

Bonds and Guarantees: *Update*

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1 Introduction

- 1.1 A number of recent cases have arisen in relation to bonds and guarantees, and this paper sets out, by way of an update, those cases. In addition, a number of old cases are also included as a reference point.

2 Interpretation – on demand or guarantee?

- 2.1 The case of *Vossloh Aktiengesellschaft v Alpha Trains (UK) Limited* [2010] EWHC 2443 (Ch) concerned a security document given by a parent company of the Vossloh Group. The guarantee related to the number of trains sold to the Alpha Group. The beneficiary claimed that the words '*principal debtor and not merely as surety, as a separate, continuing and primary obligation*' meant that the obligation was a primary obligation and not a secondary guaranteeing obligation.
- 2.2 The Judge did not agree. A mere assertion of a breach or failure to pay money was not sufficient. Reading the guarantee as a whole, it required there to be a default by the principal in performing the underlying contract or in making a payment of the sum due. The mere use of the term '*on demand*' was also insufficient. Alpha Trains therefore had to establish liability in respect of the sum due before making a call on the bond.
- 2.3 In *Carey Value Added S.L. v Grupo Urvasco SA* [2010] EWHC 1905 (Comm), the High Court had to consider whether a security document was truly an on demand bond or a secondary guarantee obligation. The expression '*all obligations of the Obligors under or in connection with the transaction documents*' was co-extensive with the borrower's liability. The guarantor was therefore responsible as primary obligor for any failure of the borrower. This did not amount to an immediate unconditional on demand bond.
- 2.4 The case of *Kookmin Bank v Rainy Sky SA & Others* [2010] EWCA Civ 582 considered the interpretation and scope of '*all such sums due*'. Six almost identical on demand

advance payment bonds had been provided as security for obligations undertaken by a Korean shipbuilder in relation to six shipbuilding contracts. The shipbuilder later became insolvent, and so the beneficiary sought repayment of instalments that had been made. The bond was in respect of '*all such sums due to you under the contract*'.

2.5 The call on the bond was resisted on the basis that demands for instalments made were not sums due. The Court disagreed, holding that the word 'such' should not be ignored. This word referred back to the sums in relation to the pre-delivery instalments under the shipbuilding contract, as the purpose of the bond was to guarantee their repayments and nothing else.

2.6 *When is a primary obligor a bondsman or merely a guarantor?*

2.6.1 *Wuhan Guoyeu Logistics Group Co Limited & Others v Emporiki Bank of Greece SA* [2012] EWHC 1715 (Comm). The security document contained the phrase '*as primary obligor*'. Construing the document as a whole, it was a guarantee and not an on demand bond. The primary obligation was to pay the sum actually due in respect of the underlying contract, not to pay on first demand without demonstration of a debt.

2.7 *On demand unconditional bonds –resisting a call*

2.7.1 The procedure is an injunction, but freezing orders also need to be considered:

2.7.2 *Injunctions*

2.7.2.1 It is important to remember that for an injunction to be granted, an applicant will need to show that it has a '*seriously arguable*' case, and also to follow the guidelines in *American Cyanamid Ethicon* [1975] AC 395. This general principle for injunctions needs to be considered in the context of resisting on demand bonds, and further, the identity of the party that can be effectively restrained.

2.7.2.2 In addition, it might also be possible in limited circumstances to rely on the terms of the underlying contract, although the on demand bond is a primary obligation in its own right.

2.7.3 *Freezing order*

2.7.3.1 A court may impose a freezing order on the money flowing from the performance guarantee (see *Bhoja Trader*, below, para 258).

2.8 *Exceptions: fraud and underlying contract*

2.8.1 In *Permasteelisa Japan KK v (1) Bouyguesstroi (2) Banca Intessa Spa* [2007] EWHC 3508 (TCC) Ramsay J held that a permanent injunction could only be provided in order to prevent a call on an on demand bond in very limited circumstances. One of the following has to be demonstrated:

- 2.8.1.1 A ‘*seriously arguable*’ case in respect of fraud; or
- 2.8.1.2 A ‘*positively established*’ breach of the underlying contract within the parties. ‘Positively established’ means more than ‘*seriously arguable*’.

2.8.2 In the case of *Sirius International Insurance v FAI General Insurance* [2004] UKHL 54, the House of Lords held that it was possible to grant an injunction where the underlying contract expressly restricted a party’s right to call upon a letter of credit. On demand bonds are sufficiently similar, and Ramsay J held in *Permasteelisa* that the same principle applied.

