The Doctrine of Strict Compliance in the context of demand guarantees*

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Abstract

In South African law the required standard of compliance regarding documents presented in terms of commercial letters of credit is unclear. It is presumed that the English law is followed. However, the English law is also not entirely clear as to the required standard of compliance for documents and demands required in terms of demand guarantees. Some English courts have expressed the view that as regards demand guarantees, the doctrine of strict compliance is not as strict as that demanded for letters of credit. In two recent South African cases it was argued that a less strict standard of compliance applies to demand guarantees in South Africa. English authorities were advanced to support this argument. However, this article shows that the exact application of the doctrine of strict compliance to demand guarantees under the English law is neither straightforward nor has it yet been fully established. The article examines these South African cases against the backdrop of the English cases.

INTRODUCTION

In *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd and Others,*[1] the integrity of letters of credit and demand guarantees[2] was likened

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1 [1978] 1 QB 146 (CA) ([1977] 2 All ER 862 (CA)).

2 Demand guarantees are also often referred to as 'standby letters of credit', even though the latter has a very different historical development than demand guarantee (for a brief

to 'the life-blood of international commerce'.[3] A fundamental characteristic of commercial letters of credit is the autonomy (independence) of the credit.[4] This means that the undertaking to pay embodied in the letter of credit is independent of both the performance of the underlying contract between the applicant for the credit and the beneficiary, and of the relationship between the applicant and the issuing bank.[5] As a rule, therefore, it is not a defence to a claim on the letter of credit that the beneficiary appears to have committed a breach of the underlying contract, that the contract is unenforceable, or that the applicant for the credit has failed to put the issuing bank in funds.[6] The issuing bank is simply not concerned with any dispute arising out of the possible breach of the underlying contract.[7] Established fraud is the only internationally accepted exception to the autonomy principle,[8] although certain jurisdictions such as Singapore, Malaysia, and

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discussion of this, see Kelly-Louw *Selective legal aspects of bank demand guarantees: the main exceptions to the autonomy principle* (2009) 100–103).

3 [1978] 1 QB 146 (CA) at 155G.

4 See, *eg*, *Phillips and Another v Standard Bank of South Africa Ltd and Others* 1985 3 SA 301 (W) at 304A–B and 304E–F; *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 1 SA 812 (A) at 815F–816C; *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) at 732; *Dormell Properties 282 CC v Renasa Insurance Co Ltd and Others NNO* 2011 1 SA 70 (SCA) in par [39]; *Firstrand Bank Ltd v Brera Investments CC* 2013 5 SA 556 (SCA) in par [11]; *Casey and another v First National Bank Ltd* 2013 4 SA 370 (GSJ) in pars [14]–[17] and [20]; *Casey v Firstrand Bank* (608/2012) [2013] ZASCA 131 (26 September 2013) in pars [5]–[7], [12] and [14]. See also Goode 'Abstract payment undertakings in international transactions' (1996) 22 *Brooklyn Journal of International Law* 1 at 12; 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* (1997) 174 ('Hugo: *The law relating to documentary credits*'); Schulze 'Attachment *ad fundandam jurisdictionem* of the rights under a documentary letter of credit — some questions answered, some questions raised' (2000) 63 *THRHR* 672 at 673–375; Van Niekerk & Schulze *The South African law of international trade: selected topics* (3ed 2011) at 290 and 294; Malek & Quest *Jack: Documentary credits: the law and practice of documentary credits including standby credits and demand guarantees* (4ed 2009) in pars 1.34 and 8.17; Adodo *Letters of credit: the law and practice of compliance* (2014) at 153.

5 Goode n 4 above at 12; Malan 'Letters of credit and attachment *ad fundandam jurisdictionem*' (1994) *TSAR* 150 at 150–151; Schulze n 4 above at 674; Oelofse *The law of documentary letters of credit in comparative perspective* (1997) in par 9.1 at 354–357.

6 Chuah *Law of international trade: cross-border commercial transactions* (5ed 2013) at 591.

7 See Schulze n 4 above at 674; Van Niekerk & Schulze n 4 above at 290–295.

8 Enonchong 'The autonomy principle of letters of credit: an illegality exception?' (2006) *Lloyd's Maritime and Commercial Law Quarterly* 404 at 405; Malek & Quest n 4 above in par 1.34 at 18 and chapter 9. For a recent discussion of the fraud exception in South Africa, see M Kelly-Louw 'Limiting exceptions to the autonomy principle of demand guarantees and letters of credit' in Visser & Pretorius (eds) *Essays in honour of Frans Malan: former judge of the Supreme Court of Appeal* (2014) at 197–218.

Australia also accept that there are or may be other exceptions.[9] Illegality in the underlying contract is also becoming an acceptable exception[10] in certain jurisdictions.[11]

The autonomy principle is fundamental to demand guarantees and standby letters of credit.[12] Although the issuing of a demand guarantee follows from the underlying contract between the principal (or applicant as this party is now referred to)[13] and the beneficiary, the guarantee is separate from that contract, and the rights and obligations created by the guarantee are independent of those arising from the contract, with which the guarantor is generally not concerned.[14] The majority of demand guarantees issued in practice are payable 'on demand' or 'on first demand', which clearly implies that they create a binding obligation to pay against the simplest of demands by the beneficiary without any proof of default on the contract by the principal.[15] Therefore, a guarantor (*eg*, bank) that gives a demand guarantee must honour that guarantee in accordance with its terms. A guarantor issuing a demand guarantee undertakes an absolute obligation to pay the beneficiary in accordance with the directions in the guarantee.[16]

Internationally the autonomy principle of demand guarantees, commercial letters of credit, and standby letters of credit, is also acknowledged. For

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9 For examples of some of these exceptions, see Kelly-Louw 'Illegality as an exception to the autonomy principle of bank demand guarantees' (2009) 42 *CILSA* 339 fn 2 at 340–341. For a more detailed discussion, see Horowitz *Letters of credit and demand guarantees: defences to payment* (2010).

10 See also Kelly-Louw n 8 above at 200–201.

11 For a full discussion of illegality as a possible exception, see Malek & Quest n 4 above at 412–429; Kelly-Louw n 9 above; Horowitz n 9 above at ch 7.

12 *Union Carriage v Nedcor Bank* n 4 above at 731–732; *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 2 SA 86 (SCA); *Petric Construction CC t/a AB Construction v Toasty Trading t/a Furstenburg Property Development* 2009 5 SA 550 (ECG); *Basil Read (Pty) Ltd v Nedbank Ltd* 2012 6 SA 514 (GSJ) in pars [26] and [28]; *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA) in par 14; *Dormell Properties v Renasa* n 4 above in par 39; *Casey and Another v First National Bank Ltd* 2013 4 SA 370 (GSJ) in pars [14]–[17], [20]–[22]. See also Van Niekerk & Schulze n 4 above at 294; Bennett 'Performance bonds and the principle of autonomy' 1994 *Journal of Business Law* 574; Malek & Quest n 4 above in par 1.34 at 17–18.

13 See art 2 of the 2010 'Uniform Rules for Demand Guarantees' *ICC Publication* 758 (2010).

14 Goode 'Guide to the ICC Uniform Rules for Demand Guarantees' *ICC Publication* 510 (1992) (*Guide to the URDG*) 17–18; Bennett n 12 above at 575.

15 Penn 'On-demand bonds – primary or secondary obligations?' (1986) 4 *Journal of International Banking Law* 224 at 224.

16 See the authorities listed in n 14 above.

example, in the United States of America revised article 5–103(*d)* of the Uniform Commercial Code – dealing with both commercial and standby letters of credit – codifies the principle of autonomy. This principle is also codified in articles 3 and 4 of the 1993 version of the Uniform Customs and Practice for Documentary Credits ('UCP 500');[17] articles 4 and 5 of the 2007 version of the Uniform Customs and Practice for Documentary Credits ('UCP 600');[18] article 2(*b*) of the 1992 Uniform Rules for Demand Guarantees ('URDG 458');[19] article 5(*a*) of the 2010 Uniform Rules for Demand Guarantees ('URDG 758');[20] and rule 1.06(*a*) and (*c*) of the International Standby Practices ('ISP98').[21] The United Nations Convention on Independent Guarantees and the Stand-by Letters of Credit ('UNCITRAL Convention')[22] which applies to an international undertaking such as a demand guarantee or a standby letter of credit, also mentions the autonomy principle applicable to these letters of credit and guarantees in articles 2 and 3.

The demand guarantee, commercial letter of credit and the standby letter of credit are all documentary in nature.[23] The principle of autonomy is so closely related to the documentary nature of these instruments that 'although the two principles can be separately stated, they are in reality so closely connected that they cannot be treated independently'.[24] The duration of the duty to pay, the amount payable, the conditions of payment, and the termination of the payment obligation depend entirely on the terms of the demand guarantee or letter of credit itself, and the presentation of a demand and such other documents, if any, as may be stipulated in the guarantee or credit. The issuer's/guarantor's duty is to pay against specified documents presented within the period and in accordance with the other conditions in the credit/guarantee.[25] The basic idea is that if the documents presented are

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17 See *ICC Publication* No 500 (1993) ('UCP 500').

18 See *ICC Publication* No 600 (2006) ('UCP 600').

19 See *ICC Publication* No 458 (April 1992) ('URDG 458').

20 See *ICC Publication* No 758 (2010) ('URDG 758').

21 See *ICC Publication* No 590 (October 1998) ('ISP98').

22 See the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996).

23 Kelly-Louw 'The documentary nature of demand guarantees and the doctrine of strict compliance' (part 1) (2009) 21/3 *SA Merc LJ* 306 at 307 and 311; and *Casey v First National Bank* n 12 above. For a discussion of the documentary nature of these instruments, see Kelly-Louw 'The documentary nature of demand guarantees and the doctrine of strict compliance' (part 1) (2009) 21 *SA Merc LJ* 306 and (Part 2) (2009) 21 *SA Merc LJ* 470.

24 Malek & Quest n 4 above in par 1.34 at 17.

25 *Ibid*; Chuah n 6 above at 591.

in line with the terms of the credit/guarantee, the issuer/guarantor must pay, while if the documents do not correspond to the requirements, the issuer/guarantor does not have to pay.[26] The guarantor/issuer is not obliged to authenticate the documents submitted.[27] The guarantor/issuer is therefore not interested in the investigation of external facts, such as the principal's default in performance of the underlying contract or the extent of the loss actually suffered by the beneficiary as a result of the default.[28]

The South African Appellate Division (as it then was) in *Loomcraft Fabrics CC v Nedbank Ltd & Another*[29] stressed that if a bank decided on its own to pay in terms of a commercial letter of credit where the documents did not conform to the specifications in the credit, there was nothing that the applicant (*ie* the bank's customer) could do to prevent the bank from paying. However, in those circumstances the bank would not be able to reimburse itself from the applicant's funds and would in effect be deemed to have paid from its own funds. In *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd*,[30] the South African Supreme Court of Appeal said:[31]

> A bank ('the issuing bank') that establishes a letter of credit at the request and on the instructions of a customer thereby undertakes to pay a sum of money to the beneficiary against the presentation to the issuing bank of stipulated documents … . The documents that are to be presented … are stipulated by the customer and the issuing bank generally has no interest in their nature or in their terms …. Its 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 … .*

Both the *OK Bazaars* and *Loomcraft* cases confirm that banks are not obliged to pay in terms of letters of credit (and by implication also demand

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26 See Kelly-Louw n 23 part 1 at 307; and *Casey v First National Bank* n 12 above.

27 See, *eg*, art 15 of UCP 500 and art 34 of UCP 600.

28 See the *Guide to the URDG* n 14 above at 19; Goode 'Abstract payment undertakings and the rules of the International Chamber of Commerce' (1995) 39 *Saint Louis University LJ* 725 at 735; Malan n 5 above at 151; Eitelberg 'Autonomy of documentary credit undertakings in South African Law' (2002) 119 *SALJ* 120 at 122; Kelly-Louw n 23 above part 1 at 311. See also *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 2 SA 382 (SCA) [2014] 1 All SA 536 (SCA)) in par [10].

