Oil & Gas: Unwitting 'on-demand' bond by guarantor

By Phillip Ashley , Jonathan Dames, Rob Wilson and Leontine Mathew

In *Rubicon Vantage International PTE Ltd v Krisenergy Ltd* [2019] EWHC 2012 (Comm), the Commercial Court decided that the specific wording of a 'charterer guarantee' resulted in aspects of it being treated akin to an on-demand bond rather than a co-extensive guarantee. The practical implication of this was that the guarantor, in this case the parent company of the debtor, was required to make payment before the underlying dispute was resolved, whereas payment under what is sometimes called a "true guarantee" usually only falls due following a decision on the merits of any underlying dispute. The Commercial Court's decision serves as a warning to those that use such instruments that although 'guarantees' are not presumed to be on-demand bonds, they are capable of being treated as having a similar effect to such instruments if that is the natural and ordinary meaning of the words used.

Facts

Rubicon Vantage International PTE Ltd ("**Rubicon**") is a Singaporean company that owns a Floating Storage and Offloading Facility (the "FSO") called the 'Rubicon Vantage'. In 2014, it chartered the FSO to Kris Energy (Gulf of Thailand) Limited ("**Kegot**") for use on an oil field in Southeast Asia.

The Guarantee

Around the same time that the charter was agreed, Kegot's parent company Krisenergy Ltd ("**Krisenergy**") executed a 'Charterer Guarantee' (the "**Guarantee**") in favour of Rubicon. The Guarantee was governed by English law, and provided that:

- Where *"the amount(s) demanded under this Guarantee are not in dispute between [Kegot] and [Rubicon]"*, Krisenergy, as guarantor, is obliged to pay the amounts demanded within 48 hours from receipt of a demand (clause 4).

- Where there is a dispute between Kegot and Rubicon *"as to [Kegot's] liability in respect of any amount(s) demanded under this Guarantee"*, Krisenergy is obliged to pay the amount demanded up to a maximum of USD 3 million *"notwithstanding any dispute between [Kegot] and [Rubicon]"* (clause 5). Clause 5 further stated that any sums demanded in excess of USD 3 million may be withheld or deferred by Krisenergy until a final judgment or final non-appealable award was published (or an agreement reached between Kegot and Rubicon in relation to the dispute).

- A demand under this Guarantee must be in writing and must (amongst other things) be accompanied by a calculation of sums demanded together with *"any supporting documentation reasonably required to assess such demand"* (clause 3).

The Demand

In 2015, Rubicon sent Kegot four invoices totalling a little in excess of USD 1.8 million, for works Rubicon had organised on the FSO pursuant to the terms of the charter. Kegot disputed that it was liable to pay these amounts under the charter, and legal proceedings were commenced between Kegot and Rubicon in relation to the dispute.

In the interim, Rubicon made a demand on Krisenergy under the Guarantee for the total sum outstanding under the four invoices. Krisenergy declined to pay. Its reasons included that:

1. Krisenergy was only required to pay pursuant to clause 5 where liability to pay sums had been admitted by Kegot (and only quantum remained in dispute). As liability had not been admitted, Krisenergy was not required to pay.

2. In any event, the demand was not compliant with clause 3 of the Guarantee, and therefore, it did not trigger Krisenergy's payment obligation.

Decision

The Commercial Court disagreed with Krisenergy's reasons and decided that the demand was valid, and that Krisenergy was obliged to pay the full sum demanded within 48 hours (as it did not exceed the USD 3 million maximum sum payable on demand under clause 5).

The Commercial Court's reasoning is detailed below.

(1) Payment on Demand

A so-called true guarantee typically imposes a secondary obligation on the guarantor to "see-to-it" that primary obligations under the relevant underlying contract are performed. The obligation on the guarantor to pay is therefore dependent on whether or not there has been a breach of an obligation under the underlying contract. Such instruments are typically issued by companies that have a commercial relationship with the primary obligor, such as parent companies. An on-demand bond, on the other hand, typically imposes an autonomous, primary obligation on the guarantor to pay 'on demand' (i.e. upon receipt of a demand for payment that is compliant with the terms of the bond), regardless of whether liability for breach of the underlying contract has been established. These are commonly issued by banks. (For a

summary of on-demand bonds and see-to-it guarantees, see our Law-Now on Autoridad Del Canal De Panamá v Sacyr, S.A.)

In English law, there is a presumption (the 'Marubeni presumption')[1] against construing an instrument as an on-demand bond (rather than merely a see-to-it guarantee) if the party providing the instrument is not a bank or financier.

Krisenergy accepted that clause 5 made the Guarantee, at least in part, an on-demand instrument, so there was no need to apply the Marubeni presumption in order to establish whether Krisenergy had assumed autonomous on-demand liabilities.

