

Dear Colleagues

We have prepared a summary of the facts and judgment, for those who have not yet had the opportunity to read the whole judgment. Thanks, Sam, for alerting us to the judgment.

**Koumantarakis Group CC v Mystic River Investment 45 (Pty) Ltd
(172/07) [2008] ZASCA 53 (14 May 2008)**

The court held that where a property sale agreement does not expressly require an *irrevocable* guarantee for the deposit or purchase price, then the conveyancer cannot refuse a guarantee merely because it is revocable at the instance of the bank who issued it.

(The issues in this case centered around the wording the guarantee issued in respect of the deposit, there were no problems regarding time or deadlines; the guarantee in question was delivered timeously.)

The facts:

A (seller) and B (purchaser) entered into an agreement of sale in respect of immovable property. The purchase price of R 12 million was payable as follows:

- Deposit of R 1 million rand, *secured by a bank guarantee acceptable to the seller*, which guarantee must be lodged with A within 3 days after fulfillment of the suspensive condition. (The suspensive condition related to B's conducting a due diligence exercise on the property before a certain date.)
- A similar guarantee for the balance of the purchase price to be lodged within 45 days after the guarantee for the deposit was furnished, and which must be payable on registration of transfer.

As regards the deposit, B's conveyancers sent an example of a Standard Bank guarantee to A's conveyancers and asked if a guarantee in that format would be acceptable. A's conveyancers did not respond immediately whereupon B's conveyancers requested Standard Bank to issue the guarantee, and sent it to A's conveyancers.

One of the 'standard' clauses in this guarantee (this type of clause is probably found in all of the major banks' 'standard' property guarantees) reads as follows: *'Should any new or previously undisclosed fact emerge which may prejudice the Bank's security or any circumstances arise to prevent or unduly delay registration of the abovementioned transaction/s, we reserve the right to withdraw herefrom by giving you written notice to that effect, whereupon the said sum will no longer be held at your disposal.'*

On receipt of this guarantee, A's conveyancers immediately wrote a letter informing B's conveyancers that the guarantee was not acceptable because it contained a 'right to withdraw'. They said that A required an *irrevocable* guarantee. (The agreement did state that the guarantee must be *acceptable to the seller*). A's conveyancers attached an example of wording of a guarantee which *would* be acceptable to A, to their letter. A's specimen guarantee included the following clause: *'This letter of guarantee expires one year from date of issue and is irrevocable.'*

B's conveyancers (Standard Bank?) refused to re- issue the guarantee, and countered that their guarantee (the one issued by Standard Bank and delivered to A's conveyancers, in other words, the one with the 'right to withdraw' included therein) was in line with long standing and general practice of financial institutions. B's conveyancers also argued that the agreement should not be interpreted so as to subject B to unreasonable whims of the seller.

In the letter B's conveyancers then called upon A's conveyancers to confirm that the Standard Bank guarantee already issued was indeed acceptable. However, A's conveyancers wrote back again rejecting the guarantee on the ground that the alleged long standing practice to include a

'right to withdraw' clause in a guarantee is only relevant where a sale agreement is subject to the purchaser obtaining mortgage finance, which is not the scenario in the agreement at hand.

The time for delivery of the guarantee ran out, and A advised that it considered the agreement 'null and void' (legally speaking he should have treated it as breach, but this aspect was not relevant to the case). A put the property back in the market at a higher price.

B then approached the Durban and Coast Local Division of the High Court for an order restraining A from alienating the property to any other person. The order was granted and A appealed to the SCA.

Questions before the court:

The two questions for consideration were as follows:

- (1) What is the meaning and ambit of the guarantee clause (the clause quoted above) in the relevant agreement? and;
- (2) Did A act reasonably in rejecting the guarantee that B provided?

Held:

Re question (1): What is the meaning and ambit of the guarantee clause that A and B had included in their agreement?

- The meaning and purpose of the word 'guarantee' in an agreement has to be ascertained in relation to the context in which it is used.
- In a sale agreement for immovable property, a guarantee is used in the context of bridging a gap of trust between a seller and purchaser: a seller will not part with ownership of land until he has been paid for it and a purchaser will not part with the purchase price until he has ownership of the property. A guarantee is the mechanism by which the desired reciprocity of payment and transfer can be achieved. The function of the guarantee is to make provision for payment (as opposed to furnishing security).
- The court accepted (on the evidence of B's conveyancer, a longstanding and respected practitioner) that the *standard practice is for* financial institutions to include a clause of that nature (providing for withdrawal in certain circumstances) and for sellers generally to accept such a guarantee. This would be the case unless the contract specifically calls for an irrevocable guarantee.
- The context within which a guarantee is issued is important in the interpretation of the agreement; for example, a guarantee issued only as security (as opposed to serving as a device for payment) may well cause the agreement to be interpreted that the guarantee must be irrevocable.
- The court came to the conclusion that, in view of the agreement not expressly requiring an irrevocable guarantee, and further in view of the fact there was nothing in the context to merit a contrary interpretation the agreement did not intend only irrevocable guarantees to be acceptable.
- Accordingly, the guarantee in the present case (issued by, and revocable at the instance of Standard Bank), ought to have been acceptable to A. Had A wanted an irrevocable guarantee, this should have been stipulated in the agreement.

