



DEMAND GUARANTEES

PRACTICAL ISSUES

PAVEL ANDRLE

WORDING OF GUARANTEE

- Is it truly a demand (abstract, independent guarantee) and not an accessory guarantee (suretyship)?
- Who is the issuer?
 - (a) Bank;
 - (b) Insurance company;
 - (c) Surety or fidelity company;
 - (d) Corporation?
- Is the guarantee effective/operative?

WORDING OF GUARANTEE

- Is the reduction, termination clause well drafted and workable?
- *Are conditions for demand only documentary and under control of the Beneficiary?*
- Is the expiry workable? What is it?
- Is Expiry date enforceable under the governing law?

GUARANTEE PRACTICE - ISSUES

- No expiry: date (an event)!?
- Evergreen clause(s)
- Operative clause – advance/retention payment
- Reduction clause – payment, document
- Examination of demand – what to examine, standard of compliance?

**Classification of a Payment
Guarantee – is it an independent
guarantee or a conditional one?
Recent English Law Cases**

**How to determine whether payment
guarantee in hand is the independent
one or the conditional?**

*MARUBENI HONG KONG AND SOUTH
CHINA LIMITED and THE MONGOLIAN
GOVERNMENT [2005] EWCA Civ 395*

**Classification of a Payment
Guarantee – is it an independent
guarantee or a conditional one?
Recent English Law Cases**

**How to determine whether payment
(refund) guarantee in hand is the
independent one or the conditional?**

*Wuhan Guoyu Logistics Group Co Ltd v
Emporiki Bank of Greece SA [2012]
EWCA Civ 1629*

ISSUE

Was the Payment Guarantee a guarantee or an on-demand bond?

Seller submits that the Payment Guarantee is in the nature of a *demand or performance bond*. Payment is due upon a written demand, whether or not the payment which the bond "guarantees" is actually due by the Buyer to the Seller. That demand has been made and the Seller claims summary judgment for the principal and interest.

Bank contends that the instrument is a *guarantee* properly so called. If the Second Instalment was and is not due, there can be no liability under the guarantee. There is a dispute as to whether the Buyer is liable to pay the Second Instalment which – as is common ground – has not yet come to a conclusion. The Seller must await the final determination of that question. If successful it can then recover under the Payment Guarantee.

Reasoning of the Judge

The difficulty, as so often in these cases, is that there are pointers in different directions. The following points might be thought to favour a conclusion that the document is a **traditional guarantee (yellow)**:

- i) it is called a "*payment guarantee*" not an "*on demand bond*";
- ii) clause 1 says that the Bank guaranteed "*the due and punctual payment by the Buyer of the 2nd instalment*";
- iii) clause 2 describes the second instalment as being payable (in terms different from Article 3(b) of the Building Contract) 5 days after completion of cutting of the first 300 metric tons of steel of which a written notice is to be given with a certificate countersigned by the Buyer;
- iv) clause 3 guarantees the due and punctual payment of interest;
- v) clause 4 imposes an obligation on the Bank to pay "*in the event that the Buyer fails punctually to pay the second instalment*";
- vi) clause 7 says that the guarantor's obligation is not to be affected or prejudiced by any variations or extensions of the terms of the shipbuilding contract or by the grant of any time or indulgence.

Conversely the following points might be thought to favour a conclusion that the document is an "on demand" bond:

- i) clause 4, which is the clause which requires payment by the Bank, provides that:
 - a) payment is to be made on the Seller's first written demand saying that the Buyer has been in default of the payment obligation for 20 days; and
 - b) payment is to be made "immediately" without any request being made to the Seller to take any action against the Buyer;
- ii) clause 7 provides that the Bank's obligations are not to be affected or prejudiced by any dispute between the Seller and the Buyer under the shipbuilding contract or by any delay by the Seller in the construction or delivery of the vessel;
- iii) clause 10 provides a limit to the guarantee of US\$ 10,312,500 representing the principal of the second instalment plus interest for a period of 60 days; it is thus not envisaged that there will be any great delay in payment after default as there will be if (as in the present case) there is a dispute about whether the second instalment has ever become due.

Page's Law of Banking – guidance "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.*

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."

Court Appeal referred to the factors which the first instance judge considered demonstrated that the Payment Guarantee was a guarantee rather than an on-demand bond. These factors are set out in paragraph 30 of the judgment:

- i) the document is called a "*guarantee*";
- ii) when referred to in the exhibits to the contract, it is called an "irrevocable letter of guarantee";
- iii) clause 1 contains the "core obligation" guaranteeing the due and punctual payment of the second instalment and identifies the second instalment in the terms set out in clause 2 without at that stage saying anything about agreeing to pay on demand;
- iv) clause 3 relating to interest requires the Buyer to be in default;
- v) clause 4 follows on from clauses 1, 2 and 3 and calls for payment "*in the event that the Buyer fails punctually to pay*" and goes "well beyond" what is needed for the purpose of identifying the obligation for which the security was being given;
- vi) the closing words of clause 4 would be unnecessary if the document was an on demand guarantee;

- vii) the later words of clause 7 were only necessary if the document was a true "see to it" guarantee;
- viii) the Bank was not providing the guarantee for a set fee but was closely connected with the whole transaction which it was financing;
- ix) although the contractual background did not provide any sure guide to the contract's correct interpretation, the judge was struck by the fact that the Bank could find itself having to pay up to the amount of the second instalment without any Refund Guarantee being in place from the Seller's bank to secure its return. The refund guarantee had to be provided before the second instalment was due under the contract and indeed arbitrators have now held (subject to any appeal for which leave might be given) that because it was not provided in the appropriate terms, the Buyer was not in fact obliged to pay the second instalment. The judge evidently thought reciprocity was appropriate.

