IN THE SOUTH GAUTENG HIGH COURT, JOHANNESBURG

(REPUBLIC OF SOUTH AFRICA)

CASE NO : **19910/2011**

DELETE WHICHEVER IS NOT APPLICABLE
(1) REPORTABLE YES/~~NO~~
(2) OF INTEREST TO OTHER JUDGES YES/~~NO~~
(3) REVISED

Malindi
SIGNATURE

DATE 4/03/2013

In the matter between:

DENEL SOC LIMITED	Applicant
and	
ABSA BANK LIMITED	First Respondent
STATE BANK OF INDIA	Second Respondent
THE BANK OF BARODA	Third Respondent
UNION OF INDIA	Fourth Respondent

JUDGMENT

MALINDI AJ:

[1] The Applicant is a South African State Owned Entity (SOE), which is a

manufacturer and supplier of defence equipment. It entered into a contractual relationship with the Union of India ("UOI") or Government of India ("GOI"), the Fourth Respondent, for the supply of certain defence equipment and ammunition.

[2] As is customary in international trade, the Fourth Respondent required the Applicant to provide performance and warranty guarantees in respect of the goods that the Applicant was selling to it. These guarantees are referred to variably as bank guarantees, warranty bonds, and first demand guarantees.

[3] The Applicant, through ABSA, requested two banks in India, the State Bank of India ("SBI") (the Second Respondent) and the Bank of Baroda ("BOB") (the Third Respondent) to provide the warranty and performance guarantees, respectively. These are the principal guarantees between the two parties. Any dispute that may arise in respect thereof is governed by the laws of India.

[4] Since the banks of India also require guarantees that the Applicant will pay them if and when they discharge their obligations under the principal guarantees to the Fourth Respondent, the Applicant asked a South African bank, ABSA (the First Respondent) to provide counter-guarantees to the Second and Third Respondents. The counter-guarantees are governed by

South African law.

[5] As a result of this commercial arrangement the First Respondent is entitled to draw upon the Applicant's bank account all the payments that it makes in the discharge of its obligations under the counter-guarantees.

[6] The counter-guarantees are also characterised as first demand guarantees, that is, that the guarantor is obliged to pay immediately upon demand being made. The guarantor does not inquire into whether there is a dispute between the party making the demand and the guarantor. Any dispute as to the underlying contract is irrelevant to the obligation to pay.

[7] With the exception of fraud, a compliant demand has to be paid on first demand. A compliant demand is one that complies with the requirements of the counter-guarantee, its terms and conditions of payment.

[8] On 26 May 2011 the Applicant obtained an urgent interim interdict on an *ex parte* basis against the Respondents, restraining the First Respondent from making payment to the Second and Third Respondents in respect of counter-guarantees issued by the First Respondent in their favour pending the finalisation of this application.

[9] The aforesaid interim relief was sought when the First Respondent

advised the Applicant on 25 May 2011 that it intended making payment at 12:00 on 26 May 2011 in respect of the counter-guarantees since the Fourth Respondent had made demand in respect of the principal guarantees issued by the Second and Third Respondents in favour of the Fourth Respondent.

[10] In this application the Applicant now applies in terms of Part B of the notice of motion for an order interdicting the First Respondent from making payment to the Second and Third Respondents in respect of such counter-guarantees pending the finalisation of arbitration proceedings, already instituted and pending in India, in respect of the aforesaid principal guarantees.

[11] The Applicant sought interdictory relief in India to restrain the Fourth Respondent from calling up or making demands in respect of the principal guarantees pending the resolution of a dispute that had arisen between the Applicant and the Fourth Respondent in arbitration proceedings in India. The Second and Third Respondents are also parties to the proceedings in India as Respondents.

[12] The Appeal Court of the High Court of Delhi made the following order on 23 March 2012:

"

1. *The bank guarantees qua which the Respondent has already*

filed the claims before the arbitral tribunal, we implore the arbitral tribunal to make attempt to decide the dispute between the parties as early as possible. Even if the final adjudication is likely to take time, the arbitral tribunal can always pass interim award deciding whether the Appellant is under any obligation to keep these bank guarantees alive or not;

2. *The bank guarantees qua which the Respondent has not so far preferred any claims, we grant six months time to the Respondent to prefer the claims. If no claims are preferred within six months, the liability of the Respondent to keep the bank guarantees alive shall cease; if the amount of the bank guarantees has already been received in this court, the Appellant shall become entitled to refund thereof;*

3. *Else we direct that the amount deposited in this court and the bank guarantees which are still alive shall be kept alive by the Appellant, and shall be subject to the orders of the arbitral tribunal;*

4. *The findings and observations of the learned single Judge being on a prima facie view of the matter shall have no bearing on the decision of the arbitral tribunal;*

5. *To balance the equity, we further direct that in the event of the Appellant succeeding in the arbitral proceedings, the costs hereafter of keeping the bank guarantees alive shall have to be borne by the Respondent."*

[13] In terms of the contract between the Applicant and the Fourth Respondent, all arbitral disputes *"shall be conducted in India under the Indian Arbitration and Conciliation Act, 1996, and the award of such arbitration shall be enforceable in Indian Courts only"*. Therefore the Applicant is unable to subject the counter-guarantee disputes to arbitration or to High Court proceedings in India since only the principal guarantees fall under the jurisdiction of Indian Courts or arbitration tribunals. On the other hand and in terms of the same agreement, the counter-guarantees between the First Respondent and Second and Third Respondents are subject to South African law. It is for this reason that the Applicant has launched the proceedings in respect of counter-guarantees in South Africa.

