Neutral Citation Number: [2021] EWCA Civ 1147

Case No: A4/2020/0995

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMMERCIAL COURT (QBD)
Mr Justice Robin Knowles CBE
[2020] EWHC 803 (Comm)

Royal Courts of Justice,
Strand, London, WC2A 2LL

Date: 23/07/2021

Before :

SIR GEOFFREY VOS, Master of the Rolls
LORD JUSTICE BAKER
and
LORD JUSTICE POPPLEWELL

- -

Between :

SHANGHAI SHIPYARD CO. LTD.

Appellant

- and -

REIGNWOOD INTERNATIONAL INVESTMENT (GROUP) COMPANY LIMITED

Respondent

- -
- -

Steven Berry QC (instructed by **Holman Fenwick Willan LLP**) for the **Appellant**
Zoe O'Sullivan QC and Harry Wright (instructed by **Onside Law Limited**) for the **Respondent**

Hearing dates : 14 July 2021

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Approved Judgment

Lord Justice Popplewell :

1. This is an appeal from a decision of Knowles J on two preliminary issues determining questions of construction of a guarantee given to support the obligation of a buyer to pay the final instalment of the price under a shipbuilding contract.

2. The Appellant ("the Builder") is a company incorporated in the People's Republic of China which operates, as its name suggests, a shipyard in Shanghai providing shipbuilding and repairing services. It is part of the China State Shipbuilding Corporation ("CSSC"), one of the two largest shipbuilding conglomerates in China, with interests in various shipyards, equipment manufacturers and shipbuilding related companies. The Respondent ("Reignwood" or "the Guarantor") is a Hong Kong company, and part of an international multi-industrial conglomerate first established in Thailand in 1984. Reignwood describes itself as offering investment services, and investing in airport construction, metal processing, food manufacturing and technology sectors.

3. By a shipbuilding contract dated 21 September 2011 ("the Shipbuilding Contract") between the Builder and Reignwood as the buyer (not at that stage guarantor), the Builder agreed to build an offshore drillship (Hull No. S6030) ("the Vessel") for a total price of US$ 200 million. Reignwood had no previous experience of the offshore drilling industry. It came to be involved in the purchase of this vessel as one of four drillships to be built by the Builder at the behest of three individuals who in 2011 had established a company incorporated in Bermuda, Opus Offshore Limited ("OOL"), with a view to purchasing the drillships for operation in the deep sea offshore drilling industry. Reignwood agreed with the management of OOL to participate as a financial investor for the purpose of the purchase of the four drillships, each of which would be held by a single purpose vehicle owned by OOL as the holding company. Opus Tiger 1 Pte. Ltd. ("Opus Tiger 1" or "the Buyer") was incorporated in Singapore as the first of these four companies, and became the buyer under the Shipbuilding Contract by way of novation. Reignwood acquired a 70% shareholding in OOL and funded the US$ 30 million required for the first two instalments on each of the four drillships, totalling US$ 120 million.

4. The Shipbuilding Contract was based on a form which was shortly to be published by the China Maritime Arbitration Commission ("CMAC") as a standard form for use in the Chinese export market, which has become known as the "CMAC Standard Newbuilding Contract (Shanghai Form)", with a number of significant amendments negotiated by the parties. It provided that the price of US$ 200 million should be paid in three instalments, the first (US$ 10 million) within 30 days of the effective date of the contract, the second (US$ 20 million) six months thereafter, and the third (the final instalment of US$ 170 million) upon delivery. The Delivery Date, as defined in clause 6.1, was to be 900 days after receipt by the Builder of a bank letter of credit securing the payment of the first and second instalments. The contract provided that the final price might fall to be adjusted both by reference to modifications to the specification, and by reference to delays or advancement in the building programme. It also provided for the delivery date to be extended in certain eventualities, such as delay caused by *force majeure*. Clause 8.1(c) provided that the final instalment of US$ 170 million should be adjusted to reflect any increase or decrease due to modifications and/or adjustments of the contract price in accordance with the provisions of the contract. Title

and risk passed to the buyer only upon delivery of the Vessel. Late payments of any instalments, including the final instalment, carried interest at 5% per annum.

5. Clause 8.6 which was headed "Security for Payment of Instalments before Delivery", provided that within three days of the Builder providing what was in substance, although not in name, a refund guarantee supplied by CSSC in the sum of US$ 30 million in an agreed form, the buyer should deliver to the Builder an irrevocable and unconditional Letter of Guarantee in the form annexed as Schedule 6B, issued by Reignwood, to secure the buyer's obligation for the payment of the final instalment of the contract price. At this stage Reignwood was the counterparty to the Shipbuilding Contract as buyer, but the clause anticipated the substitution of a special purpose vehicle as the buyer under the Shipbuilding Contract by defining Reignwood also in this clause as "Payment Guarantor". In fact the substitution did not occur until after Reignwood provided the guarantee.

6. Clause 7.1 of the Shipbuilding Contract provided for it to be governed by English law and by clause 17.2 for any dispute "which cannot be settled amicably" to be referred to arbitration in London in accordance with the LMAA Rules; and that unless the parties agreed on a single arbitrator, the tribunal should consist of three arbitrators one appointed by each party and the third by the two so chosen or the President of the LMAA failing agreement.

7. Reignwood arranged for the Letter of Credit for the first two instalments to be issued and provided to the Builder on 31 October 2011, as a result of which the Delivery Date was fixed, 900 days later, as 18 April 2014.

8. On 17 November 2011 Reignwood entered into an "Irrevocable Payment Guarantee" in favour of the Builder in the terms required by the Shipbuilding Contract ("the Guarantee"). It provided, in relevant respects, as follows:

> "
>
> IRREVOCABLE PAYMENT GUARANTEE
>
> To: Shanghai Shipyard Co., Ltd…
>
> 1. In consideration of your entering into the Shipbuilding Contract with [Reignwood] as the buyer ("the Owner") for the construction of one (1) self propelled drill ship with Shipyard's Hull No. S6030 ("the Drillship"), we, [Reignwood] hereby IRREVOCABLY, ABSOLUTELY and UNCONDITIONALLY guarantee in accordance with the terms hereof, as the primary obligor and not merely as the surety, the due and punctual payment by the OWNER of the Final Instalment of the Contract Price amounting to a total sum of United States Dollar US$170,000,000 as specified in (2) below… .
>
> 2. The instalments guaranteed hereunder, pursuant to the terms of the Contract, comprise the Final Instalment in

the amount of U.S. Dollars One Hundred and Seventy Million (US$ 170,000,000) payable by the Owner.

