



The current legal position on demands for payment under construction guarantees.

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In terms of most standard-form contracts, the contractors are required to furnish guarantees for the benefit of the employer in the event that the contractor fails to perform its contractual obligations. In most instances, the guarantees will be on-demand, unconditional guarantees which impose a primary obligation on the guarantor to pay the beneficiary on its first demand (or on-demand) where the principal fails to perform the contract¹. The guarantor's obligations are not affected by disputes over the underlying contract between the beneficiary and the principal. The beneficiary is usually entitled to payment simply on submitting a statement that the principal has failed to perform the contract². On-demand guarantees are "the lifeblood of commerce", as indicated by the Supreme Court of Appeal in *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (A). This means that guarantees should not be subjected to judiciary scrutiny and the terms of the guarantees should govern the parties. Parties should solely rely on the terms of the guarantees, and the underlying contract is irrelevant when a beneficiary claims in terms of the guarantee³.

When a beneficiary claims in terms of a guarantee, it needs to ensure that the terms of the guarantee are adhered to. This avoids future disputes that may arise in the event that the terms of the guarantee are not adhered to. The question that arises is whether the beneficiary is required to strictly or substantially comply with the terms of the guarantee.

¹ Nikita Lalla, Zama Ngcobo & Thandeka Nene (2020) 'When is non-compliance compliance?' <https://www.lnpinc.co.za/when-is-non-compliance-compliance/>

² Lucinde Rhodie and Kara Meiring (2020) 'Bank guarantees in a time of uncertainty' available at <https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/dispute/dispute-resolution-29-april-Bank-guarantees-in-a-time-of-uncertainty.html>

³ Andrea Frosini (2020) *7 The Principle of Strict Compliance: the requirement of compliance of the demand with the terms of the guarantee*. Access in <https://www.linkedin.com/pulse/7-principle-strict-compliance-requirement-demand-terms-frosinini/>

This issue was deliberated on by the Supreme Court of Appeal (“**SCA**”) in the recent case of *Millenium Aluminium and Glass Services CC and Others v Group Five Construction (Pty) Ltd and Another* (693/2021) [2022] ZASCA 180 (14 December 2022). The issue, in this case, was whether Group Five Construction (Pty) Ltd (“Group Five Construction”) complied with the terms of the guarantee, which dealt with the calling for payment under an on-demand guarantee. The Supreme Court of Appeal had to take into account the long established on-demand guarantees legal principles.

Group Five Construction was appointed as a contractor to carry out the Pearls of Umhlanga – Pearl Sky project in Durban, a spectacular residential resort offering luxury apartments and penthouses. In terms of the JBCC Series 2000 Nominated/Selected Subcontract Agreement 5.0 of 2007 (the “**Subcontract**”), Millenium Aluminium and Glass Services CC (“**Millenium**”) was appointed as a subcontractor for the completion of the works. In terms of the Subcontract, Millenium was required to furnish a performance guarantee in favour of Group Five Construction. As such, Millenium obtained and provided such a guarantee from Constantia Insurance Company Limited (“**Constantia**”).

Millenium argued that the demand by Group Five Construction on Constantia was incorrectly made as the payment certificate was issued by Group Five KZN instead of Group Five Construction. Millenium averred that Group Five KZN was not a party to the underlying contract and the guarantee, which was not a party to neither the construction contract or the guarantee⁴. As such, Millenium argued that Constantia was not obliged to pay as the demand was made by the wrong party.

The High Court rejected Millenium’s argument⁵. The basis of the High Court’s rejection was that Group Five KZN and Group Five Coastal were the same company with the same registration number, with Group Five Coastal having simply changed its name to Group Five KZN. The court went further and noted that in terms of the guarantee, Group Five Coastal acted as agents for Group Five Construction, and therefore any document issued by Group Five Coastal was effected as the agent for Group Five Construction.

⁴ Sechaba Mchunu ‘Be wary when calling up a construction guarantee’ (2023) available at <https://www.derebus.org.za/be-wary-when-calling-up-a-construction-guarantee/>

The court stated that Group Five Construction was in compliance with clause 4 of the guarantee and it ordered Constantia to pay Group Five Construction the amount claimed in terms of the guarantee.

Millenium, appealed to the SCA and argued that strict compliance of demand guarantees is required, and that since the payment certificate and reconciliation statement were not in the name of the contractor as defined in the guarantee, the High Court ought to have found that the requirements of the guarantee were not met. The SCA stated that the issue for determination was whether there was compliance with the guarantee where an entity that made the demand on guarantee, was not the same entity that issued the payment certificate and reconciliation statement. Clause 4.1 states that a written demand must be issued by the contractor to the subcontractor, stating that the amount certified in a payment advice was not paid. The payment advice was issued by Group Five KZN (Group Five Coastal), acting as the agent for Group Five Construction. In terms of clause 4.2 and 4.3 the payment advice was sent with an on-demand guarantee made by Group Five Coastal on Constantia. There was no doubt Constantia knew the identity of the contractor as it had issued the guarantee and the payment advice specifically referred to the project, Pearls of Umhlanga – Pears Sky, and identified the subcontractor as Millenium.

The SCA accordingly dismissed Millenium's appeal, holding that Group Five Construction had met the requirements in order to rely on the guarantee and as a result was entitled to payment under the construction guarantee from Constantia.

Comments

* The SCA reiterated the legal principle that was established in *Lombard Insurance Company v Schoeman and others* [2018] 1 All SA 554 (GJ) where the beneficiary had not adhered to one of the terms of the guarantees which related to the place where the guarantee was supposed to be addressed by the beneficiary. The court held that the beneficiary is required to adhere to the terms of the guarantee, however, in interpreting the wording of the guarantee, the interpretation should be practical and business-like and as long as proper demand was made and received, the place at which it was received was irrelevant.

* Upon interpretation of the clause that dealt with the party who is supposed to make a demand in terms of the guarantee in the above SCA judgment, it would be impractical and not business-like to argue that the demand was incorrectly made by Group Five KZN instead of Group Five Construction as they had the same company

registration number and were part of the same group. There was substantial compliance by the beneficiary of clause 4 of the guarantee and in terms of South African law, strict compliance with the guarantee is not necessary.

* The SCA decision is welcomed as it will deter insurers, contractors and subcontractors from circumventing the consequences of a guarantee, where the beneficiary has substantially adhered to the terms of the guarantee.

* In terms of South African law, the insurers, contractors and subcontractors can circumvent the consequences of a guarantee if it can be proved that the beneficiary fraudulently claimed in terms of the guarantee.

* That being said, it is advisable for parties to a guarantee to adhere to the terms of the guarantee fully to avoid disputes. However, in terms of South African law, non-compliance in terms of guarantees is acceptable if it constitutes substantial compliance.