[14] The grounds on which the Applicant relies for the interdict sought are as follows:

[14.1] The demands made by the Fourth Respondent against the Second and Third Respondents are not strictly compliant, and in turn the demands made by the Second and Third Respondents against the

First Respondent, which are identical to the first mentioned demands, are similarly not strictly compliant.

[14.2] The Fourth Respondent's demands in respect of the principal guarantees are fraudulent. The Second and Third Respondents' demands in respect of the counter-guarantees are similarly fraudulent since they were made with full knowledge of the fraudulent demands in respect of the principal guarantees.

[15] The Applicant's case is therefore underpinned by the two grounds; non-compliance and fraud. Since the question whether the Fourth Respondent made fraudulent demands has been referred to arbitration in India, the Applicant submits that it would be desirable and practical that the question of fraud be resolved before the counter-guarantees are called up.

[16] It is common cause that the Applicant and the Fourth Respondent entered into a contract, effective from April 2008, for the supply of defence related equipment, the Applicant being the seller or the vendor, and the Fourth Respondent being the buyer.

[17] In terms of the warranty clause, the Applicant made certain warranties, *inter alia*, that:

[17.1] the products supplied shall conform to agreed technical specifications;

[17.2] the warranty on such products shall be for a period of 5 years;

[17.3] the products shall be free from all defects in design, material, workmanship, performance and packaging; and

[17.4] repairs to defects in the products shall be warranted for the remainder of the original warranty period and that all replaced products or components will be warranted for a period of 5 years from date of delivery.

[18] Pursuant to the warranties given by the Applicant, the parties agreed to a warranty bond clause which reads as follows:

> *"10.1 For every consignment of the products to be delivered to the buyer in accordance with the delivery schedule as set out in Annex "D", a warranty bond in the form of a Bank Guarantee from a first class bank duly confirmed by the Bank of Baroda, New Delhi Branch, equal to 5% (five percent) of the value of the relevant consignment, shall be furnished by the Seller, by not later than 30 (thirty) days before the FOB (Incoterms 2000)*

delivery of the relevant consignment. The warranty bond shall become effective on FOB delivery of the relevant consignment. The buyer will be entitled to call on a warranty bond in the event that the seller has failed to replace (delivered FOB) or rectify defective products within a period of 150 days after receipt of the buyers notice in terms of clause 9.3."

[19] In respect of performance warranties, the parties agreed to a performance bond agreement which reads as follows:

"12.1 The Seller will 60 (sixty) days prior to the FOB delivery date of the first production lot of products, ... furnish the Buyer with a Performance Bond equal to 5% (five percent) of the total value of the contract amounting to two million five hundred and forty five thousand United States dollars (US$2 545 000), issued by a first class bank and duly confirmed by the New Delhi branch of Bank of Baroda, State Bank of India, Canara Bank, or Bank of India.

12.2 The Performance Bond will automatically and in full terminate 90 days after FOB delivery of the last production lot. In case of delay in deliveries the Seller will extend the validity of the Performance Bond at his expense by an adequate period to

cover 90 days from actual last FOB delivery ..."

[20] Another clause that will be relevant in these proceedings is the Penalty for Use of Undue Influence clause, which reads as follows:

"17.1 The Seller undertakes that he has not given, offered or promised to give, directly or indirectly any gift, consideration, reward, commission, fees, brokerage or inducement to any person in service of the Buyer, or otherwise in procuring the contract or forbearing to do any acts in relation to the obtaining or execution of the contract, or any other contract with the government for showing or forbearing to show favour or disfavour to any person in relation to the contract, or any other contract within the government. Any breach of the aforesaid undertaking by the Seller, or anyone employed by him or acting on the behalf (whether with or without the knowledge of the seller), or the commission of any offence by the seller or anyone employed by him or acting on his behalf, as defined in Chapter IX of the Indian Penal Code, 1860 or the Prevention of Corruption Act 1947, or any other Act enacted for the prevention of corruption, shall entitle the Buyer to cancel the contract and all/or any other contracts with the Seller, and recover from the Seller the amount of any loss arising from such cancellation. The decision of the

Buyer or his nominee to the effect that breach of the undertaking has been committed shall be final and binding on the seller.

