Autonomy of a Performance Guarantee: South African Decision Illustrates Convergence of Common Law Approaches

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A recent decision of the South Africa Supreme Court of Appeal in *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146 has illustrated the convergence of approaches taken by common law jurisdictions to the autonomy of a performance guarantee from the underlying contract.

Background. In August 2017, a joint venture of Strabag International GmbH and Aveng Africa (Pty) Ltd (the "Claimants") was awarded a contract by the South African National Roads Agency Soc (the "Respondent") to construct the Mtentu River Bridge in the Eastern Cape (the "Site"). The contract required the Claimants to procure the issue of two on-demand guarantees in the Respondent's favour (the "Performance Guarantees").

The contract was affected by severe disruptions. Local communities living near to the Site protested that locals be employed on the project and that materials be sourced from local suppliers. Some protests turned violent, potentially endangering the Claimants' workforce. As a result of these disruptions, no works were performed after 22 October 2018.

On 30 January 2019, the Claimants gave notice of termination, contending that the disruptions constituted *force majeure* that had prevented them from performing works for longer than the contractual threshold for termination. The Respondent rejected the *force majeure* argument. It gave the Claimants until 4 February 2019 to return to the Site. When the Claimants did not return the Respondent issued its own notice of termination on 5 February 2019.

The dispute whether the disruptions constituted *force majeure* was referred to arbitration. Pending resolution of the arbitration proceedings, the Claimants sought confirmation from the Respondent that it would not call upon the Performance Guarantees. The Respondent refused, instead notifying the Claimants of its intention to make a call. The Claimants therefore applied urgently to the Gauteng Division of the High Court in Pretoria for an interlocutory interdict to restrain the Respondent from

calling upon the Performance Guarantees, asserting that the Respondent's call would be unlawful as "*it had not met certain conditions in the underlying contract which limited its right to call up the guarantee*".

Decision of the High Court. At first instance, Makhuvele J engaged in an assessment of the merits of the Claimants' position. She determined that their *force majeure* claim had no legal basis, that the Claimants should have returned to work when instructed to do so and that the Respondent was therefore justified in terminating and making a call on the Payment Guarantees.

Accordingly, Makhuvele J dismissed the Claimants' application for an injunction without needing to opine on whether the Respondent's right to call upon the Performance Guarantees could, in principle, be limited by the provisions of the underlying construction contract. However, she said that, had that been the only issue to determine, she would have found in favour of the Claimants. She further noted that there "*is a need for the Higher Courts to pronounce*" on the issue.

Decision of the Supreme Court of Appeal. In the Supreme Court of Appeal, Magoka JJA gave the judgment, with which Navsa and Saldulker JJA and Goosen and Unterhalter AJJA agreed. He dismissed the Claimants' appeal.

Magoka JJA began by saying that South African law firmly recognises the autonomy principle, that a performance guarantee is *autonomous* from the underlying contract in respect of which the guarantee was issued. As such, a performance guarantee must generally be honoured in accordance with its terms, without reference to the underlying contract. This followed the approach of Lord Denning in the English case of *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 (CA) 983b, where he opined that a bank issuer of a performance guarantee should "*not [be] concerned with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not*," with the only exception being where fraud by the beneficiary is established.

Magoka JJA continued that the Claimants in this case had argued that a further exception should be created to restrict a beneficiary from making a call until the conditions in the underlying agreement had been met. The Claimants relied on the previous South African case *Kwikspace Modular Buildings Ltd v Sabodala Mining Co Sarl and Another* [2010] ZASCA 15, where the Court of Appeal found that a contractor may restrain a beneficiary from calling upon a performance guarantee, without any allegation of fraud, if the underlying contract contains a right for the contractor to do so. However, this was subject to the caveat that "*the terms of the building contract should not*

readily be interpreted as conferring such a right." The Claimants relied on a series of Australian and English authorities to broadly similar effect.

Considering the authorities, Magoka JJA noted that "*given the significance of performance guarantees and letters of credit in international trade and commerce, such claims as are made by the Joint Venture in relation to the underlying contract, should be approached with caution*." Nevertheless, he held that South African law followed the same approach as Australia and England & Wales and recognised an exception to the autonomy principle in circumstances where the underlying contract contained a restriction on the beneficiary's right to make a call, subject to the caveat expressed in *Kwikspace*.

Magoka JJA then turned to the underlying contract in this case and found that it did not impose any express restriction on the Respondent's right to call on the Performance Guarantees. On the contrary, the Respondent was required to indemnify the Claimants for the consequences of a wrongful call on the Performance Guarantees, and Magoka JJA considered this to indicate that the Respondent did not need first to prove its entitlement to make a call on the Performance Guarantees, as otherwise the indemnity could never be engaged. Accordingly, there was no basis for the Claimants' attempt to restrain the Respondent's call.

Approaches to the "Autonomy Principle" in the Common Law. The autonomy principle is firmly established across the common law world, yet there is some variance in the range of exceptions recognised in each jurisdiction.

- ***Australia***. In Australia, a contractor may restrict the beneficiary from making a call on a performance guarantee if the contractor can show that the call would be a breach of a term in the underlying contract. It is not necessary to allege any fraud on the part of the beneficiary. This position was recently confirmed in the *Victoria Supreme Court judgment in Uber Builders and Developers Pty Ltd c MIFA Pty Ltd* [2020] VSC 596, where Nichols J re-affirmed that "*where the contract does impose an obligation on the right to access the security, the party seeking to restrain recourse must establish the existence of a serious question to be tried as to whether the beneficiary has in fact met the contractual requirements*."

- ***England & Wales***. Historically, the position in England & Wales was that a contractor could only restrain a beneficiary from making a call on a performance guarantee if fraud has been established. On the modern approach, however, a contractor may also obtain an injunction restraining a call by the beneficiary if it can show a strong case that the underlying contract "*clearly and expressly prevents*" the beneficiary from making a call, without the need to establish fraud, as was the case in *Simon Carves v Ensus UK Ltd* [2011] EWHC 657 (TCC) and *Doosan Babcock Ltd v Comercializadora de Equipos y Materiales Mabe Limitada* [2013] EWHC 3010 (TCC).

- ***Singapore***. Singapore takes a broader approach to the range of exceptions to the autonomy principle. In Singapore, a party may restrain a call on a performance bond on either the ground of fraud or unconscionability, and these are regarded as separate grounds. In *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] SGCA 28, the Singapore Court of Appeal confirmed that the elements of unconscionability include abuse, unfairness and dishonesty. In that case, the court continued an injunction, finding that the employer's conduct in making unfounded allegations of delays on the part of the contractor to justify making a call on a performance guarantee was unconscionable conduct. More recently, the Singapore courts have said that "*it would be unfair for the beneficiary to realise his security pending resolution of the substantive dispute even if the account party cannot show that the beneficiary had been fraudulent in calling on the bond*", as set out in *Sunrise Industries (India) Ltd v PT OKI Pulp & Paper Mills* [2018] SGHC 145.

Comment. While this judgment of the South African Supreme Court of Appeal emphasises the autonomy of a performance guarantee from its underlying contract and the importance of ensuring that generally such guarantees are performed when called upon by their beneficiaries, it confirms that, as a matter of South African law, in an appropriate case the provisions of the underlying contract can restrict the ability of the beneficiary to make a call. In doing so, the Court has moved closer to the positions under the laws of England & Wales and Australia, although it has not moved as far as the position under Singapore law.

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