

# A Comparative Analysis of the Approach to the Conformity of a Supporting Statement Calling for Payment Under Demand Guarantees

T Chivizhe\*

Online ISSN  
1727-3781

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## Author

Tinaye Chivizhe

## Affiliation

Eduvos, Midrand, South Africa

## Email

tinaye.chivizhe@eduvos.com

## Date Submitted

16 January 2022

## Date Revised

29 May 2022

## Date Accepted

31 May 2022

## Date Published

27 October 2022

Guest Editor Dr Karl Marxen

Journal Editor Prof C Rautenbach

## How to cite this article

Chivizhe T "A Comparative Analysis of the Approach to the Conformity of a Supporting Statement Calling for Payment Under Demand Guarantees" *PER / PELJ* 2022(25) - DOI <http://dx.doi.org/10.17159/1727-3781/2022/v25i0a14060>

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## DOI

<http://dx.doi.org/10.17159/1727-3781/2022/v25i0a1460>

## Abstract

The core requirement of a demand guarantee is to receive payment through the delivery of documents or a call for payment that meets the requirements of the demand guarantee. The call for payment may be accompanied by a declaration alleging a breach of the underlying agreement or a statement with full particulars of the breach. However, the extent to which the data in the supporting statement or statement of breach must comply with the guarantee requirements is not always entirely clear. Over the years, a strict standard of compliance of the statement with the terms of the guarantee has been employed. This has threatened the commercial use of demand guarantees due to demands for payment being rejected. This article draws upon the approach in resolving the problems related to the conformity of a statement accompanying the call for payment through an analysis of international instruments applicable to demand guarantees (the *Uniform Rules for Demand Guarantees* (URDG758); the *International Standby Practices* (ISP98); the *United Nations Convention on Independent Guarantees and Standby Letters of Credit* (UNCITRAL Convention); the *Supreme Court of the People's Republic of China Letter of Credit Rules* (Chinese LC Rules); the *Provisions of the Supreme People's Court of the People's Republic of China on Several Issues Concerning the Trial of Disputes Over Independent Guarantees* (Chinese IGP), the recently issued *International Standard Demand Guarantees Practice* (ISDGP) and international case law in an attempt to find the most feasible approach for South African law. A supporting statement accompanying a call for payment is conforming if it indicates the event triggering the guarantor's obligation to pay as specified in the demand guarantee. Furthermore, in ascertaining whether a supporting statement is compliant, a technical interpretation of the terms of the guarantee should be avoided in favour of one that advances the common intention and purpose of the guarantee.

## Keywords

Call for payment; demand; demand guarantee; strict compliance; statement of breach; supporting statement; compliance; conformity.

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## 1 Introductory remarks

Demand (or independent) guarantees are often used in domestic and global sales contracts, construction or engineering projects, and other large commercial contracts.<sup>1</sup> They serve as a security mechanism to guarantee the proper performance of any obligation in terms of the underlying contract.<sup>2</sup> Such an obligation could be financial (security for an obligation to pay)<sup>3</sup> or non-financial (to deliver some other performance).<sup>4</sup> This instrument operates as a risk allocation device concerning claims relating to a breach of contract between the parties to the underlying agreement.<sup>5</sup> In such an instance, the beneficiary will receive compensation in the event of a breach of contractual obligations without the need for claiming damages or proving default or the amount of its loss.<sup>6</sup> Demand guarantees may or may not be governed by any rule sets which are intended to provide certainty to guarantee practice internationally. These rules include: the *Uniform Rules on Demand Guarantees 758* (URDG758);<sup>7</sup> *International Standard Demand Guarantees Practice for URDG758* (ISDGP);<sup>8</sup> *International Standby*

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\* Tinaye Chivizhe. LLB LLM LLD. Head of Law Programme, Eduvos, Midrand, South Africa. Attorney of the High Court of South Africa. Email: tinaye.chivizhe@eduvos.com. ORCID: <https://orcid.org/0000-0001-6670-6696>. The roots of this contribution lie in research done for the author's doctoral thesis titled *A Comparative Study of the Law and Practice Relating to the Compliance of Documents Calling for Payment Under Letters of Credit and Demand Guarantees* (North-West University 2021).

<sup>1</sup> Kelly-Louw 2013 *SA Merc LJ* 410. For a more comprehensive background on demand guarantees, see Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* 110-114; Marxen *Demand Guarantees in the Construction Industry* 56-59.

<sup>2</sup> Hapgood *Paget's Law of Banking* 702. For a discussion of the types of guarantees encountered in the construction industry, see Chivizhe *Law and Practice Relating to Compliance of Documents* 70-74.

<sup>3</sup> For example, financial obligations arising from loans, leases, mergers and acquisitions, joint ventures, or payment obligations under a contract of sale.

<sup>4</sup> Bertrams *Bank Guarantees in International Trade* 2. For some diverse examples of the use of these instruments domestically, see *Compass Insurance Company Limited v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA); *Lombard Insurance Co Limited v Schoeman* 2018 1 SA 240 (GJ).

<sup>5</sup> Bertrams *Bank Guarantees in International Trade* 71.

<sup>6</sup> Bertrams *Bank Guarantees in International Trade* 14.

<sup>7</sup> Drafted by the Banking Commission of the International Chamber of Commerce (ICC), *ICC Uniform Rules for Demand Guarantees, ICC Publication No 758* (2010) (URDG758). For an excellent brief background, see Byrne *Letter of Credit Rules and Laws* 81. For a more comprehensive background, see Hugo 2017 *TSAR* 6-14.

<sup>8</sup> The International Standard Demand Guarantee Practice for URDG758 was drafted by the Banking Commission of the ICC - *International Standard Demand Guarantee Practice for URDG758, ICC Publication No 814E* (2021) (ISDGP). The ISDGP is destined to be a companion document to the URDG as it expands on the URDG by providing best practice and “unparalleled insight into the correct application of the URDG in a practical context” see Introduction to the International Standard Demand Guarantee Practice for URDG758.

