OUTER HOUSE, COURT OF SESSION

[2020] CSOH 42

CA135/19

OPINION OF LORD CLARK

In the cause

BUCHAN BIOGAS LIMITED

Pursuer

against

BSG CIVIL ENGINEERING LIMITED

Defender

Pursuer: Borland QC; Morton Fraser LLP
Defender: Howie QC; MacRoberts LLP

13 May 2020

Introduction

[1] The defender granted a guarantee ("the Guarantee") in favour of the pursuer, in respect of claims by the pursuer against another company ("the Contractor"). The dispute between the parties concerns the construction of the terms of the Guarantee and, put broadly, whether it requires the defender to pay the pursuer on-demand, or whether the defender is only required to pay the pursuer in the event that the Contractor has a liability to the pursuer. The case called for a debate on this issue.

Background

[2] The pursuer wished to build an anaerobic digestion plant in Aberdeenshire, for the

generation of biogas from waste. On 21 July 2015, Williams Industrial Services Limited, the Contractor, contracted with the pursuer to engineer, procure and construct the plant for the pursuer ("the Works Contract"). The defender, a civil engineering and building company, was a sub-contractor engaged by the Contractor in relation to the works to be carried out under the Works Contract. The Guarantee was granted by the defender in favour of the pursuer in respect of the Contractor's duties under the Works Contract. The Contractor carried out work under the Works Contract. On 6 February 2018, the Contractor entered into administration, thereby becoming insolvent for the purposes of the Works Contract and also the Guarantee. By letter dated 21 August 2019, the pursuer served a demand under the Guarantee on the defender, in terms of which the pursuer sought payment of £2,019,603.28.

The key terms of the Guarantee

[3] In the Guarantee, the defender is designated as the "Guarantor", the pursuer as the "Client", and the principal debtor as the "Contractor". The term "Insolvent" is defined in the Guarantee as having the same meaning as in the Works Contract. In the Works Contract, the term "Insolvent" is defined as meaning, *inter alia*, the relevant party entering into administration. In the Guarantee, the term "Obligations" is defined as meaning each and every term, provision, condition, obligation, undertaking and agreement on the part of the Contractor to be performed, observed or carried out by the Contractor as contained or referred to in the Works Contract. For present purposes, the key terms of the Guarantee are as follows.

> "**2. Guarantee**
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> 2.1 Subject always to the limitations on the Guarantor's liability set out in Clause 5, the Guarantor shall indemnify the Client against all loss, debt, damage, interest, cost and expense incurred by the Client by reason of any failure of the Contractor to perform, observe or comply with the Obligations and shall,

on first written demand, pay to the Client, without any deduction or set-off, the amount of that loss, debt, damage, interest, cost and expense.

3. Performance obligations

3.1 Subject always to the limitations on the Guarantor's liability set out in clause 5, if, at any time, the Client informs the Guarantor that any default is made by the Contractor in the performance of any of the Obligations, the Guarantor will pay any sum or sums that may be payable in consequence of any default made by the Contractor in the performance of any of the Obligations.

3.2 Without prejudice to the foregoing generality any determination of the Works Contract, or of the Contractor's employment under it, or the Contractor is Insolvent or otherwise legally extinct shall be conclusive evidence for the purposes of this Guarantee of the Contractor's default in the performance of the Obligations.

4. Liability as if sole principal obligor

4.1 As between the Guarantor and the Client (but without affecting the Obligations), the Guarantor shall remain liable under this Guarantee as if it were the sole principal obligor and not merely a surety.

4.2 The Guarantor shall not be discharged nor shall its liability be affected by anything which would not discharge it or affect its liability if it were the sole principal obligor including, but not limited to:

4.2.1 any amendment, modification, waiver, consent or variation, express or implied, to the scope of the Works or to the Works Contract or any related documentation;

4.2.2 the granting of any extensions of time or forbearance, forgiveness or indulgences in relation to time to the Contractor;

4.2.3 the enforcement, absence of enforcement or release of the Works Contract or of any security, right of action or other guarantee or indemnity;

4.2.4 the dissolution, amalgamation, reconstruction and/or reorganisation of the Contractor or any person;

4.2.5 any indulgence or additional or advanced payment, forbearance, payment or concession to the Contractor;

4.2.6 any compromise of any dispute with the Contractor;

4.2.7 any failure of supervision to detect or prevent any fault of the Contractor; or

4.2.8 any assignation of the benefit of the Works Contract.

5. Limitations

5.1 Subject to Clause 5.2, the Client undertakes to the Guarantor that it shall not demand any payment pursuant to this Guarantee unless and until:

5.1.1 the aggregate of monetary claims made against the Contractor arising from the failure by the Contractor to perform, observe or comply with the Obligations exceeds £1,000,000;

5.1.2 the Client has first demanded payment from the Contractor under the Works Contract (and the Guarantor shall be notified in writing of such demand) for all such claims (including those in excess of £1,000,000), and payment in full under the Works Contract has not been received within 14 days of such demand (or demands);

5.1.3 the Client shall notify the Guarantor in writing if payment from the Contractor has not been received within 14 days; and

5.1.4 if payment has not been received within a further 28 days from the date of the notice under Clause 5.1.3 (during which time the Client shall seek to engage with the Guarantor to discuss the Guarantor's proposals for addressing the situation), then the Client shall be entitled to submit a demand in accordance with Clause 2.1 and the Guarantor shall indemnify the Client in accordance with Clause 2.1.

