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Dispatch

Dispatch highlights some of the most important legal developments during the last month, relating to the building, engineering and energy sectors.

Bonds and guarantees

Caterpillar Moteren GMBH & Co K.G v Mutual Benefits Assurance Company

[2015] EWHC 2304 (Comm)

This was an application for summary judgment by Caterpillar against MBAC, a Liberian Insurance Company, for sums said to be due pursuant to two Advance Payment Bonds ("APB") and two Performance Bonds ("PB"). The application depended on whether the bonds were "on-demand" bonds or guarantees. If they were guarantees, Caterpillar would have to prove liability. Caterpillar had entered into two subcontracts with ICE for the provision of construction services. Between 5 February and 14 March 2014 Caterpillar made advance payments to ICE. Disputes arose between Caterpillar and ICE and on 10 May 2014 Caterpillar purported to terminate the subcontracts and demanded from ICE the return of the advance payments and a further sum by way of liquidated damages. ICE disputed Caterpillar's claims.

Caterpillar therefore demanded payment from MBAC under the bonds. With regard to the APBs, Caterpillar declared that ICE had failed to execute the tasks for which an advance payment had been made and demanded payment in the sums set out in the bonds. With regard to the PBs, Caterpillar declared that ICE had not met its obligations under the subcontracts and demanded payment in the sums set out in the bonds, adding that the damages caused by ICE exceeded the sums claimed. MBAC refused to pay the sums demanded under the bonds. MBAC said that it was only liable to pay Caterpillar if it was established that ICE was liable to Caterpillar in the sums claimed.

As noted in the *Wuhan Guoyu* case (*Dispatch* Issues 145, 150 and 164), there will be a presumption that a bond is an "on-demand" bond where that instrument (i) relates to an underlying transaction between 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.

To take the APB, clauses 1 and 2 described the nature of the obligation undertaken by MBAC. By clause 1, MBAC:

"guarantees and undertakes to pay, without reference to the CONTRACTOR [ICE], the BENEFICIARY herein [Caterpillar] forthwith on demand …….as may be claimed by the BENEFICIARY to be due from the Contractor on account of the failure of the CONTRACTOR in observance and performance of the terms and conditions of the contract…and in particular, the CONTRACTOR'S failure to fully satisfactorily and timely execute the tasks for advance payment."

The undertaking was to pay "forthwith on demand" and "without reference to" the Contractor. The sum which was to be paid was that claimed by the Beneficiary as being due from the Contractor. These phrases strongly suggested that MBAC's liability was to pay the sum which was demanded by Caterpillar rather than that which was proven or admitted to be due from ICE to Caterpillar. On the other hand, the use of the word "guarantee" (which appears not only in the clause but also in the title and opening section of the instrument) and the reference to a failure by ICE to perform its obligations could be said to have suggested that the parties intended that MBAC would only pay where ICE had actually failed to perform its obligations.

However, clause 2 put the matter beyond doubt. Here, MBAC agreed that the decision of Caterpillar: "*as to whether any money is payable by the Contractor to the Beneficiary or whether the Contractor has made any such default or defaults as aforesaid and the amount or amounts to which the Beneficiary is entitled*" would be binding on them. Further, MBAC was not entitled to "*as[k] the Beneficiary to establish its claims*" but "*shall pay the same to the Beneficiary forthwith on demand*".

Mr Justice Teare noted that the APB: (i) related to an underlying transaction between parties in different jurisdictions; (ii) contained an undertaking to pay on demand; (iii) whilst MBAC was not a bank it was a financial or insurance institution engaged in the business of providing bonds to its customers; but (iv) it did have a clause excluding or limiting the defences available to a guarantor. This, however, was not fatal as the Judge said that this was because the clause may well have been inserted to put beyond doubt that the rule applicable to true guarantees did not apply. Clauses 1 and 2 made it clear that the instrument was undoubtedly intended to be an "on-demand" bond.

The PB was in a different form. Clause 3 provided as follows:

"Whenever Principal shall fail to pay the lawful claims of any Person with respect to the work, including Subcontractors and suppliers, the[y] Surety shall pay the same in an amount not exceed the bonded Sum."

The reference to a liability arising to pay "lawful" claims might have suggested that this was a guarantee. However, that suggestion was inconsistent with clause 4 which provided that MBAC was to pay Caterpillar once Caterpillar had "declared" that ICE was in default. MBAC was to pay "unconditionally" and without demur "the amount of damages claimed by" Caterpillar. Any such declaration was referred to in the second sentence as a "demand". If there were any doubt that such words manifested an intention to create an "on-demand" bond such doubt was displaced by the second sentence which stated that any such demand shall be "conclusive" as regards the amount due and payment by MBAC.