*Practices 1998* (ISP98);<sup>9</sup> the *Provisions of the Supreme People's Court of the People's Republic of China on Several Issues Concerning the Trial of Disputes over Independent Guarantees* (Chinese IGP);<sup>10</sup> and the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (henceforth: UNCITRAL Convention).<sup>11</sup> For these rules to apply to a demand guarantee transaction, the URDG758 and ISP98 need to be contractually incorporated by the parties into the guarantee.<sup>12</sup> The Chinese IGP, on the other hand, applies as an authoritative statement of Chinese law in a similar manner as a judgment of the highest court in a country governed by the *stare decisis* rule;<sup>13</sup> and the UNCITRAL Convention, as an international convention, governs as statutory law in those few countries that have ratified it or have acceded to it.<sup>14</sup> When any of these rules governs a guarantee, they must, of course, be taken into account when ascertaining whether a call for payment is compliant.

Most demand guarantees, however, are not governed by any of these rule sets. This is evident in South Africa, where domestic guarantees are seldom governed by any of them. Instead, there are governed by standard-form guarantees (such as those that form part of the suite of agreements propagated and published by the Joint Building Contracts Commission (JBCC)).<sup>15</sup> In circumstances where the rule sets are not applicable, the

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<sup>9</sup> Drafted by the Institute of International Banking Law and Practice (IIBLP) and endorsed by the ICC - *International Standby Practices*, ICC Publication No 590 (1998) (ISP98). For an authoritative brief background, see "Editor's Overview" in Byrne *Letter of Credit Rules and Laws* 29. For a more comprehensive background, see Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* 114-119; Marxen *Demand Guarantees in the Construction Industry* 59-61. See also Hugo 2017 *TSAR* 16.

<sup>10</sup> *Provisions of the Supreme People's Court of China on Several Issues Concerning the Trial of Disputes Over Interpretation of Independent Guarantee Provisions* (2017) (Chinese IGP). These rules were adopted by the Judicial Committee of the Supreme People's Court in July 2016 and came into effect in the same year. They were translated by the IIBLP and published in Byrne *Letter of Credit Rules and Laws* 317 where a good brief background is provided. On these rules, see further Hugo "Demand Guarantees" 129-132; Hugo 2019 *BRICS Law Journal* 22-23.

<sup>11</sup> This Convention, *United Nations Convention on Independent Guarantees and Standby Letters of Credit* (1996), drafted by the United Nations Commission on International Trade Law (UNCITRAL), was adopted by the General Assembly in 1995 and became effective on 1 January 2000 in those countries that adopted the Convention, namely Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama, and Tunisia (hereafter the UNCITRAL Convention). Again, a good brief background is provided by Byrne *Letter of Credit Rules and Laws* 211. See also Marxen *Demand Guarantees in the Construction Industry* 61-62.

<sup>12</sup> Article 1(a) of the URDG758; Rules 1.01-1.04 of the ISP98. See further Hugo "Bank Guarantees" 437, 439; Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* 112, 118.

<sup>13</sup> See Byrne *Letter of Credit Rules and Laws* 317.

<sup>14</sup> Article 28 of the UNCITRAL Convention.

<sup>15</sup> See, for example, *Compass Insurance Company Limited v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA); *Dormell Properties 282 CC v Renasa*

guarantees must essentially be interpreted using the normal rules of interpretation of contracts. These instruments are typically documentary in nature, which implies that payment is triggered by delivery to the guarantor of a written demand with or without documents that meet the requirements of the guarantee.<sup>16</sup> A beneficiary under a demand guarantee receives payment upon demand or on a demand accompanied by a declaration alleging breach of contract or specified documents.<sup>17</sup> The statement accompanying the demand typically serves to support the beneficiary's entitlement to call up the guarantee. A statement indicating the reason for calling for payment under the guarantee may be required. This usually takes the form of a demand accompanied by a statement alleging that the applicant is in breach of the underlying contract.<sup>18</sup> A distinction should be made between a statement alleging breach and one particularising the nature of the breach. A demand guarantee may require a mere statement of breach<sup>19</sup> but may also need the breach to be particularised. For instance, the demand guarantee may require that the demand simply allege that the applicant is in breach of its warranty obligations.<sup>20</sup> On the other hand, the guarantee may require the statement to indicate how the applicant has breached its warranty obligations. For example, that goods supplied are defective. Determining the extent to which the supporting statement must adhere to the requirements of the demand guarantee is often problematic.<sup>21</sup> The proper approach to solving problems relating to the conformity of a supporting statement is explored below with reference to the relevant rule sets that may be applicable and foreign case law in point.

### **1.1 General requirements of a demand**

A demand guarantee may require a simple demand for payment or a demand for payment accompanied by a declaration alleging breach of contract or a statement with full particulars of the breach. It may also be more complex in that it may require further documents, apart from the demand. These documents may emanate from the beneficiary (for example, a notice of cancellation) or a third party (for example, a liquidation order or

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*Insurance Company Ltd* 2011 1 SA 70 (SCA); *Group Five Construction (Pty) Ltd v Member of the Executive Council for Public Transport, Roads and Works Gauteng* 2015 5 SA 26 (GJ); and *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* (23125/2014) [2015] ZAGPJHC 264 (20 October 2015). In none of them were any of these rule sets applicable.

<sup>16</sup> *Bridge Benjamin's Sale of Goods* 2221.

<sup>17</sup> Bergsten 1993 *International Lawyer* 860.

<sup>18</sup> See, for example, *Denel Soc Ltd v Absa Bank Ltd* 2013 3 All SA 81 (GSJ).

