

A REVIEW OF THE DECISION OF THE SUPREME COURT OF APPEAL

***Coface South Africa Insurance Co Ltd v East
London Own Haven t/a Own Haven Housing
Association 2014 (2) SA 382 (SCA)***

1 Introduction

Conventionally in construction projects, the construction contractor (principal debtor) appointed by the developer (employer) to construct the project works, will be required to procure security in favour of the developer for the proper performance of its obligations under the (underlying) construction contract. The security so procured is *inter alia* in the form of a construction guarantee issued by a financial institution (usually a bank or an insurance company) in favour of the developer, at the behest of the construction contractor.

Generally, the guarantee can either be what is called “a conditional guarantee”, also known as a “suretyship guarantee”, in which case the guarantee will constitute an accessory obligation to the underlying construction contract – wherein the developer would be required to at least allege and, depending on the terms of the guarantee, sometimes also establish liability on the part of the contractor (*Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd* 2011 (5) SA 528 (SCA) par 13; *Trafalgar House Construction (Bregions) Ltd v General Surety and Guarantee Co Ltd* [1995] 3 ALL ER 737 (HL) 742J–743D; and *Vossloh Atkiengesellschaft v Alpha Trains (UK) Ltd* [2010] EWHC 2443 (Ch) par 19–20). Alternatively, the guarantee could be what is called an “on-demand” guarantee, in which case the guarantee will constitute a primary (independent) obligation, wherein no allegation of liability on the part of the contractor under the construction contract is required (*Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159 (CA) 170H; and *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA) par 20). Where a guarantee constitutes an on-demand guarantee all that is required for payment is a (written) demand by the claimant, stated to be on the basis of the event specified in the guarantee. The nature of this type of guarantee is such that it is not concerned with disputes arising out of the underlying contract and it is only in cases where there is clear fraud on the part of the beneficiary, where the demand will not be honoured (*Edward Owen Engineering Ltd v Barclays Bank International Ltd supra* 171A-B; and *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd supra* par 20). This is as a result of the principle of autonomy originally developed in the context of documentary letters of credit but later

applied to other types of payment undertakings such as demand guarantees (see Ellinger and Neo *The Law of International Finance* (2008) 300).

The autonomy of demand guarantees (and letters of credit), which has been said to be their essential characteristic, has long been accepted and has long been affirmed in a plethora of cases both locally and abroad (*Edward Owen Engineering Ltd v Barclays Bank International Ltd supra* and [1978] All ER 976 (CA) 983; *Ex parte Sapan Trading (Pty) Ltd* 1995 (1) SA 218 (W) 224I–225G; *Intraco Ltd v Notis Shipping Corp (The Bhoja Trader)* [1981] 2 Lloyd's Rep 256 (CA) 257; *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd supra* par 20; *Loomcraft Fabrics CC v Nedbank Ltd* 1996 (1) SA 812 (A) 816G–817A; *Minister of Transport and Public Works, Westerns Cape v Zanbuild Construction (Pty) Ltd supra* par 14; *Phillips v Standard Bank of South Ltd* 1985 (3) SA 301 (W) 303B–304H; *Power Cuber International Ltd v National Bank of Kuwait SAK* [1981] 3 ALL ER 607 (CA) 613B; and *RD Harbottle (Mercantile) Ltd v National Westminster Bank* [1977] 2 ALL ER 862 (QB) 870B–D). In *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* (2014 (2) SA 382 (SCA)), the South African Supreme Court of Appeal (hereinafter “SCA”) overturned its previous decision in *Dormell Properties 282 CC v Renasa Insurance Co Ltd* (NNO 2011 (1) SA 70 (SCA)) and restated the independence of demand guarantees from underlying contracts. *Dormell* indicated a divergence from the established autonomy principle. In *Dormell Bertelsmann AJA*, writing for the majority, seemingly reaffirming the autonomy of the demand guarantee in question, then had regard to an arbitration award and held that the beneficiary (*Dormell*) had lost the right to enforce the guarantee (par 41). In *Coface* the SCA held that the decision of the majority in *Dormell* was clearly wrong and should not be followed (par 25). This paper considers the unanimous SCA decision and submits that the decision cannot be faulted and should be welcomed.