17.2 Giving or offering of any gift, bribe or inducement, or any attempt to any such act on behalf of the Seller towards any officer/employee of the Buyer, or to any other person in a position to influence the decision of the buyer, directly or indirectly, or any attempt to influence any officer/employee of the buyer for showing any favour in relation to this or any other contract, shall render the Seller to such liability/penalty as the Buyer may deem proper, including, but not limited to, termination of the contract, imposition of penal damages, forfeiture of the bank guarantee and refund of the amounts paid by the Buyer."

[21] It is appropriate to refer to examples of the principal bank guarantee and counter-guarantees as stipulated by the First Respondent and the demand made by the Fourth Respondent. The two respective guarantees were communicated by the First Respondent to the Second and Third Respondents in one message which reads as follows:

DEAR SIRS,

WHEREAS YOU HAVE ENTERED INTO A CONTRACT

REFERENCE NUMBER 81552/GS/WE-4/D(GS-IV)-I (HEREINAFTER REFERRED TO AS THE "SAID CONTRACT") DATED 27 MARCH 2002 WITH M/S DENEL (PTY) LTD TRADING AS PMP (HEREINAFTER REFERRED TO AS "THE SELLER") HAVING ITS PRINCIPLE OFFICE AT DENEL BUILDING, JOCHEMUS STREET, ERASMUSKLOOF FOR THE SUPPLY OF 100 AMR'S (HEREINAFTER REFERRED TO AS "THE GOODS") AND WHEREAS THE SELLER HAS UNDERTAKEN TO PRODUCE A WARRANTY BOND FOR AN AMOUNT OF USD22 0.767, 00 (TWO HUNDRED AND TWENTY THOUSAND SEVEN HUNDRED AND SIXTY SEVEN UNITED STATES DOLLARS ONLY) BEING EQUAL TO 5 PCT (FIVE PERCENT) OF THE TOTAL CONTRACT VALUE OF THE GOODS DELIVERED AS SPECIFIED IN THE SAID CONTRACT TO SECURE ITS OBLIGATIONS TO THE BENEFICIARY WITH RESPECT TO THE GOODS SPECIFIED IN THE SAID CONTRACT,

1. *WE, STATE BANK OF INDIA, ..., HEREBY EXPRESSLY, IRREVOCABLY AND UNRESERVEDLY UNDERTAKE AND GUARANTEE AS PRINCIPLE OBLIGOR ON BEHALF OF THE SELLER THAT IN THE EVENT THAT THE BENEFICIARY SUBMITS A WRITTEN DEMAND TO US STATING THAT THE SELLER HAS NOT PERFORMED*

ACCORDING TO THE WARRANTY OBLIGATIONS FOR THE GOODS DELIVERED UNDER THE SAID CONTRACT, WE WILL PAY YOU ON DEMAND AND WITHOUT DEMUR, ANY SUM UP TO A MAXIMUM OF USD22 0 .767,00 (TWO HUNDRED AND TWENTY THOUSAND SEVEN HUNDRED AND SIXTY SEVEN UNITED STATES DOLLARS ONLY). YOUR WRITTEN DEMAND SHALL BE CONCLUSIVE EVIDENCE TO US THAT SUCH REPAYMENT IS DUE UNDER THE TERMS OF THE SAID CONTRACT. WE UNDERTAKE TO EFFECT PAYMENT WITHIN SEVEN (7) WORKING DAYS FROM RECEIPT OF SUCH WRITTEN DEMAND.

2. *WE SHALL NOT BE DISCHARGED OR RELEASED FROM THIS UNDERTAKING AND GUARANTEE BY ANY ARRANGEMENTS, VARIATIONS MADE BETWEEN THE BENEFICIARY AND THE SELLER, OR ANY FORBEARANCE WHETHER AS TO PAYMENT, TIME PERFORMANCE OR OTHERWISE.*

3. *IN NO CASE SHALL THE AMOUNT OF THIS GUARANTEE BE INCREASED.*

4. *UNLESS A DEMAND UNDER THIS GUARANTEE IS MADE TO ITS IN WRITING ON OR BEFORE THE EXPIRY DATE AS PROVIDED HEREAFTER OR UNLESS THIS GUARANTEE IS EXTENDED BY US, AT THE REQUEST OF THE SELLER ALL YOUR RIGHTS UNDER THIS GUARANTEE SHALL BE FORFEITED AND WE SHALL BE DISCHARGED FROM THE LIABILITIES HEREUNDER.*

5. *THIS GUARANTEE SHALL BE A CONTINUING GUARANTEE (WHICH MEANS THE GUARANTEE WILL ALSO BE VALID IF THE BANK IS IN LIQUIDATION OR BANKRUPTCY) AND SHALL NOT BE DISCHARGED BY ANY CHANGE IN THE CONSTITUTION OF THE BANK OR IN THE CONSTITUTION OF THE SELLER.*

6. *THIS GUARANTEE WILL EXPIRE ON 30 JUNE 2005 BEING 16 MONTHS FROM THE DATE OF INSPECTION IN INDIA (HEREINAFTER REFERRED TO AS "EXPIRY DATE").*

7. *PLEASE RETURN THIS LETTER OF GUARANTEE IMMEDIATELY AFTER OUR LIABILITY THEREUNDER HAS CEASED TO BE VALID.*

8. OUR LIABILITY UNDER THIS GUARANTEE WILL CEASE TO BE VALID AFTER EXPIRY DATE EVEN IF THE GUARANTEE DEED IS NOT RETURNED TO US .