3. We also IRREVOCABLY, ABSOLUTELY and UNCONDITIONALLY guarantee, as primary obligor and not merely as surety, the due and punctual payment by the Owner of interest on the Final Instalment guaranteed hereunder at the rate of five percent (5%) per annum from and including the first day after the default until the date of full payment by us of such amount guaranteed hereunder.

4. In the event that the Owner fails to punctually pay the Final instalment guaranteed hereunder in accordance with the Contract or the Owner fails to pay any interest thereon, and any such default continues for a period of fifteen (15) days, then, upon receipt by us of your first written demand, we shall immediately pay to you or your assignee all unpaid Final 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 Owner or with respect to any other security which you may hold.

   In the event that there exists dispute between the Owner and Builder as to whether:

   (i) the Owner is liable to pay to the Builder the Final Instalment; and

   (ii) the Builder is entitled to claim the Final Instalment from the Owner,

   and such dispute is submitted either by the Owner or by you for arbitration in accordance with Clause 17 of the Contract, we shall be entitled to withhold and defer payment until the arbitration award is published. We shall not be obligated to make any payment to you unless the arbitration award orders the Owner to pay the Final Instalment. If the Owner fails to honour the award, then we shall pay you to the extent the arbitration award orders.

   …

7. Our obligations under this guarantee shall not be affected or prejudiced by:

   (a) any dispute between you as the Builder and the Owner under the Contract; or

(b) the Builder's delay in the construction and/or delivery of the Drillship due to whatever causes; or

(c) any variation or extension of their terms thereof; or

…

(e) any time or indulgence granted by you or any other person in connection therewith; or

(f) any illegality, invalidity or unenforceability of the terms of the Contract; or…

…

8. Any claim or demand shall be in writing signed by one of your officers and may be served on us either by hand or by post and if sent by post to [Reignwood's Hong Kong address] (or such other address as we may notify to you in writing , or by tested telex SWIFT code via Siam Commercial Bank PCL HK, with confirmation in writing.

…

10. The maximum amount … that we are obliged to pay to you under this Guarantee shall not exceed the aggregate amount of U.S. Dollars One Hundred Seventy-one Million Four Hundred and Sixteen Thousand Six Hundred and Sixty-six and Cents Sixty-seven Only (USD171,416,666.67) being an amount equal to the sum of:

(a) The Final Instalment guaranteed hereunder in the total amount of United States Dollars One Hundred Seventy Million Only (US$ 170,000,000; and

(b) Interest at the rate of five percent (5%) per annum on the instalment for a period of sixty(60) days in the amount of [US$1,416,666.67] …

11. All payments by us under this Guarantee shall be made without any set-off or counterclaim and without deduction or withholding for or an account of any taxes, duties, or charges whatsoever …

12. This Letter of Guarantee shall be construed in accordance with and governed by the Laws of England."

9. At this stage Reignwood was still the buyer under the Shipbuilding Contract, such that the guarantee was not a third party guarantee. The contemplated substitution of the special purpose vehicle did not take place until a little over a year later when on 30 November 2012 the Shipbuilding Contract was novated by an agreement under which all Reignwood's rights and obligations as buyer were transferred to Opus Tiger 1, a 100% subsidiary of OOL.

10. There were various addenda to the Shipbuilding Contract. The Delivery Date was initially extended to 21 June 2014, and then 30 April 2015. By a third addendum on 29 June 2015, by which stage construction had still not been completed, arrangements were made to facilitate Opus Tiger 1 being able to respond to an invitation to tender on a project, which required it to own the Vessel at that stage. Addendum No. 3 therefore contained an agreement that Opus Tiger 1 would take title to the Vessel by 29 June 2015, but physical control would remain with the Builder until a physical Delivery Date of 30 September 2015, with the Vessel mortgaged to the Builder.

11. On 12 December 2016 the Builder gave notice of completion of the Vessel to the Buyer. On 11 January 2017, the Builder made a demand to the Buyer for the final instalment and other sums allegedly due under the Shipbuilding Contract. On 23 January 2017 the Builder sent a notice of default to the Buyer for non-payment of the sums allegedly due, and on 17 February 2017 the Builder sent a cancellation notice to the Buyer. On 23 May 2017 the Builder made a demand of the Guarantor for the final instalment under the Guarantee.

12. At some stage there arose a dispute between the Builder and the Buyer as to whether the Vessel was in a deliverable condition. It is not clear from the evidence before us whether this was before the Builder's demand for the final instalment from the Buyer, or before the demand on the Guarantee, or at some stage thereafter. The Buyer contended that the Vessel contained a number of major and critical defects, the detail of which is not material to the current dispute.

13. OOL failed to repay its financing debt to Reignwood, and in December 2016 Reignwood had issued a winding up petition in Bermuda, alleging that the debt stood at some US$ 56 million. A winding up order was made on 17 February 2017.

14. On 10 December 2018, Reignwood commenced proceedings in Singapore against Opus Tiger 1 and the Builder seeking leave to commence a London arbitration in the name of Opus Tiger 1 under the Shipbuilding Contract as a derivative action. This was opposed by the Builder, but the order was granted by the Singapore Court on 6 May 2019. On 3 June 2019, Reignwood commenced arbitration against the Builder, in the name of Opus Tiger 1, in accordance with clause 17 of the Shipbuilding Contract.

