

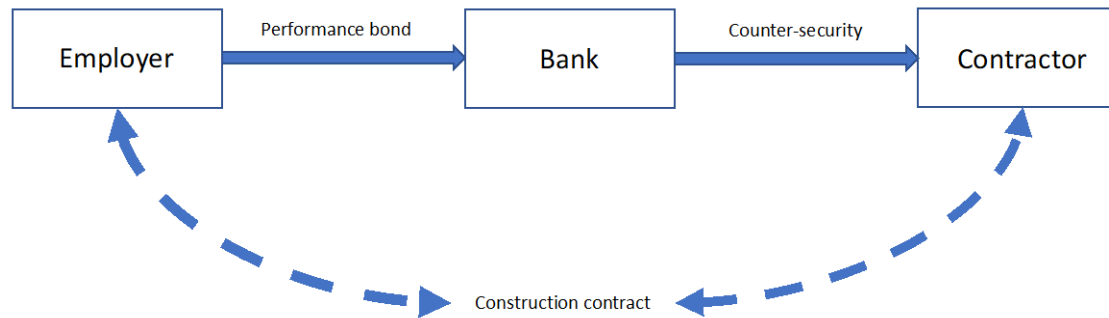
# On Demand Bonds and Performance Guarantees: Things to think about in light of COVID-19



**Fountain Court**  
CHAMBERS

A presentation by  
Anneliese Day QC, Tony Francis and Claire King  
4 June 2020

## Performance Bonds



## Differences between On Demand Bonds and Contingent Guarantees

- **On Demand Bonds**

- Often called “demand” guarantees but not guarantees at all
- Bank makes immediate payment upon presentation of a compliant demand
- No enquiry into rights and obligations of contractor and employer
- Only defence is fraud