<sup>19</sup> *Sea-Cargo Skips AS v State Bank of India* [2013] 1 Lloyd's Rep 477 (QB).

<sup>20</sup> See, for example, *Denel Soc Ltd v Absa Bank Ltd* 2013 3 All SA 81 (GSJ).

<sup>21</sup> For a discussion on the standard of compliance relating to demand guarantees, see Hugo 2018 *TSAR* 680-690; Kelly-Louw 2016 *CILSA* 85-129; and *Compass Insurance Company Limited v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA).

even a judgement or arbitral award). It must be emphasised from the outset that the demand should be in the form and manner stipulated in the guarantee for it to be complying.<sup>22</sup>

The URDG758 defines a demand as "a signed document" by the beneficiary demanding payment under a demand guarantee.<sup>23</sup> The ISDGP<sup>24</sup> states that a demand includes "any document, however titled, signed by the beneficiary that permits it to infer that the beneficiary is demanding payment under the guarantee".

The ISP98 provides that a demand can be "in the form of a draft or other instruction, order, or request to pay".<sup>25</sup> Unless the guarantee states differently, a separate demand for payment is not required.<sup>26</sup> If a separate demand is needed, it must be signed by the beneficiary indicating the amount demanded and when the demand was issued.<sup>27</sup> The ISP98 also does not require an explanatory statement in the demand but sets out the contents of such a statement where it is required by the demand guarantee.<sup>28</sup> Thus, a demand under the ISP98 consists of any wording which constitutes a request for payment by the beneficiary directed to an appropriate person.<sup>29</sup> It follows that if precise wording is required in a demand, the demand guarantee should specifically indicate the wording.<sup>30</sup>

A demand under the UNCITRAL Convention may be in "any form which preserves a complete record of the text of the undertaking and in conformity with the terms and conditions of the undertaking".<sup>31</sup> It requires the presentation of a demand and "any certification or other document required by the undertaking".<sup>32</sup> According to the Explanatory Note of the UNCITRAL Secretariat on the Convention,<sup>33</sup> the process of demanding payment involves presenting a demand for payment and any accompanying documents in accordance with the terms and conditions of the undertaking.

The Chinese IGP require "a demand for payment and presentation of documents complying with the terms and conditions of the Guarantee".<sup>34</sup> It

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<sup>22</sup> Bertrams *Bank Guarantees in International Trade* 47.

<sup>23</sup> Article 2 of URDG758.

<sup>24</sup> Paragraph B34 of ISDGP.

<sup>25</sup> Rule 4.16(c) of ISP98.

<sup>26</sup> Rule 4.16(a) read with Rule 4.16(b) of ISP98.

<sup>27</sup> Rule 4.16(b) of ISP98.

<sup>28</sup> Rule 4.17 of ISP98.

<sup>29</sup> Byrne *Official Commentary* 184.

<sup>30</sup> Byrne *Official Commentary* 184.

<sup>31</sup> Article 15(1) as read with Art 7(2) of the UNCITRAL Convention.

<sup>32</sup> Article 15(2) of the UNCITRAL Convention

<sup>33</sup> Paragraphs 26, 39, 21 and 22 of the Explanatory Note in UNCITRAL Secretariat 1996 <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/guarantees.pdf>.

<sup>34</sup> Article 1 of the Chinese IGP.

specifically indicates the type of documents that may accompany a request for payment other than a statement of default, such as documents issued by a third party, a court judgement, or an arbitral award, among others.<sup>35</sup>

## **1.2 Conclusion in summary**

The URDG758,<sup>36</sup> ISP98,<sup>37</sup> and Chinese IGP<sup>38</sup> accordingly contain specific stipulations regarding the nature and form of a demand, while the UNCITRAL Convention<sup>39</sup> is more flexible in this regard. Moreover, the ISP98 does not require an explanatory statement in the demand unless the demand guarantee provides otherwise. The content of such a statement, if not set out in the guarantee itself, is prescribed by the ISP98.<sup>40</sup> As apparent from the above, the different rule sets contain general provisions relating to demands which could be helpful to the guarantor in determining the conformity of a demand.

## **2 The approach to conformity of a supporting statement in rule sets applicable to a demand guarantee**

### **2.1 The URDG758**

The URDG758 stipulates that:

A demand under the guarantee shall be supported by such other documents as the guarantee specifies, and in any event by a statement by the beneficiary, indicating in what respect the applicant is in breach of its obligations under the underlying relationship. This statement may be in the demand or in a separate signed document accompanying or identifying the demand.<sup>41</sup>

The above provision requires the supporting statement to indicate in what respect the applicant is in breach of its obligations under the underlying relationship.<sup>42</sup> This means a mere allegation that the applicant is in breach of the underlying contract is not sufficient, as the particulars of the breach should be stated. The URDG758 also requires any supporting statement to be signed; it does not require a signature on any other document.<sup>43</sup> The supporting statement is to be signed by the beneficiary indicating the nature of the breach of underlying obligations.<sup>44</sup> The requirement that a demand contain a supporting statement is mandatory unless the parties expressly

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<sup>35</sup> Article 1 of the Chinese IGP.

<sup>36</sup> Article 2 as read with Arts 15(a) and (b) of URDG758.

<sup>37</sup> Rule 4.16 of ISP98.

<sup>38</sup> Article 1 of the Chinese IGP.

<sup>39</sup> Article 15(1) as read with Art 7(2) of the UNCITRAL Convention.

<sup>40</sup> Rule 4.17 of ISP98.

<sup>41</sup> Article 15(a) of URDG758.

<sup>42</sup> Articles 15(a) and (b) of URDG758.

<sup>43</sup> Articles 15(a) and (b) of URDG758.

