THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 947/13
Reportable

In the matter between:

STATE BANK OF INDIA	**FIRST APPELLANT**
BANK OF BARODA	**SECOND APPELLANT**
and	
DENEL SOC LIMITED	**FIRST RESPONDENT**
ABSA BANK LIMITED	**SECOND RESPONDENT**
UNION OF INDIA	**THIRD RESPONDENT**

Neutral citation:	*State Bank of India v Denel SOC Limited* (947/13) [2014] ZASCA 212 (3 December 2014)
Coram:	Brand, Bosielo, Theron and Mbha JJA and Fourie AJA
Heard:	24 November 2014
Delivered:	3 December 2014

Summary: Interpretation of on demand guarantees ─ whether demands compliant with terms of guarantees ─ whether a South African court has jurisdiction where a guarantee expressly provides that it should be governed and construed in accordance with the exclusive jurisdiction of the Indian courts.

ORDER

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

1 The appeal is upheld to the extent reflected in the substituted order that follows.

2 Each party is to pay its own costs on appeal.

3 The order in the court below is substituted by the following order:

> '1 The first respondent is interdicted from making payment in respect of the counter guarantees listed in annexure A to the applicant's notice of motion dated 25 May 2011, excluding counter guarantee number 821-02-0002584G, pending finalisation of the arbitration and court proceedings already instituted or to be instituted in India, pertaining to the principal guarantees to which the counter guarantees relate.
>
> 2 The respondents are declared liable for payment of the costs of the application, including the costs of the Part A proceedings, which costs are to include the costs consequent upon the employment of two counsel.'

JUDGMENT

Fourie AJA (Brand, Bosielo, Theron and Mbha JJA concurring):

[1] The question in this appeal is whether the first respondent, Denel Soc Limited (Denel), is entitled to an interdict prohibiting its banker, the second respondent, Absa Bank Limited (Absa), from honouring its undertaking to pay on eight counter guarantees issued by Absa in favour of the appellants, State Bank of India and Bank of Baroda (collectively referred to as the Indian banks). The court a quo (per Malindi AJ) granted the interdict and the Indian banks have appealed against the whole of the judgment and the order granted. The appeal is with the leave of the court a quo.

Background

[2] During the period January 2000 to April 2002, Denel and the third respondent, the Union of India (the UOI), concluded four written contracts in terms of which Denel

undertook to supply the UOI with defence related equipment. As security for the due performance of its contractual obligations, Denel was required to furnish one performance and seven warranty guarantees (the principal guarantees) to the UOI, in the format set out in the annexures to the contracts.

[3] Denel instructed Absa, with whom it has a banker-client relationship, to attend to the issuing of the principal guarantees. Absa thereupon instructed the Indian banks to issue the eight principal guarantees in favour of the UOI. In turn, Absa issued eight counter guarantees in favour of the Indian banks in consideration for the eight principal guarantees issued by the Indian banks.

[4] In due course the UOI contended that Denel had breached its contractual obligations and called upon the Indian banks to pay the amounts of the principal guarantees to it. The Indian banks duly complied and then called upon Absa to pay the corresponding amounts due in terms of the counter guarantees. Absa initially refused to comply with the demands of the Indian banks, contending that the claims made in terms of the counter guarantees 'were not worded under and in terms of the guarantees issued'. Absa subsequently changed its mind and advised Denel that it intended making payment to the Indian banks of the amounts due in terms of the eight counter guarantees and to recover the aggregate payments of USD 3 776 197 from Denel.

[5] Denel disputed that the UOI was entitled to call up the principal guarantees and maintained that Absa was accordingly not lawfully bound to honour the counter guarantees. However, the changed attitude of Absa prompted Denel to approach the South Gauteng High Court, Johannesburg, on an urgent ex parte basis and it was granted an interim interdict restraining Absa from making payment to the Indian banks on the counter guarantees. The Indian banks opposed the confirmation of the interim interdict but, as mentioned earlier, the interim order was made final by Malindi AJ. This order effectively interdicted Absa from making payment in respect of the counter guarantees, pending the final determination of arbitration and court proceedings in India between UOI and Denel pertaining to the principal guarantees.

Legal Principles

[6] The parties are agreed as to the applicable legal principles, but differ on the application of these principles to the peculiar facts of this case. A convenient starting point is the principle that South African courts, like their international counterparts, should jealously guard the international practice that banks honour the obligations they have assumed in terms of guarantees issued by them. In *Loomcraft Fabrics CC v Nedbank & another* 1996 (1) SA 812 (A) Scott AJA at 816E-G approved the following dictum of Kerr J in *R D Harbottle (Mercantile) Ltd & another v National Westminster Bank Ltd & others* [1977] 2 All ER 862 (QB) at 870b-d:

'The machinery and commitments of banks . . . must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.'

