [1995] ZASCA 127; 1996 (1) SA 812 (SCA); [1996] 1 All SA 51 (A); [1996] 1 All SA 51 (A) (17 November 1995) par 5.}

Moreover, Horowitz amply summarized the relationship between letter of credit and demand guarantee as follows:

“Letter of credit and guarantees share the characteristic of abstraction from the underlying agreement that called for their use. Nonetheless, they differ on one key respect. Letters of credit are primary both in form and intent. They do what they appear to do: serve as the payment method for transaction. By contrast demand guarantees are primary in form, but secondary in intent. They bear the appearance of primary instruments, because they present and on-demand form of payment. However, they are secondary in intent, inasmuch as they serve a ‘back-up’, or standby, role.”\footnote{Horowitz \textit{Letters of Credit and Demand Guarantees defences to payment} (2010) 227.}

The close resemblances of the features of the two commercial instruments accounts for the jurisprudence relating to one being applied to the other. The jurisprudence relating to the interpretation of the doctrine of strict compliance in the context of the letter of credit, for instance, has been relied on when the doctrine was being considered in the context of the demand guarantee.
In *Edward Owen Engineering Ltd v Barclays Bank International Lt* the court held that performance bonds stand 'on a similar footing' to letters of credit.\(^{113}\) This view was accepted by South African courts in *Loomcraft Fabrics CC v Nedbank Ltd & another*\(^ {114}\) and in *Dormell Properties 282 CC v Renasa Insurance Co Ltd & others NNO.*\(^ {115}\)

While there are close resemblances between the demand guarantee and letter of credit, the two are not identical. The main difference between the two, however, lies in their respective functions: whilst the letter of credit is an instrument of payment, the demand guarantee is an instrument of guarantee. As reflected hereunder the courts also drew some distinctions between the two.

*In Lombard Insurance Holdings (Pty) Ltd v Landmark Holdings (Pty) Ltd and Others* the court drew parallels between the letter of credit and the demand guarantee and reasoned that in case of irrevocable letters of credit, unlike demand guarantees, the bank undertakes to pay provided only that the conditions specified in the credit are met.\(^ {116}\)

In *Siporex Trade SA v Banque Indosuez* the court held that

> “the contrast between a letter of credit and a performance guarantee was 'sound', since with the former the bank deals with the documents themselves, whereas with the latter the guarantor can rely on a statement that a 'certain event has occurred'”.\(^ {117}\)

### 3.3 Application of doctrine of strict compliance in a letter of credit transaction

Unlike in case of demand guarantees, the application of the doctrine of strict compliance in letters of credit is universally accepted. There is a string of cases, South African and foreign, which confirms the application of the doctrine of strict compliance in letters of credit practice beyond any doubt. In South Africa the court in *OK Bazaars (1929) Ltd v*
Standard Bank of South Africa Ltd set out the application of the doctrine on strict compliance to letters of credit as follows:

“[The bank’s] interest is confined to ensuring that the documents that are presented conform with its client’s instructions (as reflected in the letter of credit) in which event the issuing bank is obliged to pay the beneficiary. If the presented documents do not conform with the terms of the letter of credit the issuing bank is neither obliged nor entitled to pay the beneficiary without its customer’s consent. The obligation of the issuing bank was expressed as follows in Midland Bank Ltd v Seymour [1955] 2 Lloyd’s Rep 147 at 151:

‘There is, of course, no doubt that the bank has to comply strictly with the instructions that it is given by its customer. It is not for the bank to reason why. It is not for it to say: ‘This, that or the other does not seem to us very much to matter.’ It is not for it to say: ‘What is on the bill of lading is just as good as what is in the letter of credit and means substantially the same thing.’ All that is well established by authority. The bank must conform strictly to the instructions which it receives.”118