29 Note 4 above.

30 2002 3 SA 688 (SCA).

31 *Id* at pars [25]–[26] at 697G–698D per Nugent JA (emphasis added).

guarantees and standby letters of credit), unless the documents presented comply with the terms of the credit (or guarantee).[32]

The documentary character of the documentary credit, which includes a standby letter of credit (and by implication also a demand guarantee), is confirmed internationally in article 5 of the UCP 600 (a similar provision was found in art 4 of the UCP 500, the predecessor of UCP 600).[33] The ISP98 also affirms the documentary character of the standby letter of credit (including other independent undertakings, such as demand guarantees).[34] The documentary nature of demand guarantees is further confirmed in URDG 458 and URDG 758.[35]

A question often arising when a demand for payment is made in terms of a demand guarantee/letter of credit is how strictly the documents and/or the demand must conform to the terms of the guarantee/credit before valid payment is permitted. It is often queried whether the standard is strict enough for even the most minor deviations to entitle the guarantor/issuer to refuse payment and, indeed, oblige it to do so unless otherwise authorised by the principal/applicant of the guarantee/credit; or if the standard is substantial compliance in terms of which deviations that the guarantor/issuer has no reason to believe are of commercial significance, may be ignored.[36] Of course, whether or not the letter of credit or demand guarantee is subject to any specific international rules (such as the UCP, URDG 458, URDG 758 or ISP98) or is subject to the UNCITRAL Convention, will also play an important role in determining the required standard of compliance.[37]

It has been said that an 'ally of the principle of autonomy of credits is the doctrine of strict compliance'.[38] It is generally accepted that the doctrine of

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[32] See also *Denel Soc Ltd v Absa Bank Ltd* [2013] 3 All SA 81 (GSJ) in pars [51]–[52]; and Kelly-Louw n 23 above part 2 at 484.

[33] See art 5 read with art 4 of the UCP 600. See also art 14(*a*) and *(d)* of the UCP 600.

[34] See rule 1.06(*a*) read with rule 1.06(*d*) and rule 4.08 of the ISP98. The documentary character of a standby letter of credit is closely linked to its independence (see Byrne (edited by Barnes) *The Official Commentary on the International Standby Practices* (1998) Official Comment 7 to rule 1.06 at 26).

[35] See art 2(*b*) read with art 9 of URDG 458. See also arts 6 and 19*(a)* of URDG 758.

[36] Kelly-Louw n 23 above part 1 at 307.

[37] *Id* at part 2 485. For a discussion of what the required standard of compliance for documents and demands is in the respective international rules and the UNCITRAL Convention, see Kelly-Louw n 23 above part 1; Van Niekerk & Schulze n 4 above at 290–300; Adodo n 4 above; Byrne *Standby & demand guarantee practice: understanding UCP600, ISP98 & URDG 758* (2014) ch 4.

[38] Chuah n 6 above at 600.

strict compliance applies to commercial letters of credit.[39] The doctrine requires that the documents presented in terms of a letter of credit must be precisely those for which the letter of credit calls.[40] Therefore, 'unless the documents presented are in strict compliance with their description in the letter of credit and are conforming as having performed the contract, no payment need to be made'.[41]

Although under English law it is settled law that the doctrine of strict compliance applies in relation to commercial letters of credit, it is not entirely clear what the required standard of compliance is for documents and demands required in terms of demand guarantees.[42] A few English courts have expressed the view that the doctrine of strict compliance does not apply as rigidly to demand guarantees as to letters of credit.[43]

A number of South African cases imply that the principle of strict compliance applies to commercial letters of credit.[44] However, to date no direct authority in South African case law has shed light on the matter.[45] Based on the long-standing tradition in South African courts of following English precedent relating to letters of credit, it is generally assumed that South Africa also follows the English approach of applying the standard of strict documentary compliance to letters of credit.[46]

In *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd*,[47] the South African Supreme Court of Appeal was concerned with whether or not the beneficiary had complied with the requirements of the demand guarantee when it made its demand for payment. Relying on English case

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39 Kelly-Louw n 23 above part 1 at 317 and part 2 at 475; Adodo n 4 above at 151 and 152.

40 See Malek & Quest n 4 above at 184; Chuah n 6 above at 600; McKendrick (gen ed) *et al Sale of goods* (2000) in par 14–060; Van Niekerk & Schulze n 4 above at 295–299; Oelofse n 5 above at 271. See also *I E Contractors Ltd v Lloyds Bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496 (CA) at 500.

41 Chuah n 6 above at 600. For a discussion the rationale behind the principle, see Adodo n 4 above at 154–160.

42 For a full discussion, see Chuah n 6 above at 626–628.

43 See the full discussion below.

44 See, *eg*, *Delfs v Kuehne and Nagel (Pty) Ltd* 1990 1 SA 822 (A); *Nedcor Bank Ltd v Hartzer* 1993 CLD 278 (W); *Standard Bank of South Africa Ltd v OK Bazaars (1929) Ltd* 2000 4 SA 382 (W); *OK Bazaars v Standard Bank* n 30 above, particularly at 697G–698A; *Casey v First National Bank* n 12 above, particularly in pars [24] and [26] (although in that case the standby letter of credit was issued subject to UCP 500).

45 Kelly-Louw n 23 above at part 1 321.

46 *Ibid*; Hugo: *The law relating to documentary credits* n 4 above at 314; Oelofse n 5 above at 288.

47 2012 2 SA 537 (SCA).

law, the beneficiary argued[48] that the doctrine of strict compliance was restricted to commercial letters of credit.[49] Unfortunately, based on the facts in *Compass* the Supreme Court of Appeal found it unnecessary to decide whether 'strict compliance' was necessary for demand guarantees.[50] In *Denel Soc Limited v ABSA Bank Limited and Others*,[51] it was again argued that a less strict standard of compliance was required in instances involving demand guarantees. Here too, neither the court of first instance, nor the Supreme Court of Appeal[52] in *Denel,* offered any opinion on this important issue. Attention will be given to these South African cases where it has been argued that the doctrine of strict compliance is restricted to commercial letters of credit. The applicability of this doctrine to demand guarantees in general is also discussed.

ENGLISH LAW

Strict compliance and commercial letters of credit

The doctrine of strict compliance was originally developed for commercial letters of credit.[53] It has been claimed that this doctrine can be attributed to Viscount Sumner's statement in *Equitable Trust Company of New York v Dawson Partners Ltd*:[54]

> It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorised to accept are in the matter of the accompanying documents strictly observed. *There is no room for documents which are almost the same, or which will do just as well.* Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transaction thus financed, cannot take it upon itself to decide what will do well enough and what will not.[55]

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[48] See, *eg*, *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146 159; *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496 (CA) 501. See also the full discussion of these cases below.

[49] 2012 2 SA 537 (SCA) in pars [7]–[9] and [11].

[50] In par [13].

[51] [2013] 3 All SA 81 (GSJ).

[52] See *State Bank of India v Denel SOC Limited* [2015] 2 All SA 152 (SCA).

[53] Hugo 'Construction guarantees and the Supreme Court of Appeal (2010–2013)' in Visser & Pretorius (eds) *Essays in honour of Frans Malan: former judge of the Supreme Court of Appeal* (2014) at 159–173 at 163.

[54] (1927) 27 Lloyd's Rep 49 (HL) at 52 (emphasis added).

[55] This *dictum* has been cited with approval and applied in various cases, see, for instance, *JH Rayner and Company Ltd v Hambro's Bank Ltd* [1943] KB 37 (CA) at 40–41; *Bank Melli Iran v Barclays Bank (Dominion, Colonial and Overseas)* [1951] 2 Lloyd's Rep 367 (KB) at 374–375; *Moralice (London) Ltd v E D & F Man* [1954] 2 Lloyd's Rep 526 (QB) at 532; *Gian Singh & Co Ltd v Banque de L'Indochine* [1974] 2 Lloyd's Rep 1 at

A similar statement was made in an earlier English case. In *English, Scottish and Australian Bank Ltd v Bank of South Africa*,[56] Bailhache J said:[57]

> It is elementary to say that a person who ships in reliance on a letter of credit must do so in *exact compliance* with its terms. It is also elementary to say that a bank is not bound or indeed entitled to honour drafts presented to it under a letter of credit unless those drafts with the accompanying documents are in strict accord with the credit as opened.

Both these statements are widely accepted as expressing the principle of strict compliance with the greatest degree of accuracy and clarity,[58] and for almost a century have neither been questioned nor improved upon.[59]

The documentary nature of letters of credit emerges more clearly when the doctrine of strict compliance is applied.[60] In English law the doctrine of strict compliance is well established for commercial letters.[61] Initially, under the American law[62] the exact standard of compliance was uncertain,[63] although the majority supported the principle of strict compliance sensibly applied. In terms of this approach, strict compliance did not mean a blind adherence. Today, the United States of America applies a principle of strict compliance to commercial and standby letters of credit. It determines what amounts to 'strict compliance' by looking at the standard of practice as set out in the UCP, other rules issued by associations of financial institutions, and how they are applied locally and regionally.[64] According to the United States the

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12; *Banque de L'Indochine et de Suez SA v JH Rayner (Mincing Lane) Ltd* [1983] 1 QB 711 (CA) ([1983] 1 Lloyd's Rep 228 (CA)) at 730; *Glencore International AG v Bank of China* [1996] 1 Lloyd's Rep 135 at 146.

56 (1922) 13 Lloyd's Rep 21.

57 (1922) 13 Lloyd's Rep 21 at 24 (emphasis added).

58 *Rayner v Hambro's Bank* n 55 above at 40–41. See also Adodo n 4 above at 154; Malek & Quest n 4 above at 184.

59 See, *eg*, *Gian v Banque de L'Indochine* n 55 above at 12. See also Adodo n 4 above at 154.

60 Chuah n 6 above at 600.

61 For a discussion of the application of this doctrine in relation to letters of credit under the English law, see Chuah n 6 above at 600–604 and the authority cited there; Malek & Quest n 4 above at 184–189 and the authorities cited there; Adodo n 4 above at 154–164.

62 For a concise discussion of the American law on this issue, see Kelly-Louw n 23 above part 1 at 319–321.

63 For a brief discussion of what the position under the 1962 version of Article 5, particularly section 5–114(1), of the United States' Uniform Commercial Code ('UCC') was, see Kelly-Louw n 23 above part 1 at 319. See also Adodo n 4 above at 151–152.

64 See, section 5–108(a) read with section 5–108(e) of Revised Article 5 of the United States' UCC. See also Adodo n 4 above at 155.

effect of using standard practice as a way of measuring strict compliance, is that 'strict compliance does not mean slavish conformity to the terms of the credit'.[65]

The English courts insist that the documents must comply strictly with the requirements of the letter of credit.[66] However, this doctrine is apparently not the same as exact compliance.[67] For example, this approach to strict compliance does not mean that a document will be treated as non-conforming if every 'i' is not dotted or every 't' not crossed or if it contains obvious typographical errors. Although literal, mirror image conformity is generally required, minor variations between the documents tendered and the terms of the credit may sometimes be disregarded.[68] So, as a general rule, a rigid and meticulous replication of precise wording is not required in all instances.[69] A literal, mirror image application of the rule of strict documentary compliance has also drawn fierce criticism over the years.[70] Malek and Quest suggest that the correct approach is that 'a document containing an error in a name or similar should be rejected unless the nature of the error is such that it is unmistakably typographical and that the document could not reasonably be referring to a person or organisation different from the one specified in the credit'.[71] In assessing this, they suggest that a bank should 'look only at the context in which the name appears in the document and not judge it against the facts of the underlying contract'.[72]

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65 See the Official Comment 1 to section 5–108 of the UCC. See also Kelly-Louw n 23 above part 1 at 321.