Conclusion of the Judge

The Court of Appeal accepted these were valid points but they did not have regard to previous authority: the first instance judge should have considered Padgett's guidance and the related authority.

The Court of Appeal confirmed Paget's guidance should **apply as a strong presumption where the obligation to pay is expressed to be "on demand"**, and added that it should even apply in circumstances where the fourth criterion is not satisfied (namely, where the security document does not contain clauses excluding or limiting the defences available to a guarantor). In reaching this conclusion, the Court of Appeal applied its earlier decision in *Gold Coast Ltd v Caja de Ahorros* [2002] 1 LIR 617.

GUARANTEE TEXT – CASE STUDY



If you make an advance payment of GBP100,000.00 to Global Business plc we undertake to pay you on demand GBP100,000.00 plus interest if Global Business plc fails to perform Contract No. 1234 dated 1 June 2018 for the supply of a new computerised booking system irrespective of any court order made against us.

Our liability will be reduced by 10% of the value of deliveries to you on presentation of appropriate documentary evidence to us.

This undertaking expires on completion of the works or 1 June 2020, whichever is earlier.

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URDG Demand guarantee requires:

- demand and
- copy of an invoice and
- copy of a transport document.

Beneficiary presents:

- demand, copy of an invoice and a copy of a document described as „acceptance protocol“ which confirms receipt of the goods and is signed by the Applicant.



Question: *Is the presentation complying?*

- 1. Are there any arguments for accepting such a presentation as complying?**
- 2. On the other hand, can we argue that the presentation does not comply?**

Article 23: „Extend or Pay“

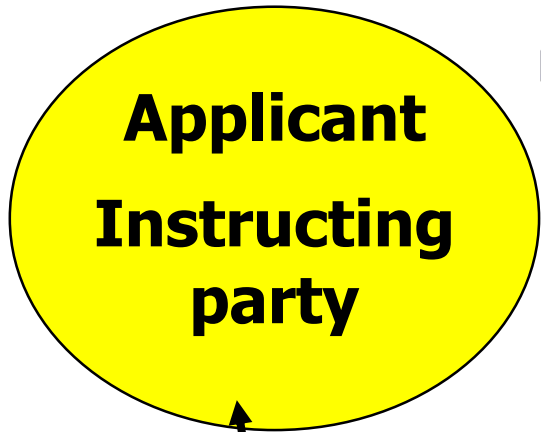


Complying demand – includes as an alternative a request to extend the expiry:

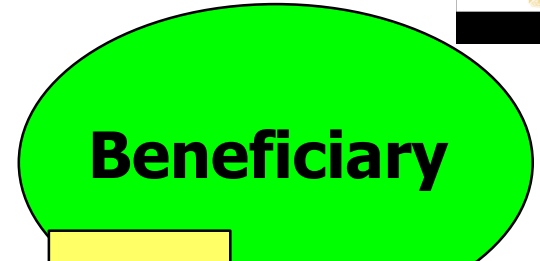
Guarantor may suspend payment ⇒
for period upto **30 calendar days**

- following the day of demand
- to inform the Instructing party

and decide whether to „**extent or pay**“



Underlying relationship



**max 30
days
suspension**

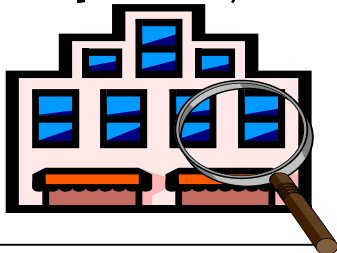
demand

Extend
or
pay

Guarantee
*We herewith
undertake to pay
you on your first
demand.....*
URDG 758

Information
about
suspension

Suspension
for period max
4 days less



COUNTER- GUARANTOR



Counter- Gu
We herewith under
you on your first de

Extend
or
pay

GUARANTOR

Article 23: „Extend or Pay“



Complying demand under Counter-guarantee – includes as an alternative a request to extend the expiry:

Counter-guarantor may suspend payment



for a period **not exceeding four calendar days less than the period** during which payment of the demand under the Guarantee was suspended.

Article 23: „Extend or Pay“



- The demand for payment is deemed to be withdrawn if the period of extension requested in that demand or otherwise agreed by the party making that demand is granted within the period.
- No such period of extension is granted, the **complying demand shall be paid without the need to present any further demand.**
- The Guarantor or Counter-guarantor **may refuse to grant any extension** even if instructed to do so and shall then pay.

EXTEND OR PAY – ANY ISSUES?



- ☹️ **Can it be a fraudulent demand?**
- ☹️ **What to do with only „*extend*“ demands?**
- ☹️ **„*Extend or pay*“ demand does not comply – what to do?**
- ☹️ **„*Extend or pay*“ does not indicate the period of suspension taken by the Guarantor.**
- ☹️ **„*Extend or pay*“ does not specify the required period of extension.**



Thank you
for your kind
attention