In Loomcraft the court held that

“the liability of the bank to the beneficiary to honour the credit arises upon presentment to the bank of the documents specified in the credit, including typically a set of bills of lading, which on their face conform strictly to the requirements of the credit. In the event of the documents specified in the credit being so presented, the bank will escape liability only upon proof of fraud on the part of the beneficiary.”119

It is well established that in the context of letter of credit there is no room for documents which are almost the same, or which will do just as well.120 The applicability of strict compliance in the context of letter of credit has never been disputed. What has been the subject of debate is whether strict compliance also entails trivial aspects, or trivial discrepancies can be ignored.121 There is a school of thought which holds that even in instances where the doctrine of strict compliance is applicable, it must not be taken to mean that there must be exact compliance. It holds that it would be ludicrous to extend the rule to the dotting of I’s or the crossing of t’s. In the American case of New Braunfels National Bank v Odiorne the court cautioned against oppressive perfectionism in the name

119 Loomcraft (n 114) par 1.
120 See n 31 above.
121 Hugo (7) 416-418
of strict compliance. The court was essentially cautioning against implementing strict compliance in a manner that is not practically acceptable. In *Baque de l'Indochine at de Suez SA v JH Rayner (Mincing Lane) Ltd*, reflecting on the view that strict compliance means no room for documents that are almost the same, the court held that “strict compliance does not mean rigid meticulous fulfilment of the precise wording in all cases.”

The lingering question is whether the standard that the demand for payment applicable to letters of credit is also applicable to demand guarantees. There are two perspectives to this question. On one hand there is a view that the required standard for letters of credit is stricter than in the case of demand guarantees. This question was vigorously argued in *Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd* where the beneficiary argued that the standard for letters of credit is stricter than in the demand guarantee context.

Part of the reasoning for the view that a stringent standard of compliance is required for letters of credit rather than demand guarantees is that demand guarantees may require only a written demand to trigger payment while the letter of credit typically requires a number of documents to trigger payment. This means that documents are more important in letter of credit than in demand guarantee. The other argument is that since demand guarantees have a cash replacing effect, it must not be made too difficult for the beneficiary to be paid by insisting on strict compliance of the documents.

In 2009 Kelly-Louw, having thoroughly analysed available evidence, predicted that courts in South Africa, influenced by English courts, will also apply to demand or performance guarantees the same standard of strict documentary compliance as they do to letters of credit.
Consistent with the above, In *Schoeman and Others v Lombard Insurance Company Limited*\textsuperscript{128} the court cautioned against attempts to divide the essential distinction between letters of credit and demand guarantees as there is little gain in doing so.\textsuperscript{129} The court held that the real issue is simply whether there was compliance with the terms of the guarantee under circumstances.\textsuperscript{130} What the court was essentially saying is that the question whether the doctrine of strict compliance applies to the demand guarantee as it applies to the letter of credit is dependent on the terms of guarantee, not in the concepts themselves.

As indicated above, the courts have not always been consistent in the question. In *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* the court, in approval of the *Siporex* case, observed that

“Accordingly, the English courts (followed by the South African courts) have, thus far, taken the approach that there is a difference or 'contrast' between a guarantee where the call is simply based on the say-so statement of the one party that an event has occurred and between letters of credit where the bank is in possession of documents (such as bills of lading) establishing the foundation of the call. The courts have indicated that the more 'strict' compliance is required of the banks and of the documents presented to activate letters of credit because the banks themselves are in a position to evaluate the call by perusing the various documents. No mention has been made of the degree of rigour of compliance in the case of performance guarantees.”\textsuperscript{131}

### 3.4 Conclusions

The application of the doctrine of strict compliance to letters of credit has been recognised conclusively in South Africa. In addition, the exact standard of compliance is regarded as 'strict'. The study will now move to consider its application to demand guarantees and what the exact standard of compliance in this regard is.

\textsuperscript{128} (1299/2017) [2019] ZASCA 66 (29 May 2019)

\textsuperscript{129} *Schoeman* (n 128) par 22.

