THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case no**:** 756/10

In the matter between:

COMPASS INSURANCE COMPANY LTD **Appellant**

and

HOSPITALITY HOTEL DEVELOPMENTS (PTY) LTD **Respondent**

Neutral citation: ***Compass Insurance v Hospitality Hotel*** **(756/10) [2011 ZASCA 149 (26 September 2011)**

Coram: Lewis, Van Heerden, Cachalia, Malan and Leach JJA

Heard: **09 September 2011**

Delivered **26 September 2011**

Summary: Where construction guarantee requires that court order of liquidation of contractor be attached to demand for payment, in absence of order, demand non-compliant and guarantor not liable to pay.

ORDER

On appeal from: South Gauteng High Court, Johannesburg (Willis J sitting as court of first instance):

The appeal is upheld with costs. The order of the court below is replaced with:

'The application is dismissed with costs.'

JUDGMENT

LEWIS JA (VAN HEERDEN, CACHALIA, MALAN AND LEACH JJA concurring)

[1] The sole question in this appeal is whether the respondent, Hospitality Hotel Developments (Pty) Ltd (Hospitality Hotel), complied with the requirements of a performance guarantee given by the appellant, Compass Insurance Company Ltd (Compass Insurance), in making demand for payment.

[2] Hospitality Hotel is a property development company that had been engaged to carry out an upgrade of a hotel. It engaged the services of a construction company for this purpose, and that in turn engaged a subcontractor to install a computer network, wireless and internet system in the hotel. Compass Insurance is a short term insurer which issues construction (performance) guarantees to employers or owners. On 4 February 2008 it issued a construction guarantee to Hospitality Hotel for the performance of the work undertaken by the subcontractor. The sum guaranteed was R1 444 428.51 and the guarantee expiry date was 30 April

2008.

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

[4] Clause 4 of the construction guarantee provided that, subject to the guarantor's maximum liability, Compass Insurance undertook to pay Hospitality Hotel the full outstanding balance 'upon receipt of a first written demand from the Employer [Hospitality Hotel]'. The sub-clauses that follow are the subject of the dispute. For they provide that the written demand must state:

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

OR

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*.' (My emphasis.)

[5] It is common cause that there had in fact been no cancellation at the time the letter of demand was sent, though the letter did state that there was, and that the subcontractor was provisionally liquidated prior to the issue of the demand. But it is further common cause that the court order was not attached to the letter of demand, as required by clause 4.2 of the guarantee. The copy of the court order was delivered only months later, on 26 November 2008,

long after the expiry of the guarantee on 30 April 2008.

[6] The high court, referring to cases dealing with contractual interpretation, held that on a reading of the guarantee it was 'perfectly obvious' that it was not the intention of the parties that a failure to furnish the copy of the court order with the demand would be 'fatal' to it. The sentence relating to the furnishing of the copy of the court order was 'divisible' from the aspects entitling the beneficiary to payment. The copy could thus be provided after the expiry of the guarantee date. Compass Insurance was thus liable to pay the sum claimed.

[7] Hospitality Hotel's argument in opposing the appeal is that all concerned knew that the subcontractor had in fact been liquidated; there was some difficulty in obtaining the order, however, and that once there was knowledge of the existence of the order that was sufficient for demand to be made. The demand was not defective, it contended, despite the failure to attach the order to it. Strict compliance with the terms of the guarantee was not required.

[8] Hospitality Hotel argued that while strict compliance with letters of credit has been required by South African courts, performance guarantees should be treated differently. Although this court said in *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd*[1] that the performance guarantee in question was not unlike an irrevocable letter of credit, Hospitality Hotel contended that there is no authority to suggest that there must be strict compliance with the terms of the guarantee.