However, Krisenergy sought to argue that:

- The Marubeni presumption should be applied *"by analogy"* when interpreting the scope of such autonomous on-demand liabilities in clause 5.
- This should lead the court to construe clause 5 restrictively, as Krisenergy was not a bank.
- The reference in clause 5 to *"liability in respect of any amount(s)"* should therefore be narrowly construed to only trigger the payment obligation where liability to pay sums had been admitted by Kegot (and only quantum remains in dispute).
- As liability had not been admitted, clause 5 did not apply.

The Commercial Court rejected this argument. It confirmed that the Marubeni presumption is directed to the question of whether a particular instrument is an on-demand bond or a see-to-it guarantee. Once the parties accepted that the Guarantee was (at least to an extent) an on-demand bond, that presumption was spent.

It then became necessary to interpret the scope of clause 5 *"simply by considering the words the parties chose to use to record their agreement, free from any antecedent presumption as to what meaning they are likely to have, or as towards a wide or narrow construction"*.

Following this approach, the Commercial Court considered the words *"...where the amount(s) demanded are not in dispute"* in clause 4 as clearly referring to disputes as to both liability and quantum. Further, that clause 5 captured *"what is left over from Clause 4"*, so that it applied where Kegot disputed either liability to pay an amount, or where Kegot disputed the quantum demanded.

The Commercial Court's reasoning was not impacted by a provision in the charter stating that *"where an item billed is disputed in good faith, it is not payable until any dispute has been resolved"*. Just because this rule applied to Kegot did not mean this needed to apply to Krisenergy as well. In fact, the Commercial Court considered that it may well make commercial sense for a guarantor to be obliged to *"pay-now-argue-later"*, even if the party to the relevant underlying contract is not, on the basis that the guarantor has more cash and can more easily *"weather the cash flow strain"* of making an immediate payment.

(2) Compliant Demand

Krisenergy also argued that clause 3 of the Guarantee, which required a demand to be accompanied by *"any supporting documents reasonably required to assess such demand"*, would naturally include any documents reasonably required to ascertain:

i. What work had been done (so Krisenergy could assess whether that work was within the scope of works for which Kegot was liable under the charter); and

ii. whether the costs of that work were reasonably incurred, or were reasonable in amount.

It argued that since such documentation had not been provided, the demand was not compliant with the terms of the Guarantee, and that Rubicon had therefore not validly triggered Krisenergy's payment obligation meaning that Krisenergy was therefore not required to pay.

The Commercial Court disagreed. It considered that while Kegot would require the documents at (i) and (ii) above in order to assess the merits of the arguments against Kegot, such documents were not reasonably required by Krisenergy to assess the demand. Instead, all that Krisenergy reasonably required were documents from which Krisenergy

could quickly find out whether (and to what extent) the underlying claim relating to the amounts demanded was admitted or disputed by Kegot.

Further, the Commercial Court was "*prepared to assume without deciding*" that Krisenergy also reasonably required documents "*sufficient to allow Krisenergy to form a provisional view as to whether or not the claims which give rise to the demands are bona fide and not fraudulent claims*".

By providing 270 pages of supporting documents, including third party invoices, the Commercial Court decided that Rubicon had satisfied the requirements of clause 3 and issued a valid demand.

Comment

Parent company guarantees are a common feature in the oil and gas industry.

When drafting a guarantee, parties should carefully consider whether the guarantee is intended to operate as a true 'see-to-it' guarantee, an on-demand instrument, or, as was unusually agreed in this case, both.

The key difference being:

i. 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, and the inclusion of a "conversion to indemnity" (which is a very common feature of properly drafted

guarantees), 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.

ii. An "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, but subject to the express requirements of the bond, a simple statement (usually in a prescribed form) 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.

On-demand obligations are more typically assumed by banks or financial institutions who issue bonds. However, in this decision the Commercial Court has made clear that parent companies are able to give such "on-demand" bonds. Although there is a presumption against them doing so, that is merely a presumption that may be displaced by clear words in the instrument.

As such, it is important that parent companies consider, with care, whether they are seeking to give a typical parent company guarantee – or to go further and create an obligation to pay a sum "on-demand" without any need to first satisfy that the sum is contractually due under the underlying (guaranteed) obligation.

If a parent company chooses to assume such "on-demand" obligations then, as confirmed by this decision, there is no presumption that such rights should be interpreted narrowly or restrictively.

Although this was not an issue in the current case, parent companies wishing to assume on-demand obligations should also be mindful of any regulatory regimes that may apply. For example, in the United Kingdom, a guarantee that contains primary, on-demand, payment obligations and that is issued in exchange for payment of a premium may constitute a 'contract of insurance' under the Financial Services and Markets Act (Regulated Activities) Order 2001 (SI 2001/544). In such circumstances, if the guarantor is not duly authorised by the relevant authorities, it could be exposed to criminal liability.

Rubicon Vantage International PTE Ltd v Krisenergy Ltd [2019] EWHC 2012 (Comm) – Before Nicholas Vineall QC sitting as Deputy High Court Judge.

End Notes

[1] From the judgment in *Marubeni Hong Kong v Mongolian Government* [2005] EWCA Civ 395

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