\textsuperscript{130} *Schoeman* (n 128) par 22.

\textsuperscript{131} (23125/2014) [2015] ZAGPJHC 264 (20 October 2015) par 30.
Chapter 4: Requirement of a complying demand submitted under a demand guarantee

4.1 Introductory remarks

Owing to the fact that South African courts have always relied and/or borrowed from the English precedent in cases dealing with demand guarantee and letters of credit, reflections on the development of the doctrine of strict compliance in South Africa cannot ignore the development of same in England. Consequently, this part of this work will deal with both South African and English court decisions.

It must be mentioned at the outset that various conditions stipulated in the demand guarantees have been the subject of arguments before the courts. The conditions relating to the person to make demand, the time within which demand, accompanied required documents, must be made, the place where demand could be made, the manner in which demand can be made and whether only the first demand is acceptable.

4.2 Tracking the development of the doctrine of strict compliance in South Africa

This part of work will identify and discuss English and South African courts decisions pertaining to applicability of the doctrine of strict compliance in demand guarantee context. The said cases will be discussed in sequence, based on the years in which various decisions were handed down. In case of South Africa, only High Court and SCA decisions will be considered.

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133 The cases are discussed under 4.2.
134 University of the Western Cape v Absa Insurance Company Ltd (n 61).
135 Compass (n 124).
136 Schoeman (n 128).
138 Group Five (n 89).
4.2.1 The English Courts Decisions

The initial English cases which dealt with applicable standard of compliance in the context of demand guarantees required less strict compliance. The two classic examples in this regard are *Siporex*¹³⁹ and *IE Contractors Ltd v Lyds Bank Plc and Rafidian Bank*.¹⁴⁰ The two cases have been repeatedly invoked in South African courts in supporting the argument that strict compliance is not required in demand guarantee cases.

In 1986 the court in the *Siporex* case held that the standard of compliance required in the case of demand guarantees was less rigorous than the one required in terms of letters of credit.¹⁴¹ The *Siporex* approach was reinforced in 1990 by the *IE Contractors* case which followed the same reasoning and accepted that the doctrine of strict compliance in the case of demand guarantees was less needed than in the letter of credit context.¹⁴² Later on, the English courts changed their approach and started to insist on strict compliance. The turning point was the *Frans Maas (UK) Ltd v Habib Bank AG Zurich*¹⁴³ decision which was handed down in 2001. In this case the demand guarantee required presentation of a written statement which read: “[T]he Principals have failed to pay you under their contractual obligation”. Instead, the demand that was made read: “[W]e claims the sum of £500,00… [the Principals] having failed to meet their contractual obligations to us. The guarantor refused to pay on the basis that the demand did not comply with the precise terms of the guarantee. The court did accept that it was required for the demand to meet the precise terms of the guarantee. The court, however, held that the demand did not comply with the guarantee in that it did not allege breach of a payment obligation. The court found the demand to be wide enough to cover any claim for damages for unliquidated and unascertained sums arising from breach of the agreement. Consequently, the court found that the demand was not sufficiently consistent with the requirement in the demand guarantee.¹⁴⁴ A deduction could therefore be made that had

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¹³⁹ See n 101 above.
¹⁴⁰ (1990) 51Build LR 1.
¹⁴¹ See n 117 above.
¹⁴² *IE Contractors* (n 140) par 500.
¹⁴⁴ *Frans Maas* (n 143) par 59 and 60.
the demand sufficiently complied with the requirements of the demand the court would have accepted that it was compliant with the requirement in the demand guarantee.

As discussed below, the SCA in South Africa in Compass overturned the High Court judgment which adopted the concept of sufficient compliance.\textsuperscript{145} This reflects some disparities in how the South African and English courts have adopted different approaches to the content of the doctrine.