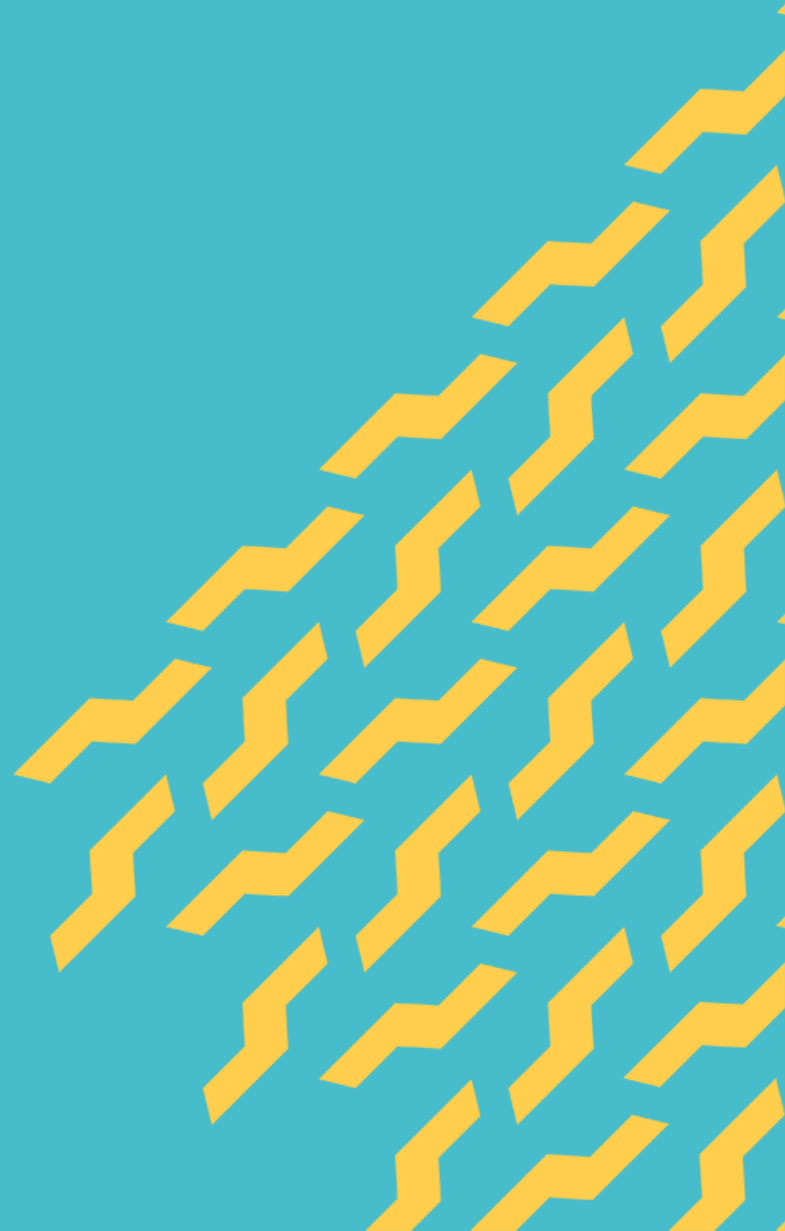
- **Contingent Guarantees**

- Must prove failure to perform (can be slow and costly)
- Equitable defences may also be available

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# On Demand Bonds



# On Demand Bonds: what are they?

**Edward Owen Engineering v Barclays Bank International** [1978] 1 QB 155

(a “new transaction”)

***“So long as the Libyan customers make an honest demand, the banks are bound to pay: and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate they will not be able to prove it to be dishonest, so they will have to pay. All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least 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. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.”***

# On Demand Bonds: what are they?

**IE Contractors v Lloyds** [1990] 2 Lloyds Rep 496 at 499

*“The first principle which the cases establish is that a performance bond, like a letter of credit, will generally be found to be conditioned upon the presentation of one or more documents, rather than upon the actual existence of facts which those documents assert. **If the letter of credit or bond requires a document asserting that goods have been shipped or that a contract has been broken, and if such a document is presented, the bank must pay. It is nothing to the point that the document is untruthful, and that the goods have not been shipped or the contract not broken. The only exception is what is called established or obvious fraud.** This doctrine had been laid down by cases too numerous to mention.”*

# Demand or True Guarantee?

**Wuhan Guoyu v Emporiki Bank** [2012] EWCA Civ  
1629

*"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."*

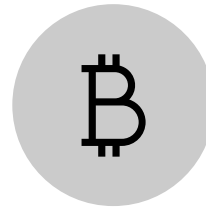
# Demand or True Guarantee?



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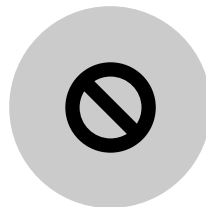
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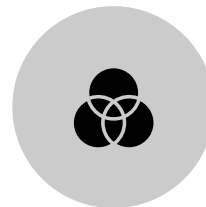
GUARANTOR NOT A  
FINANCIAL  
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WORDING  
SUGGESTING BANK'S  
LIABILITY NOT  
SECONDARY



NO EXCLUSION OF  
GUARANTOR'S  
EQUITABLE  
DEFENCES



PARTIES IN  
DIFFERENT  
JURISDICTIONS



# Fail to comply with formal requirements at your peril!

## Sea Cargo Skips AS v State Bank of India [2013] EWHC 177

- Required a statement that delivery of a vessel had been delayed by more than 270 days according to Article IV(E) (the cancellation clause)
- ***“slavishly follow the wording of the refund guarantee”***
- Failure to refer to Article IV(E) was fatal
- ***“the refund guarantee required, not a statement that there had been 270 days delay of any character which entitled the Buyer to cancel, but a statement that there had been 270 days delay of a particular character which entitled the Buyer to cancel, namely, that set out in article IV 1 (e).”***

# The Fraud Exception

## National Infrastructure Development Company Ltd v Banco Santander

[2017] EWCA Civ 27

*“there is a real prospect that the Banks will establish at trial that the only realistic inference is that the fraud exception applies.”*

# The Fraud Exception

Need “*extraordinary facts*” which are capable of being proven either:

- on the documents or
- without the need for detailed oral examination of witnesses.