15. Meanwhile, the Builder had commenced the present proceedings in the Commercial Court against Reignwood under the Guarantee, the Claim Form being served on 5 September 2018. The claim was defended by the Guarantor on the grounds, amongst others that, (1) the guarantee was a "see to it" guarantee in which the Guarantor's liabilities were no greater than those of the Buyer, and that the Buyer had no obligation to pay the final instalment of the price as a result of defects in the Vessel and/or the absence of Classification Society approvals; and (2) in any event the proviso in clause 4 of the Guarantee was engaged and accordingly no sums were due unless and until the subject of a London Arbitration award.

16. An order was made for preliminary issues to be determined in these terms:

> "Whether on the true construction of the Guarantee:
>
> a. As regards the Guarantor's liability thereunder:
>
> i. It is a demand guarantee, such that – subject to issue b. below – the Guarantor's liability thereunder arose upon and by reason of the Demand, whether or not the Buyer was liable to pay the Final Instalment under the terms of the Contract; or
>
> ii. It is a "see to it" guarantee or a conditional payment obligation, such that – subject again to the issue set forth in b. below – the Guarantor's liability thereunder arose upon the Demand only if the Buyer was liable to pay the Final Instalment under the terms of the Contract.
>
> b. The Guarantor is entitled to refuse payment under Clause 4 pending and subject to the outcome of the arbitration between [the Builder] and [the Buyer] in respect of a dispute as to the Buyer's liability to pay and [the Builder's] entitlement to claim that Final Instalment –
>
> i. Only if the arbitration has been commenced between those parties as at the date the Demand is made; or
>
> ii. Regardless of when such arbitration is or may be commenced?"

17. The Judge determined both issues in favour of the Guarantor. He held that it was a "see to it" guarantee; and that in any event Clause 4 was engaged by the commencement of the arbitration, notwithstanding that it had commenced after the date of demand. The Judge granted permission to appeal on both issues.

18. We were told that the arbitration hearing has recently been concluded and the award is awaited; and that the Vessel remains at the Builder's yard in China. Although OOL has been wound up, Opus Tiger 1, the Buyer, has not. We do not know its solvency position.

The First Issue

Shipbuilding contracts

19. Shipbuilding contracts typically provide for payment by the buyer by instalments during the course of construction, and delivery against a final payment. Two aspects of the performance of the obligations are commonly guaranteed. One is the payment by the buyer of the instalments. These do not always include payment of the final instalment, due on delivery, because typically transfer of title in the vessel and physical delivery does not occur until the final instalment is paid, so that the builder has some measure of security in the physical possession of the vessel. This may however prove inadequate because the residual market value of the vessel at the yard

may well be less than the total contract price, not only if the yard made a good bargain at the outset, but by reason of movements in ship values over what is typically the several years required for construction, and the bespoke nature of the vessel having been built to the buyer's specification. A second obligation commonly secured by guarantee is that of repayment by the builder of instalments paid by the buyer, in the event that the buyer is entitled to terminate the contract. These are commonly referred to as refund guarantees.

20. In the Shipbuilding Contract in this case the refund guarantee provided by the Builder was for $30 million and was called a Completion Guarantee; the label is misleading, because although clause 8.4.1 suggested that it was to be as security for the Builder's performance of its obligations under the contract, it was to be in a prescribed form which made clear that it was only to secure part of the Builder's obligations, limited, in effect, to refund obligations in the event of termination or actual or constructive total loss of the Vessel during construction.

21. There were two documents providing security for the Builder in relation to payment of instalments. The first two instalments were to be paid (not merely secured) by the Builder drawing down on a letter of credit from the buyer's bank in prescribed form, payable against a copy of the Contract, the Completion Guarantee and a commercial invoice. The final instalment was secured by the Guarantee whose construction is in issue.

"Guarantees"

22. Suretyship can be traced back to Old Testament times and before, and in the modern era has come to be known more commonly as a guarantee. A traditional guarantee by way of suretyship is an undertaking by the guarantor to be answerable for the debt or obligation of another if that other defaults. Traditional guarantees by way of suretyship are sometimes called "see to it" guarantees, following the dictum of Lord Diplock in *Moschi v Lep Air Services Ltd* [1973] AC 331, 348 that the nature of the guarantor's obligation was "to see to it that the debtor performed its own obligation to the creditor". Where the debt or performance obligation arises under a contract between the obligor/debtor and obligee/creditor, the essential feature of such a guarantee, for present purposes, is that the liability of the guarantor depends upon there being a liability of the obligor/debtor. The guarantor's liability is secondary, in the sense that it is contingent upon the obligor's continuing liability and default. Such guarantees, however, sometimes describe the guarantor's obligations as those of a primary obligor, to make clear that the default of the obligor gives rise to an independent and primary liability of the guarantor, who is liable and in breach of his obligation by the very fact of default by the obligor without more; hence the "see to it" characterisation of the guarantor's obligation. I shall refer to such an instrument as a surety guarantee.

23. Security for performance of a payment obligation may also be provided by an undertaking to pay a sum on demand, or within so many days of a demand, irrespective of whether the obligor/debtor is under a liability to make the payment. Such undertakings are also commonly termed guarantees, but their defining characteristic for present purposes is that they are payable on or by reference to an event, namely the demand, and without reference to the obligor's liability. The demand may have to be in prescribed form, and/or may have to be accompanied by

prescribed documents, but it is the demand which triggers the liability to pay. I shall refer to such undertakings as demand guarantees. Surety guarantees sometimes require a demand as a trigger for the payment obligation, in addition to the condition of obligor liability, so that the presence in the instrument of a requirement for a demand is not itself determinative; but a demand in surety guarantees is a variation of the standard suretyship arrangement under which the guarantor is a primary obligor and assumes liability simply by reason of the default of the obligor without the need for a demand against it; whereas a demand is of the very essence of a demand guarantee. The defining characteristic of a demand guarantee, for present purposes, is that the guarantor's obligation to pay arises by reason of the demand, without the beneficiary having to establish a liability of the obligor.