<sup>44</sup> See paras H104, H105 and H111 of ISDGP.

exclude the URDG758 provision quoted above.<sup>45</sup> However, there are no limitations to the level of detail required in the supporting statement.<sup>46</sup> The particulars of the breach should be included in the supporting statement. This requirement seems to limit the application of the URDG758 to guarantees involving a breach of obligations.<sup>47</sup> The ISDGP, however, addresses this issue by stating that the provisions of Article 15(a) must be excluded in cases where the payment of a demand is not dependent upon an applicant's breach.<sup>48</sup>

The demand guarantee may provide specific terms to be used in the supporting statement. If it does not, the beneficiary can use any terms, provided that they indicate the nature of the breach.<sup>49</sup> The applicant should provide the guarantor with clear instructions regarding the specific terms required for the supporting statement, which should align with the underlying contract. A document containing a call for payment need not necessarily contain a statement about why a demand is being made. The supporting statement can be included in the text of the demand or as a separate document.<sup>50</sup>

## **2.2 Other rule sets**

In terms of the ISP98,<sup>51</sup> if the contents of a statement are not set out in the guarantee, the demand conforms if it includes "a representation to the effect that payment is due because a drawing event described in the guarantee has occurred" as well as a date indicating when it was issued and the beneficiary's signature. The ISP98 prescribes the contents of a supporting statement if the guarantee requires it, and such a statement will not necessarily be a statement of default, as guarantees are not always default undertakings.<sup>52</sup> Thus the ISP98 requires a statement to indicate that the event triggering the issuer's obligation to pay as stated in the guarantee has taken place. This rule does not explicitly stipulate the wording of the statement indicating that the drawing event has occurred, as this is shown in the guarantee text.

The Chinese IGP indicates that where a demand guarantee requires a supporting statement to accompany a demand for payment, the statement must indicate the "event triggering the obligation to pay".<sup>53</sup> The UNCITRAL

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<sup>45</sup> Byrne *Standby and Demand Guarantee Practice* 162.

<sup>46</sup> Paragraph H106 of ISDGP.

<sup>47</sup> Byrne *Standby and Demand Guarantee Practice* 160.

<sup>48</sup> Paragraph H110 of ISDGP.

<sup>49</sup> Paragraph H105 of ISDGP.

<sup>50</sup> Articles 15(a) and (b) of URDG758; Para H103 of ISDGP; and Rule 4.16(a) of ISP98.

<sup>51</sup> Rules 4.17(a)-(c) of ISP98. See also ISP98 Model Form 1.

<sup>52</sup> Byrne *Official Commentary* 184.

<sup>53</sup> Article 1 of the Chinese IGP.

Convention<sup>54</sup> does not explicitly provide for the requirements of a supporting statement. Still, the demand and accompanying documents must be presented following the terms of the undertaking.

### **2.3 Conclusion in summary**

In summary therefore, the ISP98<sup>55</sup> and Chinese IGP<sup>56</sup> contain similar provisions in providing that the supporting statement should indicate the event triggering the obligation to pay. In contrast, the URDG758 requires the statement to outline how the applicant has breached the underlying contract.<sup>57</sup> Although the different rules discussed above stipulate the requirements for a supporting statement, it is not clear to what extent the statement must adhere to the guarantee requirements. This is usually strongly dependent on the interpretation of the text of the guarantee. This issue will be dealt with in the conclusion.

## **3 The approach to conformity of a supporting statement in guarantees not subject to any rule set**

The approach to conformity of a supporting statement where the guarantee is not subject to any rules sets may be more difficult. This question must be determined by interpreting the guarantee without the assistance of any terms from the rule sets considered above. As will be highlighted below, there has not been a consistent approach in case law.

The position under English law is that a statement accompanying a call for payment should strictly adhere to the terms stated in the demand guarantee.<sup>58</sup> Furthermore, the determination of whether the demand meets the terms of the guarantee is a matter of interpretation of the terms of the demand guarantee, which need to be adhered to.<sup>59</sup> This approach was illustrated in the case of *Frans Maas (UK) Ltd v Habib Bank AG Zurich*,<sup>60</sup> where the guarantee required a demand "stating that [Palmier] have failed to pay you under their contractual obligations".<sup>61</sup> The call for payment stated that "there had been a failure to meet contractual obligations" without any

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<sup>54</sup> Article 15(1) as read with Art 7(2) of the UNCITRAL Convention.

<sup>55</sup> Rule 4.17 of ISP98.

<sup>56</sup> Article 1 of the Chinese IGP.

<sup>57</sup> Articles 15(a) and (b) of URDG758.

<sup>58</sup> *Enonchong Independence Principle* 91. See further *Sea-Cargo Skips AS v State Bank of India* [2013] 1 Lloyd's Rep 477 (QB); *Frans Maas (UK) Ltd v Habib Bank AG Zurich* [2001] Lloyd's Rep 14; and *MUR Joint Ventures BV v Compagnie Monegasque De Banque* [2016] EWHC 3107 (Comm).

<sup>59</sup> *Sea-Cargo Skips AS v State Bank of India* [2013] 1 Lloyd's Rep 477 (QB); *Rainy Sky SA v Kokmin Bank* [2011] UKSC 50, [2012] 1 Lloyd's Rep 34 (SC).

<sup>60</sup> *Frans Maas (UK) Ltd v Habib Bank AG Zurich* [2001] Lloyd's Rep 14 (the *Frans Maas* case).