[7] This court has pronounced on the nature of 'on demand' guarantees such as the principal and counter guarantees in this case, and described same as 'not unlike irrevocable letters of credit' which establish a contractual obligation on the part of the guarantor to pay the beneficiary on the occurrence of a specified event. See *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd & others* 2010 (2) SA 86 (SCA) para 20; *Minister of Transport and Public Works, Western Cape, & another v Zanbuild Construction (Pty) Ltd & another* 2011 (5) SA 528 (SCA) para 15 and *Guardrisk Insurance Co Ltd & others v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA) para 14. In *Loomcraft Fabrics* at 816C-817F, this court stressed the importance of allowing banks to honour their obligations under irrevocable undertakings without judicial interference. It was held that an interdict restraining a bank from paying in terms of such an undertaking, will not usually be granted save in the most exceptional cases. In this regard reliance was placed on the following observation made in *Intraco Ltd v Notis Shipping Corporation (The Bhoja Trader)* [1981] 2 Lloyd's Rep 256 (CA) at 257:

'Irrevocable letters of credit and bank guarantees given in circumstances such that they are the equivalent of an irrevocable letter of credit have been said to be the life blood of commerce. Thrombosis will occur if, unless fraud is involved, the courts intervene and thereby disturb the mercantile practice of treating rights thereunder as being the equivalent of cash in hand.'

[8] A 'first demand' guarantee, such as the principal guarantees, is independent of the underlying contract which gives rise to the guarantee. Therefore, regardless of a dispute between the parties to the underlying contract, the guarantee must be paid on demand. Likewise, a counter guarantee is independent of the underlying contract and is also independent of the principal guarantee. See the authorities referred to in para 7 above and the doctoral thesis by Michelle Kelly-Louw at the University of South Africa in October 2008, *Selective Legal Aspects of Bank Demand Guarantees* at 72.

[9] A bank issuing an on demand guarantee is only obliged to pay where a demand meets the terms of the guarantee. Such a demand, which complies with the terms of the guarantee, provides conclusive evidence that payment is due. From this it follows that the beneficiary in the case of an on demand guarantee should comply with the requirements stipulated in the guarantee. In *Frans Maas (UK) Ltd v Habib Bank AG Zurich* [2001] Lloyd's Rep Bank 14 para 58, it was put as follows:

'The question is: what was the promise which the bank made to the beneficiary under the credit, and did the beneficiary avail himself of that promise? . . . It is a question of a construction of the bond. If that view of the law is unattractive to banks, the remedy lies in their own hands.'

As was stated in *Minister of Transport and Public Works, Western Cape & another v Zanbuild Construction (Pty) Ltd & another*, supra, para 13, all that is required for payment is a demand by the beneficiary, stated to be on the basis of the event specified in the guarantee. Whether or not the demand is compliant will turn on an interpretation of the guarantee.

[10] The only exception to the rule that the guarantor is bound to pay without demur, is where fraud on the part of the beneficiary has been established. The party alleging fraud has to establish it clearly on a balance of probabilities. Fraud will not lightly be inferred and a party has to prove that the beneficiary presented the guarantee to the bank knowing that the demand was false. Mere error, misunderstanding or oversight, however unreasonable, would not amount to fraud. See *Loomcraft Fabrics* at 817G-H and *Guardrisk Insurance* paras 18 and 19.

The application of the legal principles

[11] I will first consider the terms of the relevant guarantees. With regard to the seven principal warranty guarantees, the Indian banks undertook to pay the UOI in the event that the President of India submits a written demand that Denel has 'not performed according to the warranty obligations' under the contract concluded between Denel and the UOI. In the principal performance guarantee issued by the Indian banks, the undertaking was to pay the UOI, in the event that the President of India declares 'that the goods have not been supplied according to the contractual obligations' under the contract concluded between Denel and the UOI. In each of the eight principal guarantees it was recorded that the UOI's written demand would be conclusive evidence that such payment is due, which payment would be effected upon receipt of such written demand.

[12] The eight counter guarantees issued by Absa to the Indian banks in consideration for the eight principal guarantees issued by the latter to the UOI, typically contain an undertaking along the following lines:

'We Absa Bank Limited . . . hereby irrevocably and unconditionally confirm that we undertake to pay you on your first written demand by authenticated SWIFT message stating that you have been called upon to make payment under and in terms of your guarantee. . . .'

Although there are some minor differences in the wording of the counter guarantees, it does not detract from the basic undertaking given in each of the eight counter guarantees, namely that Absa would be liable to make payment upon receipt of a written demand by the Indian banks stating that they have been called upon to make payment under and in terms of their principal guarantees. I should add that the amount of each counter guarantee is the same amount guaranteed in terms of its corresponding principal guarantee.