66 See, *eg*, *English v Bank of South Africa* n 56 above; *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Lloyd's Rep 49 (HL) at 52; *Rayner v Hambro's Bank* n 55 above at 40–41; *Bank Melli Iran v Barclays Bank* n 55 above at 532. For a more detailed discussion of his doctrine, see Adodo n 4 above at 154–177; Malek & Quest n 4 above at 184–189 and all the case law cited; Chuah n 6 above at 600; King *Gutteridge & Megrah's Law of bankers' commercial credits* (8ed 2001) at 181–187; Hugo: *The law relating to documentary credits* n 4 above at 296–298 and the authorities cited there; Oelofse n 5 above at 282–288.

67 See also *Kredietbank Antwerp v Midland Bank Plc* [1999] Lloyd's Rep Bank 219 (CA).

68 Adodo n 4 above at 158.

69 See King n 66 above in par 7–13 at 186 and authorities cited; Adodo n 4 above at 156 and 160; Malek & Quest n 4 above at 186–187 and the authorities cited. See also paragraph 25 of the International Standard Banking Practice for the Examination of Documents Under Documentary Credits, 2007 Revision for UCP 600 (*ICC Publication* No 681 (E) (2007)). If a letter of credit is subject to UCP 600 or UCP 500 some lenience to the application of the doctrine of strict compliance is allowed.

70 Adodo n 4 above at 156.

71 Malek & Quest n 4 above at 188.

72 *Ibid*.

The doctrine is, however, still strictly applied to the extent that it has been claimed that there is no room for the maxim *de minimis non curat lex* (*ie* the rule of insignificance).[73] For example, in *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran*,[74] documents were rejected on the basis of inconsequential discrepancies. In this case a letter of credit required that the buyer's name appear on all documents. One of the documents did not contain this and the English Court of Appeal refused to ignore the discrepancy. 'Nothing is trivial because banks are not expected to test the materiality of the information or particulars required under the credit and contract between buyer and seller'.[75] However, the theoretical view is that insignificant, immaterial, and trivial differences – for example typographical errors in names – are not considered to be discrepancies.[76]

Adodo suggests that the applicable test to determine if a particular discrepancy is sufficiently material to entitle the presentee to reject the document 'is that of the hypothetical opinion of a reasonable banker located in the jurisdiction of the presentee or of the presenting bank or beneficiary, depending on the character of the omitted or misspelled terminology in issue in the individual case'.[77] He adds that an omitted word, a spelling mistake, or a false description is material if it invites the reasonable overseer of a bank document to enquire whether the documents presented might prompt litigation, mislead the bank, necessitate legal advice, increase the likelihood of non-performance of the underlying contract, or lead to fraud by the beneficiary.[78] However, in practice – as illustrated by the *Seaconsar* case – it is not always easy to establish whether or not a difference (discrepancy) actually falls into one of these categories.[79] It is impossible exhaustively to define the nature and extent of the bank's duty with regard to the exactness of compliance of documents presented to it under a letter of credit, and each case must be considered on its merits in the light of the language of the credit and the circumstances in which it was drawn up. Therefore, a dogmatic generalised approach must be rejected[80] and a measure of common

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73 Chuah n 6 above at 601 and 627; Malek & Quest n 4 above at 186. See also *Moralice v E D & F Man* n 55 above; *Soproma SpA v Marine and Animal By-Products Corpn* [1966] 1 Lloyd's Rep 367; *Trafigura Beheer BV v Kookmin Bank* [2005] EWHC 2350 (Comm); and the authorities listed in Adodo n 4 above at 155.

74 [1993] 1 Lloyd's Rep 236 (CA).

75 Chuah n 6 above at 601.

76 Malek & Quest n 4 above at 186.

77 Adodo n 4 above at 159.

78 *Ibid*; see also the authorities listed there in which he alleges this test was used.

79 Malek & Quest n 4 above at 186–187.

80 King n 66 above in par 7–16 at 187.

sense is to be applied when the standard – which is in principle strict – is applied.[81] However, despite the 'common sense' and 'elementary' nature of the rule of strict compliance advocated by Malek and Quest, they correctly point out that there has been considerable debate and litigation over just how strict or exact the compliance must be.[82] According to them the passages in *Equitable Trust* and *English v Bank of South Africa* quoted above, illustrate that it is not part of the bank's role to consider the materiality of discrepancies to the parties or whether they affect the value or effect of the documents. They are, however, of the view that document examination in general requires judgment by the bank and is not merely a mechanical comparative exercise.[83] They argue that the doctrine of strict compliance should not be applied in a literal or robotic way and does not require the presentation of documents, the contents of which exactly mirror the relevant sections of the letter of credit.[84]

Strict compliance and demand guarantees

It is generally accepted that a demand for payment under a demand guarantee must comply with any requirements set out in the guarantee.[85] Whether or not a beneficiary is entitled to payment is 'a question of construing the wording of the guarantee'.[86] In determining what standard of compliance applies to documents/demands presented/made in terms of a demand guarantee, one must first ask whether the guarantee was issued subject to any international practice rules – for example, the UCP 600,[87] URDG 458, URDG 758,[88] or ISP98.[89] These practice rules do not expressly state that the principle of strict compliance applies, but rather contain 'a general formulation of the standard by which compliance is to be measured'.[90] Although the 'formulations differ in wording, they enunciate the same general concept'.[91] The UNCITRAL Convention also does not

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81 See Goode n 4 above at 6; Chuah n 6 above at 600–604 and the authorities cited; Malek & Quest n 4 above at 184–189 and the authorities cited.

82 Malek & Quest n 4 above at 184.

83 *Id* at 184–185.

84 *Id* at 185.

85 Enonchong *The independence principle of letters of credit and demand guarantees* (2011) at 86.

86 Malek & Quest n 4 above at 367.

87 See n 33 above.

88 See, *eg*, art 2 read with arts 20(*b*) and 19(*b*) of the URDG 758.

89 See rule 2.01 and 4.01 of the ISP98.

90 Byrne n 37 above at 123.

91 *Ibid*.

expressly state that the principle of strict compliance applies, but contains various indications that compliance indeed means strict compliance.[92]

However, where the demand guarantee is not governed either by these international rules or by the UNCITRAL Convention, the precise standard of compliance required under English law remains uncertain.[93] It is unclear whether the doctrine of strict compliance should be strictly adhered to – as is required for commercial letters of credit.[94] Particularly in earlier judgments, certain English courts held that in this regard demand guarantees must be treated differently from commercial letters of credit. For example, *Siporex Trade SA v Banque Indosuez*[95] offers some authority for the proposition that the doctrine does not apply with the same rigour when it involves demand guarantees. However, more recent decisions by the English courts strongly suggest that they have started applying this doctrine very strictly[96] and no longer distinguish between its application to commercial letters of credit and demand guarantees.[97]

In *Siporex*, the application of the doctrine of strict compliance to demand guarantees was questioned. The demand guarantee (performance guarantee) in *Siporex* stipulated: 'We hereby engage and undertake to pay on your first written demand any sum or sums not exceeding … in the event that, by latest 7 December 1984 no bankers irrevocable documentary letter of credit has been issued in favour of Siporex … . Any claim(s) hereunder must be supported by *your declaration to that effect ...* '.[98] The demand made under the guarantee contained various errors. Not only was the contract date incorrect, it also provided that 'no *valid* … letter of credit' had been tendered, rather than stating that the buyer had failed to open a letter of

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[92] Bertrams *Bank guarantees in international trade: the law and practice of independent (first demand) guarantees and standby letters of credit in civil law and common law jurisdictions* (4ed 2013) 139 and see also the authority relied upon by Bertrams in footnotes 63–65.

[93] For a full discussion, see Chuah n 6 above at 626–629; and Enonchong n 85 above at 82–93.

[94] Chuah n 6 above at 626; and Enonchong n 85 above at 87.

[95] [1986] 2 Lloyd's L Rep 146 (QB (Com Ct)).

[96] Enonchong n 85 above at 83.

[97] See, for example, *Lorne Stewart plc v Hermes Kreditversicherungs AG and Amey Asset Services Ltd* [2001] All ER (D) 286; *Maridive & Oil Services (SAE) v CAN Insurance Co (Europe) Ltd* [2002] EWCA Civ 369; *Consolidated Oil Ltd v American Express Bank* (2002) CLC 488 (CA) and all the authorities in this regard listed in Enonchong n 85 above at 87–88 and in Chuah n 6 above at 627–628. See also Malek & Quest n 4 above at 369.

[98] [1986] 2 Lloyd's Rep 146 (QB (Com Ct)) at 148 (emphasis added).

credit.[99] The bank argued that the principle of strict compliance, as established in relation to letters of credit, applied. Siporex (beneficiary), in contrast, contended that there was a substantial difference between letters of credit and demand guarantees in that for letters of credit exact compliance with documentary requirements was vital, whereas for demand guarantees exact (precise) wording was not essential, especially where the guarantee required a declaration 'to that effect'.[100]

Hirst J accepted Siporex's argument that the doctrine of strict compliance, as it applies to letters of credit, was not to be applied when considering the validity of the demands under a demand guarantee.

The judge added that he was accepting Siporex's argument on this point of principle, 'subject to the rider, that of course it is quite essential that there should be no ambiguity, no risk of the bank being misled, and no risk of it being confused or otherwise prejudiced'.[101] In the end, the court found that the demand was valid despite its errors.

Hirst J explained why he considered it justifiable for the requirement of compliance to be less strict in the case of demand guarantees.[102] In doing so, he said:[103]

> [I]n a letter of credit the bank is of course dealing with the very documents themselves, and is obliged to compare with meticulous care those tendered with those described in the mandate, whereas in the present case the bank is dealing with no more than a statement in the form of a declaration to the effect that a certain event has occurred.

Malek and Quest question whether any such distinction can be drawn. They point out that the only valid distinction between letters of credit and demand guarantees in this respect 'lies in the fact that the documentary requirements of the former are different to those of the latter and so the scope for application of the principle may be more limited with the latter'.[104]

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99 [1986] 2 Lloyd's Rep 146 (QB (Com Ct)) at 158–159. See also Malek & Quest n 4 above at 359.
100 *Id* at 367–368.
101 *Id* at 159.
102 Chuah n 6 above at 626; Enonchong n 85 above at 87.
103 [1986] 2 Lloyd's Rep 146 (QB (Com Ct)) at 159.
104 Malek & Quest n 4 above at 368.

Hirst J also found that precise wording was not essential, particularly where the performance bond itself specifies no more than a 'declaration to that effect'. According to Chuah, Hirst J's position was largely that even if it had been wrong to say that the doctrine did not apply, the end result was correct because the guarantee required no more than a declaration to the effect that there had been a default. The demand guarantee itself allowed a less than precise requirement.[105]

The application of the doctrine to demand guarantees was also considered in *IE Contractors Ltd v Lloyds Bank Plc and Rafidain Bank.*[106] IE Contractors concluded a contract with a party (employer) to build three poultry slaughterhouses in Iraq. IE Contractors instructed its bank, Lloyds, to instruct an Iraqi bank (Rafidain Bank) to issue three demand guarantees (performance bonds) in favour of the Iraqi beneficiary (employer). Rafidain issued the guarantees at the request of Lloyds Bank, against counter-guarantees (counter-indemnities) from Lloyds. Lloyds Bank also obtained counter-indemnities from IE Contractors for the counter-guarantees (counter-indemnities) it had issued in favour of Rafidain. The demand guarantees were governed by Iraqi law and provided that the Rafidain promised to pay the Iraqi beneficiary the specified amount unconditionally and on demand 'being your claim for damages' occasioned by IE Contractors. The demand referred to breaches of contract but made no reference to damages. The court of first instance[107] held that the demand was invalid because it had neglected to state that the demand was for damages occasioned by IE Contractors.[108]

Staughton LJ, who delivered the judgment for the Court of Appeal in *IE Contractors*, stated that because the English courts had been considering demand guarantees for quite some time, the English judgments and the practice of the bankers were relevant in guiding the court to reach a decision in this case (particularly regarding the construction of the demand guarantees involved).[109] Staughton LJ[110] indicated that the reasoning behind the doctrine of strict compliance regarding letters of credit also applied to demand guarantees. He added that, just as in the case of letters of credit, the 'general principle said to be applicable to transactions of this kind is the

[105] Chuah n 6 above at 626.
[106] [1990] 2 Lloyd's Rep 496 (CA).
[107] Per Leggatt J in [1989] 2 Lloyd's Rep 205 (QB (Com Ct)).
[108] Enonchong n 85 above at 88.
[109] [1990] 2 Lloyd's Rep 496 (CA) at 499. See also Malek & Quest n 4 above at 359.
[110] Purchase LJ and Sir Denys Buckley concurred.

doctrine of strict compliance'.[111] Therefore, if the demand did not comply with the terms of the guarantee the guarantor was entitled to reject it.[112]

Staughton LJ confirmed the application of the doctrine to demand guarantees, but shared Hirst J's view in *Siporex* that there was less need for the doctrine in relation to these instruments.[113] He advanced two main reasons for his view: [114]

> firstly, demand guarantees were used less frequently than letters of credit and attracted attention at a higher level in banks. They were also not as important a part of the day-to-day mechanisms of ordinary trade; and secondly, the kind of documents which demand guarantees require are typically different from those required under letters of credit.