The \textit{Frans Maas} case has been relied on by South African courts as an authority for the view that strict compliance in the context of demand guarantee applies.\textsuperscript{146} Kelly-louw views the case as an indication that the English courts are moving towards applying the same degree of strict compliance to demand guarantees as they do to commercial letters of credit.\textsuperscript{147}

The change of approach to strict compliance was crystallised in 2013 by \textit{Sea-Cargo Skips AS v State Bank of India}\textsuperscript{148} decision. In the said case the court held that -

“For my part I would respectfully doubt that there is less need for the doctrine of strict compliance in the field of performance bonds than in the letters of credit. In the field of performance bonds, as in the field of letter of credit, the banks who provide the bonds deal with documents. Banks must honour their obligation to pay if documents which conform with the requirements of the bond are tendered. Thus the banks must determine, on the basis of the presentation alone, whether it appears on its face to be a complying presentation…”\textsuperscript{149}

The \textit{Sea-Cargo} case is regarded as one of the clearest cases wherein the English courts have moved to embrace strict compliance.\textsuperscript{150}

\textsuperscript{145} Compass (n 124) par 3&13.
\textsuperscript{146} Enonchong (n 3) 95.
\textsuperscript{147} Kelly-Louw (n 81) 104.
\textsuperscript{148} [2013] EWHC 177 (Comm).
\textsuperscript{149} Sea-Cargo (n 148) par 27.
\textsuperscript{150} Kelly-Louw (n 100) 126.
The English courts approach, which favoured strict compliance, was disrupted in 2016 by *MUR Joint Ventures BV v Compagnie Monegasque De Bank*\(^{151}\). In this case the relevant part of the demand guarantee provided that “the Bank’s obligation under this Guarantee to make a Guaranteed Payment shall arise forthwith upon written demand sent to the bank by way of registered mail to the above-mentioned bank’s address”. The demand was not sent by registered mail but by courier, fax and e-mail, and it was received by the bank.\(^{152}\) The point was taken that as the stipulated mode of making the demand was not complied with, the demand was not a valid demand. In accepting that the demand was compliant the court held that –

“In my view, this requirement in clause 1 is directory, not mandatory. That is because the guiding principle is one of effective presentation of a demand. The first demand and all its attachments were sent by a variety of means, including couriering. The importance of registered mail is that the communication in question is signed for by the recipient and signature precludes any suggestion that it was not received. In this case there is no question but that the demand and its attachments were received by the Bank. Presentation of the first demand was effective.”\(^{153}\)

The *MUR Joint Ventures* approach of only insisting on compliance with mandatory aspects of the demand guarantee marks a clear departure from the *Frans Maas* case approach where the court accepted that it was required for the demand to meet the precise terms of the demand guarantee without differentiating between directory and mandatory aspects.

4.2.2 The South African courts decisions

Some of the South African courts’ decisions discussed in this part of this work turned on the interpretation of clause 5 of the JBCC standard form agreement. For that reason and ease of reference, the said clause is quoted hereunder. The clause provides that -

“5.0 Subject to the Guarantor’s maximum liability referred to in 1.0 or 2.0, the Guarantor hereby undertakes to pay the Employer the guaranteed Sum or the full outstanding balance upon receipt of a

\(^{151}\) [2016] EWHC 3107 (Comm).

\(^{152}\) *MUR Joint Ventures* (n 151) par 5.

\(^{153}\) *MUR Joint Ventures* (n 151) par 43.
first written demand notice from the Employer to the Guarantor at the Guarantor’s physical address calling up this Guarantee for Construction stating that –

5.1 The Agreement has been terminated due to the Constructor’s default and that the Security for Construction is called up in terms of 5.0. The demand notice shall enclose a copy of notice of termination; or

5.2 A provisional sequestration or liquidation court order has been granted against the Contractor and that the Guarantee for Construction is called up in terms of 5.0. The demand notice shall enclose a copy of court order”