[9] The reason for requiring strict compliance with a letter of credit is that it is an instrument that compels a bank to pay on demand irrespective of the status of the underlying debt. Nugent JA put it thus in *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd*:[2]

'[The bank's] interest is confined to ensuring that the documents that are presented

1 *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 (2) SA 86 (SCA) para 20.
2 *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 (3) SA 688 (SCA) para 25.

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

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

[10] Some years after the decision in *Midland Bank* Lord Denning, then MR, said in *Edward Owen Engineering Ltd v Barclays Bank International Ltd*[3] that performance bonds stand 'on a similar footing' to letters of credit. 'A bank which gives a performance guarantee must honour that guarantee *according to its terms*.' (My emphasis.)

[11] However, Hospitality Hotels argued that performance bonds should be treated differently and that strict compliance with the terms of the bond was unnecessary. It contended that there is English authority for this proposition. It cited *Siporex Trade SA v Banque Indosuez*[4] in which Hirst J said that a contrast between a letter of credit and a performance guarantee was 'sound', since with the former the bank deals with the documents themselves, whereas with the latter the guarantor can rely on a statement that a 'certain event has occurred'. This statement was approved by the Court of Appeal in *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank*[5] where Staughton LJ said that there is less need for a doctrine of strict compliance in the case of performance bonds. But he said also that 'it is a question of construction of

3 *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 (CA) at 171A-B. The case was cited and approved in *Loomcraft Fabrics CC v Nedbank Ltd* 1996 (1) SA 812 (A) at 816G-H and in the judgment of Cloete JA in *Dormell Properties 282 CC v Renasa Insurance Co Ltd & others NNO* 2011 (1) SA 70 (SCA) para 63.

4 *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146 at 159.

5 *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496 (CA) at 501.

the bond'.

[12] Dr Michelle Kelly-Louw in her LLD thesis *Selective Legal Aspects of Bank Demand Guarantees*[6] suggests that English courts have in fact started to apply the same degree of 'strict compliance' to demand guarantees as to letters of credit, citing in support *Frans Maas (UK) Ltd v Habib Bank AG Zurich.*[7] She states that courts in South Africa will also apply to demand or performance guarantees the same 'standard of strict documentary compliance' as they do to letters of credit.[8] However, that case turned, like most, on the interpretation of the guarantee itself, and while observing that strict compliance might not be necessary for performance bonds (citing *Siporex* and *IE Contractors*), the court held that the demand in question did not comply with the terms of the guarantee.

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

[14] It should not be incumbent on the guarantor to ascertain the truth of the assertion made by the beneficiary that the subcontractor had been placed under provisional liquidation. That is why Compass Insurance required a copy of the order itself. Similarly, the guarantor should not have to establish whether a contract has in fact been cancelled. That is why a copy of the notice of cancellation, if there has in fact been cancellation, is required to be attached to the demand (clause 4.1). The very purpose of a performance bond is that the guarantor has an independent, autonomous contract with the beneficiary and that the contractual arrangements with the beneficiary and other parties are of no consequence to the guarantor.

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6 University of South Africa (2008) at 68-69.
7 *Frans Maas (UK) Ltd v Habib Bank AG Zurich* [2001] Lloyd's Rep Bank 14 paras 57-60.
8 Op cit at 332-333.

[15] There may be cases where what is referred to as a guarantee constitutes no more than an accessory obligation.[9] However, it is the terms of the guarantee itself that will determine its nature. The guarantee in this case is an independent contract that must be fulfilled on its terms. There 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.

[16] Accordingly the appeal is upheld with costs. The order of the court below is replaced with:
'The application is dismissed with costs.'

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C H Lewis
Judge of Appeal

APPEARANCES:

APPELLANT:	T Dalrymple
Instructed by	Frese, Moll & Partners, Roosevelt Park Webbers, Bloemfontein
RESPONDENT:	C J McAslin
Instructed by	Mkhabela Huntley Adekeye Inc, Waverley McIntyre & Van Der Post, Bloemfontein.

9 As in *Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd* (68/2010) [2011] ZASCA 10.