The case is divided into seven sections. Section 2 provides an overview of the facts of the case, section three discusses the application before the High Court, section four discusses the second application before the High Court, section five considers the *Dormell* decision, section six discusses the case before the SCA. Section seven evaluates the SCA's (unanimous) decision. The conclusion submits that the unanimous decision is arguably the SCA's most important in the subject since its landmark decision in *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd (supra)* and should be welcomed.

2 Facts of the case

The respondent, East London Own Haven (“ELOH”), an association incorporated in terms of section 21 of the Companies Act 61 of 1973, trading under the name and style of Own Haven Housing Association, entered into a principal construction agreement with Construct Construction (Pty) Ltd (“the constructor”) in respect of construction to be undertaken at Kenwick Close, East London (par 1). Conventionally, the construction contract required the contractor to execute a construction guarantee in favour of ELOH, in terms of which a guaranteed sum would be paid upon cancellation of the

construction agreement on the basis of default by the contractor (par 2). Such a guarantee was executed by Coface South Africa Insurance Co Ltd ("Coface") in favour of ELOH and in terms thereof Coface guaranteed payment by it to ELOH of the guaranteed sum (par 2).

Of particular importance in the terms of the construction guarantee was clause 5.1. The clause provided that Coface (guarantor) undertakes to make payment upon receipt of a first written demand from ELOH (employer), calling up the construction guarantee and stating that (par 4):

"The agreement has been cancelled due to the Constructor's default and that the construction guarantee is called up in terms of 5.0. The demand shall enclose a copy of the notice of cancellation."

On 22 September 2008 the contractor was informed that the cancellation agreement was cancelled with immediate effect. The letter stated that (par 5):

"due to the slow progress of building works on sight, we are obliged to place on record that you again have failed to comply with clause 15.3 of the contract between you and East London Own Haven in that you have failed to proceed with works with due skill, diligence, regular Expedience to bring the works to practical completion as per dates in ..."

On 29th January 2009 ELOH delivered to Coface's nominated *domicilium* a letter giving notice that (par 6):

"the contract was cancelled due to the contractor's default and that the construction guarantee is hereby called up in terms of clause 5.0 thereof and payment of the guaranteed sum of R 1, 172, 583.80 is hereby called for ..."

Payment was not made. ELOH then instituted proceedings against Coface claiming payment of the money due and owing under the construction guarantee. Under and in terms of the guarantee Coface was to make a payment to ELOH of R1 172 583, 80.

3 The application before the High Court

In its plea denying liability, the defendant (Coface) sought to contest plaintiff's (ELOH's) assertion that it was entitled to cancel because of default on the part of the contractor. It blamed the plaintiff for faulty design and vehemently denied that the contractor had defaulted on its obligations and thus denied that it was liable in terms of the guarantee (par 8). The defendant pleaded that the grounds upon which the principal building agreement was cancelled were not grounds for lawful termination and accordingly the plaintiff was non-suited in seeking any relief pursuant to such termination (par 8).

The plaintiff was of the view that this defence was based on the principal building agreement. It accordingly excepted to this defence as being one which is pertinently precluded by reason of the terms of the construction guarantee and accordingly bad in law and irrelevant to the issues between the parties in respect of the obligations arising out of the terms of the

construction guarantee (par 9). In this regard the plaintiff made reference to clause 3.1 of the guarantee which provided that (par 9):

“any reference in this Guarantee to the Agreement is made for the purpose of convenience and shall not be construed as any intention whatsoever to create an accessory obligation or any intention whatsoever to create a suretyship”.

Plaintiff, therefore, argued that the only jurisdictional fact of relevance to the calling up of the guarantee was the fact of the cancellation of the principal building agreement (par 10). The validity of such cancellation was of no relevance (par 10).

Defendant contended that one of the jurisdictional facts for invoking the construction guarantee was the cancellation of the principal building agreement due to the contractor's default, and that there is therefore nothing to preclude defendant from alleging facts indicating that the contractor was not in default and accordingly that the construction guarantee may not be called up (par 11).

