**Brick Court Chambers Seminar**

**Bank Guarantees**

***Wuhan Guyou Logistics Group Co Ltd v. Emporiki Bank of Greece SA***

Christopher Clarke J: [2012] EWHC 1715 (Comm); [2013] 1 Lloyd’s Rep 161

Court of Appeal (Longmore, Rimer and Tomlinson LJJ):

1st Judgment: [2012] EWCA Civ 1629; [2014] Lloyd’s Rep Plus 2

2nd Judgment: [2013] EWCA Civ 1679; [2014] Lloyd’s Rep Plus 3

Bank guarantees are a standard feature of shipbuilding contracts, and there is nothing novel about issues arising between bank and beneficiary as whether a surety contract is a guarantee or a bond -- a "see to it" or traditional guarantee or a "demand" guarantee or bond.

I don’t suppose it would be very difficult to produce a document which is self evidently only a “see to it” guarantee – or to produce one that is self-evidently a demand guarantee/bond – payable on demand.

The difference is of course very significant. If it is an old fashioned guarantee, the surety’s liability is co-extensive with that of the principal debtor. The beneficiary is going to have to prove that the principal debtor is liable to make the payment before he can recover judgment against the Bank. In practice, it may not be difficult for the Bankr to stave off an application for summary judgment, and that means delay and expense.

By contrast a demand guarantee” or true performance bond is payable on production of the requisite documents – often no more than a self-certifying statement that the amount is due. Assuming the beneficiary has prepared the documents properly, the Bank is going to have to put up a seriously arguable case of fraud if it is to avoid summary judgment – a much more formidable difficulty, not least because fraud cannot even be alleged without a *prima facie* case.

I said that it shouldn’t be too difficult to make it clear one way or the other. But that isn’t always real business life – the parties are jockeying for position. Neither is quite able to achieve what it would really like and each hopes that it has done enough to win the argument, should it ever arise.

Such was the guarantee in *Wuhan Guyou v. Emporiki Bank of Greece SA*

The underlying facts were straightforward and not unusual – that is until there was a twist in the tail, as to which I will say more hereafter.

Wuhan Guyou operate a shipyard in Yangzhou in China. In 2006 they agreed to build a 57,000 DWT bulk carrier for Tomassos Navigation of the Marshall Islands, but really Greece

The price was payable by instalments. Emporiki Bank of Greece SA guaranteed the second instalment of $10.3 million payable on the cutting the 1st 300 mt of steel. It did not guarantee any subsequent instalment.

Guarantee had plenty in it for both parties’ arguments:

*Details of Guarantee*

*(1) In consideration of your entering into a Shipbuilding Contract dated 29th November 2006 (“the Shipbuilding Contract”) with Tamassos Navigation Ltd as the buyer (“the BUYER”) and WUHAN Guoyu Logistics Group CP LTD and Yangzhou Guoyo Shipbuilding CO., LTD as the seller (“the SELLER”) for the construction of one (1) 57,000 Metric Tons Deadweight OEC known as YANGZHOU GUOYU SHIPBUILDING COMPANY LTD. HULL NO. GY404 (“the VESSEL”), we, EMPORIKI BANK OF GREECE SA, hereby IRREVOCABLY, ABSOLUTELY and UNCONDITIONALLY guarantee, as the primary obligor and not merely as the surety, the due and punctual payment by the BUYER of the 2nd installment of the Contract Price amounting to a total sum of United States Dollars 10,312,500.00 (Ten million three hundred twelve thousand five hundred only) as specified in (2) below.*

*(2) The Instalment guaranteed hereunder, pursuant to the terms of the Shipbuilding Contract, comprises the 2nd installment in the amount of U.S. Dollars 10,312,500.00 (Ten million three hundred twelve thousand five hundred only) payable by the BUYER within five (5) New York banking days after completion cutting of the first 300 MT of steel plate in your Seller’s workshop and written notice thereof along with certificate of cutting of steel plate countersigned for approval by the Buyers representative.*

*...*

*(4) In the event that the BUYER fails to punctually pay the second Installment guaranteed hereunder or the BUYER fails to pay any interest thereon, and any such default continues for a period of twenty (20) days, then, upon receipt by us of your first written demand stating that the Buyer has been in default of the payment obligation for twenty (20) days, we shall immediately pay to you or your assignee the unpaid 2nd Installment, together with the Interest as specified in paragraph (3) hereof, without requesting you to take any or further action, procedure or step against the BUYER or with respect to any other security which you may hold.*

*(5) We hereby agree that at your option this Guarantee and the undertaking hereunder shall be assignable to the Bank of China Limited, Hubei Branch, 65 Huangshi Road, Wuhan City, Hubei 430013, the People’s Republic of China……*