5.2 Where the Contractor is Insolvent or otherwise legally extinct the Client shall not be required to comply with the provisions of Clause 5.1 and the Guarantor shall indemnify the Client in accordance with Clause 2.1 on the Client's first written demand for all claims in excess of £1,000,000 arising from the Contractor being Insolvent or otherwise legally extinct. The Employer's written demand shall constitute conclusive proof (and be admissible as such) of the Guarantor's obligation to pay such sums.

5.3 For the avoidance of doubt, the Guarantor shall have no liability under this Guarantee for the first £1,000,000 of losses the Client suffers arising from the Contractor being Insolvent or due to the Contractor's failure to perform, observe or comply with the Obligations. The maximum aggregate liability of the Guarantor to make payment to the Client (in respect of one or more demands) pursuant to this Guarantee shall be £3 million (three million pounds sterling) less any sums capable of recovery by any subsisting on-demand bond procured in favour of the Client by the Guarantor.

5.4 In any action by the client for breach of this Guarantee the Guarantor shall have available to it all defences, counterclaims and set offs as may have been available to the Contractor under the Works Contract.

5.5 So long as any sums are payable (contingently or otherwise) under this Guarantee the Guarantor shall not on any grounds make any claim or threaten to make any claim whether by proceedings or otherwise against the Contractor for the recovery of any sum paid by the Guarantor pursuant to this Guarantee; save where such claim is by way of counter-indemnity for the Guarantor's obligations under this Guarantee. Any such claim shall be subordinate to any claims (contingent or otherwise) which the Client may have against the Contractor in connection with the Works Contract or any other agreement until such time as the Client's claims have been satisfied by the Contractor."

The pleadings

[4] The pursuer averred:

"6.1 The pursuer has suffered losses in excess of £3 million arising from the Contractor being insolvent…

6.3 By virtue of clause 5.2 of the Guarantee, the Demand constitutes conclusive proof of the defender's obligation to pay the sum demanded. The pursuer is therefore contractually entitled to payment from the defender of the amount sought in terms of the Demand. Decree as first concluded for should therefore be pronounced."

[5] In answer, the defender averred:

"6.1 Not known and not admitted. Explained and averred that it is not sufficient, for a right to payment to arise under the Guarantee, that money has been lost by the Pursuer that it is irrecoverable in the administration. It is necessary also that the initial liability of Williams Industrial Services Ltd to the Pursuer arose because of its breach of the contract between the Pursuer and the said company. In correspondence dated 8 March 2019 from solicitors in Northern Ireland acting on behalf of the Pursuer, which the Pursuer has since stated as withdrawn in light of supposed further and continuing losses, the Defender was informed that the money being sought by the Pursuer included legal costs and expenses liability arising out of litigation between the Pursuer and William Industrial Services Ltd over a bond issued by Allied Irish Bank. On the face of it that sum does not arise from the combination of the insolvency of Williams Industrial Services Ltd and its prior failure to meet its contractual obligation. It arises out of litigation about, as appears, an autonomous instrument and is not a loss against which the Guarantee is issued. Should these monies continue to be claimed in the present action, the call on the bond sought to be enforced, is excessive and seeks to recover sums to which the

> Guarantee does not extend, as the Pursuer, through their said solicitors in Northern Ireland will have been aware.
>
> …
>
> 6.3 Clause 5.2 of the Guarantee is referred to for its terms beyond which no admission is made. Explained and averred that the Guarantee is a cautionary obligation and not an on-demand bond. On its true construction the said Guarantee is a reciprocal obligation as so demonstrated by the terms of Clause 5.1, and not an on-demand bond. Were it such a bond the terms of Clause 4.2 would be needless, though they are of significance to a cautionary obligations. Clause 3.2 renders "insolvency" testament to a breach of the contract, if no other breach exists, but that Guaranteed by the Guarantee remains the same, namely, the loss incurred by the Pursuer as a result of failure by Williams Industrial Service to comply with the "obligations" so defined in the Guarantee. In the event of insolvency, the Pursuer need not go through the expense in Clause 5.1 in making a demand, but the Guarantee will only cover losses from breach of contract insofar as irrecoverable by reason of insolvency. Clause 5.4 of the Guarantee affords the Defender all the defences open to Williams Industrial Services under its building contract, a provision fundamentally inconsistent with the characterisation of the bond Guarantee so an "on-demand bond" and with the final sentence of Clause 5.2 which falls to be rejected as inconsistent with the Guarantee as a whole. The Pursuer is accordingly obliged to set forth the basis upon which it contends that the sum sued for is the consequence of breach of the building contract on the part of William, the sum claimed having no apparent relation to any such loss."

Submissions

[6] Each party lodged a Note of Argument in advance of the debate. In oral submissions, senior counsel each adopted the contents of his Note of Argument and developed his submissions. I have taken into account the full terms of the Notes of Argument and the oral submissions and I now give a brief summary of each party's position.