UNQUOTE

IN CONSIDERATION OF YOUR ISSUING THE WARRANTY BOND IN FAVOUR OF THE PRESIDENT OF INDIA THROUGH THE JOINT SECRETARY (ORDNANCE), MINISTRY OF DEFENCE, AT OUR REQUEST AGAINST OUR COUNTER GUARANTEE NO. 821-02-0010566-G, WE, ABSA BANK LIMITED, TRADING AS ABSA CORPORATE AND MERCHANT BANK, INTERNATIONAL BANKING SA - PRETORIA CENTRE, HEREBY IRREVOCABLY AND UNCONDITIONALLY CONFIRM THAT WE UNDERTAKE TO PAY YOU ON YOUR FIRST WRITTEN DEMAND BY AUTHENTICATED S.W.I.F.T./TELEX MESSAGE STATING THAT YOU HAVE BEEN CALLED UPON TO MAKE PAYMENT UNDER AND IN TERMS OF YOUR GUARANTEE, NOTWITHSTANDING ANY CONTESTATION OR PROTEST BY THE SELLER, BY OURSELVES OR ANY OTHER THIRD PARTY, THE SUM NOT EXCEEDING THE MAXIMUM AMOUNT OF USD22 0.767, 00 (TWO HUNDRED AND TWENTY THOUSAND SEVEN HUNDRED AND SIXTY SEVEN UNITED STATES DOLLARS ONLY).”

[22] The demand reads as follows:

"DEAR SIR

AS THE SELLER HAS NOT PERFORMED ACCORDING TO THE CONTRACTUAL OBLIGATIONS FOR THE GOODS DELIVERED UNDER THE SAID CONTRACT THE VALIDITY OF ABOVE MENTIONED WARRANTY BANK GUARANTEE BE EXTENDED UP TO 04.12.2010 FAILING WHICH THIS LETTER MAY BE TREATED AS NOTICE FOR ENCASHMENT OF BOTH THE ABOVE BANK GUARANTEES AND DEMAND DRAFTS/CHEQUES FOR THE FULL VALUE OF GUARANTEES IN FAVOUR OF PCDA HQRS MINISTRY OF DEFENCE NEW DELHI MAY BE SENT IMMEDIATELY 2.RECEIPT OF THIS COMMUNICATION MAY PLEASE BE ACKNOWLEDGED BY RETURN FAX AT 011-23018304 YOURS FAITHFULLY SD/DY SECRETARY TO THE GOI FOR AND ON BEHALF OF THE PRESIDENT OF INDIA

UNQUOTE"

WITH REGARD TO THE ABOVE MESSAGE WE REQUEST YOU TO EITHER EXTEND THE GUARANTEE AS REQUIRED OR ARRANGE FOR IMMEDIATE PAYMENT OF THE SUM IN TERMS OF YOUR

COUNTER GUARANTEE IN FAVOR OF SBII, JOHANNESBURG "

[23] These documents arise out of a contractual relationship between the Applicant and the Fourth Respondent giving rise to the aforesaid underlying contracts. These gave rise to the warranty and performance guarantees referred to.

[24] The Applicant instructed the First Respondent to issue the guarantees. The First Respondent requested its counterparts in India, the Second and Third Respondents, to issue the principal guarantees in favour of the Fourth Respondent as guarantors of the Applicant's obligations to the Fourth Respondent. The First Respondent in turn issued counter-guarantees to the Second and Third Respondents as a guarantor of their obligations to the Fourth Respondent.

[25] The Fourth Respondent called upon the Second and Third Respondents to pay on the basis of the principal guarantees. The demands were made essentially in the terms set out in Annexure "D3" as quoted above. Having honoured their obligations to the Fourth Respondent, the Second and Third Respondents have called upon the First Respondent to honour the counter-guarantees in their favour. Whilst the Second and Third Respondents are guarantors under the principal guarantees and the Fourth Respondent the beneficiary, the Second and Third Respondents are

beneficiaries under the counter-guarantees whilst the First Respondent is the guarantor thereunder.

[26] Since it is common cause between the parties that Annexures "D1" and "D2" are typical of the other principal and counter-guarantees, I shall not examine each of the principal and counter-guarantees in respect of the demands that are relevant to this application.

