Performance bonds given by a foreign government.

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PERFORMANCE BONDS GIVEN BY A FOREIGN GOVERNMENT

Marubeni Hong Kong & South China Ltd v The Mongolian Government
[2005] EWCA Civ 395

Facts

Marubeni had entered into a contract for the sale of machinery with Buyan, a Mongolian company. The contract provided for a guarantee to be issued by the Mongolian central bank on behalf of the Mongolian Government. The Mongolian Ministry of Finance issued a letter described as a guarantee on behalf of the Mongolian Government accompanied by an opinion from the justice minister that the guarantor had full power and authority to enter into the guarantee.

Marubeni, having had to reschedule the debt twice, made a final demand for payment but Buyan still failed to pay. Marubeni then issued proceedings to enforce the guarantee. The High Court gave judgment for the Mongolian Government, holding that the refinancing of the contract involved a material variation of the transaction to which the guarantee related and as such, the Mongolian Government, as guarantor, was discharged from the guarantee.

Marubeni's argument was that the guarantee obligation was in the form of an unconditional independent promise to pay on demand and did not operate as a simple guarantee which could be defeated by a material variation of the underlying transaction. That was rejected by the High Court.

Marubeni appealed.

Decision

The Court of Appeal dismissed the appeal, characterizing the instrument not as a demand bond or guarantee but as secondary or conditional promise to act as surety. Such a conditional promise was subject to the rule in *Holme v Brunskill* (1878) 3 QBD 495, meaning that the twice rescheduling of the debt would have constituted a material variation of the suretyship upon which the surety would be discharged. Although the terms of the guarantee had stated that it was payable on demand, in the case of a non-banking instrument (such as this which was issued by the Mongolian Government and not a bank for a commission) very clear and unambiguous language must be used to displace the presumption against the finding of a primary undertaking.

Comment

It is worth reminding ourselves that where there is a primary promise to pay, such as that in a demand bond, that promise is unconditional and would be activated as long as the demand is made in compliance with the stipulated documentary conditions. Such a promise or undertaking has been characterized as potentially draconian and could lend itself to abusive calls. There is thus a presumption that unless clear and explicit wording is used, the presumption would be 'in favour of a construction which holds a performance bond to be conditioned upon documents rather than facts' (*Esal Commodities v Oriental Credit* [1985] 2 Lloyd's Rep 546, *per* Staughton LJ). On that basis, it is particularly significant that the Court of Appeal made a distinction between performance bonds issued by banks and those by non-banks. The court alluded to the fact that the banks make a profit from issuing such bonds through the receipt of a commission. Although not expressly stated, it would also seem from the tenor of the court's judgment that a commercial background offers a sufficiently strong basis to construe in favour of the finding of a demand bond. In non-bank cases, there was less of a factual matrix to guide the construction of the instrument in that direction.

The approach taken by the Court of Appeal in making that distinction does not offer businesses interested in investing and selling abroad to countries with a high risk rating (resulting in few banks being prepared to act as guarantors for local buyers) much comfort. This is especially so, given the fact that a foreign government might quite legitimately be perceived by international investors as being of a greater financial standing than a foreign bank. In such a context, the distinction made between banks and government agencies who act as guarantors should not be material. The factual and commercial matrix remains the same – in a standard performance bond scenario, the buyer's lack of creditworthiness makes it difficult for the buyer to import, as such, a guarantee is required and that guarantee is provided for by a third party who, in a case where no bank is prepared to step in, is the government. It is difficult to see why the fact that the guarantor is the government should make a difference to the construction issue. A more apposite context would the international investment environment; indeed, the court should have looked at the investment environment as forming the factual matrix. Investors would be slow to assume the very high risk of investing in developing countries without being able to rely on an expedient and no-questions-asked mechanism of performance guarantee. That is especially so where, if default had to be first proved before the guarantee can be relied on, the inconvenience, risk and expense of litigation in a foreign jurisdiction and a foreign law might well be unavoidable. That said, however, there is still the precise wording of the present instrument with which to contend.

The instrument read:

> the undersigned Ministry of Finance of Mongolia unconditionally pledges to pay to you upon your simple demand all amounts payable under the Agreement if not paid when the same becomes due (whether at stated maturity, by acceleration or otherwise) and further pledges the full and timely performance and observance by the Buyer of all the terms and conditions of the Agreement.

The court considered it to mean that the obligation to pay could only arise when and if the amounts payable under the agreement were not paid when they became due. The court thus concluded that there was no demand bond intended. On this issue, the court is on stronger ground – it is particularly perilous for the seller not to question, during negotiations, the reference in the letter to the

Mongolian Government's pledging the full and timely performance of the buyer. That, coupled with the presumption against a construction leaning to a demand bond, could naturally be taken to mean that the performance bond is to provide a secondary undertaking following actual default.

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