Submissions for the pursuer

[7] A valid demand having been made by it under the Guarantee (in the form of the demand dated 21 August 2019) there was an obligation on the defender, as the guarantor, to make payment to the pursuer of the sum demanded. The single issue was a question of

contractual construction. Clause 2.1 refers to the defender being obliged to pay the pursuer on its written demand. Clause 3 states that if the Contractor is "Insolvent" that "shall be conclusive evidence for the purposes of this Guarantee of the Contractor's default in the performance of its Obligations". Reference was made to the definitions of "Insolvent" and "Obligations". By virtue of clause 3.2 of the Guarantee, the Contractor was to be taken, conclusively, as in default of its obligations under the Works Contract on account of its insolvency. It followed that there was an entitlement on the part of the pursuer to serve a written demand on the defender pursuant to clause 2.1 of the Guarantee. Clause 5.2 of the Guarantee was a significant provision, its effect being that, where the principal debtor is insolvent, there is a clear contractual obligation on the defender to pay the pursuer on the latter's written demand in respect of all "claims" in excess of £1,000,000 arising from the principal debtor being insolvent. The final sentence of clause 5.2 was very important. The reference to the Employer's written demand was an obvious typographical error. It should sensibly be read as a reference to the written demand of the Client, i.e. the pursuer. The final sentence of clause 5.2 made it crystal clear that, where the principal debtor is Insolvent, the pursuer's written demand will constitute "conclusive proof" of the defender's obligation to pay the amount demanded. The sentence was unambiguous.

[9] The position that emerged from these provisions was, in summary, as follows. (1) In terms of clause 5.2 of the Guarantee, if the Contractor is "Insolvent", the defender is required to indemnify the pursuer, in accordance with clause 2.1, on the latter's "written demand". (2) The clause 5.2 obligation to indemnify is in respect of "claims", as opposed to decisions in relation to disputes, awards or decrees, etc. (3) The obligation to indemnify in terms of clause 5.2 is in respect of claims in excess of an initial £1 million threshold of claims. (4) The claims must arise from the principal debtor' insolvency. (5) Clause 5.2 provides that the

pursuer's written demand is "conclusive proof" of the defender's obligation to pay to the pursuer the sum demanded. (6) That is consistent with indemnification by the defender in accordance with clause 2.1 which also refers to the obligation to pay on the pursuer's written demand.

[10] The proper approach was that taken in *Gold Coast Ltd* v *Caja De Ahorros Del Mediterraneo,* [2002] 1 Lloyd's Rep 617. The reference to payment on the first written demand was reflected in clauses 2.1 and 5.2 of the Guarantee in this case. In *Marubeni Hong Kong and South China Ltd* v *Government of Mongolia* [2004] 2 LLR 198, Creswell J again considered the nature of the document as a whole and the obligation to provide an indemnity. Clear language is needed, but that test was met here and so the presumption was displaced or rebutted (see also *IIG Capital LLC* v *Van der Merve* [2008] 2 LLR 187, *per* Waller LJ at [30]). There was nothing that pointed towards it being a secondary liability and in particular that factor was absent in the insolvency situation, where clause 5.2 could scarcely be clearer. Clause 5.2 in the Guarantee here contained a conclusivity clause that is even stronger than in *Marubeni.* The decision in *Vossloh AG* v *Alpha Trains UK Ltd* (2010) 132 Con LR 32 (at [26]) showed that shifting the risk of insolvency was the intention. Insolvency is conclusive evidence of default. Clause 5.2 was conclusive evidence of both liability and the amount. *Spliethoff's Bevrachtingskantoor BV* v *Bank of China Ltd* [2015] 2 LLR 123 refers (at [73]) to the target being cashflow. The key principles were summarised by Blair J in *Autoridad del Canal de Panama* v *Sacyr SA* [2017] 2 LLR 351 (at [80] *et seq)*. It showed that the inclusion of clause 4.2.1 in the Guarantee is not necessarily a significant factor, such clauses often being included in on-demand cases, out of an abundance of caution.

[11] Turning to the issue of construction of the Guarantee, the application of clause 5.4 could not stand in an insolvency situation as it would include defences on the merits (i.e. that the Contractor was not in default) whereas insolvency is different. One could certainly have a document which is a hybrid. Here, in a non-insolvency situation, clauses 3.1 and 5.1 provided for a particular regime and in that situation clause 5.4 could have meaningful application; issues of default and consequences are all live issues in a non-insolvency situation. But there was a different and distinct regime in the case of insolvency, provided for in clauses 3.2 and 5.2. Contrary to the defender's submission that the last sentence of clause 5.2 fell to be rejected, the court was invited to read the Guarantee as a whole. Clause 5.4 could not stand against the pursuer when the Contractor is insolvent. A defence on liability would "hit the wall" of clauses 3.2 and the final sentence of clause 5.2. Thus, clause 5.4 did not apply in insolvency. The defender contends that clause 4.1 of the Guarantee is the kind of provision one sees in cautionary obligations or ordinary Guarantees rather than in on-demand bonds, but that was contradicted in the case law: *Gold Coast Ltd* (at [25]) and *Autoridad del Canal de Panama* (at [81] (5)). Looking at clause 4.2.4, the position stated in clause 4.2 applies even where the Contractor is dissolved and under clause 4.2.6 any compromise is also irrelevant for the purposes of liability of the guarantor. The defender's reliance on the fact that the instrument was called a Guarantee was misplaced. Labelling is not a significant factor in determining the nature and type of instrument: *Gold Coast Ltd* (at [21]); *Spliethoff's Bevrachtingskantoor BV* (at [84]). The defender's contention that clause 5.2 refers back to clause 2.1 was incorrect. *Bitumen Invest AS* v *Richmond Mercantile Ltd FZC* [2016] EWHC 2957 (Comm) supported the pursuer's position, which was obviously the probable intention in a situation where the Contractor is insolvent. This was commercially sensible, as vouched by *Vossloh AG*. In relation to legal extinction, the parties

had provided for this scenario. Contrary to the defender's position, in an insolvency situation there was plainly a good commercial reason to provide for cash flow and to secure monies that might not otherwise be available from an insolvent Contractor. In relation to the passing of the risk back to the principal debtor, reference was made to *Speirsbridge Property Developments Ltd* v *Muir Construction Ltd* 2008 SCLR where Lord Glennie held that such a term was implied into the building contract.

