Judgment in *Shanghai Shipyard Co Ltd v Reignwood International Investment (Group) Company Limited* [2021] EWCA Civ 1147

In a succinct and forceful judgment, the Court of Appeal has held that a guarantee given to secure the payment by the buyer of the final instalment under a shipbuilding contract is a demand guarantee requiring payment on demand and not a *"surety guarantee"* payable only upon proof that the buyer is liable to pay the final instalment. Popplewell LJ (giving the only judgment) noted that while both types of guarantee guard against *"counterparty risk"* (i.e. the risk that the buyer, often a one-ship company with no assets, will be unable to pay the final instalment) a demand guarantee is also intended to provide cashflow protection.

As in many other guarantee cases (as the courts have often pointed out) the guarantee was poorly drafted and contained language which pointed to both primary and secondary liability. In its earlier decision in *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA* [2013] 1 All ER (Comm) 1191, the Court of Appeal had sought to bring commercial certainty to this difficult area of the law by commending reliance on a presumption set out in *Paget's Law of Banking.* Under the *Paget* presumption, if the guarantee (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. A countervailing "strong" presumption that if the guarantee is issued outside the banking context, it is presumed not to be a demand guarantee, derives from the Court of Appeal's decision in *Marubeni Hong Kong and South China Ltd v Mongolian Government* [2005] 1 WLR 2497.

However, Popplewell LJ vigorously criticised the use of presumptions, which he said did not assist commercial certainty where some but not all of the *Paget* conditions were met, and indicated that if presumptions had any place to play at all, it would only be where all the conditions were met. He stressed that the primary focus should always be on the actual words used in their context.

The second issue in the case concerned the application of a proviso in the guarantee that if there was a dispute as to the buyer's liability to pay the final instalment which was referred to arbitration, the guarantor would not be obliged to make payment until the issue of the arbitration award. The Court held that this did not mean that the guarantor's liability in such a case was secondary: it was still an obligation to pay against a document, but the document was an arbitration award rather than a written demand.

The Court also held that the proviso would only come into effect where the dispute had already been referred to arbitration prior to the making of the demand under the guarantee, although the clause did not spell this out in express terms. The Court's reasoning was that if liability under the guarantee arose immediately upon demand (as the Court had held it did), that liability was not suspended simply because an arbitration was then commenced. To prevent liability arising on demand, the dispute had to be referred to arbitration *before* the demand was made: the guarantor's payment obligation would then be deferred until the award was issued.

The Court's reasoning raises the possibility that the guarantor would have to pay in full on demand, only for an arbitral tribunal to rule later that the buyer was not under any liability to pay the final instalment under the shipbuilding contract. How can the guarantor recover any overpayment in these circumstances? Popplewell LJ expressed the view (without deciding) that there would have to be an accounting between the buyer and the shipyard, and that the shipyard would not be entitled to retain anything over and above the sums actually owed to it by the buyer, as suggested in *Cargill International SA v Bangladesh Sugar and Food Industries Corporation* [1998] 1 WLR 461 at 469B, 471G. It seems that the guarantor itself would have no direct right to recover the overpayment from the shipyard, and would have to look to the buyer (its subsidiary in this case) to make it whole.

Zoe O'Sullivan QC acted (leading Harry Wright of 7KBW) for the guarantor Reignwood.

Zoe O'Sullivan QC