Contract interpretation: incorporation of terms

Northrop Grumman Mission Systems Europe Ltd v BAE Systems (Al Diriyah C41) Ltd

[2015] EWCA Civ 844

In December 2010, BAE entered into an agreement with NGM whereby NGM would supply software licences together with associated training and support to BAE, in two tranches, on 20 December 2010 and 20 December 2011 (the "Licence Agreement").The Licence Agreement was very brief and did not include the usual boiler plate clauses providing, for instance, for dispute resolution, limitation of liability and as to the matter in dispute, termination. There was, however, an apparent intention to incorporate these provisions by reference, and sub-clause 5.1 stated that:

"5.1 This Agreement shall be governed by the terms contained within the 'Enabling Agreement…"

The Enabling Agreement was in effect a framework agreement between NGM and a company connected with BAE, "BAESI", which set out the terms upon which NGM would provide products and services to BAESI, on behalf of and for BAE. The Enabling Agreement included the usual boiler plate provisions which were lacking from the Licence Agreement. These included a termination provision which at sub-clause 10.4 entitled BAESI to terminate "for convenience at any time". BAE subsequently terminated the Licence Agreement for convenience in November 2011. NGM disputed the termination and commenced proceedings, seeking a declaration that sub-clause 10.4 did not apply to the Licence Agreement. At first instance (*Dispatch* Issue 172) the issue was decided in favour of BAE. NGM appealed.

The principal issue before the CA was whether sub-clause 10.4 of the Enabling Agreement was incorporated by reference into the Licence Agreement by sub-clause 5.1 so as to entitle BAE to terminate for convenience. The CA framed the issue as being "purely about contractual construction", namely: if sub-clause 10.4 of the Enabling Agreement was found to apply to the Licence Agreement then "*it is common ground that the Licence Agreement has been terminated*". The CA then went on to apply the principles on the "incorporation of provisions into a contract by reference to another contract, between the same or different parties", set out in *Skips A/S Nordheim v Syrian Petroleum Co Ltd* [1984] 1 QB 599. Here LJ Oliver set out a two-stage test:

"[1] whether the terms are so clearly inconsistent with the contract… that they have to be rejected or [2] whether the intention to incorporate a particular clause is so clearly expressed as to require, by necessary implication, some modification of the language of the incorporated clause so as to adapt it to the new contract…"

Following this approach, the CA found as follows:

(i) the words "governed by" in sub-clause 5.1 clearly demonstrated an intention that the terms of the Enabling Agreement be incorporated into the Licence Agreement;

(ii) termination for convenience under sub-clause 10.4 was not "flatly inconsistent" with any clause in the Licence Agreement on the same subject matter;

(iii) while not inconsistent, differences between the two agreements such as the parties and certain phrases meant sub-clause 10.4 could not be incorporated unamended;

(iv) it was therefore necessary to carry out an "appropriate manipulation" of the language of sub-clause 10.4 to overcome these differences; and

(v) the solution needed to strike a balance between giving effect to the words "governed by" in sub-clause 5.1 and allowing "a level of domination by the Enabling Agreement which would be "surplus, insensible, or inconsistent" with the provisions of the Licence Agreement."

Accordingly, sub-clause 10.4 was incorporated and the Licence Agreement had been validly terminated. In reaching this decision, the CA was dismissive of the use of technical arguments, raised by NGM. LJ Briggs noted that the parties had chosen the word "governed", and it was a word with a sufficiently clear meaning.

Further, NGM sought to bolster their arguments by reference to what was described as the admissible matrix of fact, namely that NGM was only prepared to charge discounted prices for the software licences if a contract for the supply of the whole of the specified number was placed by a certain date, failing which BAE would have needed to pay a substantially higher price. This was a fact that could only be ascertained from the email negotiations of the Licence Agreement. NGM submitted that this was the type of fact which it was legitimate to ascertain by reference to the party's negotiations. This was despite the usual rule as expressed in the *Chartbrook v Persimmon Homes Ltd* [2009] AC 1101, case where Lord Hoffmann said:

"Evidence of pre-contractual negotiations is not generally admissible to interpret a concluded written agreement. But evidence of pre-contractual negotiations is admissible to establish that a fact was known to both parties and to elucidate the general object of the contract".

LJ Briggs agreed with Lord Hoffman saying that a "*fact…known to both parties*"means:

"some objective part of the background matrix of fact other than a mere negotiating position taken by one of the parties, however vigorously expressed."

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