International Arbitration Alert

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A High Point for On-Demand Bonds: English Court of Appeal Questions 'Paget's Presumption'; English High Court Rejects Emergency Arbitrator to Stop a 'Call'; and Singapore Court of Appeal Supports Express Exclusion of 'Unconscionability' Ground

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On-Demand Bonds or Guarantees are preferred relative to "see to it" Bonds or Guarantees. This is because under On-Demand Bonds the obligation to pay arises through a demand being made under the Bond whereas under a "see to it" or conditional Bond the beneficiary is entitled to receive payment only after establishing a liability of the principal in the underlying contract.[i] On-Demand Bonds are instruments of primary liability and, commensurate with the autonomy principle, typically operate independent of the rights and obligations in the underlying contracti. On-Demand Bonds are currently enjoying a high point in terms of enforceability. We say this because:

- The English Court of Appeal in *Shanghai Shipyard Co. Ltd. v Reignwood International Investment (Group) Company Ltd* [2021][ii] has rejected "Paget's Presumption" (that where an instrument is not issued by a bank or other financial institution, it was unlikely to be an On-Demand Bond and "cogent indications that the instrument was intended to operate as a demand guarantee will be required") stating that it would be "a recipe for commercial uncertainty" if a bond given by a bank would "mean something different" if the exact same wording was adopted by a non-bank. The identity of the guarantor should not lead to any preconceptions as to the nature of the bond.
- The English High Court in *Shapoorji Pallonji & Company Private Ltd v Yumn Ltd & Standard Chartered Bank* [2021][iii] considered the legal question of how an English Court should exercise its powers to restrain a bond call, where the underlying dispute to which the bond call related was a dispute that was to be resolved in international arbitration. The Court rejected the Emergency Arbitrator[iv] "option" thus upholding the notion that autonomous financial instruments take effect without regard to related and underlying disputes.
- While courts in Malaysia and Singapore have increasingly recognised unconscionability as a "separate and independent ground" in restraining "calls" on bonds and guarantees, parties now seek to expressly exclude the ground of

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unconscionability by contract. The practice of excluding unconscionability is spreading (perhaps out of caution) beyond the Far East and especially in jurisdictions where good faith is relevant. Happily, jurisprudence from the Singapore Court of Appeal in *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd* [2015][v] makes clear that such clauses are not void and unenforceable—they merely limit the right to an equitable remedy and are not therefore an ouster of the jurisdiction of the court.

Rejection of "Paget's Presumption"

Shanghai Shipyard Co. Ltd. v Reignwood International Investment (Group) Company Ltd considered the proper construction of a guarantee given to support the obligation of a buyer to pay the final instalment of the price under a shipbuilding contract. The respondent, Reignwood (a Hong Kong company), had provided the guarantee but later sought to limit its enforceability on the basis of the "Paget's Presumption". Reignwood was part of an international multi-industrial conglomerate first established in Thailand in 1984. It described itself as offering investment services and investing in airport construction, metal processing, food manufacturing and technology sectors—it was not a bank or a financial institution. Paget's Law of Banking 11th edition, under the heading of "Contract of Suretyship v. demand guarantee", stated:

"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." (Emphasis added.)

Reignwood argued that it was not a bank and hence the presumption must be that the guarantee was not on-demand. The Court of Appeal rejected use of the so-called "Paget's Presumption" stating at [43]:

"[There is] 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."

Having rejected the presumption, the Court of Appeal looked at the critical language that pointed towards the instrument being an on-demand guarantee, citing at [37]:

(1) The capitalised words "ABSOLUTELY and UNCONDITIONALLY" in clause 1 and 3 language that would convey to a businessman 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" that gave a clear indication that the document was not a surety guarantee.

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(3) The words in clause 4 that triggered the payment obligation “upon receipt by us of your first written demand” which were “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...” that indicated immediate payment which would not be appropriate in the case of a surety guarantee (because in that latter case, 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).

(5) Clause 7(a), which expressly provided that obligations on the Guarantor are to be unaffected by any dispute under the Building Contract (a “see to it” guarantee would make the Guarantor’s obligation dependent upon the very thing which clause 7(a) provided was not to affect or prejudice the obligation).