*….*

*(7) Our obligations under this Guarantee shall not be affected or prejudiced by any disputes between you as the SELLER and the BUYER under the Shipbuilding Contract or by the SELLER’s delay in the construction and/or delivery of the VESSEL due to whatever causes or by any variation or extension of their terms thereof or by any security or other indemnity now or hereafter held by you in respect thereof, or by any time or indulgence granted by you or any other person in connection therewith, or by any invalidity or unenforceability of the terms thereof, or by any act, omission, fact or circumstances whatsoever, which could or might, but for the foregoing, diminish in any way our obligations under this Guarantee.*

*IN WITNESS WHEREOF, we have caused this Letter of Guarantee to be executed and delivered by our duly authorised representative the day and year above written.”*

So the contract was headed “guarantee”.

In clause 1, the guarantee was of due and punctual payment instalment – consistent with old fashioned guarantee.

And in clause 4, in event buyer fails punctually to pay the second instalment supported the argument that unless the instalment was actually *due*, the guarantee would not respond

On the other hand clause 4 stated upon receipt by us of your first written demand stating that the Buyer has been in default of the payment obligation for twenty (20) days, we shall immediately pay to you or your assignee the unpaid 2nd Instalment, together with the Interest as specified in paragraph (3) hereof, without requesting you to take any or further action, procedure or step against the BUYER or with respect to any other security which you may hold

By the time the Yard was ready to cut the steel, the buyers had lost interest in the vessel because the market had collapsed.

There was a dispute between the Yard and the buyer about whether the 2nd instalment had become due. The Yard unable to produce a certificate of first steel cutting because the buyer’s representative refused to countersign it. And there was a dispute as to whether the terms of the refund guarantee proffered by the Yard were compliant with the shipbuilding contract.

The arbitration trundled on between Yard and the Buyer – the issue was to whether 2nd instalment became due – and subsequently whether 3rd instalment became due

In the meantime, the Yard made a demand against the Bank under the guarantee. The Bank refused to pay and an application was made for summary judgment in the Commercial Court

Christopher Clarke J refused summary judgment. He clearly thought that a document headed guarantee was *prima facie* an old fashioned guarantee. He produced a lengthy judgment with a full analysis of the many authorities in the field. In his view [66] the core obligation was in clause 1 – to his mind the classic language of a traditional guarantee. As he put it, it was a guarantee of what was due – it was not a guarantee of what was *not* due.

The wording in clause 4 did not change this. True it referred to a demand but that was a necessary but not sufficient condition of recovery [73]

There was a genuine issue as to whether the second instalment was due and payable by the buyer – so application for summary judgment against the Bank was refused.

The case went on appeal to a strong CA – Longmore, Rimer and Tomlinson LJJ. There was a very different atmosphere. The flavour can perhaps be discerned from CA’s comment in their Judgment that Christopher Clarke J’s judgment was “exhausting document”

We enquired whether the court meant exhaustive, but it did not.

The Court said they did not find the case particularly easy. There were 6 pointers towards it being a guarantee and 4 for it being a bond. But it would be absurd if the 6-4 score was decisive of the result.

This is not a tick box test, but the commercial community deserved greater certainty, if that could be achieved. The Court said there was a strong presumption that if certain elements existed, the guarantee would be treated as a bond

They adopted the so called Paget factors – based on what is now at §34.4 of 13th ed of Paget Law on Banking:

“Where an instrument (i) relates to an underlying transaction between the parties in different jurisdictions, (ii) is issued by a bank, (iii) contains an undertaking to pay “on demand” (with or without the words “first” and/or “written”) and (iv) does not contain clauses excluding or limiting the defences available to a guarantor, it will almost always be construed as a demand guarantee.

…

In construing guarantees it must be remembered that a demand guarantee can hardly avoid making reference to the obligation for whose performance the guarantee is security. A bare promise to pay on demand without any reference to the principal’s obligation would leave the principal even more exposed in the event of a fraudulent demand because there would be room for argument as to which obligations were bei ng secured.”

Longmore LJ said that the words “will almost always be” in Paget amount to a presumption fully justified by the Court of Appeal authorities such as *Howe Richardson v Polimex* [1978] 1 Lloyd’s Rep 161, *Owen v Barclays Bank* [1978] QB 159 and *Esal (Commodities) Ltd v Oriental Credit Ltd* [1985] 2 Lloyd’s Rep 546 and more recently *Gold Coast v. Caja de Ahorros* [2002] 1 Lloyd’s Rep 617

Longmore LJ echoed the wise words of my late father in *Siporex v. Banque Indosuez* [1986] 2 Lloyd’s Rep 146:

“it is extremely important that … there should be a consistency of approach by the Courts, so that all parties know clearly where they stand.”