<sup>61</sup> *Chuah Law of International Trade* 626.

reference to a "failure to pay".<sup>62</sup> The Court found the supporting statement to be non-conforming as without further investigation, the bank could not determine whether or not a failure to pay had occurred.<sup>63</sup> Furthermore, the Court found that the demand did not comply with the terms of the guarantee because the statement in the demand did not allege a "failure to pay" but a "failure to meet contractual obligations".<sup>64</sup> The Court remarked as follows:

Without there being any question of resorting to the doctrine of strict compliance, it seems to me that a failure to 'meet a contractual obligation' is far from being the same as 'failure to pay under a contractual obligation'. In effect, the former concept is wide enough to cover any claim for damages for unliquidated or unascertained sums arising from any breach of the WTA, which would seem to me to widen the scope of the guarantee far beyond that which the parties intended. In my view, the natural scope of the guarantee is limited to the failure to pay the liquidated and ascertained sums falling due under the WTA from time to time.<sup>65</sup>

From the above dictum, the Court's approach nevertheless seems reasonably strict in requiring the statement of breach to be in the exact form as required by the demand guarantee. The key consideration by the court was whether the event which triggered the guarantor's obligation to pay had been stated, namely a failure to meet payment obligations, not any general breach. This needed to be reflected by the demand. This approach is commendable. It recognises the independent nature of demand guarantees in that the guarantor is not required to verify the nature of the breach of the underlying contractual obligations. Furthermore, the determination of whether the demand meets the terms of the guarantee is a matter of interpretation of the terms of the demand guarantee, which need to be adhered to.<sup>66</sup>

The approach that the supporting statement should indicate the event triggering the obligation to pay was illustrated in the English case of *Sea-Cargo Skips AS v State Bank of India*.<sup>67</sup> In this case, the demand guarantee required the call for payment to be accompanied by a statement indicating that the vessel or its construction was delayed for more than 270 days as set out in article IV1(E) of the contract.<sup>68</sup> The call for payment under the guarantee indicated that the vessel's construction had been delayed by more than 270 days and that the buyer had accordingly exercised its right

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<sup>62</sup> Chuah *Law of International Trade* 626.

<sup>63</sup> *Frans Maas* case para 57.

<sup>64</sup> *Frans Maas* case para 58.

<sup>65</sup> *Frans Maas* case paras 58-60.

<sup>66</sup> *Sea-Cargo Skips AS v State Bank of India* [2013] 1 Lloyd's Rep 477 (QB); *Rainy Sky SA v Kokmin Bank* [2011] UKSC 50, [2012] 1 Lloyd's Rep 34 (SC).

<sup>67</sup> *Sea-Cargo Skips AS v State Bank of India* [2013] 1 Lloyd's Rep 477 (QB) (the *Sea-Cargo* case). See a similar approach in the earlier *Frans Maas* case.

<sup>68</sup> *Sea-Cargo* case para 7.

to cancel the contract. However, the call for payment did not indicate that the delay was as stipulated in article IV1(E) of the agreement.<sup>69</sup>

The Court found that the call for payment was non-compliant as it had to state the nature of the delay so that the guarantor could determine on its face that the demand was compliant.<sup>70</sup> It further concluded that the requirement that the buyer must state under what terms it was entitled to repayment served to prevent the abuse of the refund guarantee.<sup>71</sup> For this reason, the demand had to state on its face that which the bank could not investigate. Again, this case employed a strict approach to the requirements of the demand guarantee by finding that the delay stated in the demand was not the delay specified in the guarantee.

The Scottish case of *South Lanarkshire Council v Coface SA*<sup>72</sup> is also of interest in this regard.<sup>73</sup> In this case, Coface SA (guarantor) issued a performance guarantee to the South Lanarkshire Council (the Council) as security for the land restoration obligations of the open pit mine operator, the Scottish Coal Company Ltd (Scottish Coal) following the cessation of mining operations.<sup>74</sup> The guarantee required the call for payment to include a notice in writing of any breach of the agreement by the company (Scottish Coal), and the costs of the restoration works to be carried out.<sup>75</sup> A further term of the guarantee was that the guarantor would not be obliged to investigate the authenticity or validity of a claim, as a written demand from an authorised official of the beneficiary would be sufficient evidence of the guarantor's obligation to pay.<sup>76</sup>

Scottish Coal faced financial difficulties and appointed a liquidator. The liquidator informed the council that Scottish Coal's funds were insufficient to cover the cost of restoration of the project.<sup>77</sup> The Council then submitted a call for payment on the guarantee with a statement indicating that Scottish Coal was in breach of its restoration obligations and liable for the cost of restoration works to be carried out due to the violation.<sup>78</sup> However, the call for payment failed to indicate the particular amount that Coface was liable

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<sup>69</sup> *Sea-Cargo* case para 13.

<sup>70</sup> *Sea-Cargo* case para 43.

<sup>71</sup> *Sea-Cargo* case para 44.

<sup>72</sup> *South Lanarkshire Council v Coface SA* [2016] BLR 237 (Inner House, Extra Division) (the *South Lanarkshire* case).

<sup>73</sup> For a discussion of this case, see Chivizhe *Law and Practice Relating to Compliance of Documents* 210-213.

<sup>74</sup> *South Lanarkshire* case para 1.

<sup>75</sup> *South Lanarkshire* case para 7.

<sup>76</sup> *South Lanarkshire* case para 7.

<sup>77</sup> *South Lanarkshire* case para 4.

<sup>78</sup> *South Lanarkshire* case para 5.

to pay, nor did it indicate the costs that the Council would incur in carrying out the restoration works itself.

The Court of first instance had to decide whether the beneficiary had presented a complying demand. Coface argued that the document sent by the Council did not constitute a valid notice as required by the guarantee. However, this argument fell through, and the matter was taken on appeal to the Inner House (Scottish Court of Appeal). On appeal, Coface challenged the decision of the court of first instance on the basis that the notice demanding payment was invalid because, although it indicated a breach of contract, it did not demand payment of a specified sum.