24. That is not to say that the liability of the obligor is irrelevant to a demand guarantee. It may only be called on if the guarantor can assert in good faith that the secured obligation has arisen. The demand must say in what respect the obligor is in breach of its obligations under the underlying relationship (see 15(a) of the ICC Uniform Rules for Demand Guarantees). Demand guarantees therefore necessarily have to make reference to the obligations for which they provide security. Paragraph 35.8 of Paget's Law of Banking 15th edn. (2018), in a passage under the heading of "contract of suretyship v demand guarantee", whose inclusion in a previous edition was cited with approval in *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA* [2013] 1 All ER (Comm) 1191, states:

> "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 being secured.

25. There is another reason why the underlying obligations may need to be referred to if, as I am inclined to think, a demand guarantee does not involve the beneficiary being entitled to *retain* the proceeds of the guarantee irrespective of the merits of any dispute as to the obligee's entitlement under the underlying relationship. If the position between obligor and obligee is subsequently determined to be that the debt or obligation was not owed, it would appear from *Cargill International SA v Bangladesh Sugar and Food industries Corporation* [1998] 1 WLR 461 at 469B, 471G that the obligee is liable to account to the obligor to the extent that the guarantee has provided payment in excess of the obligee's entitlement. A demand guarantee provides that where there is a dispute, the guarantor must "pay now and argue later". It would be surprising if it gave the beneficiary a "pay now and never have to argue" entitlement. If that be right, the underlying liability for which the demand guarantee is security remains relevant to the ultimate accounting between the parties. I have expressed my views on this last point in a provisional way because it was left open in *Wuhan* at [33] and by the Judge in this case. We did not hear adversarial argument on it because Mr Berry QC conceded the point, and it is not necessary for the determination of the appeal.

26. Guarantees other than surety guarantees may require payment upon or by reference to an event other than a demand, or be conditional upon such an event, such as an arbitration award, in which case they may be described as a conditional bond.

Analytically demand guarantees form a subset of conditional bonds in this sense, the demand being merely one type of event upon which liability may be conditional.

27. The usual purpose of a surety guarantee is to provide the beneficiary with protection against counterparty risk, that is to say the risk of failure of performance arising from deficiencies in the financial or commercial probity of the obligor. The beneficiary is therefore concerned to ensure that the guarantor is someone who is of sufficient financial and commercial probity that he can be relied on to make good any default of the obligor, or against whom the obligation can readily be enforced in an accessible jurisdiction. This is usually an important consideration in relation to the obligations of buyers of vessels under a shipbuilding contract. Ownership of ships is often vested in companies with no other business or assets, which are incorporated in jurisdictions which offer not only tax advantages but secrecy as to beneficial ownership of so called "one ship companies". Shipbuilding contracts are often made with such special purpose vehicles, who during construction are "no ship companies", with no assets other than the shipbuilding contract itself, the benefit of which may be mortgaged to the person financing the purchase, and beneficial ownership of which may change hands without the knowledge of the shipbuilder. Shipbuilding contracts are usually, therefore, a paradigm example of cases in which one party, the shipbuilder, needs protection from counterparty risk.

28. A demand guarantee also fulfils this purpose of eliminating or reducing counterparty risk. However it serves an additional purpose which is one of cashflow. In the shipbuilding context, as in other areas of commerce, cashflow is important, and is sometimes described as the lifeblood of the business. It is as important for a buyer, who will often have financing obligations, as it is for a builder, whose ability to fund the building of the vessel in question or other vessels depends upon timeous receipt of the instalments.

29. All this may seem trite, but I am concerned to emphasise it because we were much pressed in argument with a submission by Ms O'Sullivan QC on behalf of Reignwood which treated the starting point for determining the categorisation of the Guarantee as being to identify the nature of the institution providing the instrument, whether a bank or equivalent financing institution, with such institutional identification driving the resulting analysis by reference to presumptions. She relied on reference to presumptions in some of the authorities which I will address in due course, but this approach seems to me misconceived as a matter of principle in the present context for three reasons. First, the essential feature of the counterparty risk aspect, which is common to both types of guarantee, is that the beneficiary obligee will wish to ensure that the guarantor is of sufficient financial and commercial probity to eliminate this risk, or at least reduce it to an acceptable level. He will therefore look to a guarantee being provided by such a person. This may be a person independent of the obligor, such as a bank or other financial institution; or it may be a related party, such as a parent company. What matters for the purposes of counterparty risk is not the nature of the business carried on by the guarantor as such, whether banking, other financial business or commercial trading activity. It is simply the commercial and financial strength and probity of the guarantor. A well-resourced and reputable trading company in an accessible jurisdiction may provide better protection for a beneficiary against counterparty risk than a bank with political

affiliations operating in an underdeveloped jurisdiction giving rise to uncertainties of enforcement.

30. Secondly, whether an institution can be equiparated with a bank because of its financing function is not a simple binary question, as the facts of this case illustrate. Reignwood is a parent company as an indirect majority shareholder in Opus Tiger 1. It also, however, performed a financing function in that it only became such a parent for the purposes of enabling the OOL group to purchase the four drillships, which was not part of its existing group activity, and funded the payment of the first two instalments for each, including the $30 million paid under the Shipbuilding Contract. It clearly exercised a financing function beyond that which might arise between parent and subsidiary in an established group of companies in relation to the group's business.

31. Thirdly, in the shipbuilding context it has long been established that payment and refund guarantees may be demand guarantees: an early example of a payment guarantee being held to be a demand guarantee is *Hyundai Shipbuilding and Heavy Industries Co Ltd v Pournaras* [1978] 2 Lloyd's Rep 502. Further examples are *Wuhan* and *Spliethoff's BV v Bank of China Ltd* [2016] 1 All ER (Comm) 1034, discussed below. In *Hyundai* the guarantee was given by an individual, and a Liberian company, not a bank. In the latter two the guarantor was a bank, but it ought not to make any difference if the wording is the same. If a non-bank gives a guarantee adopting a form of wording which, if given by a bank, would be a demand guarantee, I do not see how it can mean something different from an identical instrument if issued by a bank. Such a conclusion would be a recipe for commercial uncertainty and would, in my view, subvert the reasonable expectations of the parties as objectively expressed in the words of their agreement. Ms O'Sullivan's submissions on behalf of Reignwood led to this unacceptable conclusion. She submitted that the fact that Reignwood was not a bank, or a financial institution akin to a bank, but merely a parent, gave rise to a presumption about the nature of the Guarantee which might lead to a different conclusion to that which would follow if a bank had issued it, by reference to the application of different starting presumptions. I would balk at any approach to construction which would lead to such an uncommercial result.