*Tetronics* at paragraph 37  
per Fraser J.

## Injunctions to restrain bond calls by contractor



Demand by the beneficiary (employer) has been made fraudulently and that the bank was aware of the fraud.



The terms of the underlying contract preclude the bond call.

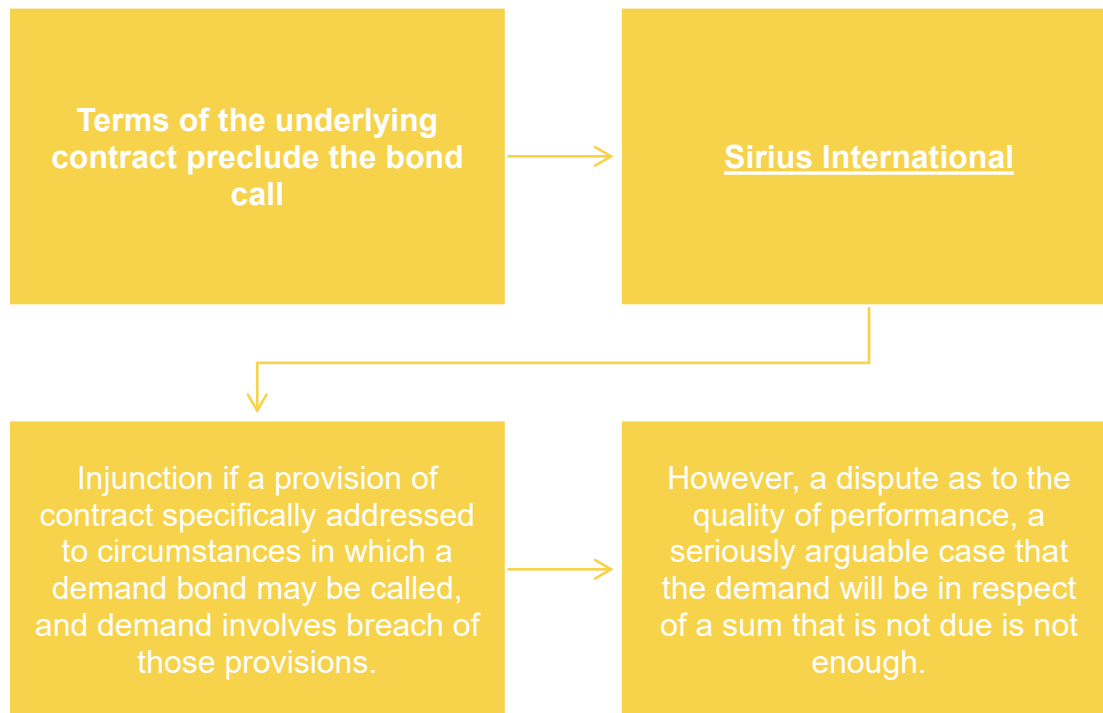
# Injunctions to restrain bond calls by contractor

Demand by the beneficiary (employer) has been made fraudulently and that the bank was aware of the fraud.

“*Extraordinary facts*” in *Tetronics (International) Ltd v HSBC Bank Plc* [2018] EWHC 201

- Contractor sent a legal opinion to the bank in advance of the demand stating that there was no ground for a demand
- Contractor had an active dialogue with the bank’s Relationship Manager in advance of the demand being made
- Relationship Manager was told that the demand would be fraudulent.