In determining whether the call for payment was compliant the Inner House reiterated that the wording of the contract had to be construed in context and in accordance with the purposes that the agreement was intended to achieve.<sup>79</sup> It emphasised the need for a common-sense approach to avoid an unduly technical interpretation of the guarantee.<sup>80</sup> The Inner House found that the notice sent to the guarantor satisfied the requirements of the guarantee as it sufficiently indicated that Scottish Coal was in breach of their contractual obligations.<sup>81</sup> As a result, the breach of contract stated in the call for payment was the event triggering the guarantor's obligation to pay under the guarantee.<sup>82</sup> The Court further noted that the actual state of affairs in the underlying agreement relating to the costs of restoration works was irrelevant to the guarantor's obligation to pay under the guarantee.<sup>83</sup> The Court concluded that the terms of the guarantee had to be interpreted practically, based on commercial common sense, in order to promote the common intention of the parties and the basic purpose of the guarantee.<sup>84</sup>

This judgement deviated from a strict standard of compliance. The Court emphasised that the determining factor was whether the event triggering the guarantor's obligation to pay had been indicated in the demand for payment. The basis of the Court's decision was on the premise that the statement showing the cost of remedial works was not the event triggering the guarantor's obligation to pay as this would require a factual enquiry into the underlying contract to which the bank was not privy. In addition, this did not affect the payment obligation of the guarantor because, irrespective of the costs of the restoration, the full amount of the guarantee was payable as the event triggering the obligation to pay had been stated.

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<sup>79</sup> *South Lanarkshire* case para 9.

<sup>80</sup> *South Lanarkshire* case para 10.

<sup>81</sup> *South Lanarkshire* case para 19.

<sup>82</sup> *South Lanarkshire* case para 19.

<sup>83</sup> *South Lanarkshire* case para 20.

<sup>84</sup> *South Lanarkshire* case para 22.

In South Africa, the requirements of a complying demand have not been clearly determined.<sup>85</sup> Some previous decisions<sup>86</sup> have favoured a strict approach to apply to demand guarantees in the same way it applies to letters of credit.<sup>87</sup> However, the current approach is that the requirements of a complying demand depend on the interpretation of the terms of the guarantee.<sup>88</sup> It follows still, with this approach, that the clear and precise terms of the guarantee must be adhered to meticulously, which implies a high level of compliance.<sup>89</sup>

The requirement of a conforming demand involving a statement of breach was considered in *Denel Soc Ltd v Absa Bank Ltd*.<sup>90</sup> In this case Denel entered into an agreement with the Union of India (UOI) to supply specific defence equipment and ammunition. Denel, through Absa Bank, procured warranty and performance guarantees from the State Bank of India and Bank of Baroda (the Indian banks).<sup>91</sup> Absa then issued eight counter guarantees for the benefit of Denel to back the primary guarantees issued by the Indian banks to Denel's contractual counterparty, the UOI. Seven of the guarantees required a demand stating that Denel had not performed according to the "warranty obligations" under the contract concluded with the UOI.<sup>92</sup> The eighth guarantee required a demand that the "goods supplied" by Denel were not in accordance "with the contractual obligations".<sup>93</sup>

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<sup>85</sup> On complying demands in South African case law generally, see *Compass Insurance Company Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA) 540A-541F; *Lombard Insurance Co Limited vs Landmark Holdings (Pty) Ltd* 2010 2 SA 86 (SCA); *Denel Soc Ltd v Absa Bank Ltd* 2013 3 All SA 81 (GSJ); *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* (23125/2014) [2015] ZAGPJHC 264 (20 October 2015); *Group Five Construction (Pty) Ltd v Member of the Executive Council for Public Transport, Roads and Works Gauteng* 2015 5 SA 57 (SCA). See further Kelly-Louw 2017 *THRHR* 152; Kelly-Louw 2016 *CILSA* 116-126.

<sup>86</sup> See *Grinaker LTA Rail Link Joint Venture v Absa Insurance Company Limited* (24110/2014) [2015] ZAGPJHC 302 (10 November 2015); *Guardrisk Insurance Company Limited v Kentz (Proprietary) Limited* 2014 1 All SA 307 (SCA); *Lombard Insurance Co Limited vs Landmark Holdings (Pty) Ltd* 2010 2 SA 86 (SCA).

<sup>87</sup> *Stefanutti & Bressan (Pty) Limited v Nedbank Limited* (5311/2008) [2008] ZAKZHC 50 (30 July 2008).

<sup>88</sup> Hugo "Bank Guarantees" 458. See also *Denel Soc Ltd v Absa Bank Ltd* 2013 3 All SA 81 (GSJ) 90 paras 35-44; *Compass Insurance Company Limited v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA) para 14.

<sup>89</sup> Chivizhe *Law and Practice Relating to Compliance of Documents* 201. For a similar view see Kelly-Louw 2016 *CILSA* 107; Enonchong *Independence Principle* 86-87.

<sup>90</sup> *Denel Soc Ltd v Absa Bank Ltd* 2013 3 All SA 81 (GSJ) (the *Denel* case). For a detailed discussion of this case, see Kelly-Louw 2016 *CILSA* 116-126.

<sup>91</sup> *Denel* case para 3.

<sup>92</sup> *Denel* case para 20.

<sup>93</sup> *Denel* case para 20.

A dispute arose between the parties, and the UOI demanded payment on the basis that the goods supplied by Denel did not meet its contractual obligations.<sup>94</sup> The call for payment under the first seven guarantees alleged that Denel had not performed according to "contractual obligations" instead of indicating that Denel had not performed according to its "warranty obligations".<sup>95</sup> The demand under the other guarantee stated that Denel had "not fulfilled its contractual obligations". What was required was a notice that the goods supplied were not in accordance with the contractual obligations. Therefore, none of the demands was in the exact terms required by the guarantees.