In 2011 the SCA dealt with the doctrine of strict compliance in Compass.154 In this case Hospitality Hotel was employed to carry out the upgrade of a hotel.155 It engaged the services of a construction company for this purpose. The construction company in turn engaged a subcontractor for some work.156 Compass Insurance is a short-term insurer which issues construction (performance) guarantees to employers or owners. On 4 February 2008 it issued a construction guarantee to Hospitality Hotel for the performance of the work undertaken by the subcontractor. The sum guaranteed was R1 444 428.51 and the guarantee expiry date was 30 April 2008.157

Clause 4 of the construction guarantee provided that, subject to the guarantor’s maximum liability, Compass Insurance undertook to pay Hospitality Hotel the full outstanding balance ‘upon receipt of a first written demand from the Employer [Hospitality Hotel].’158 The sub-clauses thereto provided that a written demand must state:

“4.1 The agreement has been cancelled due to the Recipient’s [the subcontractor’s] default and that the Advance Payment Guarantee is called up in terms of 4.0. The demand shall enclose a copy of the notice of cancellation;

OR

154 See n 124 above.
155 Compass (n 124) par 2.
156 See n 156 above.
157 See n 156 above.
158 Compass (n 124) above par 4.
4.2 A provisional sequestration or liquidation court order has been granted against the Recipient and that the Advance Payment Guarantee is called up in terms of 4.0. *The demand shall enclose a copy of the court order.*"^{159}

The subcontractor breached the contract and was issued a breach notice. It was provisionally wound up in the Western Cape High Court on 23 April 2008. On 25 April Hospitality Hotel sent a letter to Compass Insurance demanding payment of the sum guaranteed. The latter refused to pay on the basis that the demand did not comply with the terms of the guarantee in that it was not accompanied by a copy of the court order of provisional sequestration of the subcontractor. Hospitality Hotel accordingly applied to the South Gauteng High Court, Johannesburg, for an order compelling payment. The court granted the order on the basis that, because the order had been furnished subsequently, there had been sufficient compliance with the terms of the guarantee. The matter was taken to SCA for an appeal."^{160}

In this matter is was common cause there had in fact been no cancellation at the time the letter of demand was sent, though the letter did state that there was, and that the subcontractor was provisionally liquidated prior to the issue of the demand. It was also common cause that the court order was not attached to the letter of demand, as required by clause 4.2 of the guarantee."^{161}

The high court, referring to cases dealing with contractual interpretation, held that

"on a reading of the guarantee it was ‘perfectly obvious’ that it was not the intention of the parties that a failure to furnish the copy of the court order with the demand would be ‘fatal’ to it. The sentence relating to the furnishing of the copy of the court order was ‘divisible’ from the aspects entitling the beneficiary to payment. The copy could thus be provided after the expiry of the guarantee date. Compass Insurance was thus liable to pay the sum claimed."^{162}

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159 See n 158 above.
160 Compass (n 124) par 3.
161 Compass (n 124) par 5.
162 Compass (n 124) par 6.
The SCA did not align itself with the reasoning of the High court in that, after considering several cases dealing with the doctrine of compliance, it held that there was no justification to depart from the terms of the guarantee as it is an independent contract that must be fulfilled in its terms and departure therefrom would defeat its very purpose. The court further observed that -

“In my view it is not necessary to decide whether ‘strict compliance’ is necessary for performance guarantees, since in this case the requirements to be met by Compass in making demand were absolutely clear, and there was in fact no compliance let alone strict compliance. The guarantee expressly required that the order of liquidation be attached to the demand. It was not.”

Though the court in Compass clarified the fact that “sufficient compliance” was distinct from strict compliance, the court did not decide on whether strict compliance is necessary for demand guarantee. Hugo is of the view that, despite the court’s reluctance to say, the Compass case supports the notion that the doctrine of strict compliance applies to demand guarantees. As it will be clarified below, Compass was used in subsequent cases to support the view that doctrine of strict compliance applies to demand guarantees.