# Injunctions to restrain bond calls by contractor



# Injunctions to restrain bond calls by contractor

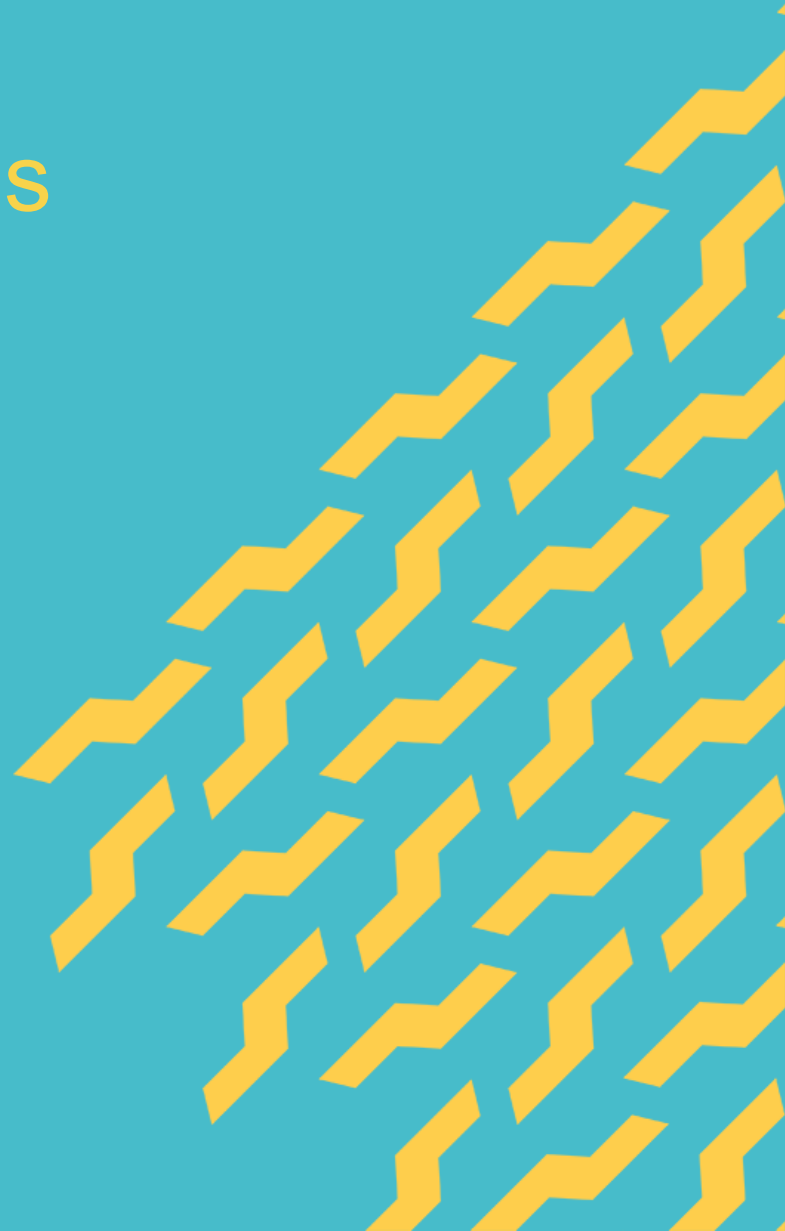
Permasteelisa Japan v Bouyguesstroi and Bank Intesa SpA [2007] EWHC 3508: must “*positively establish*” that demand would not comply with contractual mechanism. Seriously arguable not enough. Injunction refused

Simon Carves v Ensus: [2011] EWHC 657: “*strong case*” for injunction was sufficient.

Doosan Babcock v Comercializadora de Equipos y Materiales Mabe Limitada [2013] EWHC 3201: “*realistic prospect*” of showing main contractor had not failed to issue a Taking Over Certificate in bad faith and demand would allow employer to benefit from own wrong

MW High Tech v Biffa Waste Services Ltd [2015] EWHC 949: dispute about whether there had been a default under the contract so as to allow a demand under performance bond to be made. No injunction granted following *Permasteelisa*

# Performance Guarantees






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## Firms warn of performance bonds freeze

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# Alternatives to Guarantees

- Employer will ultimately pay additional costs for obtaining guarantees
- Think about alternatives if costs start to increase:
  - Longer payment terms
  - Larger retentions
  - Amended termination provisions (e.g. termination for convenience)

# Basic Checklist

1. When does my guarantee expire?
2. How much does my guarantee cover?
3. Has the guarantor got any assets?
4. What are the notification provisions?
5. When will payment be made?