Submissions for the defender

[12] The document should be examined without any preconceptions as to the category into which it falls (*Gold Coast Ltd*) but there were presumptions, known as the "the *Paget* presumption" and "the *Marubeni* presumption", each rebuttable. The *Marubeni* presumption, operates where the *Paget* presumption, which applies in an international banking context, does not, and is a strong presumption. The drafting of the document may not be entirely internally consistent but the better view was that the instrument is a Guarantee or cautionary obligation. Wording in the Guarantee which might suggest that it is an on-demand contract faded away when the rest of the surrounding text is read. The default required to be a real one in order to trigger a liability on the part of the defender and, by virtue of clause 2.1, the liability was for the loss incurred by the pursuer "by reason of any failure by the Contractor to perform the Obligations". The reference in clause 2.1 to payment on a "first written demand" was born of fear of the problem illustrated by *Royal Bank of Scotland Ltd* v *Brown* 1982 SC 89. Clause 4 excluded defences which would be apt to a Guarantee, but are quite meaningless in the context of an autonomous bond (see *Vossloh AG* (at [27])). The author of the instrument was aware of the distinction between an on-demand bond and a Guarantee. It was not realistic to suggest that clause 4 is redundant; rather its purpose was to preclude certain defences from being raised. Not insignificantly, the

instrument is called a "Guarantee". The draftsman was aware of a distinction between a Guarantee and an on-demand bond (see clause 5.3). The instrument does not speak of the making of "irrevocable" or "unconditional" payment against the demand. Clauses 2.1 and 5.1 pointed towards the obligation being of a secondary nature and clause 5.5 was clearly designed to attack a cautioner's rights of relief against the principal. The *Marubeni* presumption was reinforced by clause 4.1. The pursuer's reliance on clauses 3.2 and 5.2 was misplaced. Conclusive evidence clauses can be found in both Guarantees and on-demand bonds (*Autoridad del Canal de Panama*, (at [81](6)) and are to be strictly construed with any ambiguity being resolved in favour of the guarantor (*Vossloh AG* (at [52])). The conclusive evidence clauses do not cover any given amount of money. The construction proffered by the pursuer was unlikely to have been the intention of reasonable businessmen.

[13] This was not the classical on-demand bond position. In reality, the object of the instrument was to secure a correctly calculated payment compensating, but not over-compensating, the beneficiary for the loss it actually sustained through the Contractor's breach of the main contract. Furthermore, the Guarantee was not concerned with securing cash flow (the hall-mark of the on-demand bond: *Spliethoff's Bevrachtingskantoor BV*) or allocating the risk of financing any loss which the beneficiary may have sustained pending the resolution of the merits of the Works Contract disputes. That was made patent by the existence of clause 5.4, which is directly contradictory to the pursuer's position. It further contradicts the conclusive evidence provisions in clauses 3.2 and 5.2. If these were to be construed as barring any challenge by the defender to the assertion of liability to pay such figure as may be inserted in the written demand made by the beneficiary, those clauses are repugnant to the rest of the instrument and should therefore be rejected as being inconsistent with the remainder of the instrument. Alternatively, even if not rejected

outright, the court would be left with drafting which is internally inconsistent on matters material to the classification of an instrument as an on-demand bond or as a cautionary obligation. In that situation, the drafting of the instrument would not be sufficient to displace the *Marubeni* presumption.

[14] When one looked at the definitions in the EPC contract, a Guarantee differs from a bond, and a bond means the on-demand bond from a financial institution. The on-demand bond has to be in the form set out in schedule 7 and it refers to the obligor being irrevocably and unconditionally liable. Those drafting the Guarantee knew that an on-demand bond barred any discussion of underlying obligations. While cases such as *Gold Coast Ltd* indicated that labelling does not mean anything very much, here a professionally drawn-up contract showed differences in the wording between a Guarantee and an on-demand bond. The only point in having clause 4 was because the instrument is a Guarantee and not an on-demand bond. Contrary to the submissions for the pursuer, insolvency is not a different circumstance. If the court is faced with the need to reject clauses in a document then rejection should follow. The reference in clause 5.2 to the word "claim" was not of any specific significance because what is to be indemnified is in accordance with clause 2.1. If the pursuer's position is correct then the defender, exercising its rights under the *Speirsbridge Property Developments Ltd* approach would not get anything back. Clause 4 deals with the question of being legally extinct but the pursuer argues that the defender needs to pay to the pursuer whatever it claimed, even when the Contractor is extinct and the defender has no chance of getting it back. Clause 5.5 again gave no prospect of getting money back. There was no sense in saying the defender is protected when the Contractor is solvent, but if the Contractor is insolvent the pursuer could be overcompensated, and the defender could not insist on the pursuer just getting what it is due, and the defender will not be able to recover

the sums claimed. The pursuer's position involved a contradiction of the expression "any action" in clause 5.4. Rejecting clauses is generally not an appropriate approach but having regard to the *Marubeni* presumption there is nothing to overcome that presumption. Accordingly there were two possible resolutions: the court could either reject the conclusive evidence provisions in the final sentence of clause 5.2 and the relevant part of clause 3.2 or simply use the *Marubeni* presumption.