[27] The Second and Third Respondents resist the application on the grounds that:

[27.1] As a matter of legal principle, since a demand guarantee is independent from the underlying contract between the principal and the beneficiary (that is, the contract between the Applicant and the Fourth Respondent as seller and buyer respectively), regardless of a dispute between the parties to the underlying contract, the guarantee must be paid on demand. The submission is made on the basis of the *"principle of independence"* or *"autonomy"* of a counter-guarantee being independent of the principal guarantee.

[27.2] Whilst established fraud on the part of the beneficiary is an exception to the principle that the demand guarantee is payable on the presentation of a demand regardless of whether the obligations

in the underlying contract have been performed or not, the Applicant has failed to establish fraud on either the First Respondent's part or on the part of the Second and Third Respondents.

[27.3] The Fourth Respondent's demands were compliant.

[27.4] The First Respondent and the Applicant have waived their rights to refuse to honour the counter-guarantees because of alleged non-conforming demands for payment by the Fourth Respondent.

[28] The principal guarantees and related counter-guarantees relevant to these proceedings are first demand guarantees.[1]

[29] The Court in the **Dormell Properties** case quoted with approval the judgment of Lord Denning MR in **Edward Owen Engineering Ltd v Barclays Bank International Ltd**[2] where he said:

"A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the

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1 **Dormell Properties 282 CC v Renasa Insurance Company Ltd and Others NNO** 2009 (1) SA 70 SCA at paragraph 38, 39 and 63

2 [1978] QB 159 (CA) [1978] 1 All ER 976; (1977 3 WLR 764) at 983 B-D

question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice."

[30] In South African Law, the principal guarantee and the related counter-guarantee are interpreted as independent guarantees, that is, a counter-guarantee is interpreted on its own, irrespective of whether the call under the principal guarantee was proper or not. The exception of fraud applies to counter-guarantees.

[31] Michelle Kelly-Louw: **Selective Legal Aspects of Bank Demand Guarantees**, Doctoral Thesis submitted to the University of South Africa in October 2008 describes the independence of the counter-guarantee to the principal guarantee as follows:

"2.5.2.8 Independence of the counter-guarantee from the guarantee

When a counter-guarantee ... is issued – that is, in an indirect (four party) guarantee structure – the counter-guarantee possesses the same independence from the demand guarantee as the latter from the underlying contract

between the principal and the beneficiary. Accordingly, as long as the guarantor's demand under the counter-guarantee complies with the requirements of the counter-guarantee, the guarantor is entitled to payment (in the absence of established fraud or another ground for non-payment), whether or not the guarantor has paid the beneficiary or has perceived a demand for payment or is legally liable to pay a demand received."

[32] Anthony Pierce[3] defines counter-indemnities as follows:

"The extent of the indemnity is encapsulated in the wording of the counter-indemnity. It is an area of significant risk for the exporter. Their wording is often all-embracing, counter-indemnifying guarantors for everything they do, or even fail to do, in relation to the issue, maintenance and cancellation of the guarantee.

The majority of banks and surety companies use their own standard forms of counter-indemnity. These vary considerably in terms, conditions, and complexity. The exporter should ensure that his liability under the indemnity is not open ended as to value, reason for claim or

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[3] Demand Guarantees in International Trade : London, Sweet and Maxwell 1993 at 28

validity. *Most standard form counter-indemnities contain a* conclusive evidence clause, *which makes it virtually impossible for the exporter to dispute the validity of any claim. Exporters need to study the terms of the required counter-indemnity most carefully (and if necessary take legal advice) before instructing the bank to issue a bank demand guarantee."*

[33] Regarding the fact that the guarantee and interbank counter-guarantee are autonomous, Pierce goes on to say[4]:

> *"(a) The banker who is the counter-guarantor and whose counter-guarantee is claimed by the banker who is the primary guarantor cannot request the latter to justify that the beneficiary claimed the guarantee in writing or that it was paid by the said banker, if no such provision was included in the counter-guarantee ...*
>
> *(b) The fact that the beneficiary's claim against the primary guarantor was fraudulent does not vitiate by fraud the claim against the counter-guarantee by the banker who was the primary guarantor, as long as there was* no fraudulent collusion *between the said banker and the beneficiary; and*

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[4] at 36

(c) It does not matter whether the claim against the primary guarantee was made outside the time limit; the only thing that matters is whether the counter-guarantee was claimed within the agreed period of time."

[34] The learned author further states that:

"Bank demand guarantees are normally viewed by learned Judges as absolute undertakings *by banks to pay if the conditions of payment are satisfied. In this respect they are similar to a banker's confirmed documentary credit and many considerations applying to the latter apply also to bank demand guarantees.*

...