However, the Indian banks paid the guarantees and demanded payment from Absa under the counter-guarantees. Denel then applied to the High Court for an interim interdict restraining Absa from paying the Indian Banks under the counter-guarantees because the demands made by UOI were not strictly compliant with the requirements of the guarantees. As a result, the demands made by the Indian banks against Absa were not strictly compliant with the terms of the guarantees.<sup>96</sup> The Court found that the demands did not comply with the terms of the counter-guarantees. Absa was not obliged to make payment to the Indian banks under the counter-guarantees in the absence of compliant demands. Malindi JA referred to several English authorities,<sup>97</sup> casting doubt on the application of the doctrine of strict compliance under demand guarantees, as well as the dictum in the *Compass Insurance* case<sup>98</sup> and stated:

It is clear, therefore, that the Court found it unnecessary to pronounce whether the doctrine of strict compliance applied or not as there was no compliant demand in terms of the promise which the bank made to the beneficiary.<sup>99</sup>

The learned Judge further indicated that the standard of compliance under a guarantee turned on the interpretation of the guarantee itself and remarked as follows:

Similarly, in my view, in the case of demand guarantees, the beneficiary must meet the conditions specified in the guarantee. Whether the condition or term of the guarantee 'conform strictly to the requirements of the credit' or to the

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<sup>94</sup> *Denel* case paras 23-24.

<sup>95</sup> *Denel* case para 21.

<sup>96</sup> *Denel* case para 13.

<sup>97</sup> *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496 (CA) 501; *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146 (QB) 159; and *Frans Maas* case paras 57-60.

<sup>98</sup> *Compass Insurance Company Limited v Hospitality Hotel Developments (Pty) Ltd* 2012 2 SA 537 (SCA). For a detailed discussion of this case see Kelly-Louw 2016 CILSA 113-116.

<sup>99</sup> *Denel* case para 43.

principle of 'strict compliance' is a matter of a proper interpretation of the guarantee itself.<sup>100</sup>

He further explained that the event triggering the obligation to pay was not stated in the demand for payment, such that the demands were non-compliant as they were made for a broader purpose than that to which the parties had agreed.<sup>101</sup> The principal and counter-guarantees were called up for reasons not contemplated by the guarantees as they were for the applicant's failure to perform according to the contractual obligations for the goods delivered.<sup>102</sup> The learned Judge reasoned as follows:

The principal and counter guarantees in this matter were restricted to payment upon the occurrence of an event, which was 'that the seller has not performed according to the warranty obligations' or that the second and third respondents have been called upon 'to make payment under and in terms of [their] guarantee', respectively. Neither the principal guarantor nor the counter guarantors were obliged to pay for non-performance 'according to their contractual obligations'.<sup>103</sup>

Additionally, in interpreting the requirements of the guarantee, Malindi AJ, relying on the *Frans Maas (UK) Ltd v Habib Bank AG Zurich* case, explained that the demand was non-complying as:

A failure to meet a contractual obligation is far from being the same as a failure to meet a warranty or guarantee obligation. A failure to meet a contractual obligation is wide enough to cover any claim in circumstances where the proper interpretation of the guarantee itself limits the applicant's and the first respondent's obligations to breaches of performance and warranty guarantees.<sup>104</sup>

The outcome of the case was based on the interpretation of the demand guarantee. Furthermore, since the wording of the demand guarantee was clear, a more expansive interpretation would defeat the purpose of the guarantee, which secured the failure of the applicant to meet warranty obligations only. Thus, the Court reasoned that the standard of compliance depends on the interpretation of the terms of the guarantee and found that none of the demands complied with the terms of the demand guarantees.<sup>105</sup>

Furthermore, the approach taken by Malindi AJ was premised on whether the event triggering the bank's obligation to pay had been satisfied in the demand without the guarantor resorting to the underlying contract. In this case, the event triggering the guarantor's obligation to pay related to a failure to meet the warranty obligations. The call for payment had not alluded to this event; as a result, the demand was non-compliant. Strict

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<sup>100</sup> *Denel* case para 51.

<sup>101</sup> *Denel* case para 52.

<sup>102</sup> *Denel* case para 53.

<sup>103</sup> *Denel* case para 47.

<sup>104</sup> *Denel* case para 48.

<sup>105</sup> *Denel* case para 52.

adherence to the demand guarantee was required to protect the bank, which was not able to verify whether the event triggering payment had occurred.

Although the Court did not pronounce on the application of the doctrine of strict compliance, in reaching its conclusion it applied a strict approach by finding that the statement of breach accompanying the demand did not satisfy the requirements of the guarantee.<sup>106</sup> Kelly-Louw submits that the Court's reasoning that the demands were non-compliant denotes an application of strict compliance.<sup>107</sup> Furthermore, the Court's reliance on the English case of *Frans Maas* lends support to the view that English courts apply a strict standard of compliance.<sup>108</sup>

The decision of the High Court was taken on appeal. The Supreme Court of Appeal had to determine whether Denel was entitled to prohibit Absa from paying under the guarantees issued in favour of the Indian Banks.<sup>109</sup> The Court referred to the law relating to guarantees, and English and South African case law. It noted that the compliance of a demand under a guarantee depends on interpreting the terms of the guarantee.<sup>110</sup> It further reiterated that a demand which complies with the terms of the guarantee provides conclusive evidence that payment is due.<sup>111</sup>

In reviewing the language of the guarantee, the Court found that the demands deviated from the requirements of the guarantees, which prescribed a statement indicating that Denel had not supplied the goods as per its "warranty obligations" under the underlying contract.<sup>112</sup> The Supreme Court of Appeal further reasoned that the call for payment was premised on Denel's failure to supply the goods in accordance with warranty obligations and not failure to meet contractual obligations.<sup>113</sup> Consequently, in the absence of compliant demands, Absa was not obliged to honour the demands for payment.<sup>114</sup> The Court found that the demands did not indicate the event triggering the obligation to pay, which was a failure by Denel to meet warranty obligations and not comply with contractual obligations.<sup>115</sup>

The Court accordingly upheld the decision of the High Court. It reasoned that the failure to meet contractual obligations was not the event triggering payment as required by the guarantee but the breach of warranty

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<sup>106</sup> Kelly-Louw 2016 *CILSA* 120

<sup>107</sup> Kelly-Louw 2016 *CILSA* 125.