Re question (2): Did A act reasonably in rejecting the guarantee that B provided?

- In order to answer this question, the court conducted a double enquiry: Firstly, a seller must exercise an honest judgment in deciding whether to accept or reject a guarantee

and secondly, the seller's decision to reject must be objectively viewed, i.e. be based on reasonable grounds (in other words, ask the question 'what would satisfy the reasonable man?').

- A was faced with a guarantee in which the bank had reserved to itself the right to withdraw from the guarantee where (1) 'any new or previously undisclosed facts emerge which might prejudice the bank's security'; and (2) where 'any circumstances arise to prevent or unduly delay registration of transfer'.
- The court held that with regard to the 'new or undisclosed facts'-ground, it has to be remembered that the guarantee conferred rights on the seller and the bank would have to justify its withdrawal on grounds which would relate to its security. This would require the bank to prove new facts that had arisen or prior material facts that had not been disclosed. For A to contend that the guarantee could be revoked at any time on grounds entirely outside the knowledge and control of A, is exaggerated - the bank is not entitled to a 'whimsical' withdrawal of the guarantee (as alleged by A) but is limited to a withdrawal which must be factually based and related to its security.
- The other ground for withdrawal deals with 'any circumstance which may arise to prevent or unduly delay' registration of transfer. In this regard the court held that 'undue delay' does not by implication discharge a guarantee. 'Undue delay' must be seen within the meaning of the provision whereby the bank has reserved its right to withdraw. 'Undue delay' cannot be equated with 'unreasonable delay'. Undue delay refers to delay occasioned by unforeseen circumstances whereas unreasonable delay would imply some failure by the purchaser to comply with its obligations. It must be kept in mind that the seller is responsible for timeous transfer of the property and that it is therefore within A's powers to ensure maximum reduction of delay.
- Accordingly it was held that the right to withdraw is not as wide as alleged by A and is not liable to be employed capriciously.
- The rejection of the guarantee on the mere ground of revocability is therefore unreasonable.

The court accordingly held that A was not entitled to reject the guarantee on the basis it did, and that the guarantee delivered by B complied with the terms of the agreement. Accordingly there was a valid and binding agreement between A and B and A was ordered to do the necessary to effect transfer to B.

Comment

Conveyancers and their clients are continually faced with the dilemma where sellers have an expectation of irrevocability but the financial institutions issuing the guarantees always cover themselves by inserting the 'right to withdraw' escape clause in some form or another.

From the context of providing some certainty, this Supreme Court of Appeal case judgment is to be welcomed. We submit that few conveyancers will argue that it has for a long time been the practice to accept bank guarantees with this type of an escape clause, in property transactions. An interesting question concerning the nature of typical property guarantees arises from the judgment. The court states that

" [32] In this case....the guarantee....was not intended to serve as security in the true sense of the word."

In our view, most conveyancers, if asked what the purpose of a guarantee is, would answer that it "serves as security for the payment of the purchase price", whether the agreement expressly uses the word 'security' or not.

Is the judgment correct, then, in stipulating that the typical guarantee issued for a deposit or balance of a purchase price, *is not security in the true sense of the word?* To answer the question, conveyancers will have to haul out their university text books and review basic concepts

concerning the law of security. We have (reluctantly) come to the conclusion that the court is correct in this view; a guarantee in this context is not security in the legal technical sense. But in a practical sense, the furnishing of a guarantee provides the secure knowledge (*gemoedsrus*) (except for the revocability issue) that the purchase price will be paid. In this sense, it does serve as security. It is both the instrument of payment, and the security for payment.

Some lessons to be learned from the facts of the case and the judgment:

- if the seller desires an irrevocable guarantee in a transaction to be issued, stipulate it clearly in the agreement;
- conveyancers must apply their minds very carefully before rejecting guarantees; the reasonableness of the rejection and the context within which the guarantee was issued and rejected are important issues;
- revisit the 'guarantee' clause in standard agreements of sale. However, an inflexible demand for 'irrevocable guarantees' may well backfire, if banks refuse to co-operate.