The Court of Appeal (Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 QB 159; [1978 1 All ER 976]; [1978 1 LL report 166] refused an injunction by the exporter which attempted to prohibit Barclays Bank International from paying. The Master of the Rolls followed precedent by placing such guarantees, as previous judges had done, on a similar footing to letters of credit insofar as they concerned the position of the bank. Lord Denning MR observed:

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

The bank could not become involved in contractual disputes between the exporter and the buyer; it was obliged to pay "on demand without proof or condition". Lord Denning concluded that no injunction could be imposed upon the bank to restrain payment. Under English case law the position of the exporter is, therefore, clear. He has almost no power to prevent payment by the bank, and will ultimately become liable himself because of the counter-indemnity required from him by the bank. Cases subsequent to those mentioned above have confirmed the position.

In the event of an unfair call, the exporter is left merely with a claim for

breach of contract against the buyer, with all the difficulties of establishing and enforcing such a claim in the courts of the overseas buyer's country.

The only possible exception would be where the bank had clear notice of fraud on the part of the buyer."[5]

[35] There was much debate about whether the principle of strict compliance should apply with equal force in regard to bank guarantees as it does to documentary credits. Roeland F Bertrams[6] comes to the conclusion that the principle of strict compliance, while *"without any doubt sensible, solid and cogent"* in respect of documentary credits, a justification for the relaxation of the principle of strict compliance in favour of substantial compliance in appropriate cases such as under a bank guarantee exists.

[36] In **Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd**[7] the guarantee expressly required that the order of liquidation be attached to the demand. It was not. The Court held that it was not necessary in that case to decide whether *"strict compliance"* was necessary for performance guarantees, since, in that case, the requirements

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[5] at 83-84

[6] Bank Guarantees in International Trade (3rd Revised Edition) : Kluwer Law International at 140 - 143

to be met by the Respondent in making demand were absolutely clear and there was, in fact, no compliance at all , let alone strict compliance.

[37] The case involved a construction guarantee which 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]"*. The relevant sub-clauses thereto provided that the written demand must state:

> *"4.1 The agreement has been cancelled due to the recipient's [the sub-contractor's] default in that the Advance Payment Guarantee is called up in terms of 4.0.* The demand shall enclose a copy of a notice of cancellation;
>
> *OR*
>
> *4.2 A provisional sequestration or liquidation court order has been granted against the recipient in that the Advance Payment Guarantee is called up in terms of 4.0.* The demand shall enclose a copy of the court order."
>
> (emphasis original)

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[7] 2012 (2) SA 537

[38] Lewis JA in the **Compass Insurance** case referred to the judgment of Nugent JA in **OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd**[8], where he said in relation to letters of credit:

> *"[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."*

[39] With reference to **Midland Bank Ltd v Seymour**[9] Nugent JA approved of the principle of strict compliance.

[40] Lewis JA in the **Compass Insurance** case also referred to the **Edward Owen Engineering** case, which was cited and approved in **Loomcraft CC v Nedbank Ltd and Another** 1996 (1) SA 812 (A); [1996] 1 All SA 51 at 816 G-H and in **Dormell Properties 282 CC v Renasa Insurance Company Ltd and Others NNO**[10], where it was stated:

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[8] 2002 (3) SA 688 SCA at paragraph 25

[9] [1955] 2 Lloyd's Rep 147 at 151

[10] 2011 (1) SA 70 (SCA) at paragraph 63

"A bank which gives a performance guarantee must honour that guarantee according to its terms*."* (emphasis original)

Lewis JA referred further to Kelly-Louw's doctoral thesis[11] where she suggests that English Courts have started to apply the same degree of *"strict compliance"* to demand guarantees as to letters of credit, and concluded that:

"[13] 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 Hospitality Hotel 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."

[41] For Kelly-Louw to come to the conclusion 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, she relied on the case of **Frans Maas (UK) Ltd v Habib Bank AG Zurich**[12] where it was said:

"The question is : what was the promise which the bank made to the

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[11] at 68-69

[12] [2001] Lloyds Reports Bank 14 at paragraphs 57-60

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. If that view of the law is unattractive to banks, the remedy lies in their own hands."[13]

[42] It was held that the demand did not comply because:

"The statement in the demand of 14 December 1998 does not in terms allege a 'failure to pay' but a 'failure to meet contractual obligations'. Without there being any question of resorting to the doctrine of strict compliance, it seems to me that a failure to 'meet a contractual obligation' is far from being the same as 'failure to pay under a contractual obligation'. In effect, the former concept is wide enough to cover any claim for damages for unliquidated or unascertained sums arising from any breach of the WTA, which would seem to me to widen the scope of the guarantee far beyond that which the parties intended. In my view the natural scope of the guarantee is limited to the failure to pay the liquidated and ascertained sums falling due under the WTA from time to time."

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[13] at 103 paragraph 58

[43] It is clear therefore that the Court found it unnecessary to pronounce on whether the doctrine of strict compliance applied or not as there was no compliant demand in terms of *"the promise which the bank made to the beneficiary"*.

[44] As Lewis JA stated in **Compass Insurance**, every case of this nature, like most, will turn on the interpretation of the guarantee itself[14].