Guarantees of the kind before the Court, Longmore LJ observed were “almost worthless if the Bank can resist payment on the grounds that a foreign buyer is disputing whether a payment is due”.

So the appeal was allowed

Bank petitioned the Supreme Court for permission to appeal – refused by Lords Clarke, Mance and Sumption on basis that no arguable point of law.

So it is is now authoritatively established in international trade that a Bank guarantee will be treated as an on demand bond if:

1. It contains an undertaking to pay “on demand” (with or without the words “first” and/or “written”) and
2. does not contain clauses excluding or limiting the defences available to a guarantor, it will almost always be construed as a demand guarantee

I would add that I don’t think the presence of some standard clauses limiting defences is of much importance. Clause 7 of the guarantee before the CA provided that the Bank’s obligations were not to be affected or prejudiced by any dispute between the Seller and the Buyer under the shipbuilding contract or by any delay by the Seller in the construction or delivery of the vessel. CA did not think the affected the result.

I would also emphasise that the presumption is different where the guarantee is of a domestic transaction, or where it is not given by a bank.

However, there was a twist in the tail: shortly before the hearing in the CA, the arbitrators in the dispute between the Yard and the buyers issued an award deciding that the second instalment guaranteed by the Bank had not actually fallen due because of defects in the refund guarantee, but the third instalment (not guaranteed by the Bank) had fallen due.

What was to happen? CA left it for further argument.

We re-assembled in November last year to debate it -- in the meantime payment had been made to Reed Smith, the Yard's solicitors.

In the judgment of the Court of Appeal delivered by Tomlinson LJ put the issue as follows:

Is the money paid over by the Bank pursuant to its obligation under the guarantee held by the Seller on trust for the Bank, alternatively on trust for the Buyer who would in turn hold the money on trust for the Bank?

He answered as follows:

The answer to this question is in my view no. It is only the very unusual facts of this case which have enabled some plausibility to be given to what is essentially a heretical proposition which, if accepted, would be subversive of the basis upon which international trade is routinely financed.

The starting point of the Bank’s argument was to note that the Bank guaranteed “due and punctual payment” of the second instalment and that the guarantee requires the Seller to state in the demand that the Buyer has been in default of the payment obligation and that such default has continued for a period of twenty days. The Seller so stated in its demand of 22 June 2011.

The second step in the argument was to assert that once the arbitration award became final, the Seller knew that the second instalment had not in fact become due from the Buyer. From that it was reasoned that when payment was ultimately made to the Seller by the Bank, the Seller knew that it was money to which it was not entitled. That knowledge gave rise to a trust on receipt of the money. It was the effect on the conscience of the recipient which gave rise to the trust. An analogy was made with the position of a recipient of money who has been paid that money by reason of a mistake.

The Court of Appeal rejected these arguments robustly. There was no analogy with cases of mistake, where by definition no obligation to pay ever arose. Here, on making its demand of the Bank, the Yard acquired a complete and immediately enforceable cause of action against the Bank. The Bank was obliged to pay immediately, as paragraph 4 of the Payment Guarantee spelt out in terms. Thereafter the Yard’s right to payment from the Bank was indefeasible, and it was of no relevance that the Yard subsequently discovered that its demand, although made in good faith, was in fact made upon an incorrect premise.

The Yard was liable to account for the money received – not to the Bank, but to the buyer. It was contrary to all principle that the guarantor/Bank should have a remedy. The guarantor had simply done, or was being required to do, that which it had promised to do.

CA did not decide whether the Yard held the money on trust for the Buyer or just had a liability to account to it. But they gave a strong hint that the only liability was to account to the Buyer. Tomlinson LJ said:

I can only observe that it is difficult to see why the principles to which I have already referred do not militate conclusively against the creation of any trust affecting the money in the hands of the Seller. In particular, I see great force in Mr Hirst’s submission that the creation of a trust for the Buyer is inconsistent with the obligation to account which envisages the payment of the balance due on striking the account as between Seller and Buyer.

So it looks as if the Yard will only be liable to account for the money received from the Bank to the buyer – but here is the key commercial point: it can account in this case *after* set off of the unpaid third instalment awarded by the Arbitrators (or any other debt).

Some commentators have said that the result is that the Bank has ended up guaranteeing the third instalment – something it never agreed to do. I suggest that is to misunderstand the different contractual relationships. What happens between buyer and seller at the accounting stage has nothing to do with the Bank

These are strong judgments – they emphasise the independent or self standing nature of the contract of guarantee and the importance of cashflow in international trade.

Jonathan Hirst QC

27 February 2014