32. What this illustrates is that in the present context there ought to be no room for a priori preconceptions or assumptions about the nature of the instrument to be derived from the identity of the guarantor. What matters is the wording in which the parties have chosen to express their bargain, interpreted in accordance with the well-established rules of construction.

33. Before turning to the language of the instrument, I wish to say something about the citation of case law on this exercise of construction. Disputes as to whether an instrument is a surety guarantee or a demand guarantee are common, and are fertilised by the tendency to construct them from more than one precedent with negotiated variations. Reliance on decided cases on what are said to be similarly worded instruments is only of assistance in very limited circumstances. An authoritative decision that a form of words bears a particular meaning can legitimately point towards the same construction being placed on the same words if used in another contract in the same context. This is because consistency of judicial approach promotes certainty for businesspeople, and because commercial parties

with access to legal advice can reasonably be expected to have intended to achieve the same result as that revealed in the precedent if they use the same form of words in the same context. In *Enterprise Inns Plc v Forest Hill Tavern Public House Ltd* [2010] EWHC 2368 (Ch), Morritt C said of a previous decision at [22]:

> "Plainly such a decision cannot be conclusive as to the interpretation of other contracts made at different times, between different parties and in different circumstances even though both are questions of law. But a decision on the interpretation of a contract may be persuasive as to the interpretation of another contract using similar language by parties involved in a similar trade and in similar circumstances, particularly where knowledge of the previous decision may be imputed to the parties."

34. The availability of this line of argument is, however, rare, at least so far as concerns disputes as to the nature of a guarantee. It is only capable of application if the words used in the document *taken as a whole* are materially identical; and if the contractual context in which they are used is materially identical. Both counsel before us were guilty of identifying a word or phrase in the Guarantee and then pointing to an authority in which such word or phrase was part of the language used and in which the result had been a conclusion of surety guarantee on the one hand or demand guarantee on the other, in order to argue that its inclusion was not fatal to the outcome in the case cited, or that its inclusion supported the conclusion in the case cited. Where there is other language in the instrument being construed in the case cited which means that as a whole it is not materially identical to that before the court in the instant dispute, as there was in all but two of the cases cited to us, that is not an appropriate use of authority or valid process of argument because the nature of any given instrument turns upon its language as a whole in its particular commercial context. I would associate myself with the concern expressed by Longmore LJ in *Wuhan* at [22] at the process adopted in the decisions of the first instance judge in that case, and in *Meritz Fire and Marine Insurance Co Ltd v Jan dee Nul NV* [2011] 1 All ER (Comm) 1049, of analysing over 20 authorities in order to resolve the issue. Citation of authority to argue that the inclusion of a particular phrase in the case cited was not fatal to the outcome achieves no more than is achieved by the well-known principle of construction that an instrument is to be interpreted according to the whole of its language.

35. There are only two cases which engage the legitimate line of argument in the present appeal, in my view, namely *Wuhan* and S*pliethoff's*, although I will have to refer to some others cited by the parties to explain their irrelevance. Nevertheless the primary focus should be and remain on the words used by the parties and the commercial context in which they are used. I have addressed the commercial context of the Guarantee, which points in neither direction. I turn to its language.

The language of the guarantee

36. There are a number of features of the language which to my mind are neutral:

(1) Mr Berry relied upon the fact that when the Guarantee was given, and for a period of just over a year afterwards, Reignwood was the buyer under the Shipbuilding Contract, and submitted that it must have been a demand guarantee during that period because to treat it as a surety guarantee in such a two-party

situation would deprive it of any additional value to the Builder. He recognised that the evidence reflected an intention to substitute a special purpose vehicle as the buyer, but submitted that so long as there remained a possibility that the substitution would not occur, the Guarantee must be construed consistently with that possibility. I am unable to accept this argument. The evidence suggests an intention to substitute a special purpose vehicle, as would be common, and that is what occurred, albeit after some delay. The intention from the outset was therefore that there should be the normal three-party situation, as the terms of the Shipbuilding contract confirm in defining Reignwood as the provider of the Guarantee as "Payment Guarantor" rather than "Buyer". There is no warrant for inferring that the parties ever intended or contemplated the possibility of the Guarantee applying in a two-party situation.

(2) Mr Berry relied on the words "as primary obligor" in clauses 1 and 3. However a surety guarantee may be expressed as imposing a primary obligation and not infrequently does so.

(3) Ms O'Sullivan placed reliance on the words "due" and "punctual" payment in clauses 1 and 3; "payable" at the end of clause 2; "punctually" in the first line of clause 4; "in accordance with the Contract" in line 2 of clause 4; and "default" in the penultimate line of clause 3 and the third line of clause 4. All of these, she submitted, involved the concept that the final instalment must actually have become due and payable by way of a liability of the Buyer before the obligations under the Guarantee arose. In *Wuhan*, Longmore LJ treated wording which was similar to this in some respects as a pointer towards the document being a surety guarantee (although other language led to the conclusion that it was a demand guarantee). For my part, I would treat these expressions as neutral because they are equally capable of doing no more than is necessary in a demand guarantee to identify the matters which the Builder must in good faith state in order to make a valid demand, and quite possibly also to identify the liabilities by reference to which any subsequent accounting is to take place. They may be an example of what can hardly be avoided for that purpose, in the language of the passage from *Paget* quoted above.

37. The critical language which, in my view, points strongly towards the Guarantee being a demand guarantee is the combination of the following:

(1) The capitalised words "ABSOLUTELY and UNCONDITIONALLY" in clause 1 and 3. It might be said that the obligations under a demand guarantee are not strictly speaking absolute or unconditional, in that payment is conditional on a valid demand, which itself is dependent on a good faith view of whether there has been a default by the obligor. But that could be said of almost any obligation in any instrument. What this language would convey to a businessman is that the obligations were not conditional on the liability of the Buyer.

