

Payment guarantees the life blood of commerce

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In the past, our courts have called payment guarantees issued by banks in commercial deals 'the life blood of commerce' which should not lightly be subjected to judicial interference.



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The Supreme Court of Appeal (SCA) recently confirmed this principle in the case of the State Bank of India and Another v Denel SOC Limited and Others (947/13) [2014] ZASCA 212, but also emphasised that a demand made pursuant to a payment guarantee (which is independent of the underlying contract and is similar to an irrevocable letter of credit), must comply strictly with the terms and requirements set out in such guarantee.

In the case, the SCA was asked to set aside an interdict granted by the South Gauteng High Court prohibiting Absa Bank from honouring its undertaking to pay on eight counter guarantees issued by Absa Bank in favour of the State Bank of India and the Bank of Baroda (Indian Banks).

Facts of case

The facts were briefly as follows: Denel contracted with the Union of India (UOI) to supply it with defence equipment. As security for its contractual obligations, Denel was obliged to furnish UOI with counter guarantees. The counter payment guarantees contained irrevocable and unconditional undertakings by Absa Bank to pay the Indian Banks on receipt of a demand that the Indian Banks had been called upon to make payment in terms of the principal guarantee. The principal guarantees contained undertakings by the Indian Banks to pay the UOI in the event that the president of India declares "...that the goods have not been supplied according to the warranty obligations under the contract".

A dispute arose between the parties and the UOI issued a demand to the Indian Banks on the basis that the goods had not been supplied 'according to the contractual obligations' of Denel. On the strength of this demand, the Indian Banks paid UOI and issued a demand to Absa Bank which simply repeated the demands made upon the Indian Banks by the UOI.

The SCA held that the terms of the demands made under the counter guarantees didn't comply with the terms of the respective counter guarantees in that they referred to Denel's 'contractual obligations' as opposed to its 'warranty obligations'. Accordingly, Absa Bank was not obliged to make payment in terms of the counter guarantees.

In light of this decision, beneficiaries of payment guarantees should ensure strict compliance with the exact terms of a payment guarantee when making a demand for payment.

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