



LEGAL BRIEFING

Meritz Fire and Marine Insurance Co Ltd v Jan de Nul NV and Codralux SA

[2011] EWHC 3362 (COMM), Mr Justice Beatson

In this case the Court looked at whether the Advance Payment Guarantees that were the subject of the claim were performance bonds (otherwise known as demand guarantees) or pure guarantees.

The Facts

The two defendants entered into shipbuilding contracts with a Korean company, Huen Woo Steel Co ("Huen Woo"). The Meritz Fire and Marine Insurance Company ("Meritz") agreed to issue Advance Payment Guarantees ("APGs") to the defendants guaranteeing advanced payments made to Huen Woo pursuant to those the shipbuilding contracts.

The APGs were subject to the Uniform Rules for Demand Guarantee of the International Chamber of Commerce No. 458 ("URDG 458"). Huen Woo later merged with another company and it became clear that the new company was suffering from financial difficulties. The defendants terminated the contract and demanded repayment of the monies paid plus interest. The successor company was declared insolvent. The defendants then demanded payment from Meritz under the APGs.

Meritz refused to pay out under the APGs. They argued that they were a surety and had only guaranteed the obligations of the original Korean company, Huen Woo, and not those of its successors. Alternatively, they were discharged from liability as a result of material variations to the shipbuilding contracts. The defendants argued that, as the APGs were unconditional Performance Bonds, it was irrelevant whether there were material variations to the shipbuilding contract and/or which corporate entity failed to make the refund of the advance payments.

The distinction is crucial as, in the absence of fraud, a performance bond must be honoured on demand and without regard to the underlying contract(s). Here the amount at stake was over US\$20 million.

The Issue

The key issue of interest was whether the APGs were unconditional performance bonds (i.e. a primary obligation) or guarantees (i.e. a secondary obligation).

The Decision

Whilst there were features supporting either side's case the Judge held that the APGs were performance bonds. In reaching this decision the Judge took the approach that the APGs should be construed as a whole.

The Judge noted that the APGs in question had three out of four of the key characteristics cited by a leading textbook (*Paget's Law of Banking*) that would lead to an instrument "*almost always... be construed as a demand guarantee.*" These were: (a) the underlying transactions, the shipbuilding contracts, were between parties of different jurisdictions; (b) the APGs did not contain clauses excluding or limiting defences available to a surety as typically found in a classic guarantee where the surety's liability is secondary; and (c) the undertaking was to pay on demand or, in this case, to pay "*within thirty (30) days after the demand is made.*" In relation to the fourth criteria (that the instrument was issued by a bank) he noted that, whilst Meritz's primary business is an insurance company, it was also providing financial

instruments in return for a fee in the same way a bank would do.

The Judge also held that there was no inconsistency between the URDG 458 and the APGs as they satisfied the definition of "*demand guarantee*" under the rules. The APGs were payment undertakings issued by an insurance company in writing for the payment of money in presentation in conformity with the terms.

The Judge noted obiter that the defendants' submissions, that the element of conditionality in clause 2 of the APGs and the reference to arbitration in clause 6 suggested the APGs were guarantees, "*had force*." However, in light of all of the other indications "*these did not tip the balance against construing the APGs as demand guarantees*."

Comment

Anyone considering offering, or accepting, a guarantee and/or performance bond should not do so without carefully scrutinising the wording and ensuring that it is clear what form of instrument they are providing and/or being provided with. The presence of some features may be "*indicative and not decisive*" and it is necessary to look beyond terminology to the substance of the instrument as a whole in order to determine their nature. The cost of relying on "standard" wording can be substantial.

Claire King
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