Staughton LJ refused to endorse the strict approach followed by the court of first instance[115] as he could not agree with its finding that the demand was invalid because it failed to state that it was 'for damages' occasioned by IE Contractors. He, in contrast, held that the demand was valid because it stated in substance – although not expressly – that what it claimed was damages for breach of contract. The judge declined to interpret the demand guarantee as postulating that the issuer (Rafidain Bank) would pay if, but only if, the precise words of the guarantee appeared in the demand. He also stressed that the degree of documentary compliance required by a demand guarantee might be strict or less strict, depending on the construction of the guarantee.[116]

Malek and Quest[117] agree with Staughton LJ that demand guarantees are less common than commercial letters of credit and for this reason may attract attention at a higher level in issuing banks. However, they disagree that this constitutes a good reason for applying any different principle of construction. They argue:[118]

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111 [1990] 2 Lloyd's Rep 496 (CA) at 500.
112 Enonchong n 85 above at 87.
113 1990] 2 Lloyd's Rep 496 (CA) at 500.
114 *Ibid*.
115 See [1989] 2 Lloyd's Rep 205 where Leggatt J, who delivered the judgment of the court of first instance said (at 207)'[t]he demand must conform strictly to the terms of the bond in the same way that documents tendered under a letter of credit must conform strictly to the terms of the credit.'
116 [1990] 2 Lloyd's Rep 496 (CA) at 501–502. See also Enonchong n 85 above at 88; Warne & Elliott *Banking litigation* (2ed 2005) at 281.
117 Malek & Quest n 4 above at 368.
118 *Ibid*.

> The degree of leeway to be made available to the beneficiary cannot depend upon the standing of the bank official examining the documents. As Staughton LJ concluded, the application of the principle of strict compliance will depend upon the construction of the guarantee or bond. If it is loosely worded, then the wording of the demand and the content of any other documents must comply with the wording, but to say that they must comply strictly is a contradiction in terms. If, on the other hand, the guarantee or bond is precise in its requirements, they must be followed with appropriate precision.

Enonchong argues that in *IE Contractors*, Staughton LJ took the view that strict compliance with the precise words was not required because the guarantees were issued by one Iraqi company to another, in both Arabic and English and in rather vague language.[119] He emphasises that in those circumstances, Staughton LJ could not 'attribute to the parties an intention that there had to be a strict degree of compliance'.[120] The situation may, according to Enonchong, therefore be different where a guarantee is issued in England by one company to another, or in another English-speaking country in precise English language.[121]

As I have pointed out, the *IE Contractors* case also concerned counter-guarantees.[122] The counter-guarantee, like the demand guarantee, is documentary in character and comprises an abstract payment undertaking. The counter-guarantee is in principle independent of the distinct contractual relationship created by the mandate given by the instructing party (the applicant/principal's bank) to the guarantor (for example, a foreign bank which issued the demand guarantee in favour of the foreign beneficiary).[123] Therefore, a breach of that mandate by the guarantor (for example, in respect of the terms on which the demand guarantee was to be issued) is an internal matter between the guarantor and instructing party, and is not in itself grounds for refusal to pay the guarantor's demand – save in so far as the terms of the mandate are incorporated into the counter-guarantee.[124] Therefore, so long as the guarantor's (beneficiary of the counter-guarantee's) demand under the counter-guarantee complies with the

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119 See [1990] 2 Lloyd's Rep 496 (CA) at 502 and Enonchong n 85 above at 88.

120 See [1990] 2 Lloyd's Rep 496 (CA) at 502.

121 Enonchong n 85 above at 88.

122 When a counter-guarantee is issued the counter-guarantee possesses the same independence from the demand guarantee as the latter from the underlying contract between the principal and the beneficiary (see SITPRO's *Report on the use of demand guarantees in the UK* (July 2003) ('SITPRO's Report') at 5.

123 See SITPRO's *Report* n 122 at 5.

124 Kelly-Louw n 2 above at 95.

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 (of the demand guarantee), has received a demand for payment, or is legally liable to pay a demand received.[125] Therefore, the principle of strict compliance applies to a counter-guarantee just as it does to the 'primary or principal' demand guarantee which led to the counter-guarantee being issued in the first place.[126]

There were three counter-guarantees in *IE Contractors*. Two of the counter-guarantees in *IE Contractors* awarded to the Iraqi Bank, stated that the counter-guarantor (Lloyds Bank) undertook to pay on demand 'any sum or sums which you may be obliged to pay under the terms of your Guarantee'.[127] According to Staughton LJ these were payable when a demand was made, rather than on production of a document. He found that the obligation in these two counter-guarantees was to pay any sum which the Iraqi Bank (issuing bank) might be obliged to pay under its demand guarantee. Therefore, the counter-guarantee was payable on a demand by the Iraqi Bank upon Lloyds Bank following a demand by the beneficiary upon the Iraqi Bank under the demand guarantee.[128] Accordingly, it was held that in these two instances the demands on Lloyds Bank were valid.[129]

In the third counter-guarantee in *IE Contractors*, Lloyds Bank undertook as counter-guarantor to pay 'any amount you state you are obliged to pay'.[130] However, here Staughton LJ held that it was not enough for the Iraqi Bank simply to demand payment stating that the beneficiary had demanded payment under the demand guarantee. He said: 'I cannot read the demand on Lloyds Bank as stating that, with or without the doctrine of strict compliance'.[131] As a result he found that under this specific counter-guarantee the demand had to state the basis of the claim, namely that the issuer (*ie* the guarantor (Iraqi Bank)) was obliged to pay under the demand guarantee. Therefore, a demand upon Lloyds Bank which did not state that

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[125] See article 2(*c*) of the URDG and also the *Guide to the URDG* n 14 above at 20 and 45. Furthermore, see also Kelly-Louw n 2 above at 94–95.
[126] Malek & Quest n 4 above at 374.
[127] [1990] 2 Lloyd's Rep 496 (CA) at 502.
[128] Enonchong n 85 above at 90.
[129] [1990] 2 Lloyd's Rep 496 (CA) at 502.
[130] *Ibid*.
[131] *Ibid*.

the Iraqi Bank was obliged to pay under the demand guarantee was not compliant (valid) and the counter-guarantor was not obliged to pay.[132]

There are other examples where the demand has been held to be non-compliant. In *Esal (Commodities) Ltd and Reltor Ltd v Oriental Credit Ltd and Wells Fargo Bank NA; Banque du Caire SAE v Wells Fargo Bank NA*,[133] the guarantor promised to pay on demand 'in the event that the [principal] fails to execute the contract in perfect performance'. The Court of Appeal held that this guarantee required, in addition to the beneficiary making a demand, that the beneficiary inform the guarantor that the demand was being made on the basis provided in the demand guarantee itself, namely that the principal had failed to execute the contract. Therefore, a demand that neglected to state that the principal had failed to execute the contract was not a compliant demand.[134]

In *Frans Maas (UK) Ltd v Habib Bank AG Zurich*,[135] the demand guarantee required presentation of a written statement reading: '[T]he Principals have failed to pay you under their contractual obligation'. The demand made, however, read: '[W]e claim the sum of … [the Principals] having failed to meet their contractual obligations to us'. The bank (guarantor) refused to pay and contended that the precise terms of the demand had not been satisfied. The court, despite following the view expressed in *Siporex* (*ie* that strictly compliant words are not necessary), held that the demand did not comply with the guarantee in that it did not allege breach of a payment obligation. In other words, the demand was not 'sufficiently consistent with the requirement in the demand guarantee'.[136] In the court's view the demand was triggered only by the failure to pay the liquidated and ascertained sums that fell due under the underlying agreement from time to time. The demand made, however, was wide enough to cover any claim for damages for unliquidated and unascertained sums arising from any breach of the agreement. Therefore, the demand made in this case was unable to trigger the bank's liability under the demand guarantee.[137]

In my view, the *Frans Maas* case shows that the English courts are moving towards applying the same degree of strict compliance to demand guarantees

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132 See [1990] 2 Lloyd's Rep 496 (CA) at 502 and Enonchong n 85 above at 90.
133 [1985] 2 Lloyd's Rep 546 (CA).
134 Enonchong n 85 above at 90–91.
135 [2001] Lloyd's Rep Bank 14.
136 Chuah n 6 above at 626.
137 *Ibid*.

as they do to commercial letters of credit.[138] Chuah makes a similar point. He stresses that although the court in *Frans Maas* argued that there was strong justification for treating demand guarantees as being on a different footing than commercial letters of credit, the court (just as the court in *Siporex* did) felt bound to give effect to the true reading of the demand guarantee which would not be satisfied by *any* contractual failure but required a failure to pay liquidated and ascertained sums under the agreement.[139] Chuah correctly argues that although the *Siporex* the *Frans Maas* cases both supported the view that the doctrine of strict compliance does not invariably apply, they both actually relied on the precise terms of the demand guarantee for their decisions.[140] Enonchong agrees and goes even so far as to state that the *Frans Maas* case is a 'striking example of the requirement of strict compliance in the context of demand guarantees'.[141]

Sea-Cargo Skips AS v State Bank of India[142] is the most recent case to bear testament to just how strictly the English courts apply the standard of compliance in relation to demand guarantees. In this case the court, *per* Teare J, had to decide whether or not a buyer of a vessel (beneficiary) had made a compliant demand for payment under a refund (demand) guarantee issued by the State Bank of India (bank).

The demand guarantee issued by the bank stipulated that:

> should the builder be delayed in the construction of the vessel for more than 270 days … then … we shall pay you … upon receipt by us of your first demand in writing accompanied by a written statement … stating (A) that the vessel or the construction thereof is delayed with more than 270 days as set out in the contract article IV 1 E which entitles the buyer to cancel the contract and to receive repayment of the advance payments, (B) that you the buyer have pursuant to such right of cancellation duly cancelled the contract … .[143]

Article IV of the shipbuilding (underlying) contract provided for an adjustment of the contract price and for cancellation by the buyer in the event of *late delivery*. The different sub-articles of article IV dealt with different periods of delay and the buyer's right in each instance to cancel the

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[138] Kelly-Louw n 23 above part 2 at 479–480.
[139] Chuah n 6 above at 626.
[140] *Ibid*.
[141] Enonchong n 85 above at 91.
[142] [2013] 1 Lloyds Rep 477 (QB (Com Ct)).
[143] At 477 and 482.

shipbuilding contract. The actual demand made by the buyer stated that 'the Shipbuilding Contract was terminated due to delay in delivery of the Vessel in excess of 270 days' and that 'the Builder … has delayed in the construction of the vessel for more than 270 days'. It also indicated that the buyer had demanded repayment from the builder but had not been paid. The bank considered the demand not to be in the required form and refused to pay under the demand guarantee. The buyer argued that since the demand was 'in substance' what was required under the terms of the demand guarantee, it was unnecessary to use the exact words called for in the guarantee itself. The court disagreed and held that the demand made was not compliant and therefore did not trigger the bank's liability to pay.