Satchwell J, after having regard to the construction guarantee, stated that a proper interpretation of clause 5.1 entails that there must be (1) a statement (2) that there is a cancellation (3) due to (4) the contract's default. According to the judge this trigger event was not similar to irrevocable letters of credit, and the insurer's liability was very limited (par 19). She stated that she was far more persuaded by the logic of the defendants' argument that there would be no reason for clause 5.1 of the guarantee to have identified the reason for cancellation if that reason were irrelevant to the guarantee (par 20).

The judge had regard to a number of decisions of the SCA and, relying on the decision in *Dormell Properties 282 CC v Renasa Insurance Co Ltd NNO* (*supra*), she dismissed ELOHS's principal exception. In this regard, the judge said the following (par 37):

“In the present case, the fact is that there is only one ground permitted for cancellation which would render the insurer liable. That ground is the statement that cancellation is due to the contractor's default. All that is required is a statement. But, as has been exemplified in *Dormell supra*, that statement can be successfully challenged and the employer may be denied its claim to the guaranteed sum.”

Having been invigorated by this finding, before the commencement of the trial in the High Court before Lamont J, Coface applied to amend its plea to introduce a defence to the plaintiff's claim.

4 The application before the High Court

Before Lamont J, the defendant (Coface), in its amendment application, sought to introduce a defence to the claim on the following basis (par 3):

- 1 The final amount payable by the contractor to the plaintiff (ELOH) was finally determined by the issue of a final-payment certificate (incorrectly labeled “interim certificate”) which certificate purported to set out an

amount constituting the recovery of an overpayment by the plaintiff to the contractor which is due by the contractor to the plaintiff.

- 2 That a recovery statement had been issued simultaneously with that certificate reflecting an amount R nil recoverable by the plaintiff from the contractor as damages.
- 3 That the issue of the certificate finally determined that the contractor did not owe any amount to the plaintiff as a result of the alleged breach of contract by the contractor.
- 4 In the premises the defendant was not obliged to make the payment in terms of the guarantee as the indebtedness due to the plaintiff by the contractor did not fall within its terms.

Initially in its affidavit motivating the application the defendant claimed that the payment certificate was a final certificate as it had been described as such by the plaintiff (par 4). The defendant, for purposes of the argument accepted that there had been a misdescription by the plaintiff and that the payment certificate in question was an interim certificate as contemplated by the building contract. Under and in terms of the recovery statement (a document which was to be read together with the payment certificate as it is the underlying document) a R nil amount, was shown as being due by the contractor to the plaintiff in respect of damages (this was certificate 6 dated 10 October 2008) (par 4).

The upshot of the defendant's defence was that certificate 6, though it is an interim certificate, reflected a nil balance and that notwithstanding its status as an interim certificate it had become a final certificate by reason of no further certificate ever having been issued. The defendant submitted that, even if there was a right to change the interim certificate by reason of its temporary nature, such change had not been effected. Accordingly, so the argument went, the rights contained in the interim certificate constituted accrued rights (par 7). Based on this submission the defendant submitted further that the right which had accrued to the contractor was to make R nil payment in respect of damages for its breach of contract. Hence, to compel it to make payment to the plaintiff would be an academic exercise without practical effect as the plaintiff would be obliged immediately on receipt to repay the full amounts as it had no entitlement thereto (par 8). This was based squarely upon *Dormell*.

In deciding the application to amend Lamont J had regard to the purpose of a construction guarantee, namely, to enable a party to readily obtain payment by production of the documents required. He characterized the construction guarantee in question as one pursuant to which the plaintiff would be entitled to payment from the defendant upon compliance with the requirements triggering the obligation for payment upon the receipt of the first written demand, stating the matter which is required and a copy of the notice of cancellation (13). The learned judge went further to hold that, on the face of the construction guarantee, the defendant was obliged to make payment on receipt of the relevant documentation and was not entitled to

raise a defence of the nature it now sought to introduce. Simply put, he held that a guarantee of the kind under consideration was enforceable according to its terms (14). The introduction of extraneous issues as a defence is impermissible, save for very limited exceptions like fraud (14). The judge distinguished the case from *Dormell* on the basis that, in that case, it was impossible for the plaintiff to establish an entitlement to the funds which underlay its claim for payment (par 15).