In 2014 the SCA in State Bank of India and Another v Denel SOC Limited and Others followed the Compass approach in insisting that the terms of the guarantee must be complied with. In this case the court observed that -

“a bank issuing an on-demand guarantee is only obliged to pay where a demand meets the terms of the guarantee. Such a demand, which complies with the terms of the guarantee, provides conclusive evidence that payment is due.”

In arriving at this position, the court was influenced by English court in Frans Maas and Zanbuild.169

163 Compass (n 124) par 15.  
164 Compass (n 124) par 13.  
165 Hugo (n 9) 171.  
166 (947/13) [2014] ZASCA 212 (3 December 2014).  
167 Denel (n 166) par 9.  
168 Frans Maas (n 143) par 58.  
169 Zanbuild (n 23) par 13.
In 2015 South African courts, particularly the South Gauteng High Court, handed down few decisions were pertaining to strict compliance. In February the South Gauteng High Court handed down the Group Five decision. In this case the guarantee in question had similar requirements of demand as the ones in the JBCC standard form in terms of the requirement for “first written demand”. The beneficiary issued the “second demand”. The court found that the “second demand” was not conforming with the requirements of the guarantee. Thereby applying a doctrine of strict compliance.\textsuperscript{170}

On the 20 of October 2015 the South Gauteng High Court delivered the Kristabel judgment. In this case clause 5 of the guarantee in question also had similar requirements of demand as the ones in the JBCC standard form. The court, however, took a different direction and essentially held that the specific requirements of demand need not be strictly complied with. What happened in the case is that prior to making a demand, the beneficiary emailed a copy of the letter of cancellation to the respondent of which receipt was acknowledged by the guarantor.\textsuperscript{171} The beneficiary later sent a letter of demand without letter of cancelation as required by the above cited clause of the guarantee.\textsuperscript{172} The guarantor argued that there has not been ‘strict’ compliance with the terms of the credit guarantee due to the beneficiary’s failure to attach the letter of cancellation to the letter of demand and, with such failure to comply with a peremptory provision of the guarantee, the demand is fatally defective.\textsuperscript{173} The beneficiary on the other hand argued that ‘strict’ compliance was not a requirement.\textsuperscript{174} The court had to decide on whether ‘prior’ compliance rather than ‘contemporaneous’ compliance in the context of this particular matter means there has not been the required compliance with the credit guarantee. The court in this regard found that the demand was compliant (though not 'strict' compliant) with the terms of clause 5 of the guarantee.\textsuperscript{175}

\textsuperscript{170} See n 89 above.
\textsuperscript{171} Kristabel (n 131) par 2.
\textsuperscript{172} See n 171 above.
\textsuperscript{173} Kristabel (n 131) par 24.
\textsuperscript{174} See n 173 above.
\textsuperscript{175} Kristabel (n 131) par 53.
On 28 October 2015 the South Gauteng High Court once more delivered another judgment relating to strict compliance. In University of Western Cape the doctrine of strict compliance was considered in light of demand requirements similar to the ones in the JBCC form. What was in dispute in the case was whether performance by a representative can be regarded as strict compliance with the terms of the guarantee. In this case, despite the guarantee stating that the demand must be made by the employer, the demand was made by the principal agent as opposed to the employer as stated in the guarantee.\(^\text{176}\) It was argued that the applicant did not strictly comply with the terms of the guarantee. In pursuing its augment, the bank relied on the principle laid down in Compass that the demand must comply with the terms of the guarantee. It is submitted that this argument was not without merit in that the guarantee was specific in terms of who may submit demand for payment. Upon assessing the letter of demand, the court concluded that the principal agent was not acting on its own name, but as the representative of the beneficiary and that the letter was intended to be a first written demand on its behalf.\(^\text{177}\) Having made this conclusion, the court held that the issue to be decided was whether performance by a representative can be regarded as strict compliance with the terms of the guarantee.\(^\text{178}\) The court accepted that when general principles of representative or urgency to the applied to the guarantee in question it appears that performance by the employer as stipulated in clause 5 is not of such a personal nature that the guarantor may insist on personal performance. The court also considered that there was no term or condition in the guarantee which explicitly excludes performance by a representative or an agent on behalf of the employer.\(^\text{179}\)