[45] In **Harbottle (Mercantile) Ltd v National Westminster Bank Ltd and Others**[15] a counter-guarantee was given in the following terms:

> *"You are hereby irrevocably authorised and directed to pay forthwith on any demand appearing or purporting to be made by or on behalf of the beneficiary (i.e. the buyers) any sums up to the limit of your liability which may be demanded of you from time to time without any reference to or any necessity for confirmation or verification on the part of the undersigned, it being expressly agreed that any such demand shall as between the undersigned and you be conclusive evidence that the sum stated therein is properly due and payable, and you are further*

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[14] at paragraph 12

[15] [1978] 1 QB 146; **Owen Engineering** at page 172

authorised to debit any account of the undersigned ..."[16]

[46] In holding the guarantor to pay in terms of the counter-guarantee, the Court noted that :

"The Plaintiffs took the risk of the unconditional wording of the guarantees."[17]

[47] The principal and counter-guarantees in this matter were restricted to payment upon the occurrence of an event, which was *"that the seller has not performed according to the warranty obligations"* or that the Second and Third Respondents have been called upon *"to make payment under and in terms of [their] guarantee"*, respectively. Neither the principal guarantor nor the counter-guarantors were obliged to pay for non-performance *"according to their contractual obligations"*.[18]

[48] As stated in the **Frans Maas** case, the guarantor's obligations were to make payment upon the condition that the Applicant has not performed according to the warranty obligations or has defaulted under and in terms of its warranty obligations. The Second and Third Respondents were not

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[16] at 149 D

[17] at 156 A

[18] See Annexures "D1", "D2" and "D3"

obliged to pay the Fourth Respondent on the basis that the Applicant has not performed according to the contractual obligations nor is the First Respondent obliged to pay the Second and Third Respondents upon this premise. The guarantors are only obliged to pay in terms of the promise made under the warranty obligations.

[49] As was stated in **Frans Maas**[19]:

> *"A failure to meet a contractual obligation is far from being the same as a failure to meet a warranty or guarantee obligation. A failure to meet a contractual obligation is wide enough to cover any claim in circumstances where the proper interpretation of the guarantee itself limits the Applicant's and the First Respondent's obligations to breaches of performance and warranty guarantees."*

[50] English law is that performance and warranty guarantees stand on a similar footing to letters of credit and that the guarantor must pay according to its guarantee on demand, without proof or conditions, the only exception being the establishment of a clear fraud of which the bank has notice, such guarantee must be honoured *"according to its terms"*.[20]

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[19] at 104, paragraph 62

[20] **Edward Owen** at 171-172

[51] In the **Loomcraft Fabrics** matter, Scott AJA, dealing with a matter involving *"irrevocable documentary credits"* where the bank undertakes to pay the beneficiary provided only that the conditions specified in the credit are met, held that the liability of the bank to the beneficiary *"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."*.[21]

[52] Similarly, in my view, in the case of demand guarantees, the beneficiary must meet the conditions specified in the guarantee. Whether the condition or term of the guarantee *"conform strictly to the requirements of the credit"* or to the principle of *"strict compliance"*, is a matter of a proper interpretation of the guarantee itself.[22]

[53] As stated above, the demands made by the Second and Third Respondents to the First Respondent simply do not comply. The demands were made for a purpose that is too wide than the parties had agreed to, that is, that the Second and Third Respondents would pay the Fourth Respondent in the event that the Applicant fails to meet its performance and warranty guarantees, and that the Second and Third Respondents' demands and the First Respondent would similarly be restricted to those purposes.

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[21] at 815 G-J

[54] Another reason I find the demands non-compliant is that in the proceedings in the High Court of Delhi, dated 23 March 2012, the Assistant Solicitor General explained to the Court that :

> *".... The bank guarantees were invoked/encashed on the ground of the Appellant [Denel] having violated a clause, in the agreement of sale and supply of arms and ammunition, prohibiting offering of gift, bribe, inducement, etc."*[23]

[55] This is with reference to clause 17.2 of the agreement. As stated above, the guarantees were only for the purposes pertaining to clauses 9 (warranty guarantee) and 12 (performance guarantee) of the agreement. This factor is also one of simply no compliance and therefore does not require any examination as to whether it meets the standard of *"strict compliance"* or *"substantial compliance"*. Both the principal and counter-guarantees were called for the reasons which were not promised by the Applicant.

[56] It was submitted on behalf of the Second and Third Respondents that the requirements of clause 17.2 qualify the Fourth Respondent to have made

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[22] **Frans Maas** at paras 57-60; **Compass Insurance** at para [12]

[23] at page 7, paragraph 9

demand thereunder. The simple interpretation of the contract does not bear this submission out. The terms and conditions of the guarantees were wisely restricted by the seller.

