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On-demand guarantee for work on an FSO: a parent's nightmare?

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Security in the form of bonds and / or guarantees is commonly given in contracts for the building or conversion of vessels to floating production storage and offloading ("FPSO") or floating storage and offloading ("FSO") facilities. In a recent case involving an FSO, the High Court of England & Wales considered the "on-demand" nature of a parent company guarantee and found the parent company liable to pay regardless of an underlying dispute as to liability and quantum.

Facts

The court considered the case of *Rubicon Vantage International Pte Ltd v Krisenergy Ltd* [2019] EWHC 2012 (Comm). The claimant ("**Rubicon**") chartered an FSO facility to Kris Energy (Gulf of Thailand) Ltd ("**Kegot**"). Kegot is a wholly owned subsidiary of the defendant ("**Krisenergy**"). Under the charter, Kegot was obligated to procure a charterer guarantee from Krisenergy (the "**Guarantee**").

The dispute centred around four invoices sent by Rubicon to Kegot in June 2015 totalling around US$1.8 million for various works on the FSO facility prior to delivery. The invoices were disputed and not paid, and after years of negotiations and discussions, Rubicon served its first demand under the Guarantee on Krisenergy in September 2018. Krisenergy declined to pay and a second demand adding a claim for interest was made in January 2019.

Interpretation

The parties agreed that the Guarantee was in part, on-demand. However, the extent of this was in dispute.

The key provisions of the Guarantee were as follows:

> *4. In circumstances where the amount(s) demanded under this Guarantee are not in dispute between the Company and the Contractor, the Guarantor shall be obliged to pay the amount(s) demanded within forty-eight (48) hours from receipt of the demand.*
>
> *5. In the event of dispute(s) between the Company and the Contractor as to the Company's liability in respect of any amount(s) demanded under this Guarantee:*
>
> *(a) the Guarantor shall be obliged to pay any amount(s) demanded up to a maximum amount of United States Dollars Three Million (US$3,000,000) on demand notwithstanding any dispute between the Company and the Contractor*

Counsel for Krisenergy also submitted that the court should apply the presumption established in *Marubeni Hong Kong v Mongolian Government* [2005] EWCA Civ 395. In *Marubeni*, the Court of Appeal held that in transactions outside the banking context, the absence of language describing the instrument as "on demand" will create a strong presumption against construing the relevant instrument as an on-demand bond imposing

an autonomous obligation on the guarantor to pay, irrespective of the underlying liability of the principal (the “Marubeni presumption”).

Decision

The court rejected the argument that the “Marubeni presumption” should be applied. The judge held that because:

(i) the Marubeni presumption is directed to the question of whether an instrument is an autonomous on-demand instrument, or a “see-to-it” instrument; and

(ii) it was accepted by both parties that the guarantee was, at least in part, on-demand,

the role of the Marubeni presumption was “spent”. The correct approach was simply to consider “the words the parties chose to record their agreement”, free from any presumption as to what meaning they were likely to have.

Interpretation of the key clauses led the judge to decide that:

(i) under clause 4, if the amounts are not in dispute, Krisenergy would have to pay the demand within 48 hours; and

(ii) under clause 5, if the amounts are in dispute, a liability arose and Krisenergy would also have to pay any amount demanded (up to US$3,000,000).

Krisenergy argued that the interpretation of clause 5 should limit “disputes” to disputes of quantum. This was rejected by the court. The judge said that “disputed amounts” simply means a sum (or sums) “as to which liability is disputed”. It did not matter to the judge whether the dispute arose where: (i) overall liability was rejected, or (ii) where the dispute only related to a particular amount and overall liability was admitted.

Krisenergy raised further arguments that a valid demand had not been served, these were also rejected by the court and Krisenergy was ordered to pay Rubicon the sums demanded.

Commercial Implications

Parent company guarantees are a common feature in the construction, shipbuilding and offshore oil and gas industries. There are no industry standard forms of parent company guarantees but in most cases, they are unlimited and typically act to create a secondary obligation to ensure that the primary obligations under a contract are met. This means that liability needs to be established under the contract in order to establish it under the guarantee. In contrast, “on-demand” performance bonds, which are instruments typically issued by banks, create an autonomous obligation for the guarantor to pay out in the event that a compliant demand is made.

This case concerned an unusual situation in which the parent company guarantee was, in part, an “on-demand” primary obligation and, accordingly, it was held that the Marubeni presumption had no further application. It also follows the recent trend of courts being sceptical of presumptions and general rules of interpretation and instead focusing on the precise words used. This case will be of interest to the buoyant global FSO and FPSO market, and generally to parties seeking or issuing security in the forms of bonds or guarantees in contracts in the construction, shipbuilding or offshore oil and gas industries. It is a reminder that the words of a parent company guarantee need to be considered carefully in order to achieve the intended outcome.

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