Reply for the pursuer

[15] The reference to different documents which more explicitly call themselves on-demand bonds was neither here nor there. The defender's position that this is a document that "has suretyship written all over it" could not stand against the clear language of clauses 4.1 and 4.2 which refer to the sole principal obligor and not simply a surety. The defender's position that the protective clauses of the kind in clause 4 were a powerful indication of it being truly a Guarantee and not an on-demand document was directly contradicted by the authorities. It was demonstrably and clearly wrong for the defender to suggest insolvency made no difference under the terms of the Guarantee. Clauses 3.1 and 3.2 dealt with two different situations, non-insolvency and then insolvency. The same could be said about the differing regimes in clauses 5.1 and 5.2. When clause 5.2 applies, the pursuer does not have to comply with the rigmarole in clause 5.1. Claims are not determined matters. Clause 2.1 refers to indemnify without deduction or set off. Cases such as *IIG Capital LLC* showed that something called a Guarantee may well be an on-demand instrument where the guarantor is the principal obligor and not a surety. On the submission about the position the defender would be in following the insolvency or extinction of the Contractor, the point was simply that clause 5.2 and 3.2 were moving the risks of insolvency of the Contractor on to the sub-contractor, which was entirely sensible. This was vouched by *Vossloh AG* (at [26]). Rejection

of clauses is a very extreme position for a party to adopt and the court should be extremely slow to accept the submissions for the defender on that matter, particularly if, as in this case, there is a possible and tenable alternative construction. The language was of sufficient clarity to rebut the *Marubeni* presumption; it could scarcely be made any clearer than the last sentence of clause 5.2. The pursuer's position was not to reject the words "in any action" which appear in clause 5.4, but to construe these in the context of the whole of the instrument. That approach involved a much less radical position than rejecting two clauses in the instrument. There was a clear logical fallacy at the heart of the defender's position that the court should either reject the final sentence in clause 5.2 and the whole of clause 3.2 or, if not, proceed on the basis that the presumption applied. If the court did not reject those provisions then there was clear language of the sort that required to rebut the presumption.

Decision and reasons

Relevant legal principles

[16] The issue is one of construction of the terms of the Guarantee. I approach that matter in the usual fashion, as set out in *Rainy Sky SA* v *Kookmin Bank Co Ltd* [2011] 1 WLR 2900, *Arnold* v *Britton* [2015] UKSC 36 and *Wood* v *Capita Insurance Services Ltd* [2017] UKSC 24, and as endorsed by the Inner House (see eg *HOE International Ltd* v *Andersen* 2017 SC 313 and *Ashtead Plant Hire Company Limited* v *Granton Central Developments Limited* [2020] CSIH 2). However, it is noteworthy that there are no averments as to any specific elements of the factual matrix or background which are said to have an impact on the meaning of the language used in the instrument. The principal focus is therefore on the natural and ordinary meaning of the language used, taking into account the relevant aspects of the contractual context. Submissions were made on behalf of each party as to why the

construction it put forward was to be preferred as being more compatible with business or commercial common sense. As in *Midlothian Council* v *Bracewell Stirling* 2018 SCLR 606, that is a factor in this case.

[17] The particular legal principles which have been applied by the English courts in cases of the present kind are summarised neatly by Blair J in *Autoridad del Canal de Panama v Sacyr SA*, the key points for present purposes being the following:

> "[80] In approaching the construction question, the following principles appear from the case law:
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> (1) Unlike a Guarantee, a first demand bond is in principle autonomous of the underlying contract - liability may arise simply on a conforming demand within the validity of the instrument. For this reason, it has been likened to a letter of credit *(Edward Owen Engineering Ltd* v *Barclays Bank International Ltd* [1978] QB 159 at page 171, *Meritz Fire and Marine Insurance Co Ltd* v *Jan de Nul NV* [2011] BLR 320; [2011] I All ER (Comm) I 049 at para 70, *WS Tankship II BV* v The *Kwangju Bank Ltd* [20 I I] EWHC 3103 (Comm) at para 111, *Spliethoff's Bevrachtingskantoor BV* v *Bank of China Ltd* [2015] 2 Lloyd's Rep 123 at para 69).
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> (2) What the instrument is labelled, the incorporation of terms such as a principal debtor clause, or terms imposing primary liability, both of which are very common in guarantees of all kinds, and the use of words such as "on-demand", may be of limited value in determining its legal nature. The practical question, as in the present case, is in substance whether the instrument is effectively payable on demand, with or without some supporting documentation: this can only be ascertained by examining its terms *(Marubeni Hong Kong and South China Ltd* v Government *of Mongolia* [2005] 2 Lloyd's Rep 231; [2005] I WLR 2497 at para 30, *IIG Capital LLC* v *van der Merwe* [2008] 2 Lloyd's Rep 187 at para 25, *Vossloh AG* v *Alpha Trains (UK) Ltd* [2011] 2 All ER (Comm) 307 at paras 23 and 28, *Carey Value Added SL* v *Grupo Urvasco SA* [2011] 2 All ER (Comm) 140 at para 22).
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> (3) As was said in *Gold Coast Ltd v Caja deAhorros del Mediterraneo* [2002] I Lloyd's Rep 617 at paras 10 and 15, the court approaches the task of construing it by looking at the instrument as a whole 'without any preconceptions as to what it is'. To take advance payment Guarantees as an example, the issuance of such Guarantees securing advance payments made by an employer to a contractor can be in either form - it depends on what the parties agreed (see *Gold Coast* at para 11).
>
> (4) When it comes to construing the instrument, the nature of the party giving the guarantee is relevant. It has been held that there is a presumption