Returning to the facts before him, Lamont J was of the view that the interim certificate did not become a final certificate by reason of no further certification as an interim certificate is subject to variation. Consequently the judge did not accept the defendant's claim that the judgment sought would constitute academic relief. He dismissed the application for amendment with costs and ordered judgment in favour of the plaintiff. With the leave of the court the defendant appealed to the SCA.

Central to the appeal was the *Dormell* decision. At this point it is necessary to first consider that decision.

5 The *Domell* decision

In *casu* Renasa had, at the behest of Synthesis, issued a demand guarantee on behalf of Dormell. Of particular importance was clause 5 of the guarantee in which the guarantor undertook to pay the employer upon receipt of a first written demand calling up the guarantee and stating that the agreement had been cancelled due to the contractor's default. The construction did not go as had been envisaged. Dormell then cancelled the contract and called on the guarantee in terms of clause 5. Payment on demand was resisted on *inter alia* the ground that cancellation by Dormell constituted repudiation of the contract and, therefore, Dormell had lost the right to enforce the guarantee. The matter was referred to arbitration. Because the arbitration was on the underlying construction agreement, the parties to the arbitration were Dormell and Synthesis only. The arbitrator held that Synthesis had not been in breach of any term of the building contract and that Dormell had repudiated the agreement by its purported cancellation, which repudiation was validly accepted by Synthesis which thereafter cancelled the contract as it was entitled to do so. The arbitrator held that the repudiation by Dormell was unlawful. The arbitration was not taken to review.

The matter consequently came before the SCA. On appeal Bertelsmann AJA, writing for the majority, after referring to *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* (*supra*) and *Loomcraft Fabrics CC v Nedbank Ltd* (*supra* par 39), stated that:

"In principle therefore, the guarantee must be honoured as soon as the employer makes a proper claim against it upon the happening of a specified event. In the present case there is no suggestion that Dormell did not properly demand payment of the guaranteed sum. In the normal course of events payment should have been effected within seven days of demand."

Seemingly restating and affirming what is set out in the referenced SCA decisions, Bertelsmann AJA then had regard to the arbitration award which was pursuant to the underlying construction contract and held that (40):

“However, the facts of this matter are unusual because the arbitration of the dispute between Dormell and Synthesis resulted in the finding that the appellant (Dormell) was not entitled to cancel the building contract. The arbitration is final, not subject to appeal and has not been taken on review ... There is no longer any dispute about the cancellation of the underlying agreement that still has to be resolved. The arbitration has established that Dormell is in the wrong. Its repudiation of the building contract was held to have been unlawful. As a consequence, Dormell has lost the right to enforce the guarantee. There remains no legitimate purpose to which the guaranteed sum could be applied.”

The judge further stated that (par 41), if it were to be ordered to honour the guarantee, Renasa or Synthesis would be entitled to repayment of the full amount guaranteed. In this regard the judge made reference to Hudson (*Building and Engineering Contracts* 11ed (1994) par 17.078, quoted in *Cargill International SA v Bangladesh Sugar and Food Industries Corp* 4 All ER 563 QBD (Commercial Court) 570b–f), where it was stated that:

“It is generally assumed, and there is no real reason to doubt, that the courts will provide a remedy by way of repayment to the other contracting party if a beneficiary who has been paid under an unconditional bond is ultimately shown to have called on it without justification ... In cases where there has been no default at all on the part of the contractor, there would additionally be a total failure of consideration for the payment”.

The judge ultimately held that, in the particular circumstances of the case, Dormell was not entitled to an order that the guarantee should be enforced.

Cloete JA, writing for the minority, diverged from the majority judgment. He succinctly described the legal relationships that arise in relation to construction guarantees (par 61). Against that backdrop he then scrutinized clause 5.1 of the guarantee and held that Dormell complied with the provisions of clause 5 (par 62–63). As a result, he held further, that it was not necessary for it to allege that it had validly cancelled the building contract due to Synthesis’ default (par 63–64). In this regard the judge made reference to *Lombard* and *Loomcraft* (par 63). He stated that whatever disputes there were or might have been between Dormell and Synthesis, they were irrelevant to Renasa’s obligation to perform in terms of the construction guarantee (64).