[13] The next step is to consider whether the demands made by the beneficiaries for payment in terms of the respective guarantees, complied with the terms of the relevant guarantees. In each of the seven principal warranty guarantees the written demand made by the UOI was basically similarly worded, namely, that, as the goods have not been supplied (by Denel) in accordance with the contractual obligations, payment in terms of the principal guarantee is demanded. It is immediately apparent that these demands differ from the wording of the seven principal guarantees which

prescribe a demand that Denel has not performed according to the warranty obligations under the contract concluded with the UOI.

[14] Turning to the written demands made by the Indian banks in respect of the seven warranty counter guarantees, the sole inquiry is whether the Indian banks have addressed a written demand to Absa stating that they have been called upon to make payment under and in terms of their corresponding principal warranty guarantees. If so, Absa would be obliged to honour the counter guarantees without demur. If not, Absa would not be liable to make any payment in respect thereof.

[15] It is convenient to first deal with the following six warranty counter guarantees.

Absa counter guarantees nos 821-02-0009417G; 821-02-0009756G; 821-02-0009989G; 821-02-0010334G; 821-02-0011743G and 821-02-0010566G

[16] In respect of each of these counter guarantees, the Indian banks in their demand to Absa merely repeated the demand made upon them by the UOI under the respective principal guarantees. As I have indicated earlier, the UOI demanded payment from the Indian banks on the basis that Denel had not supplied the goods in accordance with its contractual obligations. It is clear that the demands made under the six corresponding principal guarantees, as well as the demands made under the six counter guarantees, do not comply with the terms of the respective guarantees. What was required in terms of the principal guarantees, is a demand that Denel had not performed according to the warranty obligations under the aforementioned contract. Similarly, a demand in terms of the six counter guarantees has to state that the Indian banks have been called upon to make payment under and in terms of their guarantee. This means that the demand should be premised on Denel's failure to supply the goods in accordance with the warranty obligations under the contract.

[17] However, both in respect of the six principal warranty guarantees and the corresponding warranty counter guarantees, the demand is expressly premised on a failure by Denel to comply with its contractual obligations and not a failure to comply according to the warranty obligations under the contract. It accordingly follows that, in respect of each of the six counter guarantees under discussion, the demands

made by the Indian banks do not comply with the terms of the counter guarantees. In the absence of compliant demands, Absa is not obliged to make payment to the Indian banks under these counter guarantees.

[18] I now deal with the remaining warranty counter guarantee and the performance counter guarantee issued by Absa in favour of the Indian banks.

Absa counter guarantee no 821-02-0002584G

[19] This is the seventh warranty counter guarantee issued by Absa in favour of the Indian banks. It has the same wording as the six warranty counter guarantees dealt with above, except for an ultimate paragraph which reads as follows:

'This counter guarantee shall be governed by and construed in accordance with the Indian laws and is subject to the exclusive jurisdiction of courts in India.'

In their heads of argument and on appeal counsel for the Indian banks submitted that the effect of this clause is to oust the jurisdiction of a South African court in regard to this counter guarantee. Therefore, it was submitted, the court a quo should not have interdicted Absa from making payment in terms thereof. I may add that this defence was not foreshadowed in the appellants' papers in the court below nor was it raised in their application for leave to appeal.

[20] In considering this submission, it has to be borne in mind that there is a banker-client relationship between Absa and Denel. The latter mandated the former to make payment in terms of the warranty counter guarantees and it has to be accepted that Denel was aware of the terms of the counter guarantee now under discussion. From this it follows that Denel was aware that, if a dispute would arise with regard to this counter guarantee, it would have to be interpreted in accordance with Indian law and by an Indian court. In fact, the ultimate paragraph of this counter guarantee expressly provides that it shall be governed and construed in accordance with Indian law and be subject to the exclusive jurisdiction of the Indian courts.

[21] A dispute has now arisen as to whether or not the demand made by the Indian banks under this counter guarantee, complied with the terms of the counter guarantee. This necessitates a construction of the wording of the counter guarantee, which, in terms of the counter guarantee, has been reserved for the exclusive

jurisdiction of the Indian courts. In my view, this constitutes a complete ouster of the jurisdiction of a South African court to deal with the question whether or not the demand complied with the terms of the counter guarantee.

[22] If a South African court were to assume jurisdiction by granting interdictory relief with regard to this counter guarantee, it may place Absa in an untenable position if the Indian banks, as they would be entitled to do, were to approach an Indian court for relief. Absa may then be faced with two conflicting decisions. I therefore conclude that the court a quo did not have the necessary jurisdiction to grant interdictory relief in regard to this warranty counter guarantee.

Absa counter guarantee no 821-02-0009587G

[23] This counter guarantee relates to the one principal performance guarantee issued by the Indian banks. As mentioned above, the undertaking given by the Indian banks, in their principal guarantee, was to pay the UOI in the event of the President of India submitting a written demand that the goods supplied by Denel were not in accordance with the contractual obligations. In terms of the counter guarantee Absa, in turn, undertook to pay the Indian banks upon their written demand stating that they (the Indian banks) have been called upon to make payment under and in terms of their principal performance guarantee.