2.9 *Relationship with the underlying contract*

2.9.1 *Simon Carves Limited v Ensus UK Limited* [2011] EWHC 657 (TCC). This case related to an on demand bond. It was held that the terms of the main contract governed when the bond was to expire. There was a ‘*very strong case*’ that the bond had expired, and therefore the injunction continued. This is a rare case of an injunction continuing in relation to a call on an on demand bond; in this case because the underlying contract arguably demonstrated that the bond had expired.

2.10 *The party to the fraud*

2.10.1 The other question to consider is that if fraud is to be established then which party must have knowledge of the fraud:

2.10.1.1 ***The Bank*** – an injunction will only be granted against a bank if there is a seriously arguable case that the person calling on it did not honestly believe the validity of the cause (*United Trading v Allied Arab Bank* [1985] 2 Lloyds 554). The purpose of obtaining an injunction against a bank is to stop them paying money under the security documents.

2.10.1.2 ***The Beneficiary*** – the court will only grant an injunction against a beneficiary if there is a ‘seriously arguable’ case that the beneficiary could not honestly have believed in the validity of its own call on the document (*Intraco Limited v Notis Shipping Corporation ‘Bhoja Trader’*) [1981] 2 Lloyds 256, at para 257.

2.10.1.3 ***Third parties by freezing order*** – the court may impose a freezing order on the money flowing from the performance guarantee (see once again *Bhoja Trader*, this time para 258).

3 *Statute of Frauds 1677 – ‘in writing, unsigned’*

3.1 *Golden Ocean Group Limited v Salgaocar Mining & Another* [2012] EWCA Civ 265. Exchanges of email amounted to ‘in writing’, and the name of the individual in the email amounted to an electronic signature for the purposes of the Statute of Frauds 1677.

4 **Advance payment guarantee –repayment of excess**

4.1 The Court of Appeal, in the case of *Uzinterimpex JSC v Standard Bank Plc* [2008] EWCA Civ 819, considered whether a term should be implied into an advance payment guarantee to repay any excess if the amount paid under the bond turned out to be too much.

4.2 The Court of Appeal held that it was not necessary to imply such a term in order to make the guarantee workable. The guarantee stood as an independent on demand advanced payment obligation. The Court considered that the policy of the maintenance of international commerce was more important, and that the parties needed to know that they could rely upon these documents for unconditional payment.

4.3 If there were an overpayment, then the remedy would be under the contract of sale, even though that remedy was of no value because the primary contractor was insolvent.

4.4 **Constructive trustee**

4.5 In the case of *Uzinterimpex JSC v Standard Bank Plc* [2008] EWCA Civ 819, the Court of Appeal considered (in respect of an advance payment on demand bond) whether the beneficiary could be a constructive trustee. This might be possible, but only if the beneficiary had the required degree of knowledge. In this case, there was no factual evidence to demonstrate that they had the type of knowledge that would make the retention of the money unconscionable.

5 **The requirement to provide a bond**

5.1 In *Koch Hightex GmbH v New Millennium Experience Company Limited (formerly Millennium Central Limited)* [1999] EWHC CA Civ 983, the Court of Appeal considered the obligation to provide a bond. The underlying contract required the provision of a bond which had not been provided. The Court considered that there was a distinction between a term that was a ‘*contingent condition precedent*’ rather than a ‘*promissory*’ condition. In other words, was the provision of the bond a condition precedent to something or was the provision of the bond simply a promise to provide one? However, New Millennium had chosen to terminate the contract, and so there was little point in providing the bond after termination.

6 **The rule in *Holme v Brunskill***

6.1 The general rule is that a variation to the underlying contract releases the guarantor. In the case of *Wittmann (UK) Limited v Willdav Engineering SA* [2007] BLR CA Civ 509, the Court of Appeal considered the impact of finance arrangements and consent. At first instance Judge Alton held that the provision of finance agreements between the parties (although inconsistent with the original contract) was consented to by Willdav. So the guarantee extended to the new obligation. The guarantor appealed on the basis that there had been a complete discharge.

6.2 Moore-Bick LJ considered that a distinction needed to be drawn between a variation to the contract and discharge and replacement of the contract. If a discharge takes

place then Willdave would need to agree in writing and sign in order to satisfy the Statute of Frauds 1677 and to guarantee the new contract. Buxton LJ took the view that if the guarantor knew about the changes and those changes fell within the general obligations of the guarantor, then the guarantor would continue to be bound regardless of the Statute of Frauds. The appeal was dismissed.