The judge went on to state that there was no suggestion of fraud on the part of Dormell. As a result, once Dormell had complied with clause 5 of the guarantee, Renasa had no defence to a claim under the guarantee (64). The judge further stated that the fact that an arbitrator had determined that Dormell was not entitled to cancel the contract, binds Dormell but only as regard to Synthesis (64). “It is *res inter alios acta* so far as Renasa is concerned” (64). Cloete AJ further held that the fact that the arbitrator’s award was final as between Dormell and Synthesis did not mean that it was correct, or that the appellant had to set it aside before calling up the guarantee (65). The upshot of Cloete AJ’s reasoning was that, once Dormell had complied with clause 5 of the guarantee Renasa had to pay, the only

defence being clear fraud on the part of Dormell in calling the guarantee. Regarding the issue of immediate repayment by Dormell to Renasa or Synthesis in the case where the guarantee is enforced, the learned judge stated that the majority's reliance on Hudson (*Building and Engineering Contracts* par 17.078) was misplaced as Hudson in that particular paragraph is dealing with the rights of the contractor and that, when fully quoted, it becomes apparent that there is nothing in that paragraph that supports the majority's proposition (par 66).

6 The case before the SCA

There was no dispute as to the type of the guarantee in question. It was accepted that the guarantee was the one enforceable according to its terms. It was thus unnecessary for the SCA to interpret the terms of the guarantee for purposes of categorizing it. The guarantee was an on-demand guarantee. On issue before Court therefore was the submission by the appellant to the effect that an employer may be denied its claim when default on the part of the contractor was disputed. This defence was squarely based on the decision in *Dormell*. It was accepted on behalf of the appellant that, in the event that the decision in *Dormell* is found to be flawed, the appeal should fail.

On stressing the autonomous nature of obligations by banks to a beneficiary under a letter of credit or a demand guarantee, the Court made reference to *inter alia* three authoritative cases on the subject, namely; *Edward Owen Engineering Ltd v Barclays Bank International Ltd* (*supra* par 10); *Loomcraft Fabrics CC v Nedbank Ltd* (*supra* par 12); and *Lombard Insurance Company Ltd v Landmark Holdings (Pty) Ltd* (*supra* par 13). The Court noted the fact that all these cases emphasized and affirmed that the obligations created by these undertakings are wholly independent of the underlying contracts and are not concerned with relations or disputes between the supplier and customer or the employer and contractor (par 10–13). Payments in terms of these obligations have to be effected once a demand is accordingly made. The only exception is when there is clear fraud on the part of the beneficiary (par 10–13).

The Court then turned to *Dormell* and stated that, by giving regard to and upholding an arbitration award pursuant to the underlying construction agreement, the majority in *Dormell* “indicated a divergence” to this long established and important principle of autonomy (par 14). The Court stated that the approach in the minority judgment was the correct approach (par 15). After giving due consideration to the majority and minority judgments, the Court unequivocally held that the majority decision in *Dormell* was clearly wrong (par 25). The Court further stated that reliance of the majority on Hudson (*Building and Engineering Contracts* par 17.078) as a further justification for a financial institution not paying when default on the part of a contractor was disputed, was misplaced and fallacious: First, because the English doctrine of consideration is not part of our law of contract; secondly, because that paragraph deals with the rights of the contractor and there is nothing in that paragraph that supports the proposition for which the majority held (par 25).

The Court stated that, since the decision in *Dormell* and perhaps predictably, there had been an increasing number of cases in which guaranteeing banks and insurance companies have sought to introduce contractual disputes in order to avoid meeting the guarantee. The Court held that this is the very consequence that the line of cases prior to *Dormell* sought to avoid (par 24). As it was accepted on behalf of the appellant that, should the court find that the decision in *Dormell* was wrong, the appeal should fail, the appeal was accordingly dismissed with costs (26).