[24] The written demand of the Indian banks to Absa in this instance, stated the following:

'We advise that we have been called upon by Ministry of Defence, Government of India to pay the above guaranteed amount . . . for non-fulfilment of contractual obligations.'

[25] It is clear that the principal performance guarantee issued by the Indian banks, did not contain an undertaking to pay the UOI in the event of Denel failing to comply with its contractual obligations, but only in the event that the goods supplied by Denel were not in accordance with its contractual obligations. However, the demand under the counter guarantee expressly states that payment by the Indian banks to the UOI was made upon the non-fulfilment of contractual obligations, which is not the trigger event for the invocation of the principal performance guarantee or

the corresponding counter guarantee. It therefore follows that Absa is not liable to make payment under this counter guarantee.

Conclusion

[26] To summarise, I hold the view that, save for the Absa counter guarantee no 821-02-0002584G, the court below correctly held that the requirements were met for the granting of prohibitory interdictory relief to Denel. Having regard to the general rule that a court should only grant interdictory relief of this nature in the most exceptional circumstances, I believe that Denel has satisfied this requirement. Absa is threatening to make payment under the seven counter guarantees in circumstances where the demands of the beneficiary (the Indian banks) are clearly non-compliant, and Denel has no other suitable remedy to protect its rights pending the finalisation of the arbitration and court proceedings in India.

[27] I should mention that counsel for the appellants did question the locus standi of Denel, to seek interdictory relief with regard to the counter guarantees, as it was not a party thereto. However, as explained above, there is a banker-client relationship between Absa and Denel in terms of which Denel mandated Absa to issue the counter guarantees to the Indian banks. In my view, this contract of mandate would be subject to an implied term that Absa would only make payment to the Indian banks in circumstances where the demands of the Indian banks comply with the terms of the relevant counter guarantees. From this it follows that Denel would be entitled to approach the court for interdictory relief if Absa were to threaten to make payment of a counter guarantee, in circumstances where the demand made upon Absa is non-compliant. In effect, Denel would be asking for specific performance of the contract of mandate, in the negative sense of non-performance of an act impliedly forbidden by the contract of mandate.

[28] In view of my findings above, it is not necessary to consider whether the Indian banks acted fraudulently (as alleged by Denel) in demanding payment under the counter guarantees.

[29] In the result the appeal should succeed in respect of the Absa counter guarantee number 821-02-0002584G.

[30] A formal aspect arose with regard to the terms of the court a quo's order. What the order essentially referred to was an interdict precluding Absa from making payment on the counter-guarantees pending the finalisation of arbitration proceedings in respect of those guarantees. During argument, the appellants raised the objection, however, that arbitration proceedings in India do not concern the counter-guarantees but the principal guarantees to which the counter-guarantees relate. As a solution we then suggested that the problem could be resolved by a simple amendment to the court's order. At the time no objection of prejudice was raised by the appellants, but they were nonetheless given the opportunity to make submissions with regard to the terms of the amended order, should they wish to do so. During the late afternoon of Friday, 28 November 2014, when this court's judgment was ready for delivery, the appellants saw fit to file a four page document raising arguments of substance which should have been raised much earlier. But, be that as it may, I see no merit in the argument. Moreover, it is clear to me that the proposed formal amendment to the court a quo's order cannot result in any prejudice to the appellants. Consequently that amendment will be made.

[31] Finally, with regard to the costs of the appeal, it should be borne in mind that, although the Indian banks have been successful on appeal in respect of one counter guarantee, the jurisdictional defence upon which it succeeded was only raised on appeal. In the circumstances I believe that it would be just and equitable to order that each party should bear its own costs on appeal.

[32] In the result the following order is made:

1 The appeal is upheld to the extent reflected in the substituted order that follows.

2 Each party is to pay its own costs on appeal.

3 The order in the court below is substituted by the following order:

'1 The first respondent is interdicted from making payment in respect of the counter guarantees listed in annexure A to the applicant's notice of motion dated 25 May 2011, excluding counter guarantee number 821-02-0002584G, pending finalisation of the arbitration and court proceedings already instituted

or to be instituted in India, pertaining to the principal guarantees to which the counter guarantees relate.

2 The respondents are declared liable for payment of the costs of the application, including the costs of the Part A proceedings, which costs are to include the costs consequent upon the employment of two counsel.'

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P B Fourie
Acting Judge of Appeal

APPEARANCES:

For the appellant:	S du Toit SC, with him K Hassim SC
	Instructed by:
	A W Jaffer Attorney, Pretoria
	Symington & De Kok, Bloemfontein
For the respondent:	N G P Maritz SC, with him E C Labushagne SC
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