

# SPOT THE DIFFERENCE: GUARANTEE OR ON-DEMAND BOND?

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A Commercial Court decision in September provides a reminder as to the importance of clarity when drafting guarantees and performance bonds for large international infrastructure projects. In this case, the Employer and Contractor on the large Panama

Canal expansion project disagreed over whether advance payment guarantees securing a total of US\$288 million were to be interpreted as truly “on-demand” instruments or merely “see to it” guarantees.

## Background

The difference between guarantees and on-demand bonds can be difficult to determine. Both are used to guard against the possibility of non-performance of a contractual obligation. However, the protection afforded by each is different.

A guarantee usually creates a secondary obligation, under which the guarantor guarantees the performance of a primary obligation under the underlying contract (this is sometimes referred to as a “see to it” guarantee). The liability of the guarantor is therefore dependent on the performance of the primary obligation. Whilst “primary obligor” wording in such guarantees can result in the guarantor undertaking primary obligations, the guarantor’s liability will remain dependent on whether or not there has been a breach of the underlying contract.

By contrast, a truly “on-demand” bond imposes a primary obligation on the guarantor to pay the beneficiary of the bond immediately upon receipt of a demand for payment. Payment by the guarantor is not contingent on performance of the underlying contract or proof of loss. Typically, a simple statement detailing that an obligation in the underlying contract has been breached and that loss has been suffered by the beneficiary is sufficient to trigger payment.

There is no need to prove either breach or loss.

## Autoridad Del Canal De Panamá v Sacyr, S.A. & Ors

In 2009, the Claimant (“ACP”) entered into a contract with four of the Defendants (the “Consortium”) for the design and construction of the Third Set of Locks project for the expansion of the Panama Canal. In 2010, the contract was assigned to a Panamanian-incorporated company (“GUPC”), with the Consortium entering into a Joint and Several Guarantee of GUPC’s obligations (the “JSG”). The JSG was subject to Panamanian law and provided for ICC arbitration in Miami, Florida.

By mid-2012, GUPC started to experience cash flow problems and requested ACP to make further advance payments to allow the works to proceed. Between 2012 to 2016 ACP agreed to make various advanced payments and to extend the repayment date of existing advanced payments. Each of these advanced payments and extensions were supported by specific advanced payment guarantees (“APGs”) from the Consortium. APGs given in 2012 and 2014 were similar to the JSG in providing for Panamanian law and ICC arbitration in Miami, however APGs given in 2015 and 2016 provided for English law and the exclusive jurisdiction of the English courts. In addition to the APGs, the JSG was also



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confirmed by the parties as remaining applicable to all of GUPC's obligations under the contract and therefore included GUPC's obligations to repay the additional advanced payments made by ACP.

After the advance payments had fallen due, ACP notified GUPC that it was in breach of its obligations. Simultaneously, ACP sent demands to the Consortium for payment under the APGs. In English proceedings before the Commercial Court, ACP then sought summary judgment for repayment of the outstanding advanced payment sums, totalling US\$288 million. In the meantime, the Consortium had commenced ICC arbitration proceedings claiming that repayment of the advanced payments was not due or payable under Panamanian law.

In support of its summary judgment application, ACP argued that the English law APGs were to be interpreted as on-demand bonds, requiring the Consortium to make repayment immediately upon demand and without being able to contest GUPC's liability to make repayment of the advanced payments to ACP.

ACP stressed the importance of paragraph 2.1 the English law APGs which provided that each of the guarantors contracted jointly and severally "*as primary obligor and not as surety*". ACP also relied on paragraph 4.2 of the APGs which provided that:

*"Determinations of interest rate and amounts under this Guarantee shall be made by the Employer, which determinations shall be conclusive and binding hereunder in the absence of manifest error..."*

ACP submitted that these paragraphs indicated that the obligation of the Consortium was to pay on demand. Amongst other arguments, ACP

placed particular reliance on the plural word "amounts" and argued that it was a reference both to the amount due under the guarantee and the amount of interest thereon.

### The decision

The court rejected ACP's position and held that the English law APGs were ordinary guarantees requiring proof that the advanced payments were overdue as between ACP and GUPC. The court placed emphasis on the fact that the APGs were expressed to guarantee the repayment of the advanced payments "as and when due pursuant to the Contract". Also significant was the fact that the guarantee required the Consortium, on demand, to perform the obligations which GUPC was in breach of "*in the same manner that [GUPC] is required to perform such obligations according to the terms of the [underlying] Contract*".

While the court accepted ACP's argument that the Consortium's liability under the APGs was primary, not secondary (due to the "primary obligor" language), ACP was required to go a step further and show that the Consortium's liability was triggered purely by a demand and was not contingent on proof of GUPC's liability to ACP for repayment of the advanced payment. The court also dismissed ACP's argument in relation to clause 4.2 (quoted above): the clause was intended to apply to interest only and the use of the plural word "amounts" was insufficient to change the whole nature of the instrument to an on-demand bond.

The court drew support for its conclusion from the "*Marubeni presumption*", which is a rule of thumb against construing an instrument as an on-demand bond/guarantee when the party providing the instrument is not a financial institution.

## Conclusions and implications

This decision highlights the importance of careful drafting when dealing with guarantees. Reliance on pro forma documents and the need for specialist language can sometimes result in guarantees which are a combination of different drafting, without any clear indication as to whether an ordinary "see to it" guarantee or an on-demand instrument was intended. Clarity in this regard is particularly important when dealing with non-financial institutions, given the presumption against on-demand instruments which apply in such circumstances.

## References:

Autoridad Del Canal De Panamá v Sacyr, S.A. [2017] EWHC [<http://www.bailii.org/ew/cases/EWHC/Comm/2017/2228.html>] 2228 (Comm)



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