[57] I was addressed at length by Counsel for the Applicant about whether the demands were made by the person designated to make them; whether some guarantees have expired or are current; and whether some of the demands were made within stipulated time periods. All these matters are irrelevant for consideration in view of my judgment that all these demands are not compliant in respect of all such demands.

[58] Furthermore, I find that the Applicant did not waive its rights to challenge payment under these demands. The Second and Third Respondents contend that the First Respondent waived its rights to refuse to honour the counter-guarantees because it did not object to the wording of the first demands when the Fourth Respondent made them under the principal guarantees. The Second and Third Respondents submit further that the Applicant has similarly waived its rights to dispute the validity of the demands for payment under the principal guarantees on the same basis.

[59] I agree with Counsel for the Applicant that the requests for the extension of certain guarantees by the Fourth Respondent, alternatively that the requests be treated as the demands under the guarantees, do not

amount to acquiescence to the wording of the demands. Where the extensions were granted (if any), the question whether the demands are valid does not arise. An example of a request for extension reads as follows:

"Dear Sir

As the vendor have failed to perform contractual obligations, you are requested to extend the validity date of the above referred Warranty Bank Guarantee for a further period of one year i.e. up to 15.12.2010, failing which this letter may be treated as a notice for encashment of the above bank guarantee and demand draft/cheque for the full value of guarantee in favour of PCDA Hqrs., Ministry of Defence, New Delhi, may be sent immediately.

2. Receipt of this communication may please be acknowledged by return fax at 011-23018304.

Yours faithfully"

[60] Where the extensions were not granted the question whether the demands are valid is now being contested.

[61] I might add that the Second and Third Respondents' submissions that

clause 17.2 has been invoked in this matter, is not consistent with their desire to extend guarantees that they say underpin a contract obtained unlawfully or in contravention of clause 17.

[62] I do not have to determine whether the Applicant has established fraud against the Fourth Respondent, which fraud the Second and Third Respondents had notice of and should therefore not have made their demands to the First Respondent. That issue is before the courts and the arbitration proceedings in India.

[63] In any event, my *prima facie* view is that the dispute as to whether clause 17.2 applies in this case turns more on a contractual dispute than a question of fraud.[24]

In the premises, I make the following order:

1. The First Respondent is interdicted from making payment in respect of the following guarantees pending finalisation of pending arbitration proceedings and Court proceedings in India pertaining to the aforesaid guarantees:

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[24] See **Harbottle** case

Counter-guarantee	Counter-guarantee type	Amount	Counterparty	Issued	Amount to be paid (excluding any interest)
Guarantee 821-02-0009417-G	Warranty	USD 186 750,00	Bank of Baroda	6 August 2003	USD 186 750,00
Guarantee 821-02-0009756-G	Warranty	USD 195 000,00	State Bank of India	2 October 2003	USD 195 000,00
Guarantee 821-02-0009889-G	Warranty	USD 186 750,00	State Bank of India	24 November 2003	USD 186 750,00
Guarantee 821-02-0010223-G	Warranty	USD 195 000,00	State Bank of India	8 March 2004	USD 195 000,00
Guarantee 821-02-0011743-G	Warranty	USD 195 000,00	State Bank of India	28 February 2005	USD 195 000,00
Guarantee 821-02-0010566-G	Warranty	USD 220 767,00	State Bank of India	22 April 2004	USD 220 767,00
Guarantee 821-02-0009587-G	Warranty	USD 399 000,00	State Bank of India	8 September 2003	USD 399 000,00
Guarantee 821-02-0002584-G	Warranty	USD 1 197 930,00	State Bank of India	10 July 2003	USD 1 197 930,00
TOTAL		USD5 582 714,00			8SD3 776 197,00

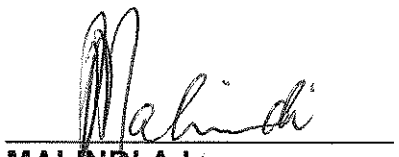
2. The First Respondent is interdicted from making payment to the above counterparty pending the finalisation of already instituted and pending arbitration proceedings in India in respect of:

2.1 the aforesaid guarantees (excluding counter guarantee 821-02-0009587-G);

2.2 in respect of counter guarantee 821-02-0009587-G,

pending finalisation of arbitration proceedings to be instituted in respect thereof in India within 1 (ONE) month.

3. Costs of the application including costs of Part A proceedings, such costs to include the costs of the engagement of two counsel. The costs against the First and Fourth Respondents to be on the unopposed scale.



MALINDI AJ
Acting Judge of the South Gauteng
High Court

Counsel for Applicant	:	NGD Maritz SC
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Instructed by	:	Gildenhuys Malatji Inc
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Counsel for First Respondent:	JGC Hamman
Instructed by:	Lowndes Dlamini Attorneys
Counsel for Second and Third Respondents:	SF du Toit SC
	SK Hassim SC
Instructed by:	AW Jaffer Attorneys
Date of Hearing:	3 and 4 December 2012
Date of Judgment	4 March 2013