# Has the guarantor got any assets?

- Established insurer or bondsman
  - Value should be “*as shown on the tin*”
- Guarantees by others:
  - What is the parent company worth?
  - In what jurisdiction is the guarantor based?

# Notification Provisions

- Practicalities:
  - Is there anybody there?
  - Notification method:
    - Can I get a hard copy there?
    - How long will it take?
  - Leave longer for delivery
  - Expressly agree another method for service if you can?
- Ensure that you can notify a claim before expiry
  - *Yuanda v Multiplex* [2020]
  - Adjudicator's decision due before expiry (just)

# How long until I get paid?

- Key differences to On Demand Bonds
  - Guarantees are secondary obligations
  - Liability is the same as for the underlying contract
  - Liability (and the amount of the liability) needs to be established and ascertained
- ABI Model Form of Guarantee Bond

*“The Guarantor guarantees to the Employer that in the event of a breach of the Contract by the Contractor the Guarantor shall subject to the provisions of this Guarantee Bond satisfy and discharge the damages sustained by the Employer **as established and ascertained pursuant to and in accordance with the provisions of or by reference to the Contract** and taking into account all sums due or to become due to the Contractor.”* [Emphasis added]

- Payment unlikely to be made instantly

# Established and Ascertained (1)

## Yuanda v Multiplex

- JCT Design and Build (2011) Subcontract (with bespoke amendments)
- Dispute re extension of time and associated LDS OR Loss and Expense
- Adjudication commenced by Contractor against the Subcontractor on 2 December 2019
- (Second) demand made on 17 January 2020
- Bond expired on 4 April 2020
- Bond based on ABI Model Form of Guarantee with bespoke amendments
  - Clause 1 along the lines of the standard wording

# Established and Ascertained (2)

## Yuanda v Multiplex

- Confirmed that the ABI Model Form of Guarantee Bond is NOT on demand
- **KEY:** Look to the underlying Contract re whether amounts established and ascertained
  - Mere statement that money is due to the Contractor NOT enough
  - No certification procedure as such within the underlying contract
  - Decision by the Adjudicator awarding sums to the Contractor “*would undoubtedly qualify as being an amount established and ascertained pursuant to.... the Contract*”
  - Mr Justice Fraser: Subcontractor would have to pay out on an Adjudicator’s decision
- Luckily the Adjudicator’s decision was due before the bond expired



# Established and Ascertained: Insolvency (1)

- Ziggurat LLP v CC International Insurance Company [2017]
  - Ziggurat employed County under a JCT 2011 Form Construction Contract
  - County provided a ABI Form Performance Bond with a bespoke amendment for insolvency:
    - *“The damages payable under this Guarantee Bond shall include (without limitation) any debt or other sum payable to the Employer under the Contract following the insolvency... of the Contractor.”*
  - County went insolvent and others finished their works
  - Held:
    - Financial ascertainment of losses pursuant to termination provisions had to be carried out
    - No liability under the termination clause until that exercise had been carried out
    - Call could only be made after that exercise was complete
    - Same defences available to Bondsman as to County re challenging amounts claimed

# Established and Ascertained: Insolvency (2)

- JCT wording and ABI Bond wide enough to include insolvency events without bespoke amendments being required
  - *Perar BV v General Surety and Guarantee Co Limited* [1994]
  - Breach of contract = failure to pay a debt post-insolvency
  - **BUT:** In *Perar* no claim had been made for payment
  - *“Had a claim been made, as the contract envisaged, it may well be that these proceedings would have been avoided, as plainly any consequent failure by the contractor to pay any such demand, if properly made, would have enabled a claim to be made under the bond...”*
- Cash flow:
  - Ascertainment under the termination provisions may take a while
  - Consider amendments to the Construction Contract and ABI Bond to allow “*payments on account*” to aide cash flow?

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# Any Questions?

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