(2) The words in clause 1 "[as primary obligor] and not merely as the surety". This is a clear indication that the document is not a surety guarantee. The Guarantor's case is that the Guarantee *was* given merely as a surety. Ms O'Sullivan asked us to treat these words as surplusage; but they are at the heart of the obligation which is identified by clause 1 of the document.

(3) The words in clause 4 that trigger the obligation "upon receipt by us of your first written demand". Payment against demand is the hallmark of a demand guarantee.

(4) The words in clause 4 "[upon receipt by us of your first written demand] we shall immediately pay to you..." Immediate payment would not be appropriate in the case of a surety guarantee, in which some period would be needed for the guarantor to investigate and form a view on whether there was an underlying liability to make the final instalment payment under the Shipbuilding Contract.

(5) Clause 7(a), which expressly provides that obligations on the Guarantor are to be unaffected by any dispute under the Building Contract. Were clause 4 not to contain the proviso in its second half, this would in my view put beyond argument that the instrument is not a surety guarantee: a surety guarantee would make the Guarantor's obligation dependent upon the very thing which clause 7(a) provides is not to affect or prejudice the obligation. The proviso to clause 4 does nothing to alter that conclusion. It is a carve out of what is otherwise a demand guarantee, modifying the parties' rights and obligations in the event that it is triggered in accordance with its terms (which is the second issue). Ms O'Sullivan submitted, and the Judge accepted, that clause 7(a) could be reconciled with the remainder of the document as a surety guarantee by confining it to disputes unrelated to the final instalment. I cannot accept that this is a tenable construction of clause 7(a) for two reasons. First the whole subject matter of the Guarantee is the final instalment; a dispute which is not capable of affecting liability for the final instalment would not be of any relevance to the Guarantee. Secondly, the language of the provision is clearly wide and unlimited. It refers to "any" dispute.

(6) The proviso to clause 4 is also more supportive of the Builder's case than that of the Guarantor. Ms O'Sullivan submitted that it was inconsistent with a liability to pay on demand. I cannot agree. When triggered, it involves an obligation to pay against a document, namely the arbitration award. It does not involve an obligation to pay in respect of an underlying liability. The Guarantor is not party to the arbitration agreement in the Shipbuilding Contract, and but for this proviso would not be bound by any award in an arbitration between the Builder and the Buyer. The award might go by default against the Buyer, without any detailed consideration of the merits, but if the document were a surety guarantee Reignwood would be entitled to challenge whether the Buyer was indeed liable notwithstanding that the tribunal had so held, absent the agreement in the proviso to abide by the award. The proviso therefore binds Reignwood to pay what may not be an underlying liability; it involves payment against a document, namely an award. Another indication that it involves payment against a document, not a liability, is that the obligation arises the moment an award is made, irrespective of any subsequent challenge, for example for procedural irregularity under s. 68 Arbitration Act 1979 (clause 17 of the Shipbuilding Contract contains an express agreement that there would be no right of appeal, but this would only preclude a s. 69 challenge). In other words the proviso to clause 4, if triggered, does not introduce a surety obligation. It is true that it introduces an obligation to pay against a different event from a demand, namely an award, and to that extent, if and when the proviso is

triggered, the obligation is converted into that which I have termed a conditional bond (of which a demand guarantee is but a subset). But I accept Mr Berry's submission that this is all of a piece with the first part of clause 4 being a demand guarantee unless and until the proviso is triggered. It is not consistent with the document being a surety guarantee unless and until the proviso is triggered because it is improbable that such a guarantee based upon secondary liability would include a provision for it to become a guarantee which did not depend upon a secondary liability.

(7) Clause 10 limits the interest payable to 60 days' worth. This envisages prompt payment on demand, not the lengthy delay which might be contemplated to resolve a dispute about the Buyer's liability.

38. There is some force in Ms O'Sullivan's argument that a contrary indication is to be found in clauses 7(b), (c) (e) and (f), which are clauses typically inserted in a surety guarantee to protect the beneficiary against the rule in *Holme v Brunskill* (1877) 3 QBD 495 and other circumstances in which the beneficiary loses the benefit of the guarantee. I regard that contrary indication as having limited weight and as insufficient to displace the much stronger factors I have identified, partly because such boilerplate clauses could not by a side wind outweigh the pointers in the clauses dealing with primary obligation; and partly because these standard terms may have been included out of an abundance of caution for the benefit of the Builder against the event that, contrary to its intention, the document was alleged and found to be a surety guarantee: they would at least preserve the benefit of the guarantee as a surety guarantee in such eventuality, in circumstances in which, for example, the rule in *Holme v Brunskill* would otherwise deprive it of any efficacy at all.

The authorities

39. In *Wuhan*, the court was concerned with a payment guarantee given pursuant to a shipbuilding contract between a Chinese builder and a Greek buyer. The guarantee was given by the buyer's bank to the builder for the second instalment of the price. The guarantee contained language which Ms O'Sullivan accepted was materially indistinguishable from the Guarantee in the instant case, save that there was no equivalent to the proviso to clause 4. It was held to be a demand guarantee.

40. At [22] Longmore LJ, giving a judgment with which Rimer and Tomlinson LJJ agreed, deprecated the exercise of extensive citation of authority to determine how near or how far the document in question differed from the document construed in a past case. He observed that the commercial community deserved better than this, if better could be done. He then identified the pointers in each direction in the language of the guarantee in that case at [23] and [24], and observed at [25] that it would be absurd to tally these numerically to reach a conclusion, but that the court should if possible assist commercial men to determine their obligations. He said, "The only assistance which the courts can give in practice is to say that while everything must in the end depend upon the words actually used by the parties, there is nevertheless a presumption that, if certain elements are present in the document, the document will be construed in one way or the other." He went on at [26] to say:

> "It is exactly this kind of assistance that the editors of Paget's Law of Banking have endeavoured to provide. In the 11th edition of that work these words appeared under the heading of "Contract of Suretyship v. demand guarantee":-
>
> > "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."