(6) Clause 10, which limited the interest payable to 60 days’ worth and which the Court considered indicated the need for prompt payment on demand, (compared to the lengthy delay which might be contemplated to resolve a dispute about the Buyer's liability under the underlying contract).

Labels and presumptions are not always conclusive. As explained above, the Court of Appeal has rejected “Paget’s Presumption”, which in the *Reignwood* call could have been fatal since the guarantor was not a bank. Similarly, one must be cautious to not automatically assume that an instrument that incorporates the ICC Uniform Rules for Demand Guarantees (URDG) is highly likely to be an on-demand bond rather than a conditional or “see to it” bond. However, in Au*toridad del Canal de Panama v Sacyr SA*[vi] Blair J at [81(7)] considered that the incorporation of the URDG is “likely to be determinative” to characterise the instrument as an on-demand bond.

Rejection of the Emergency Arbitrator

In *Shapoorji Pallonji & Company Private Ltd v Yumn Ltd & Standard Chartered Bank*, the Engineering, Procurement, and Construction (EPC) Contractor’s case was “beguilingly simple”. The Contractor asserted that the question whether or not to order Yumn to withdraw its demand or restrain it from presenting another is ultimately one for the emergency arbitrator and, thereafter, and to the extent necessary, a fully constituted arbitral panel. In that case, the Contractor contended that the Court should grant the orders sought without regard to any of the well-established principles relating to the approach an English court takes to attempts to prevent a beneficiary from recovering what is due on an on-demand bond, or a similar instrument, on the basis that:

- the substantive agreement between Yumn and the Contractor contains an arbitration agreement;
- the dispute between the parties as to whether Yumn is entitled to make a demand under the Bond is one that must be determined under the arbitration agreement; and
- the question whether Yumn should be restrained from claiming payment under the Bond should be determined by an emergency arbitrator appointed under the ICC rules [being the institutional arbitration rules the parties have agreed upon] will apply to any arbitration between them.

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The Contractor submitted (and it was agreed) that such an arbitrator will apply different and significantly laxer principles than those that are applied by the English courts and that, therefore, the Court should grant an interim order that in effect precludes Yumn from claiming sums due under the Bond until an emergency arbitrator can determine the dispute under the underlying contract.

The Court did not agree with the Contractor. By clause 12 of the Bond, the Bond and all non-contractual obligations arising from or connected with it were governed by English law, and clause 13 provided that the courts of England and Wales would have exclusive jurisdiction to determine any disputes arising from or connected with the Bond. None of this was in dispute.

Further, no authority had been cited to support the point that the Court should apply a different approach to an application under section 44 of the Arbitration Act 1996 from that which would apply to an application under section 37 of the Senior Courts Act 1981. The Court considered that there is no principled reason for adopting a different course where the party seeking an injunction from the English courts could have but chose not to refer a dispute to arbitration and apply for interim measures using such a procedure. If a party applies to an English court for an injunction to restrain a beneficiary of an on-demand bond from enforcing payment, that court will apply the same principles.

The *Shapoorji Pallonji* case does not tell us what would happen if an Emergency Arbitrator had been appointed before the “call” and Yumn had in turn applied to the English Courts. The use of arbitration interim measures seeking to stop calls on autonomous bonds cannot be discounted. The autonomy principle is important and may well determine threshold jurisdiction (i.e., arbitration or court).

