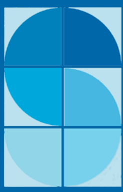


serle court

JUDGMENT

Shanghai Shipyard v Reignwood International Investment (Group) Company Ltd [2020] EWHC 803 (Comm)

In ***Shanghai Shipyard v Reignwood International Investment (Group) Company Ltd,*** [2020] EWHC 803 (Comm) Mr Justice Knowles has ruled that a guarantee given by a parent company of the obligation of its subsidiary to pay the final instalment under a shipbuilding contract is not a performance bond or "demand guarantee", but a traditional "see to it" guarantee.

The decision follows the guidance of the Court of Appeal in ***Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank*** [2012] EWCA Civ 1629, that in the interests of commercial certainty the courts should have regard to established presumptions, and should not need to trawl through dozens of previous authorities in order to determine the nature of the surety's liability. In this case, the critical factor for the court was the fact that the guarantee was issued by the parent company, and not by a bank or other financial institution.

The facts

The Shanghai Shipyard is owned by the Chinese state. Reignwood is an investment company based in Hong Kong.

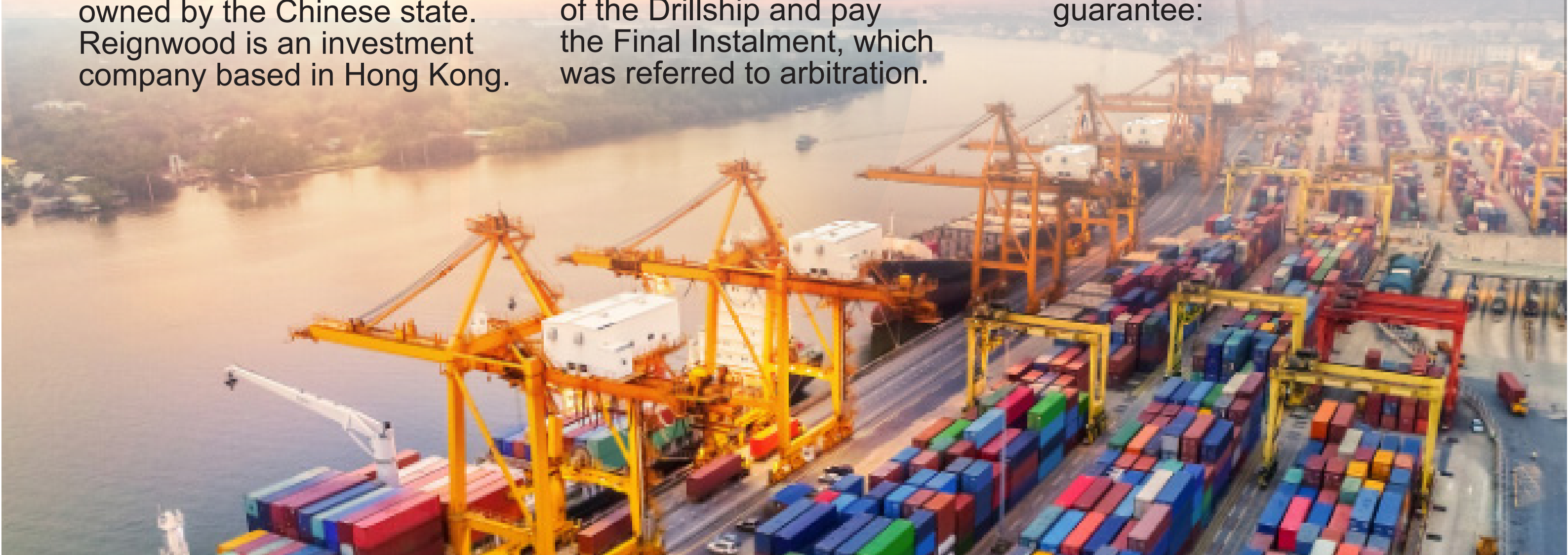
Under a shipbuilding contract made in 2011, the Shipyard agreed to construct a Tiger Class drillship for a total price of US$200m. The owner was OT1, a special purpose vehicle and indirect subsidiary of Reignwood, which guaranteed payment of the final instalment of US $170 million. A dispute arose between the Shipyard and OT1 as to whether OT1 was obliged to take delivery of the Drillship and pay the Final Instalment, which was referred to arbitration. The Shipyard also brought a claim in the Commercial Court, claiming that it was entitled to immediate payment in full under the guarantee. Mr Justice Knowles disagreed, and stayed the claim pending the outcome of the arbitration.

Under a shipbuilding contract made in 2011, the Shipyard agreed to construct a Tiger Class drillship for a total price of US$200m. The owner was OT1, a special purpose vehicle and indirect subsidiary of Reignwood, which guaranteed payment of the final instalment of US $170 million. A dispute arose between the Shipyard and OT1 as to whether OT1 was obliged to take delivery of the Drillship and pay the Final Instalment, which was referred to arbitration.

Demand bonds vs "see to it" guarantees

This case raises a frequently occurring issue as to whether a document labelled "guarantee" is a demand bond (which is not a guarantee at all but obliges the surety to pay on demand without any investigation of the underlying dispute under the shipbuilding contract), or a secondary obligation to pay only once the liability of the main debtor has been established by a judgment or arbitration award.

It is often very difficult for a court to decide this question because even standard form documents can use language which is confused and self-contradictory. To create greater certainty, the courts have favoured two presumptions to assist in resolving the dispute, both of which were relevant in this case. The first is the "Paget presumption" set out in **Paget's Law of Banking** endorsed by the Court of Appeal in ***Wuhan v Emporiki Bank***, above, which identifies that where the instrument meets the following four conditions, it will "almost always" be a demand guarantee:



(i) it relates to an underlying transaction between parties in different jurisdictions;

(ii) is issued by a bank;

(iii) it contains an undertaking to pay "on demand" (with or without the words "first" and/or "written") and

(iv) it does not contain clauses excluding or limiting the defences available to a guarantor

The second presumption is to the opposite effect: where the instrument is not issued in a banking context, there is a "strong presumption" that it is a true guarantee imposing only secondary liability: ***Marubeni Hong Kong and South China Ltd v Government of Mongolia*** [2005] EWCA Civ 395 per Carnwath LJ at [23] and [30].

In ***Wuhan v Emporiki Bank***, above the Court of Appeal made it clear that a commercial question of construction of this nature should be capable of resolution without reference to a large number of authorities. The Court of Appeal applied the **Paget** presumption to hold that the instrument was a demand guarantee.

The "guarantee" in the present case

The wording of the contract in the Shanghai Shipyard case was similar to that in Wuhan v Emporiki Bank, but with two critical differences. First, the guarantee was issued by the ultimate parent company and not by a bank. Secondly, clause 4 contained the following proviso:

"*In the event that there exists dispute between the Owner and the 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 [i.e. the Builder] 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."

Mr Justice Knowles held that the fact that the instrument was not issued "in a banking context" took it outside the **Paget** presumption, so that Reignwood was "*entitled to withhold and defer payment until the arbitration award is published*".

He went on to consider a second argument of the Shipyard that Reignwood's entitlement to withhold payment arose only where arbitration proceedings had already been commenced at the time when demand was made under the guarantee, but held that, on the wording of clause 4, Reignwood's entitlement was not limited in this way.

Zoe O'Sullivan QC of Serle Court and **Harry Wright** of 7KBW acted for Reignwood.

Zoe O'Sullivan QC