41. His conclusion at [31] was that the combination of the positive factors in favour of the document being a guarantee, taken together with the presumption, led to the conclusion that it was a demand guarantee. I would for my part treat the decision as fully justified on the language of the instrument without reference to any presumption. The application of a presumption does not sit entirely comfortably with the statements in this court by Tuckey LJ in *Gold Coast Ltd v Caja de Ahorros del Mediterraneo* [2002] 1 All ER (Comm) 142 at [15] endorsed by Waller LJ in *IIG Capital v Van Der Merwe* [2008] 2 All ER (Comm) at [7], albeit outside the shipbuilding context, that the instrument in each of those cases should be construed "by looking at it as a whole without any preconceptions as to what it is."

42. In fact condition (iv) identified by Paget for the operation of the presumption was not fulfilled in *Wuhan*, and any presumption which falls to be applied if certain conditions obtain may lead to error if it is applied where only some of the conditions obtain. As Longmore LJ himself emphasised at [25], everything must in the end depend upon the words actually used by the parties.

43. The danger of applying presumptions in this area is illustrated by the argument in the present case. Ms O'Sullivan sought to distinguish *Wuhan* on two grounds, which in essence reflected the view the Judge appears to have taken. The first was that there was no equivalent to the clause 4 proviso in that case. This is a legitimate argument on the wording of the instrument, but is unsound because, for the reasons I have given, the presence of the proviso reinforces rather than undermines the nature of the instrument as a demand guarantee. Her second point of distinction was that the guarantee in this case was given by a parent not a bank, so that only two of the four Paget conditions for the presumption existed. Mr Berry's argument was that that did not prevent the presumption arising because of the financing nature of Reignwood's involvement in this case, which he said put it somewhere between a parent and a bank, and the court's application of the presumption in *Wuhan* notwithstanding the non-fulfilment of condition (iv). I have explained why in the shipbuilding context, at least, it ought to make no difference whether the guarantor is a bank or a parent, so that Ms O'Sullivan's second ground for distinguishing *Wuhan* involves a distinction without a difference. But the argument points up the futility of seeking to apply a presumption in circumstances in which only some of the conditions for its existence obtain. Which are the important ones if not all are required? Without clear answers to such a question, the court is not by constructing a presumption which is applied in this way assisting the commercial community in promoting certainty as to the nature and legal consequences of their instruments. If resort is to be had to presumptions at all, the utility of which I would respectfully doubt at least outside the classic context of performance bonds, they should, in my view, be confined to circumstances where all the stated conditions are

fulfilled. Moreover and in any event, the primary focus must always remain on the words used by the parties in their context.

44. That said, *Wuhan* is a decision of this Court, in a similar context, on wording which contains no material distinction from the language of the Guarantee in this case. Considerations of commercial certainty suggest that the result should be the same in this case and support the conclusion I have myself reached on the language of the instrument.

45. The same is true of the decision of Carr J, as she then was, in *Spliethoff's*. In that case the shipbuilding contracts for two vessels, Hulls 38 and 39, were between Chinese builders and Dutch buyers, and the dispute concerned the refund guarantee given to the buyers by the Bank of China. The wording of the instrument was materially the same as that in the present case, including the equivalent of the proviso in clause 4, although the structure of the clauses was different. Carr J conducted her own analysis of the wording and followed *Wuhan* in determining that it was a demand guarantee.

46. That would be all the authority I would regard it as appropriate to refer to. However in deference to the argument of Ms O'Sullivan, I will deal briefly with two other authorities on which she relied.

47. *Marubeni Hong Kong and South China Ltd v Mongolian Government* [2005] 1 WLR 2497 was a case in which Hong Kong sellers agreed to supply to Mongolian buyers a textile plant and machinery, and a guarantee of the buyers' payment obligations was provided by the Mongolian Minister of Finance. It was held to be a surety guarantee. The context and wording of the instrument were very different from those in the present case, such that it provides no direct assistance in resolving the current dispute. Ms O'Sullivan relied upon it in particular for what it said about presumptions. Carnwath LJ referred to the authorities relied on by counsel for the sellers (*Esal Commodities Ltd v Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546; *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146; *IE Contractors Ltd v Lloyds Bank plc* [1990] 2 Lloyd's Rep 496; and *Gold Coast Ltd v Caja de Ahorros del Mediterraneo* [2002] 1 All ER (Comm) 142) and observed at [23] that they arose in the context of specialised forms of banking instrument developed by the banking world for its commercial customers, intended to be as good as cash in hand. He went on to say that it could not be assumed that cases relating to such banking instruments provide any useful guidance when construing guarantees given "outside the banking context". Having analysed the cases he said at [28] that they provided no useful analogy "for interpreting a document which was not issued by a bank and which contains no overt indication of an intention to create a performance bond or anything analogous to it." Having observed at [30] that there was nothing in the language used to describe the document, either in the instrument itself or in the legal opinion provided with it, to suggest it was an on demand bond, he continued:

> "The absence of such language, in a transaction outside the banking context, creates in my view a strong presumption against [the sellers'] interpretation…
>
> 31. The question then becomes whether there are sufficient indications in the wording of the instrument to displace that presumption."

48. Ms O'Sullivan relied on this passage to support her submission that the present case is "outside the banking context" and accordingly the starting point is a strong presumption

against the Guarantee being a demand guarantee. I cannot accept that Carnwath LJ was purporting to lay down a presumption as applicable to *all* cases "outside the banking context", by which he clearly meant the context of the performance bonds in the cases relied on by counsel for the sellers. What he said was directed to rejecting the reliance on those cases by the sellers, and to the context of that case. In the current dispute the different shipbuilding context produces no a priori assumption one way or another for the reasons I have endeavoured to explain.