Excluding Unconscionability

In the Far East, there has been a tangible increase in the number of injunctions seeking to restrain a call on a performance bond based on unconscionability. For example, in *Samsung C&T Corp v Soon Li Heng Engineering Pte* Ltd[vii], the Supreme Court of Singapore held that it is unconscionable for a party to make a demand on a performance bond in circumstances where the effect of so doing will be to negate an Adjudication Decision prior to any final determination of the dispute between the parties because of the legislative scheme embodied in the Building and Construction Industry Security of Payment Act (Cap 30B, 2006 Rev Ed). Similarly, *Maxwell Accent JV Sdn Bhd v Kuala Lumpur Aviation Fuelling System Sdn Bhd*[viii] concerned an application for an injunction to restrain the employer from calling on or receiving the proceeds under a bank guarantee pending the commencement and disposal of their dispute by arbitration. The Court of Appeal granted the injunction, noting that there was sufficient evidence to demonstrate a strong prima facie case that “the events leading to the call and conduct of the [employer] are of such degree as to prick the conscience of a reasonable and sensible man”. Similarly, in *Dunggon Jaya Sdn Bhd v Aeropod Sdn Bhd*[ix], the contractor argued that under express terms of the bank guarantee, monies should be released by the guarantor bank only once the contractor is found to be in breach of the contract. The Malaysian Court of Appeal noted that the bank guarantee was an unconditional or on-demand performance bond, but the employer was nevertheless restrained from calling on the bank guarantee on the basis that it was unconscionable to do so.

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Unconscionability, as a ground to restrain a call on a bond can be excluded by the parties using express terms in the underlying contract. This is important. There is a view that the unconscionability ground will be attractive in civil law jurisdictions where good faith is a welcome concept. The *Singapore Court of Appeal decision in CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd*[x] is compelling. In that case, the main contract between Asplenium and CKR required CKR to provide a performance bond for 10 percent of the contract sum in Asplenium's favour. The main contract also contained a clause ("cl 3.5.8") which stated, *inter alia*, that CKR was not (except in the case of fraud) entitled to restrain a call on the performance bond on any ground, including the ground of unconscionability. Asplenium subsequently made a call on the performance bond. CKR applied for an injunction to restrain payment from being made to Asplenium, relying on the ground of unconscionability. CKR argued that cl 3.5.8 was void and unenforceable because it was contrary to public policy as an ouster of the jurisdiction of the court. The Singapore Court of Appeal held that cl 3.5.8 was not void and unenforceable for being contrary to public policy. It merely sought to limit the right to an equitable remedy and was therefore not an ouster of the jurisdiction of the court. Andrew Phang Boon Leong JA at [24] stated:

"… a clause such as cl 3.5.8 is one which seeks to *limit* the *right* to an *equitable remedy* (as opposed to one that seeks to oust the jurisdiction of the court). Whilst it is true that CKR did argue that cl 3.5.8 was a clause that sought to exclude the discretion of the court to order an injunction in the context of an alleged unconscionable call on a performance bond, this was *not* an *ouster* of the *jurisdiction* of the court as such. On the *contrary*, such a clause could, as already noted, be (at least potentially) *subject* to the scrutiny of the court pursuant to, *inter alia*, the relevant provisions of the UCTA and, looked at in this light, *neither* party has been denied access to the court as such …"

The Singapore Court of Appeal jurisprudence is compelling but has not been tested in other jurisdictions. Nevertheless, it is apprehended that express terms will be increasingly used across jurisdictions to exclude the discretion of the court to order an injunction in the context of an alleged unconscionable "call".

[i] It is well understood that, in the event that the sum demanded by the beneficiary is more than the beneficiary's entitlement under the underlying contract, that is an issue for the beneficiary and principal rather than the guarantor. Typically, any overpayment is recovered commensurate with the 'accounting principle' in a subsequent accounting back. For more details see *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA* [2013] EWCA Civ 1679, [2014] 1 Lloyd's Rep 273, [2014] BLR 119.

[ii] [2021] EWCA Civ 1147, [2021] WLR(D) 417.

[iii] EWHC 862 (Comm).

[iv] When considering interim measures in international arbitration, Emergency Arbitrators typically apply so-called 'transnational concepts', which focus more on the preservation of the status quo between the parties, as a means of protecting the efficacy of the arbitration process as a whole.

[v] SGCA 24.

[vi] [2017] EWHC 2228 (Comm), [2017] 2 Lloyd's Rep 351.

[vii] [2020] SGCA 79.

[viii] Civil Appeal No. W-02(C)(A)-827-04/2017.

[ix] Civil Appeal Nos. S-02(NCVC)(A)-1146-06/2017 and S-02(NCVC)(A)-1147-06/2017.

[x] [2015] 3 SLR 1041.

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