<sup>108</sup> Kelly-Louw 2016 *CILSA* 125.

<sup>109</sup> *State Bank of India v Denel SOC Ltd* 2015 2 All SA 152 (SCA) (the *State Bank* case).

<sup>110</sup> *State Bank* case para 9.

<sup>111</sup> *State Bank* case para 9.

<sup>112</sup> *State Bank* case paras 12-13.

<sup>113</sup> *State Bank* case para 16.

<sup>114</sup> *State Bank* case para 17.

<sup>115</sup> *State Bank* case para 17.

obligations.<sup>116</sup> Consequently, the statement accompanying the demand did not indicate the event triggering the bank's obligation (breach of warranty obligations) and, therefore, the demand was non-compliant. The judgement applied a strict approach in the same way as the court of first instance. It follows that a supporting statement relating to an event pertaining to the underlying contract must strictly adhere to the requirements of the guarantee. This is on the premise that the guarantor cannot verify whether the breach or event triggering the guarantor's obligation to pay has occurred.

It is evident that the South African courts<sup>117</sup> have followed the English approach<sup>118</sup> by requiring a statement accompanying a call for payment to indicate the event triggering the obligation to pay as stipulated in the demand guarantee. This is a strict approach, as the demand still needs to meticulously adhere to the terms of the guarantee. However, this should not be applied in a rigid manner, but the terms of the demand guarantee must be construed in context, in accordance with the common intention of the parties and the purpose of the demand guarantee.

#### 4 Conclusion

The extent to which a supporting statement accompanying a demand for payment should comply is not entirely clear. The rules provide some guidance and certainty. It will be compliant if: (a) it indicates in what respect the applicant is in breach (as in the URDG758);<sup>119</sup> (b) it indicates that the event triggering the guarantor's obligation to pay has occurred (as in the ISP98 and Chinese IGP);<sup>120</sup> or (c) it is signed by the beneficiary and dated (as required by the ISP98).<sup>121</sup> The guidelines in the rules help ascertain the extent to which the supporting statement should comply with the requirement of the guarantee.

Where the guarantee is not subject to any of the rules the following principles have emerged: (a) the statement must be in the exact form as required by the guarantee (as seen in the *Frans Maas* and *Sea-Cargo* cases);<sup>122</sup> (b) the statement must refer to the event triggering the guarantor's obligation to pay (as seen in the *South Lanarkshire* case<sup>123</sup> and also in South African case law);<sup>124</sup> (c) in ascertaining whether a supporting

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<sup>116</sup> *State Bank* case para 17.

<sup>117</sup> *State Bank* case.

<sup>118</sup> *Frans Maas* case; *Sea-Cargo* case.

<sup>119</sup> See Art 15(a) of URDG758.

<sup>120</sup> See Art 1 of the Chinese IGP; and Rule 4.17 of ISP98.

<sup>121</sup> See Rules 4.17(a)-(c) of ISP98.

<sup>122</sup> *Frans Maas* case; *Sea-Cargo* case.

<sup>123</sup> *South Lanarkshire* case.

<sup>124</sup> *Denel* case; *State Bank* case.

statement is compliant, a technical interpretation of the terms of the guarantee should be avoided in favour of one that advances the common intention and purpose of the guarantee (as seen in the *South Lanarkshire* case).<sup>125</sup>

It is suggested that the most feasible approach to conformity of a statement accompanying a call for payment is that if the supporting statement relates to the performance of the underlying contract, a higher level of conformity with the terms of the guarantee is required. This is so because the guarantor would not be able to verify facts relating to the underlying agreement without considering extraneous facts as this would be in violation of the independence principle. Furthermore, the statement should indicate the event triggering the guarantor's obligation to pay as specified in the demand guarantee. This is so because, if the statement does not relate to the event triggering the obligation to pay, the demand would be non-compliant. However, in some instances a supporting statement need not strictly adhere to all the terms of the demand guarantee. For example where the statement does not relate to performance under the underlying agreement or to avoid absurd results and to advance the commercial purpose of the guarantee.<sup>126</sup> It is suggested that when determining whether a supporting statement is compliant, a purposive approach that advances the actual purpose of the guarantee should be adopted.<sup>127</sup> In final summary, it is submitted that many of the problems relating to conformity of a demand accompanied by a statement can be avoided or ameliorated by incorporating either the URDG758 or the ISP98. These rules provide greater certainty and harmony in the law and practice of guarantees.

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<sup>125</sup> *South Lanarkshire* case para 19.

<sup>126</sup> Bertrams *Bank Guarantees in International Trade* 146.

<sup>127</sup> *South Lanarkshire* case para 19.

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## List of Abbreviations

Chinese IGP	Provisions of the Supreme People's Court of China on Several Issues Concerning the Trial of Disputes Over Interpretation of Independent Guarantee Provisions (2017)
CILSA	Comparative and International Law Journal of Southern Africa
ICC	International Chamber of Commerce
IIBLP	Institute of International Banking Law and Practice
ISDGP	ICC International Standard Demand Guarantee Practice for URDG758, ICC Publication No 814E (2021)
ISP98	International Standby Practices, ICC Publication No 590 (1998)
SA Merc LJ	South African Mercantile Law Journal
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg
TSAR	Tydskrif vir die Suid-Afrikaanse Reg / Journal of South African Law
UNCITRAL	United Nations Commission on International Trade Law
URDG758	ICC Uniform Rules for Demand Guarantees, ICC Publication No 758 (2010)