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## CONSTRUCTION LAW BULLETIN

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### TAKE CARE WHEN CALLING UP A CONSTRUCTION GUARANTEE

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#### Introduction

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Late last year the Supreme Court of Appeal handed down a decision which underscores the importance of complying strictly with the requirements for calling up a construction guarantee.

#### Background Facts

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A property development company by the name of Hospitality Hotels (Pty) Ltd (“Hospitality”) in 2008 undertook the refurbishment of a hotel.

The works included the supply and installation of a computer network, wireless and internet system. The contractor subcontracted this element of the works to a specialist subcontractor.

Compass Insurance Company Ltd (“Compass”) issued a construction guarantee in favour of Hospitality in relation to the subcontract works concerned in the sum of approximately R1,4m with an expiry date of 30 April 2008.

The construction guarantee stipulated that if a demand was made under the guarantee on the basis of the liquidation of the subcontractor, such demand had to be accompanied by a copy of the relevant court order relating to the liquidation. The relevant ground for calling up the guarantee was expressed as follows:

*“A provisional sequestration or liquidation court order has been granted against the Recipient and that the Advance Payment Guarantee is called up in terms of 4.0. The demand shall enclose a copy of the court order.”*

The subcontractor was provisionally wound up by the Western Cape High Court on 23 April 2008.

On 25 April 2008 Hospitality sent a letter of demand to Compass calling on it to pay the guaranteed amount in light of the subcontractor’s liquidation but failed to attach a copy of the court’s provisional winding-up order.

Compass refused to make payment in terms of the demand on the grounds that the demand was defective for want of a copy of the winding-up order having been enclosed with the demand.

Subsequently, on 26 November 2008, Hospitality submitted a copy of the winding-up order to Compass.

## **High Court Decision**

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Hospitality instituted action in the Gauteng High Court, Johannesburg, for an order directing Compass to pay out in terms of the guarantee.

Hospitality argued that:

- it had experienced difficulty in obtaining the court order and that knowledge of the liquidation on the part of Compass should be deemed sufficient to validate its demand; and
- whilst construction guarantees had been likened to letters of credit where strict compliance with the formalities is required for a valid demand, performance bonds should in fact be treated differently and that strict compliance with the terms of the construction guarantee should not be necessary.

The Johannesburg High Court took the view that because a copy of the order had been furnished to Compass subsequently, there had been sufficient compliance with the requirements of the guarantee, and granted judgment in favour of Hospitality.

Invoking certain cases dealing with the interpretation of contracts, the High Court held that on a reading of the guarantee it was obvious that it was not the intention of the parties that a failure to furnish a copy of the court order would be fatal to a demand in terms of the guarantee. It found that the requirement to furnish a copy of the court order was divisible from the substantive portion of the guarantee relating to the obligation of the guarantor to effect payment under the guarantee.

## **English Case Law**

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English court decisions have been somewhat inconsistent on the point. Initially the English courts held that construction guarantees stand on a similar footing to letters of credit requiring strict compliance with their terms. These decisions have been approved in subsequent South African court decisions.

However, in a 1986 case, an English court held that there is a distinction between a letter of credit and a performance guarantee. In the latter case the court considered that a statement that an event has occurred can be sufficient as opposed to delivering a document evidencing that fact.

After some initial support for this approach, the English courts appear to be swinging back to their original standpoint that the same principles that apply to letters of credit should apply to performance guarantees.

## **Supreme Court of Appeal Decision**

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Compass took the Johannesburg High Court's decision on appeal to the Supreme Court of Appeal in Bloemfontein.

The Supreme Court of Appeal took the view that it was not necessary for it to decide whether strict compliance with the requirements of a performance guarantee is necessary in our law because in its opinion the requirements for a valid demand by Hospitality in terms of the guarantee were absolutely clear. It held that Hospitality in failing to attach a copy of the court order had been guilty of simply not complying with the guarantee, let alone strictly complying with its terms. The guarantee expressly required a copy of the court order to be attached and it had not been.

The court held that it was not incumbent on a guarantor in such a case to ascertain whether there had been a liquidation. It was up to Hospitality to attach a copy of the court order to demonstrate this fact.

## **Conclusion**

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The court held that the guarantee between Compass and Hospitality was an independent contract whose terms had to be fulfilled to enable Hospitality to require Compass to effect payment under the guarantee. There had been no compliance and therefore there was no obligation on Compass to make payment.

The decision of the Johannesburg High Court was set aside and the claim against Compass dismissed.

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