against construing an instrument as a demand bond which is not given by a bank or other financial institution *(Marubeni* at para 30, *IIG Capital* v *van der Merwe* at para 9). It has also been held that an instrument issued by a financial institution which relates to an underlying transaction between parties in different jurisdictions and contains an undertaking to pay "on-demand", and does not contain clauses excluding or limiting the defences available to a guarantor, will almost always be construed as a demand Guarantee *(Gold Coast* at para 16, *Wuhan Guoyu Logistics Group Co* v *Emporiki Bank of Greece SA* [2014] I Lloyd's Rep 266 at para 27, *Caterpillar Motoren GmbH & Co KG* v *Mutual Benefits Assurance Co* [2015] 2 Lloyd's Rep 261 at para 20).

(5) The presence of "protective clauses", ie clauses excluding or limiting the defences available to a guarantor (such as those arising from variations of the principal contract) have sometimes been treated as indicative of guarantee liability (because they are unnecessary in the case of a first demand instrument), but this is not necessarily a significant factor, since there may be other reasons for including the clauses, (eg) out of an abundance of caution *(Gold Coast* at para 25). The absence of any such clauses may be a pointer to the instrument being a first demand instrument (*Meritz*, supra, at para 74).

(6) Whilst "conclusive evidence" clauses may not in themselves point to the nature of the instrument, since they can be found in either kind, a clause which - if effective - requires payment against certification by the beneficiary, is likely to be inconsistent with the need for the beneficiary to establish the liability (other than through such certification) of the principal debtor in order to enforce the guarantee *(North Shore Ventures Ltd* v *Anstead Holdings Inc* [2011] 2 Lloyd's Rep 45; [2012] Ch 31 at para 67, *Bitumen Invest* AS v *Richmond Mercantile Ltd FZC* [2017] I Lloyd's Rep 219 at para 27). However, conclusive evidence clauses, which have found support historically through the perceived institutional reliability of the party entrusted with making the relevant calculations, are strictly construed, with any ambiguity being resolved in favour of the guarantor (*Bache & Co (London) Ltd* v *Banque Vernes et Commerciale de Paris SA* [1973] 2 Lloyd's Rep 437 at page 440, *Bangkok Bank Ltd* v Cheng *Lip Kwong* [1989] SLR I 154 at page 1159, *North Shore* at para 46)."

Application of the legal principles

[18] It is an unusual feature of this case that each side, for the construction it proffered to be upheld, required the language of the instrument to be disturbed. Notwithstanding the open and wide manner in which clause 5.4 is expressed (referring to "any action"), the submission for the pursuer effectively required other words to be read into that clause (albeit that it was submitted that this was really a matter of construction) in order to restrict

its meaning to a non-insolvent situation. For the defender, it was submitted that one whole clause (3.2) and a full sentence in another clause (5.2) required to be omitted from consideration, or as it was put, rejected. In considering the wording of the instrument, I shall assess what degree of disturbance to it (if any) is required.

[19] In embarking on this exercise, I start by, as it were, clearing the decks. It was not vouched in the productions or submissions that the terms of the Guarantee were derived from, or based upon, a form of Guarantee included in the standard forms of EPC contractual material. It is no doubt correct that one could speculate that an instrument of this degree of sophistication may well, at least in part, have come from a standard form, but I had no grounds in fact for reaching that conclusion. I proceed upon the basis that it is simply unknown whether the Guarantee was so derived or based, or on the other hand was a bespoke drafting exercise. The defender's submission that the person who drafted the Guarantee must have been aware of the wording of the standard on-demand instruments which form part of that contractual material may also be correct, but I did not understand this to be a matter of agreement and I therefore disregard that point. As to the use of the term "Guarantee", that label offers no assistance to the issue of construction. Similarly, the fact that the person who drafted the Guarantee referred, in clause 5.3, to any "on-demand bond" procured by the defender does not assist in pointing towards either side's proposed construction being correct.

[20] Clause 2.1, as the first substantive term, makes several clear points. It begins with the words "Subject always to the limitations on the Guarantor's liability set out in Clause 5". The word "always" is of importance: the limitations in clause 5, which include those stated in clause 5.4, always apply. The clause goes on to say that "the Guarantor shall indemnify [the pursuer] against all loss, debt, damage, interest, cost and expense incurred by the

[pursuer] by reason of any failure of the Contractor to perform, observe or comply with the Obligations". The natural and ordinary meaning of indemnify is to compensate or give recompense. The indemnity is also predicated upon a failure by the Contractor under its contract with the pursuer. The next sentence refers to the obligation to pay "on first written demand … without any deduction or set-off, the amount of that loss, debt, damage, interest, cost and expense". The first written demand is therefore for payment of *that* loss, debt or the like, referring back to the loss, debt or the like incurred by reason of any failure of the Contractor.