Teare J did not share Staughton LJ's sentiment expressed in *IE Contractors* and doubted whether there was a lesser need for a doctrine of strict compliance in the field of demand guarantees than in letters of credit.[144] However, he agreed with Staughton LJ's statement that whether or not a demand was sufficient to trigger the bank's liability to pay, it is the type of demand the parties intended that would trigger the bank's liability to pay.[145]

The court stated that the liability of the bank did not rely on the actual situation between the builder of the vessel and the buyer (*ie*, the parties to the shipbuilding contract), but on whether a demand for payment which contained the requisite statement by the buyer had been made. Given that the bank was not party to the shipbuilding contract, it was conceivable that the parties to the demand guarantee reasonably expected that the demand should contain a statement that the delay which had occurred was set out in article IV 1(e) of the shipbuilding contract. It was not sufficient for the buyer simply to state that the delay was more than 270 days and reaching the second, third or fourth stage. The court pointed out that the bank was, of course, not expected to examine the shipbuilding contract to see if a delay of that nature was set out in article IV clause 1(e).[146]

The court found that the demand involved did not comply with the requirements of the demand guarantee. The demand did not contain a statement that there had been a 270-day delay as set out in article IV 1(e). In the court's opinion, when the demand was read as a whole, it referred to a *delay in delivery* and not a *delay on the construction* of the vessel. Thus, the reference to 'delay in the construction of the vessel' appeared to refer to the

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[144] Paragraphs 26 & 27.
[145] Paragraph 28.
[146] Paragraph 33.

completion of construction.[147] Otherwise, the court said, it could also be that the demand contained an ambiguous reference to the delay of the type in article IV 1(e); it was inconsistent with the reference that the shipbuilding contract was terminated on the basis of delay in delivery of the vessel. While relying on *Siporex* as authority, the court concluded that an ambiguous demand could not be compliant.[148] The court agreed that it was common cause that the demand did not require a verbatim repetition of the wording of the demand guarantee, but held that it was necessary for the demand at least to refer to article IV clause 1(e) so that the bank could see 'on its face that it was a compliant demand'.[149]

In any event, the court in *Sea-Cargo* held that the demand was also defective for a different reason: it failed to state that the delay was such that 'entitles the buyer to cancel the contract and to receive repayment of the advance payments'. The court rejected the buyer's argument that any reasonable reader of the demand would understand that the buyer's demand for repayment from the builder meant that the buyer had lawfully demanded repayment from the builder.[150]

Chuah is of the opinion that there is no convincing rationale for the doctrine of strict compliance in demand guarantees. However, he emphasises that 'given the expectations of participants in international banking and the long passage of time where the principle of strict compliance has been applied to performance guarantees, it is difficult for judges, even if they might desire it, to turn the tide'.[151]

There are also writers who support the view that the standard of strict documentary compliance applied to letters of credit should be applied to demand guarantees.[152] They oppose a distinction being made between the application of the doctrine of strict compliance to demand guarantees and to letters of credit.[153] They argue that such an approach is risky for individuals whose duty it is to examine documents as it adds the additional process of having to make an initial judgment on the degree of strict compliance

[147] Paragraph 36.
[148] Paragraphs 17–22, 34 & 36.
[149] Paragraph 35.
[150] Paragraphs 40–44.
[151] Chuah n 6 above at 626.
[152] See Hapgood (with contributions from Levy, Phillips & Hooley) *Paget's law of banking* (12ed 2003) 733; Malek & Quest n 4 above at 368.
[153] Hapgood n 152 above at 733.

required. In their view, it is better to adopt the same standard of strict documentary compliance applicable to letters of credit as: [154]

> this is a standard with which all document checkers ought to be familiar; the adoption of a high standard is not unfair to beneficiaries given that a demand guarantee is similar to a promissory note payable on demand; and if a discrepancy in the documents is capable of being remedied, the beneficiary will generally be in a position to make a new demand.

Enonchong says that once a demand guarantee has been interpreted and the requirements identified, the approach of the English courts generally is to insist on strict compliance by the beneficiary – although, as in the case of letters of credit, the wording of the demand need not mirror exactly that of the guarantee.[155] He adds that although the English courts earlier expressly ruled that a less strict standard of compliance is required for demands and documents submitted in terms of demand guarantees, in more recent cases the courts have applied the same strict standard to both letters of credit and demand guarantees.[156]

The very cases that held that a less strict standard applies to demand guarantees also provide authority for just how strict or exact that compliance must be. While the position in English law is hardly straightforward, what is abundantly clear from the case law is that whether a demand for payment under a demand guarantee must comply with a particular requirement, clearly depends on the interpretation of the guarantee.[157] At least there is general consensus that the principle of strict compliance can and should be applied to demand guarantees to the extent that the wording of the guarantee renders it appropriate.[158] 'A well-worded guarantee will make clear what is required.'[159] Therefore, 'if it is intended that the beneficiary should state that the account party has defaulted in a particular way and that the beneficiary

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154 *Ibid*; Kelly-Louw n 23 part 2 at 479.

155 Enonchong n 85 above at 91.

156 *Id* at 83.

157 *Esal (Commodities) Ltd and Reltor Ltd v Oriental Credit Ltd and Wells Fargo Bank NA; Banque du Caire SAE v Wells Fargo Bank NA* [1985] 2 Lloyd's Rep 546 (CA). See also Chuah n 6 above at 627.

158 Malek & Quest n 4 above at 367 & 369; Enonchong n 85 above at 86–87; Chuah n 6 above at 627–628; and *Esal (Commodities) Ltd and Reltor Ltd v Oriental Credit Ltd and Wells Fargo Bank NA; Banque du Caire SAE v Wells Fargo Bank NA* [1985] 2 Lloyd's Rep 546 (CA).

159 Malek & Quest n 4 above at 367.

has thereby been caused loss … this should be set out in the guarantee with clarity and precision'.[160]

OTHER COMMENTATORS' VIEWS ON THE APPLICABILITY OF STRICT COMPLIANCE TO DEMAND GUARANTEES

Bertrams correctly identifies the important purposes of the strict compliance rule.[161] For example, by detailing the conditions of payment in the demand guarantee, the applicant/principal is protected as he or she indicates under what circumstances he or she is or is not prepared to accept the risk of payment, although no payment might have been due based on the underlying contract. The rule makes it clear that it is the duty of the guarantor (*eg*, bank) towards its customer (applicant/principal) to ensure that the conditions of payment have been strictly observed and that failure in this regard renders the guarantor liable to the applicant/principal. However, despite the importance of the rule of strict compliance, Bertrams also warns that it should not be allowed to produce results which are 'manifestly unreasonable or absurd'.[162]

Bertrams states that the scope of the rule of strict compliance is limited. In his view, the rule promotes precision as regards the terms and conditions of the demand guarantee, and exactitude in the description of the nature and content of the prescribed documents. Therefore, where the terms are vaguely or loosely drafted, the principle of strict compliance becomes a contradiction in terms.[163] He highlights that with commercial letters of credit the particulars of the different documents could be, and normally are, stipulated with precision. However, because of the nature of demand guarantees, the description of the particulars of the documents specified in these guarantees cannot always have the same degree of exactitude. To this he adds:[164]

> Precision can be, and usually is, achieved with respect to the identity of the person entitled to make the demand for payment, the statement of default by the beneficiary, if required, the expiry date or the expiry event if framed in a documentary fashion, the documents to be presented in connection with a reduction clause, the identity of the person issuing third-party certificates and other purely factual matters such as dates and references to the principal contract. However, when it comes to the substance of third-party documents and especially non-documentary and unascertainable conditions, matters

160 *Ibid*.
161 Bertrams n 92 above at 140.
162 *Ibid*.
163 *Ibid*.
164 *Id* at 140–41.

> tend to be different. These are areas where the doctrine of strict compliance cannot be employed and where the duty of examination by the bank is rather governed by the principle of reasonable care and discretion.

Although Bertrams agrees that the justifications for the principle of strict compliance are 'sensible, solid and cogent', he is of the opinion that there are certain instances where the justice of a rigid adherence to the principle is questionable, and where a principle of substantial compliance would be more appropriate.[165] He, however, stresses that substantial compliance as opposed to strict compliance should only be accepted in very special or clearly exceptional circumstances, and *provided that no specific justified interests of the guarantor are detrimentally affected*.[166]

In Bertrams's view a further reason why the relaxation of the principle of strict compliance in favour of substantial compliance in appropriate cases is justifiable for demand guarantees, is because there are three significant differences between demand guarantees and commercial letters of credit.[167] Firstly, with letters of credit, a request for payment is the rule and due to their high volumes, any departure from the principle of strict compliance would prejudice the general interests of the issuers. This would cause 'litigation to an extent that would jeopardise the utility of a documentary credit as a smooth and easy payment instrument'. This is in contrast to a demand guarantee where an actual demand for payment rarely takes place, and where an exception to the rule in appropriate cases would have 'less far-reaching consequences'. Second, the documents tendered under a letter of credit are generally passed on to third parties or are used in back-to-back transactions implying that the applicant (*eg*, buyer), and sometimes the issuer, have a specific interest in strictly conforming documents. The same does not apply to documents and demands presented under a demand guarantee. Lastly, in the case of letters of credit, the documents that must be submitted have intrinsic value, whereas this is not the case with demand guarantees. Bertrams also finds support for his view that a less strict standard of compliance may, in appropriate cases, apply to demand guarantees in *IE Contractors* and *Siporex*, the two English cases discussed above.[168]

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[165] Bertrams n 92 above at 140.
[166] *Id* at 145.
[167] *Id* at 146.
[168] *Ibid.*

Byrne states that the first principle of compliance with regard to demand guarantees (and standby letters) is that documents are examined 'on their face' or by their appearance, and not on the basis of the accuracy or truth of the representations they contain. He adds that the only generally accepted departure from this principle is where fraud or abuse is proven – which would have nothing to do with the standard of compliance.[169]

For Byrne compliance 'consists of the timely presentation of documents that on their face appear to satisfy the terms and conditions' of the demand guarantee. In his opinion the standard of compliance is fairly simple to state, but it is the application of the standard to specific documents and data that causes difficulty. He contends that the required documents presented under a demand guarantee must appear on their face to comply with the terms and conditions of the guarantee. Furthermore, this formula means that the documents must comply with the provisions of the demand guarantee itself, with applicable rules, and with standard international practice.[170] He correctly points out that establishing compliance of documents is not simply a matter of matching data in the documents presented with data in the demand guarantee. It is also not a matter of looking for literal replication of the data. He adds: [171]

> In part, compliance is determined by the nature of the data, by the role of the data in the document, and by the role of the document in the standby/demand guarantee transaction. Moreover, one document does not stand in isolation but as part of an entire presentation. Where the terms of the standby/demand guarantee make it apparent that literalness is required by the use of a required formulation, greater literalness is required.