On 10 November 2015 in Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others\(^\text{180}\) the South Gauteng High Court was more explicit in embracing strict compliance in holding that -

\(^{176}\) University of Western Cape (n 61) par 10.
\(^{177}\) University of Western Cape (n 61) par 12.
\(^{178}\) See n 177 above.
\(^{179}\) See n 177 above.
“Strict compliance with the terms of the guarantee is required. Our courts have strictly applied the principle that a bank faced with a valid demand in respect of a performance guarantee is obliged to pay the beneficiary thereof without investigation of the underlying contractual position.”\textsuperscript{181}

The court also held that -

“This Court is called upon to determine whether the First Respondent was entitled to refuse to make payment under the guarantee in light of the terms of the certificate in issue. The enquiry should not be elevated to a case about the interpretation of the guarantee. The guarantee is a written agreement. It is clear and unambiguous and capable of being complied with according to its tenor. It requires no interpretation or clarification as to what was required to achieve payment.”\textsuperscript{182}

In 2019 the SCA in \textit{Schoeman} followed the MUR \textit{Joint Venture} reasoning. In this case it was argued on behalf of the appellants that no proper demand had been made of Lombard Insurance by Sasol in terms of the demand guarantee because, whereas the demand guarantee required the demand to be made at Sasol’s address, it was in fact made at Lombard Insurance’s address. The court held that -

“Similarly, in this case, presentation of the demand, albeit not at Sasol’s premises, was effective. I am of the view that in the case of the demand guarantee before us, as in the \textit{MUR Joint Venture} case, the requirement of the demand being made at Sasol’s address is directory and not mandatory. The result is that the court below correctly concluded that the demands had been properly presented, with the result that Lombard Insurance’s obligation to pay was effectively triggered.”\textsuperscript{183}

In \textit{Natal Joint Municipal Pension Fund v Endumeni Municipality} the court, when dealing with interpretation of written documents, observed that

“The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary

\textsuperscript{181} Grinaker (n 180) par 14.
\textsuperscript{182} Grinaker (n 180) par 13.
\textsuperscript{183} Schoeman (n 128) par 29.
rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation; in a contractual context it is to make a contract for the parties other than the one they in fact made. The “inevitable point of departure is the language of the provision itself”, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.”

The above approach was adopted in Schoeman when dealing with interpretation of guarantee.185

4.3 Commentary
Kelly-Louw’s earlier view was that English courts have in fact started to apply the same degree of ‘strict compliance’ to demand guarantees as to letters of credit.186 Her view is based on Frans Maas which departs from the less strict standard adopted in Siporex and IE Contractors. Based on the foregoing, she then proceeded to predict 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. This view has been cited by our courts, including the SCA on few cases.187 Enonchong is also of the view that the English courts the courts have moved from less strict standard to strict compliance.188

The observation that the English courts have moved to strict compliance is quite understandable considering the move in approaches from Sipex approach to the Frans Maas. Subsequent to Frans Maas, the court in Sea-Cargo strengthened the view that English courts were applying strict compliance. However, MUR Joint Venture which held

185 Schoeman (n 128) par 23.
186 Kelly-Louw (n 1) 69.
187 See n 186 above.
188 Enonchong (n 3) 97.
that strict compliance should be applied only on mandatory aspects as opposed to directory clearly disrupts the strict compliance trajectory. Viewed in light of the *Frans Maas, MUR Joint Venture* cannot be said to have demanded strict compliance in that in *Frans Maas* it was required for the demand to meet the precise terms of the guarantee, not certain aspects of the guarantee (my emphasis).