[21] Clause 3.1 also begins with the "Subject always" point in relation to clause 5, and states that the defender "will pay any sum or sums that may be payable in consequence of any default made by the Contractor in the performance of any of the Obligations". It is therefore again triggered by a default. The sum or sums are payable "if … the [pursuer] informs the [defender] that any default is made". The natural and ordinary meaning of "informs" is the passing on of an actual fact, rather than merely asserting that there is default or simply making a demand. Accordingly, default must have occurred for the pursuer's right set out in this provision to be triggered.

[22] One of the clauses which the defender submits ought to be rejected or ignored is clause 3.2. In my view, it would be very odd for a clause containing a concept of such potential significance (the reference to conclusive evidence) simply to be ignored. It is also presented as a separately numbered and expressed clause in the Guarantee, which is indicative of the parties intending it to form part of the Guarantee. I was given no basis for concluding that it had somehow been included as a result of an error. In those circumstances, it must be taken into account. It stipulates matters that form conclusive evidence of default by the Contractor in the performance of its obligations, including the

Contractor being insolvent or legally extinct. Thus, in the circumstances covered by clause 3.2, the issue of whether or not there has been a default no longer arises: the existence of the stated circumstances, such as insolvency or extinction, is conclusive evidence of default. However, that is the extent of the conclusive evidence. Read in context, including the terms of clause 2.1, what then becomes due is any sum or sums that may be payable in consequence of the default, but only in order to indemnify (that is, compensate) the pursuer. In addition, liability also remains subject to the limitations on the defender's liability set out in clause 5, including clause 5.4.

[23] Clauses 4.1 and 4.2 make reference to the defender remaining liable and not being discharged, with the defender being treated as "if it were the sole principal obligor and not merely as surety". There is plainly some force in the pursuer's position that this equates the defender to a sole principal obligor rather than a cautioner or surety. But, equally, the defender's point that the inclusion of such language would be wholly unnecessary if the defender was indeed the sole principal obligor is well made. The individual points listed in clause 4.2 do not add anything of substance for present purposes; these are simply examples of things which would not discharge or affect the defender's liability "if it were the sole principal obligor". In my opinion, clauses 4.1 and 4.2 appear capable of being consistent with either side's construction but they do not operate as clear pointers in either direction. The case law properly regards such expressions as of limited significance.

[24] Turning to clause 5.1, it suffices for present purposes to note that it provides for the pursuer not being able to demand payment from the defender under the Guarantee unless certain precursor steps have been taken, such as having first demanded payment from the Contractor. Clause 5.2 states that where the Contractor is insolvent or otherwise legally extinct the pursuer shall not be required to comply with clause 5.1 and "shall indemnify [the

pursuer] in accordance with Clause 2.1 on the [pursuer's] first written demand for all claims in excess of £1,000,000 arising from the Contractor being Insolvent or otherwise legally extinct". This therefore results in a removal of the need for the precursor steps, but it is still a duty to indemnify (that is, compensate) and to do so "in accordance with Clause 2.1". Also, the indemnity is in respect of claims "arising from" the Contractor being insolvent or legally extinct, so again there must be a link between the insolvency or being extinct and the sum claimed. In relation to the final sentence, I accept the submission for the pursuer, which I did not understand to be questioned by the defender, that the reference to "Employer" is an error and that it should be taken to mean the pursuer. The pursuer founds very heavily on the fact that this sentence states that the pursuer's written demand for all claims in excess of £1,000,000 "shall constitute conclusive proof (and be admissible as such) of the [defender's] obligation to pay such sums". Such is the apparent force of that final sentence, that the defender submits that it must be rejected and ignored. However, I was given no clear basis as to why I should ignore this final sentence, other than that senior counsel for the defender did not regard it as reconcilable with what was otherwise, in his submission, the proper construction of the Guarantee. Giving the words their ordinary and natural meaning, the written demand constitutes conclusive proof of an obligation to make payment. However, clause 5.4 is of crucial importance and casts substantial light on the nature of the instrument. It begins with the words "In any action by the [pursuer] for breach of this Guarantee" and then refers to the defender having "available to it all defences, counterclaims and set offs as may have been available to the Contractor under the Works Contract". Of major significance is that the clause applies in any action for breach of the Guarantee. This clearly relates to the earlier references (including in clause 5.2) to the defender's obligation to pay sums due under the Guarantee. A failure to comply with such an obligation is a breach of

the Guarantee (and there may of course be other forms of breach). Clause 5.4 thus applies to any action brought in which breach of the Guarantee is alleged, including a failure to comply with the obligation stated in clause 5.2.

[25] In summary, the key clauses in the instrument begin (in clause 2.1) by creating an obligation of indemnity on the defender only when the Contractor is in default of its obligations under the Works Contract and only in respect of losses etc. incurred by reason of that failure. Clause 3.1 takes that point forward by stating that the defender will pay any sum or sums that may be payable in consequence of that default, once the pursuer has informed the defender of the default. Clauses 4.1 and 4.2 make clear that the defender is liable as if it were the sole principal obligor and not merely as surety and that its liability will not be affected by anything which would not affect its liability if it were the sole principal obligor. Clause 5.1 provides for the precursor steps to be taken, including making a demand to the Contractor. However, when the Contractor is insolvent or extinct, as clauses 3.2 and 5.2 make clear, there is an obligation to make payment on first written demand, although the sums claimed must be linked to the insolvency or extinction of the Contractor. Properly construed therefore, when the Contractor becomes insolvent or extinct, there is an obligation on the part of, and a direct right against, the defender for payment, without proof of default. To that extent, the instrument can be regarded as creating an obligation to pay on-demand, but clause 5.4 makes it absolutely clear that the defender can, if alleged to be in breach of that obligation, invoke the available defences and the like. It is quite correct that the final sentence of clause 5.2 provides that the written demand shall constitute conclusive proof of the defender's obligation to pay such sums. Thus, the obligation on the defender to make payment is constituted or proved. As a result, the precursor steps are not required (as clause 5. 2 states) and proof of default is not required