7 Evaluating the decision

The SCA's unanimous decision in *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association (supra)* needs to be evaluated against the distinction between a suretyship guarantee and a demand guarantee. A suretyship guarantee is accessory in nature and creates a duty that is secondary (conditional) in nature (Ellinger and Neo *The Law and Practice of Documentary Letters of Credit* (2010) 302; Haynes *The Law Relating to International Banking* (2010) 282; Hopgood *Paget's Law of Banking* 13ed (2007) 865; McKnight *The Law of International Finance* (2008) 1015; and Kelly-Louw "Construction of Demand Guarantees Gone Awry: Minister of Transport and Public Works v Zanbuild Construction" 2013 25 *SA Merc LJ* 405). The intention of the parties is that the surety (guarantor) will be called upon to pay or to perform the principal debtor's (contractor's) obligation under the underlying contract only if the principal debtor defaults in performance (Kelly-Louw 2013 *Merc LJ* 405). And such payment or performance will be only to the extent of the principal debtor's liability. Thus under a suretyship guarantee it is crucial that a demand is accompanied by a statement alleging default by the principal debtor and proof thereof. As a result, enforcing suretyship guarantees is often difficult and problematic. For instance, proof of the event that triggers the surety's undertaking is often difficult. The beneficiary may have to litigate complex factual details to determine whether the principal debtor is in fact in breach of the agreement (Dolan "Letters of Credit Undertakings and Suretyship Contracts: Did the Fifth Circuit Slip in Express Blower Inc v Earthcare LLC?" 2012 129 *Banking LJ* 291 293). The litigation or arbitration to resolve these factual issues may take quite some time. While the matter is being resolved, the beneficiary of the suretyship will not be entitled to the funds that are owed to it, and the surety will pay only if and when the Court or arbiter resolves the factual disputes in the beneficiary's favour. Resolution of factual disputes in the underlying agreement between the beneficiary and principal debtor determines whether the surety must pay. The surety's obligation to pay thus depends and turns on underlying contract issues under a suretyship guarantee.

A demand guarantee, on the other hand, creates a duty that is primary in nature. This payment or performance undertaking is in this regard materially independent from the underlying transaction (Haynes *The Law Relating to International Banking* 280; Hopgood *Paget's Law of Banking* 864; Kelly-

Louw 2013 *Merc LJ* 416; and Oelofse *The Law of Documentary Letters of Credit* (1997) 354–355). The resolution of the underlying contract disputes, therefore, does not determine the liability of the guarantor. This duty is thus not conditional on bringing proof of the breach or failure of the primary debtor under the (underlying) transaction. All that the beneficiary needs to do is to call on the guarantee according to its terms. Proof regarding whether or not the principal debtor (contractor) indeed defaulted is an issue between the principal debtor and the beneficiary and may be referred to arbitration or litigation. Meanwhile the guarantee has to effect payment on the demand. The notion behind this structure is “pay now and litigate later”. The purpose of a demand guarantee therefore is to provide the beneficiary with a ready source of funds that can be utilized to help meet the costs of remedying the principal debtor’s failure to perform, its non-performance or breach in terms of the underlying agreement. It prevents the project in question from being held up because of lack of funds while the beneficiary and the principal debtor litigate or arbitrate over the merits of a particular demand under the guarantee (Haynes *The Law Relating to International Banking* 280; Kelly-Louw 2013 *Merc LJ* 417). Demand guarantees are thus a mechanism created to provide the beneficiary with a speedy and efficient monetary remedy against the defaulting or non-performing principal to the underlying agreement, although no actual proof of default, non-performance or breach is required. The *Coface* decision thus needs to be evaluated against this background.

The guarantee in *casu* was accepted by both parties as being the one requiring payment according to its terms. In other words, the guarantee was a demand guarantee. At no stage of litigation was this in dispute between the parties. Of particular importance on the terms of the guarantee is clause 5 which provided that the guarantor would effect payment in full upon receipt of a first written demand from the employer calling up the guarantee stating that the (underlying) agreement has been cancelled due to the contractor’s default and that the construction guarantee is called up. The clause further stated that the demand shall enclose a copy of the notice of cancellation. In complying with these terms of the guarantee, the plaintiff, on 29 January 2009, delivered to the guarantor’s nominated *domicilium* a letter giving notice that the contract was cancelled due to the contractor’s default and that the construction guarantee was thereby called. The guarantor and the contractor then sought to dispute payment on factual matters pursuant to the underlying contract. This is clearly incompatible with the purpose or cause of demand guarantees. The situation would have been different were the guarantee accessory (suretyship guarantee) in nature. Evaluated against this background the unanimous decision of the SCA cannot be faulted.