49. Ms O'Sullivan also placed particular reliance on the decision of Sir William Blackburne in *Vossloh Aktiengesellschaft v Alpha Trains (UK) Ltd* [2011] 2 All ER (Comm) 307. The instrument was there held to be a surety guarantee, notwithstanding that it included the wording "and not merely as surety". However it was in a different context to the current case, and the wording of the instrument was very different. In particular in the language identifying the obligation there was a clear indication of secondary liability. It provides no assistance to the Guarantor in the current case.

The Respondents Notice

50. Ms O'Sullivan had an alternative argument, raised in a Respondent's Notice, that if the Guarantee was not a surety guarantee, nevertheless it was a conditional bond which in the event of dispute made it payable not on demand but conditional upon the rendering of an award. This argument adds nothing to the first issue and depends upon the resolution of the second issue. The Guarantee is a demand guarantee unless and until the proviso is validly triggered, in which case it becomes an obligation to pay against an award. The question which is raised by the second issue is whether the proviso can be triggered without the commencement of arbitration prior to the making of the demand. If so, Ms O'Sullivan's argument adds nothing: Mr Berry does not dispute that if the proviso applies the Builder must wait for an award; if, on the other hand the proviso cannot be triggered absent an arbitration commenced prior to demand, the nature of the obligation is to pay on such demand.

The Judgment

51. The Judge discussed the presumptions referred to in *Marubeni* and *Wuhan*, observing that there were material differences in those cases from the circumstances of the current dispute. Having considered the rival arguments on the terms of the Guarantee, he concluded that "the language of the Guarantee does not make the grade of a demand guarantee without the help of a presumption and … no presumption is successfully engaged." I would agree that no presumption is engaged, but have reached a different conclusion on the language of the Guarantee.

Conclusion on the First Issue

52. I would allow the appeal on the first preliminary issue and determine it in favour of the Builder.

Second Issue

53. Mr Berry submitted that in order for the proviso to be triggered there must be both a dispute and the commencement of arbitration prior to a valid demand being made. If that has not occurred before a demand is made, the Builder has an accrued right to

payment under the Guarantee, which is a right to payment "immediately upon a valid demand". It would require clear language to divest a party of an accrued right and the proviso contains no such language. Moreover divesting the Builder of an accrued right would be to permit Reignwood to take advantage of its own wrong (whilst also the buyer) or to procure that result by the failure of its subsidiary to pay (after the novation).

54. I agree that that is the effect of the language of the proviso. It defines the circumstances in which the demand guarantee ceases to be payable on demand and becomes payable against an award. It provides, unsurprisingly, that the commencement of an arbitration is necessary to convert the obligation to become one to pay against an award. That is the natural meaning of the words: it requires not only that there is a dispute but also that the dispute "is submitted" to arbitration. Both are expressed as the condition on which the Guarantor is "entitled to withhold or defer payment." If an accrued right to payment has arisen at the date of demand, there is nothing in the clause to suggest that it is thereafter suspended, or if enforced that there is a right of repayment pending the award.

55. Ms O'Sullivan sought to meet this difficulty by suggesting that the existence of a dispute alone prevented the sum being payable on demand; and that the Builder could always ensure that there was thereafter an arbitration because it could commence one itself. She submitted that a 15-day window in which to commence an arbitration, as the opportunity to convert the obligation into one to abide by the award, was an artificial and uncommercially short time, especially given the terms of the arbitration clause which contemplated an attempt at amicable settlement and an attempt to agree a single arbitrator.

56. I am unpersuaded by these points. The language of the proviso does not suggest that it is triggered by a dispute alone, but only when and if the dispute is submitted to arbitration. If Ms O'Sullivan were right, the on demand obligation would be suspended indefinitely by the existence of a dispute, and that would occur in every case of non-payment of the delivery instalment because, on her argument, "dispute" here means an arbitrable dispute which exists merely by reason of non-performance of the payment obligation. If the buyer is not prepared to put its money where its mouth is in commencing an arbitration, there seems no reason why the proviso should in effect place an obligation on the Builder to do so at risk of irrecoverable cost against a no ship company, and there is nothing in the language of the proviso to justify such a conclusion. On the other hand the parties could reasonably expect that the Guarantor would be in a position to procure the commencement of an arbitration by the special purpose vehicle it had proffered to be the buyer.

57. As to the shortness of the window for commencement of arbitration, it would in practice likely be more than 15 days, since under the Shipbuilding Contract, the Builder has to give 10 prior days' notice of the final instalment being due, so that the Buyer will know of a potential claim on the Guarantee 25 days before it can be made, when the state of the Vessel will likely be known. The arbitration clause involves no obligation to seek to settle amicably before commencing arbitration, and no obligation to seek to agree a single arbitrator. The fact that those are contemplated as possibilities does not suggest that the window for commencement of arbitration is uncommercially short. A short timeframe is entirely understandable in what is otherwise a demand guarantee whose essential rationale is to protect cashflow.

58. Ms O'Sullivan sought to support her conclusions by reference to the facts of *Spliethoff's* which contained a similar provision and in which an arbitration was commenced after the demand. This reliance is misplaced. The point was not argued in that case, because it was not available to the guarantor. In the case of Hull 38 the arbitration was indeed commenced after the demand, but in that case the guarantee obligation was to pay 30 days after demand, not on demand; and the arbitration was commenced within that 30 day period. The guarantor therefore did not acquire a cause of action before the proviso was triggered: see [21] and [26]-[28]. For Hull 39 there was an irrelevant arbitration which had earlier been concluded, but no subsequent arbitration to trigger the proviso: see [151].

59. The Judge concluded that there was nothing in the language of the proviso which indicated an intention to require commencement of an arbitration prior to demand; and that he could not see that commercial parties would contemplate that what should matter was being first to arbitration or to demand. For the reasons I have endeavoured to explain, in my view the language of the proviso does indicate such an intention; and there is nothing uncommercial in a proviso to a demand guarantee, intended to protect cash flow, having a relatively short window in which to trigger the conversion of the entitlement into one involving considerable delay.

60. Accordingly I would also allow the appeal on the second preliminary issue and determine it in favour of the Builder.

Lord Justice Baker :

61. I agree.

Sir Geoffrey Vos, MR :

62. I also agree.