He is of the view that in an attempt to describe the degree of compliance required in presentations under demand guarantees, some courts and academic writers – drawing on court cases involving performance under construction contracts – have invented a dialectic between 'strict' vs 'substantial' compliance. This distinction, in his view, is inappropriate for letter-of-credit type transactions, does not reflect practice, and leads to severe distortions. Therefore, neither the term 'strict' nor the term 'substantial' captures the standard for compliance, although 'strict' comes closer and explains its more frequent use. Byrne argues that if the term 'strict' is used to describe compliance, it immediately leads to the question

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[169] Byrne n 37 above at 122.
[170] *Ibid*.
[171] *Ibid*.

of what 'strict' means. In his view, this question cannot be answered in the abstract but only in the context of the stated terms of the demand guarantee and of the documents presented and their data taken individually and as a whole.[172]

In Byrne's opinion it is the role of the specific document in the letter of credit transaction and the data it contains which determine the measure (standard) of compliance of documents presented under a credit.[173] He points out that not all documents have the same role in a letter-of-credit transaction. He also stresses that, unlike a commercial letter of credit, commercial documents play a less important role in demand guarantees. What is important is the data contained in the documents. He adds that although data in the documents is more important in standbys/demand guarantees than the type of documents presented, the documents and the data that they include must comply with the terms and conditions of the standby/demand guarantees. According to him, the challenge is to determine what level of exactitude is required for the data.[174]

Fayers shares many of Byrne's sentiments.[175] He agrees that any forensic argument as to 'strict' versus 'substantial' compliance, or there being the same or different standards of compliance for letters of credit and demand guarantees, appears to be largely academic and misses the point. He stresses that a court – or, more importantly, the document checker – is concerned with giving effect to the instrument before it, the intention of which has to be determined by what that instrument says. It may be in a standard tailor-made form, as is more often the case in commercial letters of credit, or be of the 'off-the-peg' variety, which is more typical in the case of demand guarantees. Nevertheless, Fayers states that the inquiry will be the same.

He further asserts that a convenient starting point is a demand guarantee case and the judgment of the court of first instance in *IE Contractors*[176] delivered by Leggatt J. Addressing counsel's submission that it was important to determine whether the demand guarantee was payable on first simple demand, or on first demand in a specified form, or on first demand supported by a specified document, Leggatt J continued '[w]here courts seem to have

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[172] Byrne n 37 above at 124.
[173] *Ibid*.
[174] *Ibid*.
[175] Taken from unpublished notes compiled by Roger Fayers, Barrister (UK) and former legal advisor in the Department of Trade and Industry (UK), and which were sent to the author of this article.
[176] [1989] 2 Lloyd's Rep 205 (QB (Com Ct)).

diverged from these simple principles they may only have been responding to the wording of the particular performance bonds under consideration'.[177] Fayers points out that variety reigns when it comes to demand guarantees in that they vary in their requirements. Demand guarantees are often between two companies and banks in different jurisdictions but frequently subject to English law, and are sometimes expressed in 'language which is both prolix and vague'[178] and often drafted by persons whose first language is not English. By contrast, a particular feature of commercial (and even standby) letters of credit is that in substance and form their documentation is generally shorter and standardised by trade practice and rules in the UCP or in accordance with the UCC. According to Fayers, Leggatt J proposes a workable two-fold enquiry in determining the type of demand guarantee, an exercise that has been somewhat complicated by the fact that some judges in construing the instrument have adopted what is called a 'salutary' approach. The two questions Leggat J posed are: (I) what has been required of the beneficiary to produce a valid tender or demand; and (ii) looking at what he has produced, does this meet what is required?[179] It is at this latter point, Fayers suggests, that there is a difference in application between the demand guarantee and the letter of credit.

Fayers correctly states that the documentation for the letter of credit is generally of a common type and in a common form, for instance a clean bill of lading, a certificate of quality, or a UCC-formatted demand. So the first question, according to Fayers, will rarely give rise to much difficulty in the case of letters of credit. However, in the case of demand guarantees the first question, involving a determination of just what, if anything, the beneficiary must state, has all too often become the very source of the problem. He states that one only need look to the semantic ingenuity of counsel (and judges) in *Siporex, Esal, IE Contractors* and *Sea-Cargo* to appreciate this.

However, once this first question has been answered, Fayers sees no meaningful different degree of strictness, exactitude, or precision in answering the second question. He agrees with the observation by Malek & Quest[180] that if the documents to be tendered or the content of the demand are loosely worded or imprecise, to insist that there be conformity is a contradiction in terms; conversely, if precisely worded, then a comparison between the two must be precise.

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177 At 207; see also the full quote in n 115 above.

178 See Staughton LJ in *IE Contractors* [1990] 2 Lloyd's Rep 496 (CA) at 502.

179 [1989] 2 Lloyd's Rep 205 (QB (Com Ct)) at 208.

180 Malek & Quest n 4 above at 368.

This, according to Fayers, is not to say that answering the second question is necessarily easy. He points out that 'there can always in the context of any case be room for ambiguity and so differing views on compliance'. To accentuate this point he refers, as an example, to *IE Contractors* where there was a difference of opinion as to whether the demand guarantee covering damages that the beneficiary 'claimed' were owing to him, had been adequately asserted by the wording of the demand he made.

Fayers adds that it also leads to another aspect already alluded to by Byrne. The court cases that deal with compliance are all decisions made by judges, when in reality the vast majority of cases dealing with whether there has or has not been compliance, turn on decisions by document checkers. Fayers points out that the approach of the two is markedly different. A lawyer tends to focus more on construing the demand guarantee so as to ascertain the intention of the parties, a process which in England is made objectively by applying rules of construction. In contrast, the document checker, although accustomed to banking practice, will rather focus on trying to help the customer and to facilitate trade rather than hinder it.[181]

SOUTH AFRICAN LAW

Due to the long standing tradition of the South African courts to follow English precedent relating to letters of credit, it is generally assumed that South Africa, in all probability, is also following the English approach of applying the standard of strict documentary compliance to commercial letters of credit.[182] There is no direct authority in South Africa that could shed light on the matter, but there are very strong indications in South African case law that the principle of strict compliance is applicable to commercial letters of credit.[183] However, when it comes to demand guarantees it is uncertain whether or not the principle of strict compliance also applies. Recently two South African cases surfaced where it was argued that a less strict standard of compliance applied to demand guarantees.

Compass Insurance v Hospitality Hotel Developments

The sole question the South African Supreme Court of Appeal was concerned with in *Compass Insurance Co Ltd v Hospitality Hotel*

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181 See *Midland Bank Ltd v Seymour* [1955] 2 Lloyd's Rep 147 at 151.

182 See the authority cited in n 46 above.

183 See the list of cases listed in n 44 above. In *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited and Others* (24110/2014) [2015] ZAGPJHC 302 (10 November 2015), the court seemingly implied that the principle of strict compliance applied to demand guarantees (in par [14]).

Developments (Pty) Ltd[184] was whether or not the beneficiary, Hospitality Hotel Developments, had complied with the requirements of the construction (performance) guarantee (demand guarantee) given by the guarantor, Compass Insurance Co Ltd, when it made its demand for payment.

Hospitality Hotel Developments (beneficiary and respondent) was a property developer that had been contracted to upgrade an hotel. It appointed a construction company, which in turn contracted a sub-contractor to install a computer network and wireless and internet system for the hotel. The subcontractor's work was backed by an independent construction guarantee issued by Compass Insurance Co Ltd (guarantor and appellant), a short-term insurer. The sum guaranteed was R1 444 428 and the expiry date of the guarantee was 30 April 2008.[185]

Clause 4 of the construction guarantee, which was the subject of the dispute, provided that, subject to the guarantor's maximum liability, the guarantor (Compass) undertook to pay the beneficiary (Hospitality) the full outstanding balance 'upon receipt of a first written demand from the Employer [Hospitality]'. It also provided that the aforementioned written demand had to state that:[186]

> 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
> 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.*

The sub-contractor was in breach of the contract and was issued with a notice of breach. It was subsequently provisionally liquidated on 23 April 2008. As a result, the beneficiary (Hospitality) sent a letter to the guarantor of the construction guarantee (Compass) on 25 April 2008 demanding payment under the guarantee. The guarantor refused to pay on the ground that the demand did not comply with the conditions of the guarantee in that it was not accompanied by a copy of the court order of provisional liquidation.[187]

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184 2012 2 SA 537 (SCA).
185 Paragraph 2.
186 Paragraph 4 (emphasis added).
187 Paragraph 3.

The beneficiary applied to the South Gauteng High Court, Johannesburg ('the court of first instance') for an order enforcing payment. The order was granted by this court on the basis that as the provisional liquidation order had been provided subsequently (many months later – on 26 November 2008 and long after the expiry of the guarantee) there had been sufficient compliance with the terms of the guarantee.[188] The court of first instance referred to various cases dealing with contractual interpretation and found 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 copy could therefore be provided after the expiry of the guarantee date. The guarantor was consequently liable to pay the sum claimed.[189] The guarantor (Compass) then appealed to the Supreme Court of Appeal against this judgment.

It was common cause that when the letter of demand was sent to the subcontractor there had in fact been no cancellation, although the letter stated that there had been, and that the subcontractor was provisionally liquidated prior to the issue of the demand. It was also common cause that the court order of provisional liquidation was not attached to the letter of demand as required by clause 4.2 of the guarantee.[190] The beneficiary, however, contended that all the parties concerned knew that the subcontractor had been provisionally liquidated and that once there was knowledge of the existence of the court order, that was sufficient for a demand to be made. It also pointed out that there had been some difficulty in obtaining the liquidation order. Accordingly, the demand was not defective, despite the failure to attach the order to it. Therefore, strict compliance with the terms of the guarantee was not required.[191] The beneficiary used *Siporex*[192] and *IE Contractors*,[193] the two English cases discussed above, as authority to ague that the doctrine of strict compliance was restricted to letters of credit and did not apply equally to demand guarantees.[194]

In dealing with the arguments of the beneficiary, the Supreme Court of Appeal referred to Kelly-Louw's earlier view[195] that the *Frans Maas* case[196]

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188 Paragraphs [3] & [5].
189 2012 2 SA 537 (SCA) in par [6].
190 Paragraph [3].
191 Paragraph [7].
192 Note 95 above.
193 Note 106 above.
194 2012 2 SA 537 (SCA) pars [7]–[9] and [11].
195 Kelly-Louw n 2 above at 90–91.
196 Note 135 above at pars [57]–[60].

– an English judgment subsequent to both *Siporex* and *IE Contractors* – in reality shows that the English courts have swung back towards applying the doctrine of strict compliance to demand guarantees. The Supreme Court of Appeal also referred to Kelly-Louw's opinion that 'courts in South Africa will also apply to demand guarantees the same "standard of strict documentary compliance" as they do to letters of credit'.[197] The court found that it was unnecessary to decide whether 'strict compliance' was necessary for demand guarantees because:[198] '[I]n this case the requirements to be met … 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.'

The Supreme Court of Appeal also stressed that the guarantor was not obliged to establish the truth of the allegation made by the beneficiary that the subcontractor had been placed under provisional liquidation. This was the reason for requiring a copy of the court order.[199] As the guarantee in this case was an independent contract, the court stated that it had to be fulfilled on its terms and '[t]here is no justification for departure and indeed allowing the furnishing of the copy of the court order months after the guarantee had expired would have defeated its very purpose'.[200]

As a result the appeal was upheld and the judgment of the court of first instance was overturned.[201]

State Bank of India v Denel SOC Limited

In *State Bank of India v Denel SOC Limited*,[202] Denel Soc Ltd (seller/supplier), a South African state-owned entity and a manufacturer and supplier of defence equipment, entered into a contractual relationship with the Union/Government of India (purchaser) for the supply of defence equipment and ammunition (underlying contract). The sales contract contained warranty clauses as to the goods sold and clauses as to Denel's performance in terms of the contract.

The Union of India required Denel to provide one performance and seven warranty guarantees (*ie* demand guarantees) in respect of the goods that

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197 2012 2 SA 537 (SCA) par [12].
198 Paragraph [13].
199 Paragraph [14].
200 Paragraph [15].
201 Paragraph [16].
202 [2015] 2 All SA 152 (SCA).

