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STRICT COMPLIANCE IN THE CONTEXT OF A DEMAND MADE IN TERMS OF SUB-CLAUSES 3.3.2 AND 3.3.3 OF THE 2015 GCC PERFORMANCE GUARANTEE

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In the General Conditions of Contract for Construction Works 3rd Edition, 2015 ("*2015 GCC*"), the Pro-forma for a Performance Guarantee sets out certain conditions which need to be fulfilled to enable an employer to make a written demand. The said pro-forma provides the following:

"*3.3 Subject to the Guarantor's maximum liability referred to in 1.1 or 2.1, the Guarantor undertakes to pay the Employer the Guaranteed Sum or the full outstanding balance upon request of a first written demand from the Employer to the Guarantor at the Guarantor's physical address calling up this Performance Guarantee, such demand stating that:*

…

3.3.2 a provisional or final sequestration or liquidation court order has been granted against the Contractor and that the Performance Guarantee is called up in terms of 3.3; and

3.3.2 the aforesaid written demand is accompanied by a copy of the notice of termination and/or the provisional/final sequestration and/or the provisional liquidation court order."

In this article, we will discuss why a demand cannot be made when a company opts for voluntary liquidation and how courts have found that strict compliance with the requirements of in sub-clause 3.3.2 above is vital to the success of making a call on the guarantee.

General case law

In the cases of *State Bank of India v Denel SOC Limited and Others*[1] *and Compass Insurance Company Limited v Hospitality Hotel Developments (Pty) Limited*[2], the Supreme Court of Appeal held that where a demand is completely non-compliant with the terms of a guarantee, a beneficiary will not be entitled to rely on it. However, in the decision of *MUR Joint Ventures BV v Compagnie Monégasque De Banque*[3], the English Commercial Court was tasked with considering the standard of compliance required for the enforceability of a demand made in terms of an on-demand guarantee. In this case, the court confirmed the position that compliance is to be determined on a case-by-case basis, subject to the requirements in terms of the wording of the guarantee itself. This accords with the longstanding authority of the English Appeal Court judgment of *IE Contractors v Lloyd's Bank*[4] in which it was decided that the level of compliance required under a performance bond was either "*strict or not so strict*" depending on the actual construction of the guarantee itself – meaning that it is the written requirements of the guarantee which determine the level compliance required.

Applicable case law

The question of interpretation and compliance was considered by the Supreme Court of Appeal in *Compass Insurance Co Ltd v Hospitality Hotel Developments*[5]. The performance guarantee provided that Compass Insurance Company Ltd (the "*Insurer*") undertook to pay Hospitality Hotel Developments (the "*Employer*") the full outstanding balance upon receipt of a first written demand from the Employer. The guarantee provided that the written demand must state the following:

"*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."

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1 [2014] ZASCA 212.

2 [2011] ZASCA 149.

3 [2016] EWHC 3107, wherein "[t]*he 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*." Compass insurance sought leave appeal to the Supreme Court of Appeal, and such leave was upheld – the High Court granted Compass Insurance permission to appeal Judge Willis' decision at the Supreme Court of Appeal.

4 (1990) 51 Build LR 1.

5 2012 2 SA 537 (SCA).

The Employer made a demand in terms of the guarantee and the Insurer refused to pay. The Insurer argued that the Employer had not complied with the provisions of the guarantee by failing to attach a copy of the court order of the provisional sequestration of the subcontractor. At the time, the contract with the subcontractor had been cancelled. A copy of the court order was then only delivered more than 6 months after the expiry of the guarantee. As such, the requirements in clauses 4.1 and 4.2 above had not been complied with.

In the High Court, Judge Willis dealt with contractual interpretation and held that on a reading of the guarantee it was apparent that it was not the intention of the parties that a failure to furnish the copy of the court order with the demand would constitute non-compliance, making the demand operable. Willis stated that the requirement to enclose a copy of the court order was separable from the aspects entitling the beneficiary to payment and that such a copy could be provided after the expiry of the guarantee date. The High Court thus found that strict compliance was not required and the Insurer was liable to pay the Employer the guaranteed amount. The Insurer appealed the decision.

On appeal in the Supreme Court of Appeal, the Employer argued that strict compliance was not required because the parties knew that the liquidation of the subcontractor had been effected. The Employer went on to state that there was no authority to support strict compliance with the guarantee, as strict compliance was only required with letters of credit. Judge Lewis did not find it necessary to decide whether strict compliance was required for performance guarantees. This was because "*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*."[6]

The appeal was upheld – with the Insurer having successfully argued and won its case. Lewis confirmed that *"… it is the terms of the guarantee itself that will determine its nature* [our emphasis]".[7] The court further held that *"… the guarantee was an independent contract which needed to fulfilled on its terms."* and that there was *"… 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*."[8]

The authority above shows us that where a guarantee is precise regarding what is expected from the parties, strict compliance with the terms therein remains a requirement. It therefore follows that a guarantee which contains the provisions of clauses 3.3.2 and 3.3.3 of the 2015 GCC Pro-forma for a Performance Guarantee will likely be interpreted in accordance with that particular wording.

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6 2012 2 SA 537 (SCA) at para 13.

7 2012 2 SA 537 (SCA) at para 13.

8 2012 2 SA 537 (SCA) at para 15.

That is to say, an employer's failure, neglect and/or refusal to attach a copy of the provisional/final sequestration and/or the provisional liquidation court order as required, will render its written demand non-compliant and therefore inoperable. In contrast, where parties do not conclude a guarantee which incorporates clauses 3.3.2 and 3.3.3, substantial or even partial compliance may suffice, depending on the what the parties have agreed to.

Conclusion

The 2015 GCC provides a clear entitlement to the employer to make a demand where a provisional or final sequestration or liquidation court order has been granted against the contractor. It would be helpful for the GCC to have broadened the requirements for making a demand in terms of clause 3.3 of the performance guarantee - with the aim avoiding disputes relating to interpretation. As this is not the case[9], parties to a 2015 GCC Performance Guarantee are advised to pay special attention to the wording of such guarantee. Until then, the employer is required to attach a copy of the specified court order.

Where the parties wish to conclude a performance guarantee which caters for a situation where contractor opts for voluntary liquidation adopted by way of a special resolution, this can be addressed by making appropriate amendments to the performance guarantee in the 2015 GCC. For this, we advise parties to always get in touch with construction contracts specialists to assist with considering and effecting such amendments. As previously advised, risk free contracting should be the objective. Do not take the chance and seek to rely on substantial compliance where strict compliance is clearly required. Ensure that you always comply with the clause and give the written demand in the requisite form and place.

9 In clause 6.2.2, the 2015 GCC provides that if the performance guarantee differs substantially from the pro-forma, it shall legally be deemed that the Contractor has selected a security of ten per cent retention of the value of the Works (without limiting the Employer's right to terminate the Contract in terms of Clause 9.2). In the GCC January 2023 Final Revision for Comment, clause 6.2.2 provides that if the performance guarantee differs substantially from the pro-forma, the Employer may elect to terminate the Contract in terms of Clause 9.2. There is no longer a deeming provision for the selected security and the requirements for making a demand in the pro-forma have not been amended.