(clause 3.2). The reference in clause 5.2 to indemnifying the pursuer "in accordance with Clause 2.1" is, however, also relevant. As noted, clause 2.1 is subject always to the limitations in clause 5, including clause 5.4. The mere existence of an obligation to make payment on-demand does not stop that obligation being subject to the qualification clearly set out in clause 5.4, so that when it is sought to be enforced, defences and the like available to the Contractor can be invoked.

[26] In simple terms, the possibilities available to parties creating a contract of this sort are not limited to what could be described as a pure on-demand bond or a pure cautionary or secondary obligation. The instrument can plainly be something of a hybrid, having features of both. It can have scattered within it certain language which is suggestive of an on-demand element, but it can, as is the position here, allow that on-demand feature only to go the distance of allowing recovery in an insolvency or extinction context, but subject to the invocation of defences and the like which will preclude over-compensation.

[27] I reach that conclusion on the proper interpretation of the language in the instrument. I also note that this approach fits with what is, in my view, often the logical and commercially sensible aim of these arrangements, whether cautionary obligations or on-demand, that the payee is compensated (and not over-compensated) by the guarantor for losses. In order that there is no over-compensation, if the guarantor in an on-demand bond makes payment which turns out to constitute overpayment to the payee, then the guarantor would very probably be able to seek recovery from the principal debtor (in this case the Contactor) who then could seek recompense from the payee (the pursuer) on the basis of an implied term (as in *Speirsbridge Property Developments Ltd* v *Muir Construction Ltd*) or perhaps on other grounds, such as unjustified enrichment. This would achieve the result of there being no windfall. In the present case, in the context of insolvency or extinction there is no

need to constitute the obligation of the Contractor, because clause 3.2 and the final sentence of clause 5.2 create the obligation, but to achieve the avoidance of over-compensation (especially in an insolvency or extinction situation which places the guarantor in serious risk of not being able to recover any over-compensation) clause 5.4 also applies. The distinction between non-insolvency and insolvency simply concerns constitution of the obligation and in fact clause 5.4 has a greater relevance in an insolvency context in avoiding overpayment.

[28] I acknowledge that this conclusion differs from the submissions made by both parties, but of course the question of construction is one for the court. Moreover, as I have noted, each construction offered on behalf of the parties involved substantial disruption to the contractual terms, whether by requiring specific terms to be wholly ignored or rejected or clear wording ("if any") to be read down by, in effect, adding in words restricting it to a non-insolvency context. I accept that senior counsel for the defender, in response to a question from the court about whether clause 3.2 and the final sentence in clause 5.2 could be reconciled with the construction he was proposing, expressly stated that was not possible. But the conclusion I have reached fits largely with the defender's overall line of argument. The idea that the pursuer could achieve a windfall or indeed simply a payment just based on a claim itself seems odd, given the wording of clause 5.4. Equally, the idea that two provisions in a reasonably clear and refined contractual document require to be completely ignored is also odd. A construction that gives effect to each and every sentence and word in the Guarantee is a much more desirable outcome. It makes straightforward commercial sense to avoid-over-compensation by allowing the defender to access defences which would have been available to the Contractor, rather than having to take the longer route of making payment and then suing the Contractor (through the administrator or liquidator), who then (if able to make payment to the defender) seeks recovery from the pursuer. Of course, I also

recognise that there may be strong commercial reasons for an immediate payment to be made in certain commercial contexts, particularly to assist with cash flow. However, the avoidance of over-compensation remains important. Among the difficulties that arise with the construction advanced by the pursuer is that very substantial sums would become payable solely on the basis of a claim being made, with that claim wholly unable to be defended by the defender, leaving the defender unable to recover all or at least some of the amount it pays out from the insolvent Contractor, or in another situation the now extinct Contractor. On the construction I have adopted, the parties would indeed have a different solution in an insolvency context. There would be no need on the part of the pursuer to show any default by the Contractor or go through the preliminary steps in clause 5.1, but if need be clause 5.4 would operate to obviate any windfall. On that approach the parties have in the Guarantee selected a reasonably sophisticated and commercially sensible route.

[30] The conclusions I have reached simply rely upon the proper construction of the Guarantee. I have taken into account the factor of commercial common sense, but it adds nothing of significance to the natural and ordinary meaning of the language used. The same result would have followed by applying the *Marubeni* presumption, which does apply in light of the absence of cogent indications capable of rebutting it. The Guarantee was not granted by a financial institution, but by a private limited company in the construction sector acting as a sub-contractor. The pursuer contended that if the court does not reject the provisions in clauses 3.2 and 5.2 to which the defender referred, it would be difficult to apply the *Marubeni* presumption because the wording of those provisions would appear to strongly contradict it and indeed may well suffice to rebut it. The provisions do not have that effect. On the contrary, the language used in the Guarantee leads to the same outcome as the presumption.

Disposal

[31] Given that I have reached a view which does not directly accord with either party's submissions, I do not grant either of the motions made. I shall put the case out by-order to discuss further procedure.