Denel sold. Denel (applicant of the warranty and performance guarantees), through a South African Bank, ABSA Bank Ltd, requested two banks in India, the State Bank of India and the Bank of Baroda, to provide the warranty and performance guarantees, respectively. The seven warranty guarantees called for a written demand stating that the seller (Denel) had 'not performed according to the warranty obligations' for the goods delivered under the contract. The performance guarantee called for a written demand stating that 'the goods have not been supplied according to the contractual obligations' under the contract. In each of the eight demand guarantees it was recorded that the Union of India's written demand would be conclusive evidence that such payment was due, which payment would be effected upon receipt of such written demand. These were the 'primary or principal' demand guarantees between the two parties to the underlying contract (*ie* Denel and the Union of India) and they were governed by Indian law. The two Indian banks also required guarantees that Denel (applicant of the primary demand guarantees) would pay them if and when they discharged their obligations under the eight primary guarantees (*ie* warranty and performance guarantees) to the Union of India (beneficiary of the primary demand guarantees). Therefore, Denel requested the South African bank, ABSA Bank Ltd (*ie* counter-guarantor), to provide the two Indian banks with eight different counter-guarantees (totalling some US$5 582 714).

All the counter-guarantees were first demand guarantees. In terms of the counter-guarantees, ABSA Bank (counter-guarantor) could draw upon Denel's bank account all the payment that it (ABSA Bank) had made in the discharge of its obligations under the counter-guarantees. The counter-guarantees provided that ABSA Bank would pay the Indian banks (beneficiaries of the counter-guarantees) on first written demand stating that they have been called upon to make payment under and in terms of the principal guarantees (*ie* the main performance and warranty guarantees). It should be pointed out that initially (when the matter served before the court of first instance)[203] it seemed that all the counter-guarantees were governed by the South African law (they were all silent as to any governing international practice rules – *ie* ICC rules). It was only later, when the matter was heard by the South African Supreme Court of Appeal,[204] that it transpired that one of the counter-guarantees was, in reality, subject to the law of India.

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[203] See *Denel Soc Ltd v Absa Bank Ltd* [2013] 3 All SA 81 (GSJ).
[204] *State Bank of India v Denel SOC Limited* [2015] 2 All SA 152 (SCA).

During the course of the contractual relationship between the Union of India and Denel, the Union of India alleged that Denel had breached its contractual obligations and called upon the Indian banks to pay in terms of their primary demand guarantees. The Indian banks duly complied and in turn called upon ABSA Bank to pay the corresponding amounts due in terms of the counter-guarantees. The Union of India stated in their written demands made in terms of the primary demand guarantees on the Indian banks that 'the seller has not performed according to the contractual obligations for the goods delivered'. At first, ABSA Bank (counter-guarantor) refused to pay, contending that the demand made in terms of the counter-guarantees by the Indian banks 'were not worded under and in terms of the guarantees issued'. Later, ABSA Bank changed its mind and on 25 May 2011 advised Denel of its intention to make payment at 12h00 on 26 May 2011 in respect of the counter-guarantees in the amount of US$ 3 776 197. Denel disputed that the Union of India was entitled to make a demand on the primary demand guarantees issued by the Indian banks and maintained that ABSA Bank was accordingly not lawfully bound to honour their counter-guarantees issued in favour of the Indian banks. On 26 May 2011, Denel obtained an urgent interim interdict (injunction) on an *ex parte* basis against ABSA Bank restraining the Bank from making payment to the two Indian banks (beneficiaries of the counter-guarantees) in respect of the counter-guarantees that ABSA Bank had issued pending the finalisation of this application before the court.

Denel had applied specifically for an order interdicting ABSA Bank from making payment to the Indian banks in respect of the counter-guarantees pending the finalisation of arbitration proceedings already instituted and pending in India in respect of the primary demand guarantees. Denel also sought interdictory relief in India to restrain the Union of India (beneficiary of the primary demand guarantees) from calling up or making demands in respect of the primary guarantees pending resolution of a dispute that had arisen between Denel and the Union of India (*ie* parties to the underlying contract – sales contract for defence equipment and ammunition) in arbitration proceedings in India. The two Indian banks were also parties to the proceedings in India.

The application for confirmation of the interim interdict concerning the counter-guarantees was heard by the South Gauteng High Court,

Johannesburg ('court of first instance').[205] Denel based its application on the following grounds:

- The demands made by the Union of India (beneficiary of the primary demand guarantees) against the two Indian banks in terms of the primary demand guarantees were not strictly compliant and in turn the demands made by the two Indian banks in terms of the counter-guarantees against ABSA Bank, which were identical to the first mentioned demands, were similarly not strictly compliant.
- The Union of India's demands in respect of the primary demand guarantees were fraudulent and therefore the Indian banks' demands in respect of the counter-guarantees were similarly fraudulent since they were made with full knowledge of the fraudulent demands in respect of the primary demand guarantees.

Denel's case was therefore based on non-compliance and fraud. Denel argued that because of the question whether the Union of India had made fraudulent demands on the primary demand guarantees and had been referred to arbitration in India, it would be desirable and practical that the issue of fraud be resolved before the counter-guarantees were called up.

The two Indian banks resisted the application for the interdict on a number of grounds. First, as the counter-guarantees were independent from the primary demand guarantees, they were therefore also independent from any dispute that might arise from the underlying contract (contract of sale) between Denel and the Union of India. Secondly, although established fraud on the part of the beneficiary was an exception to the principle that the demand guarantee would be payable on presentation of a demand, regardless of whether the obligations in the underlying contract have been performed or not, Denel had failed to establish fraud on either ABSA Bank's part or on the part of the two Indian banks. Thirdly, the demands made by the Union of India on the primary demand guarantees were compliant. Lastly, ABSA Bank and Denel had waived their rights to refuse honouring the counter-guarantees because of alleged non-conforming demands for payment by the Union of India.

The court of first instance (*per* Malindi AJ) relying on a variety of authority, acknowledged that the primary demand guarantees and the counter-guarantees before they constituted independent guarantees were not only independent of each other, but also from the underlying contract in terms of

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[205] See *Denel v Absa Bank* n 203 above.

which the primary guarantees had been issued. The court agreed that provided that the beneficiary of the counter-guarantee's demand under the counter-guarantee complied with the requirements of the counter-guarantee, the beneficiary would be entitled to payment (in the absence of established fraud or any other ground for non-payment), whether or not the beneficiary of the counter-guarantee has, in fact, paid the beneficiary of the primary guarantees or has received a demand for payment on the primary demand guarantee, or was legally liable to pay a demand received on the primary guarantee.

Malindi AJ also acknowledged the documentary nature of the primary demand guarantees and the counter-guarantees. In deciding whether compliant demands were made on the counter-guarantees, Malindi AJ referred to Bertrams's opinion, discussed above, that the doctrine of strict compliance applied only to commercial letters of credit and substantial compliance applied to the demands made under demand guarantees. Malindi AJ also referred to the *OK Bazaars* case[206] where the South African Supreme Court of Appeal implied that the principle of strict compliance was applicable to commercial letters of credit. Malindi AJ also referred to the *Compass Insurance* case,[207] discussed above, where the South African Supreme Court of Appeal did not express its opinion as to whether 'strict compliance' was in fact necessary for demand guarantees. Malindi AJ, just as the court did in the *Compass* case, further referred to Kelly-Louw's view that strict compliance should also apply to demand guarantees.[208]

The court of first instance stated that the primary demand guarantee and accompanying counter-guarantees 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 Indian banks had been called upon 'to make payment under and in terms of [their] guarantee', respectively. Neither the guarantors of the principal demand guarantees (*ie* the two Indian banks) nor the counter-guarantor (ABSA Bank) of the counter-guarantees was obliged to pay for non-performance 'according to their *contractual obligations*'. Therefore, the guarantors (the two Indian banks') of the primary guarantees were obliged to make payment upon the condition that Denel had not performed according to the warranty obligations or had defaulted under and in terms of its warranty obligations. Therefore, on this premise, they were not obliged to pay the Union of India

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206 Note 30 above.
207 Note 184 above.
208 Kelly-Louw n 2 above at 90–91.

(beneficiary of primary guarantees) on the basis that Denel had not performed according to the contractual obligations, nor was ABSA Bank (counter-guarantor) obliged to pay the Indian banks (beneficiaries of the counter-guarantees). Consequently, the guarantors of the primary demand guarantees were only obliged to pay in terms of the promise made under the warranty obligations.

The court of first instance referred to the English case of *Frans Maas*,[209] discussed above, where it was stated that if the demand called for the term 'failure to pay' it would not suffice if the demand made, read 'failure to meet contractual obligations'. Based on this case, Malindi AJ therefore made the point that failure to meet a contractual obligation was far from being the same as failure to meet a warranty or guarantee obligation.

Malindi AJ acknowledged that demand guarantees had to be paid according to their terms, without proof or condition, except in cases where evident fraud, of which the guarantor had knowledge, was involved. In order to succeed, a beneficiary must meet the conditions set out in the guarantee. Therefore, whether the demand conformed strictly to the requirements of the guarantee or to the principle of strict compliance, was a matter of a proper interpretation of the guarantee itself.

In the end, Malindi AJ concluded that the demands made by the Indian banks in terms of the counter-guarantees on ABSA Bank did not comply because they were made for a purpose wider than that to which the parties had agreed – that the Indian banks would pay the Union of India (beneficiary of the primary demand guarantee) in the event that Denel (seller/applicant) failed to meet its performance and warranty guarantees in terms of the contract of sale (underlying contract related to the principal guarantees) and that the Indian banks' demands on ABSA Bank in terms of the counter-guarantees would similarly be restricted to those purposes. The court added the following:[210]

> [T]he 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 [*ie* Denel].

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209 Note 135 above.
210 *Denel v Absa Bank* n 203 above par [55].

The court of first instance held that it did not have to determine whether Denel had established fraud against the Union of India of which the Indian banks had notice, because that issue was before the courts and the arbitration proceedings in India. Accordingly, the court of first instance confirmed the interim interdict. It effectively interdicted ABSA Bank from making payment in respect of the counter-guarantees, pending the final determination of arbitration and court proceedings in India concerning the primary demand guarantees.

The two Indian banks appealed against the entire ruling of the court of first instance and the matter came before the South African Supreme Court of Appeal.

The main question the South African Supreme Court of Appeal had to answer in *State Bank of India v Denel SOC Limited*[211] was whether Denel was entitled to the interdict granted by the court of first instance prohibiting ABSA Bank (second respondent in this case and counter-guarantor) from paying out in terms of the eight counter-guarantees ABSA Bank had issued in favour of the two Indian banks (appellants in this case and beneficiaries of the counter-guarantees).

The parties agreed on the legal principles applicable to demand guarantees and counter-guarantees, but differed on the application of these principles to the peculiar facts of the case.[212]

Fourie AJA, who delivered the judgment on behalf of the Supreme Court of Appeal,[213] agreed with the court of first instance's view regarding the independent nature of the primary demand guarantees and the counter-guarantees.