Hugo accepts the view that the requirement by South African courts for proper demand which meets the terms of guarantee is the language that indicates that court are leaning to strict compliance. Consistent with the foregoing, Hugo further holds that, despite the court’s reluctance to say, the *Compass* case supports the notion that the doctrine of strict compliance applies to demand guarantees. In the same way as *Compass* case, the *Denel* case, despite the court’s reluctance to expressly say so, is regarded as authority for applicability of strict compliance in demand guarantee. This view is based on the court’s insistence that the guarantor is only obliged to pay where a demand meets the terms of the guarantee. In *Group Five* the court emphasised that the demand must meet the terms of the guarantee. In *Grinaker* the court expressly recognized the doctrine of strict compliance in guarantee context.

However, the South African courts are not consistent in insisting on demand which meets the terms of guarantee. *Kristabel, University of Western Cape and Schoeman*, for instance, do not insist on the view that demand must meet the terms of the guarantee.

In *Kristabel* the court expressly adopted a less strict approach. *University of Western Cape* deviated from the expressed requirements of the guarantee, thereby interrupting the trajectory of insisting on the demand to meet the terms of guarantee. The SCA in *Schoeman* departed from its earlier view in *Compass* and *Denel* that the demand must comply with the terms of guarantee by adapting *MUR Joint Venture*’s approach of only insisting on compliance with mandatory aspects and not dictionary ones.

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189 Hugo (n 7) 458.
190 Hugo (n 9) 171.
From the above, it is clear that the development of the doctrine of strict compliance is not linear. The South African Jurisprudence, like its English counterpart, has inconsistent decisions. The predicament is heightened by the fact that the URDG, unlike the UCP 600, does not expressly incorporate the doctrine of strict compliance in examining the documents. Affika and Goode, without providing any basis, are of the view that the doctrine nevertheless applies to the presentations under the URDG. They hold that if the documents do not strictly conform to the guarantee, their presentation is a non-complying presentation even if the non-compliance is of no practical significance and what is tendered is equally effective.\footnote{Affaki and Goode (n 6) 319.}

Though the position of Affika and Goode has some persuasive force, it is difficult to comprehend the reason for the URDG to not expressly state that the documents must strictly comply with the guarantee requirements. This is more so, when considering that the UCP 600 expressly stipulate that the required standard of compliance is strict. Important to note in this regard that the UCP 600 and URDG are both authored by the same committee of the same organisation around the same period. This leaves the question of required standard of compliance not clearly addressed.

Kelly-Louw and Hugo are of the view that same strict standard of compliance should apply to commercial letter of credit and demand guarantee.\footnote{Kelly-Louw (n 100) 128; Hugo (n 75) 662.} Despite this shared view, Kelly-Louw accepts the view that the required standard of compliance for demand guarantee remains uncertain while Hugo is of the view that the standard imposed by the courts settled the question in favour of strict compliance.\footnote{Kelly-Louw (n 100) 126; Hugo (n 7) 6458.}

4.4 Conclusions

There are contrasting court decisions, both in England and South Africa, on the applicability of strict compliance in the context of demand guarantees. The net effect of
the contradicting court decisions is indicative of the unsettledness on whether the standard of compliance required for letters of credit is applicable to demand guarantees.
Chapter 5: Conclusion

There is still much uncertainty about the applicability of the doctrine of strict compliance as regards demand guarantees in South Africa. The ancillary question, which is also still not settled, is whether the doctrine applies in the same way to demand guarantees as it does to letters of credit. The South African courts, like English courts, have taken contradicting decisions on the question. The URDG is also silent on the question. What appears to be a popular view is that the requisite standard is dependent on the positions of the guarantee itself. This introduces another difference between the demand guarantee and letter of credit in that in case of the letter of credit the doctrine is applicable without the parties stating its applicability.


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