8 Conclusion

The unanimous decision in *Coface* is arguably the SCA’s most important decision on guarantees since *Lombard* 2010 and should be welcomed. The decision is important in at least three respects. First, the decision affirms and

settles the long established autonomy principle which the SCA has applied with unyielding consistency on demand guarantees (and letters of credit) since its decision in *Loomcraft* 1996. The divergence in *Dormell* upset this consistency. This resulted in uncertainty and the position regarding demand guarantees being somewhat confused. This is evident from the increase in the number of cases before the SCA in which guaranteeing banks and insurance companies sought to introduce contractual disputes in order to avoid meeting the guarantee. In two of those cases, namely *First Rand Bank Limited v Brera Investments CC* ([2013] ZASCA 25) and *Guardrisk Insurance Ltd v Kentz (pty) Ltd* (ZASCA 182), the Court avowed preference for the minority judgment in *Dormell* but in both cases the Court was not inclined to overturn the majority judgment.

Secondly, in affirming the autonomy principle, the decision makes the South African position regarding demand guarantees to be again (after the divergence in *Dormell*) in contact with international progressive trends and standards. For instance Article 5 of the ICC's Uniform Rules for Demand Guarantees 758 ("URDG") provides that "[a] guarantee is by its nature independent of the underlying relationship, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary". (The URDG is an attempt by the ICC to codify independent guarantee practice. These rules apply to any demand guarantee or counter-guarantee that expressly indicates it is subject to them. They are binding on all parties to the guarantee or counter-guarantee except so far as the demand guarantee modifies or excludes them.)

The Uniform Customs and Practice for Documentary Credits ("UCP 600"), applicable to letters of credit (and by extension to standby letters of credit which are the equivalent of demand guarantees), also provides for the doctrine of autonomy in its Article 4. (The UCP 600 is the latest ICC revision of the Uniform Custom and Practice that governs the operation of letters of credit. It applies to any documentary credit (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules and they are binding on all parties thereto unless expressly modified or excluded by the credit). Further, jurisdictions world-wide have long recognized and shown deference to the autonomy principle, (see *Cargill International SA v Bangladesh Sugar and Food Industries Corp.* [1998] 2 ALL ER 406; *Comdel Commodities Ltd v Siporex Trade SA* [1997] 1 Lloyd's Rep 424 CA 431; *Marubeni Hong Kong & South China Ltd v The Mongolian Government* [2005] EWCA Civ, [2005] 1 WLR 2497; *Sztejn V J Henry Schroder Banking Corp.* [1941] 31 NYS 2d 631; and *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1AC 168 (HL)). Deviation by our courts from this long-standing custom and practice could have undesirable (commercial) consequences. South Africans live in one of the most prosperous countries in Africa, and actively maintain international commercial relationships with the outside world. Thus, it is important for our courts to be in line with international

attitudes and practices. No foreign party will wish to contract in a state in which its courts will readily interfere and order that a demand guarantee is unenforceable due to a dispute on the underlying agreement.

Lastly, the decision is important, not only to the principles relating to guarantees but it sheds some light on the system of judicial precedent, also called the doctrine of *stare decisis*, which applies in South Africa. *Stare decisis* literally means to “stand by previous decisions”. According to this doctrine, previous judgments create (binding) precedents which must be followed. However, it appears that a court is not absolutely bound by the *ratio decidendi* of an earlier decision of its own. If a court is of the opinion that the *ratio decidendi* of one of its earlier decisions is wrong, erroneous, or has been arrived at on some manifest oversight or misunderstanding, it may decide to depart from that *ratio decidendi*, that is, it may give a decision which it considers to be correct, (see *Bloemfontein Town Council v Richter* 1938 AD 195 at 232; *Harris v Minister of the Interior* 1952 (2) SA 428 454A–B; and *John Bell & Co Ltd v Eisselen* 1954 (1) SA 147 (A) 153). The *Coface* decision, in overturning the *Dormell* judgment, confirms this position or practice.

Gift MN Xaba
Legal Intern, ProBono.Org, Johannesburg