The Supreme Court of Appeal acknowledged that demand guarantees were documentary in nature. It agreed with the court of first instance's view that as long as the beneficiary of the counter-guarantee's demand under the counter-guarantee complied with the requirements of the counter-guarantee, the beneficiary would be entitled to payment whether or not the beneficiary of the counter-guarantee has, in fact, paid the beneficiary of the primary demand guarantees or has received a demand for payment on the primary guarantee or was legally liable to pay a demand received on the primary

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211 [2015] 2 All SA 152 (SCA).
212 Paragraph [6].
213 Brand, Bosielo, Theron & Mbha JJA concurred.

guarantee. All that was required for payment, therefore, was a demand by the beneficiary (*eg*, Indian banks), on the basis of the event specified in the guarantee. Whether or not the demand was compliant would turn on an interpretation of the guarantee.[214]

Fourie AJA confirmed that the only exception to the rule that the guarantor was 'bound to pay without demur, is where fraud on the part of the beneficiary has been established'.[215]

Next, Fourie AJA considered whether the demands made by the Union of India for payment in terms of the respective primary demand guarantees, complied with the terms of the relevant guarantees. He pointed out that in each of the seven principal warranty guarantees (primary demand guarantees), the written demand made by the Union of India was basically similarly worded – that as the goods had not been supplied by Denel in accordance with the 'contractual obligations', payment in terms of the primary guarantees was demanded. Fourie AJA held that it was immediately clear that these demands differed from the wording of the seven primary guarantees which prescribed a demand that Denel had not performed according to the 'warranty obligations' under the underlying contract.[216]

Thereafter, the Supreme Court of Appeal found that it was necessary to inquire whether the Indian banks had addressed written demands to ABSA Bank (counter-guarantor) regarding the counter-guarantees stating that they had been called upon to make payment under and in terms of their corresponding primary warranty guarantees. If so, then ABSA Bank would be obliged to honour the counter-guarantees without demur, but if not, it would not be liable to make any payment in respect of such guarantees.[217]

Fourie AJA found that in six of the primary warranty demand guarantees and the corresponding warranty counter-guarantees, the demand was expressly premised on a failure by Denel to comply with its 'contractual obligations' and not a failure to comply according to the 'warranty obligations' under the contract. Therefore, in these six instances the Indian Bank had not complied with the terms of the counter-guarantees. Accordingly ABSA Bank was not obliged to make payment to the Indian banks under these circumstances.[218]

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[214] *State Bank of India v Denel* n 211 above at par [9].
[215] Paragraph [10].
[216] Paragraph [13].
[217] Paragraph [14].
[218] Paragraph [17].

Fourie AJA then proceeded to deal with the seventh warranty counter-guarantee. He pointed out that although the counter-guarantee had the same wording as the other six warranty counter-guarantees, it had an additional paragraph which provided '[t]his counter guarantee shall be governed by and construed in accordance with the Indian laws and is subject to the exclusive jurisdiction of courts in India'. The Indian banks argued that the effect of this clause was to override the jurisdiction of the South African courts in regard to this specific counter-guarantee. Therefore, the court of first instance should not have interdicted payment on that counter-guarantee. Fourie AJA stressed that this defence was not mentioned in the Indian banks' papers before the court of first instance nor was it raised in their application for leave to appeal.[219]

In dealing with the Indian banks' submission, Fourie AJA stated that it had to be borne in mind that there was a banker-client relationship between ABSA Bank and Denel. Denel had mandated ABSA Bank to make payment in terms of the warranty counter-guarantees and it had to be accepted that Denel was aware of the terms of the counter-guarantees, including this seventh guarantee. Accordingly, the Supreme Court of Appeal held that the court of first instance did not have the jurisdiction to issue the interdict in this instance.

Lastly, the court considered the demand made by the Union of India under the primary performance guarantee issued by one of the Indian banks, State Bank of India, totalling US$ 1 197 930. As, mentioned above, the demand called for a written demand stating that the goods supplied by Denel were not in accordance with the 'contractual obligations'. The corresponding counter-guarantee issued by ABSA Bank called for a written demand stating that State Bank of India had been called upon to make payment under and in terms of their principal performance guarantee. The actual demand made by State Bank of India simply stated that a demand had been made to pay the primary performance guarantee 'for non-fulfilment of contractual obligations'. Again the Supreme Court of Appeal reached the conclusion that this was not a complaint demand and ABSA Bank was not liable to make payment under the performance counter-guarantee.[220]

The Supreme Court of Appeal held that, except for the matter involving the seventh warranty counter-guarantee over which the South African did not

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219 Paragraph [19].
220 Paragraphs [23]–[25].

have jurisdiction, the court of first instance was correct to have interdicted ABSA Bank from paying under the counter-guarantees.[221]

The Supreme Court of Appeal agreed with the court of first instance that, while the matter regarding the primary demand guarantees was still pending in India, it would not be necessary to deal with the allegations that the Indian banks had acted fraudulently.

A FEW COMMENTS

In South Africa the required level of compliance required regarding documents presented in terms of a commercial letter of credit is still not fully settled, although various courts, including the Supreme Court of Appeal, have implied that the principle of strict compliance applies to letters of credit. With regard to demand guarantees, the required standard of compliance is even more uncertain.[222] The court of first instance in *Denel* and the Supreme Court of Appeal in *Compass* both entertained arguments that a less strict standard of compliance applies to demand guarantees. Both these courts referred to Kelly-Louw's opinion that the principle of strict compliance should also apply to demand guarantees, but neither expressed an opinion on the issue. The judgment by the Supreme Court of Appeal in *Compass* cannot be faulted, but it is regretted that the court failed to express a much needed opinion as to whether 'strict compliance' is, in fact, necessary for demand guarantees. Hugo is of the view that the judgment in *Compass* in reality supports the notion that the doctrine of strict compliance also applies to demand guarantees.[223]

Even though neither court in the *Denel* case specifically stated that the principle of 'strict compliance' applies to demand guarantees, it does seem that this was, in truth, the standard that both courts applied in finding that the demands made under the primary demand guarantees and under the corresponding counter-guarantees, were not compliant. The English case of *Frans Maas*, of course, played a pivotal role in the decisions reached by both courts in the *Denel* case. It is noteworthy that the *Frans Maas* case, as explained above, actually lends support to the view that in reality the English courts apply a very strict standard. It should also be mentioned that the court of first instance in *Denel* delivered its judgment on 4 March 2013, a few

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221 Paragraph [26].

222 Hugo 'Protecting the lifeblood of commerce: a critical assessment of recent judgments of the South African Supreme Court of Appeal relating to demand guarantees' (2014) *TSAR* 661 at 662.

223 Hugo n 53 above at 171.

months before the English court delivered its judgment on 26 June 2013 in *Sea-Cargo*, which clearly supported an application of a very strict standard of compliance to demand guarantees. No reference to the *Sea-Cargo* case was made during the appeal of the *Denel* case, which is unfortunate as it would without doubt have lent support for the Supreme Court of Appeal's judgment in *Denel*.

There was strong reliance placed on English authorities in the *Denel* and *Compass* cases to support the respective parties' argument that a less strict standard of compliance applies to demand guarantees. However, some commentators, myself included, are of the opinion that the English courts – particularly in more recent times – have applied the same standard of strictness to documents submitted under demand guarantees as they do to documents submitted under commercial letters of credit. Furthermore, although the English court in *Siporex* accepted the argument that a less strict standard of compliance applied in relation to a demand guarantee, it is important to bear in mind that the court also stressed that it was accepting such a standpoint only if there was 'no ambiguity, no risk of the bank being misled, and nor risk of it being confused or otherwise prejudiced'.

There are vastly different opinions amongst commentators as to whether the doctrine of strict compliance should apply with equal vigour to demand guarantees as to commercial letters of credit. Some even question whether the doctrine should apply to demand guarantees at all. Others suggest that the same standard of compliance should apply to both commercial letters of credit and demand guarantees. Then there are those who insist that an argument as to 'strict' versus 'substantial' compliance or as to there being the same or different standards of compliance for letters of credit and demand guarantees is purely academic and serves no real purpose when determining whether there has been compliance or not in a specific instance. The only issue all commentators seem to agree upon is that the exact standard of strictness for documents and demands depends entirely on the terms set out in the demand guarantee.[224] In practice, however, it often happens that the terms in a guarantee are open to interpretation, thus necessitating the courts to determine what the required standard of compliance is.

Before the court of first instance in *Denel*, it was contended that the doctrine of strict compliance applied only to commercial letters of credit and that a

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224 See, *eg*, Hugo n 222 above at 662.

less strict standard applies to demand guarantees. In dealing with this issue, the court of first instance also referred to the opinion of Bertrams that the doctrine of strict compliance applies only to commercial letters of credit, while substantial compliance applies to the demands made under demand guarantees. It should, however, be pointed out that the court of first instance did not provide an accurate summary of Bertrams's view. It lost sight of the fact that what Bertrams had actually suggested was not a general relaxation of the principle of strict compliance regarding all demand guarantees, but simply that a less strict standard may be applied in clearly exceptional circumstances, but only if doing so would not harm specific justified interests of the guarantor.

Byrne correctly points out that the first principle of compliance with regard to demand guarantees is that documents are examined 'on their face' or by their appearance – and not with regard to the accuracy or truth of the representations they contain, unless fraud is proven. In the *Denel* case it is my view that both courts relied too heavily on the accuracy or truth of the representations made by the two Indian banks in their demands under the counter-guarantees. Although both courts in *Denel* specifically and theoretically acknowledged the independence of counter-guarantees from the primary demand guarantees, in practice they lost sight of this principle when they considered the facts of the case. The courts should not have considered whether the demands made under the primary demand guarantees were compliant and valid, because of the independent nature of the counter-guarantees. In determining if the demands under the primary guarantees were compliant, the courts completely ignored the autonomy of the counter-guarantees. The courts should only have considered the actual demands made under the counter-guarantees. To determine if the demands made under the counter-guarantees were valid and compliant, the courts should simply have considered what the counter-guarantees required for regarding the demands, and compared them with the actual demands made by the two Indian banks. From the facts in *Denel* it is not entirely clear exactly what the demands by the Indian banks under the counter-guarantees stated. It does seem, however, that they were intended expressly to state that they (*ie* Indian banks) *have been called upon to make payment under and in terms of either their corresponding primary warranty guarantees* or *principal performance guarantee.* However, based on the available facts, it appears that the actual demands made by the Indian banks all simply stated either that *'a demand had been made to pay either the primary warranty guarantees or the primary performance guarantee "for non-fulfilment of contractual obligations"'.*

It is clear that none of the actual demands made under the respective counter-guarantees complied with what was provided in the terms of the counter-guarantees. The wording used by the Indian banks in their actual demands did not correspond to the wording required in the terms of the counter-guarantees and were therefore not valid or compliant. If only that fact is considered and the doctrine of strict compliance is applied to the case, it is obvious that the demands made by the Indian banks were neither compliant nor valid. This alone should have been enough for the courts in *Denel* to hold that ABSA Bank was not obliged to pay and that it was appropriate to grant the interdict prohibiting payment. Therefore, although the end result would have been the same had the courts simply followed this route, it would have been completely unnecessary for the courts to look at facts beyond the counter-guarantees and the demands made under them. The courts, however, by also considering whether valid demands had been made under the primary demand guarantees, in reality completely ignored the independence of the counter-guarantees from the primary guarantees. This meant that the courts considered facts well beyond the terms of the counter-guarantees. For example, the courts considered the relationship between the Union of India (beneficiary of the primary guarantees) and the two Indian banks (guarantors of the primary demand guarantees). Whether the demands in terms of the primary demand guarantees were valid or not is an issue that should be addressed by the Indian courts and during the pending arbitration proceedings in India, especially as the primary demand guarantees are governed by Indian law. Based on the independent nature of a counter-guarantee, the issue of whether a valid demand was made under a primary guarantee, is not at all relevant when a ruling needs to be made on whether the demand under a counter-guarantee is compliant and valid – unless, of course, the terms of the counter-guarantee specifically provide for this. Given the facts of the *Denel* case, it is my opinion that the counter-guarantees did not call for that. Although I do not agree with how the courts in *Denel* arrived at their decisions, I do agree with the end result, namely to allow the interdict.

The *Denel* case provides authority that the South African courts apply the doctrine of strict compliance to demand guarantees. The court of first instance and the Supreme Court of Appeal both applied this doctrine very strictly. I am of the view that the same strict standard of compliance should apply to commercial letters of credit and to demand guarantees. Hugo supports this view.[225] Nevertheless, Bertrams's reasons and arguments for

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225 Hugo n 222 above at 662.

a relaxation of the rule in clearly exceptional circumstances, provided that it does not harm specific justified interests of the guarantor, definitely has merit, particularly given the fact that documents play a different role in a demand guarantee transaction than in a commercial letter of credit transaction. If South African courts were to follow Bertrams's suggestion that the rule should in extraordinary instances be relaxed, I suggest that in doing so they also follow Byrne's advice not simply to consider whether the documents presented match the data in the demand guarantee or replicate that data, but also look at the nature of the data and its role in the document and at the document itself in the demand guarantee transaction.