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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.

FIDIC: taking-over, bonds and guarantees

Doosan Babcock Ltd v Comercializadora de Equipos y Materiales Mabe Limitada

[2013] EWHC 3010 (TCC), [2013] EWHC 3201 (TCC)

Doosan contracted to supply two boilers to Mabe for a power plant in Brazil. In accordance with the Contract, Doosan arranged performance guarantees. The guarantees entitled Mabe to payment on demand and were to expire upon the issue by Mabe of Take-Over Certificates ("TOCs") by 31 December 2013, whichever was earlier. By the terms of the guarantees the provider of the guarantee undertook to pay Mabe:

"on receipt of your first demand on us in writing stating that [the Claimant] has not performed its obligations in conformity with the terms of the Contract."

As Mr Justice Edwards-Stuart noted: *"This wording could hardly be wider ... the bank giving the guarantee is concerned only with the terms of the demand, not with the question of whether or not it is justified."*

During July 2013 Doosan requested that Mabe issue the TOCs on the grounds that the boilers had been taken into use in November 2012 and May 2013 respectively. Mabe refused and relied upon a provision in the Contract permitting it to withhold the TOCs if the boilers were only put into use as a "temporary measure".

During August 2013 Mabe notified a claim for US$57m for delayed supply and defects in the boilers. In reply Doosan requested that Mabe undertake to not make any demand on the guarantees without giving at least 7 days' notice. Mabe refused to give the undertaking so Doosan applied to the TCC for an interim injunction, contending that in refusing to issue the TOCs, Mabe was in breach of the Contract and was relying upon this breach to enable a demand for payment. At the first hearing on 4 October 2013 the Judge agreed with Doosan that the Court had jurisdiction to grant relief under section 44(3) of the 1996 Arbitration Act and listed the matter for a return date in two weeks' time in order to allow the parties time to prepare evidence upon whether or not the boilers were operating on a "temporary measure" basis.

At the restored hearing, Doosan maintained that the boilers were in commercial use, relying upon press releases indicating that the boilers had exported over 7,500 hours of power to the grid since installation. Doosan submitted that where Mabe was relying upon its own breaches of the Contract to facilitate a call on the guarantees, it could show a strong case, entitling the Court to grant interim relief. Mabe argued that Doosan did not have a strong case because it had misconstrued the contractual requirements for performance tests prior to the issue of the TOCs.

Given that the Contract provided for arbitration, the Judge made it clear that the Court had no jurisdiction to make final findings on the facts or to finally determine the proper meaning of the Contract.

On the facts the Judge found that Mabe had taken the boilers into commercial use. He also found that Mabe had not complied with the contractual requirements to show that use of the boilers as a "temporary measure" was in accordance with the terms of the Contract or as agreed by the parties. In deciding whether to grant an interim injunction, the Judge recognised the principles set out in the *American Cyanamid* case and more recently in *Simon Carves v Ensus UK* (Legal Briefing, 12 of 2011) where Mr Justice Akenhead said that a claimant must show that it has a strong case that the terms of the underlying contract, in relation to which the bond had been provided by way of security, clearly and expressly prevented the beneficiary from making a demand under the bond. If so, the beneficiary could be restrained by the court from making such a demand.

The Judge rejected Mabe's argument that Doosan had misconstrued the Contract. He concluded that Doosan's factory tests were sufficient and that whilst any failure to achieve the performance tests would create a liability for liquidated damages, it would not justify non-issue of the TOCs. The Judge therefore agreed that Doosan had demonstrated a strong case. In granting Doosan interim relief, the Judge drew an analogy with the *Simon Carves* case where the parties had agreed expressly that the beneficiary's right to make a demand on the guarantee was either qualified or would be extinguished if certain events occurred.

Applying the principle set out by the House of Lords in *Alghussein Establishment v Eton College*, Mr Justice Edwards-Stuart made an alternative finding that interim relief could also be granted on the basis that Mabe should not be permitted to benefit from its own wrong. Doosan had a strong case that Mabe's refusal to issue the Take-Over Certificates was a breach of contract. It was as a result of that breach, and only that breach, that Mabe was in a position to make a call on the guarantees. If Mabe had issued the certificates, the guarantees would have expired and so there would be no guarantee on which to make a call.

The courts will usually refuse to restrain a bank from making payment under an on-demand instrument unless there is clear evidence of fraud. Doosan submitted that it could not show fraud as Mabe had not yet made a call on the guarantees but that it should not have to because the position was different where it could dispute the validity of Mabe's right to make a call. Here, the right to make a call under an on-demand guarantee was qualified by the terms of the underlying contract.

Collateral contracts: funders and contractors

Squibb Group Ltd v London Pleasure Gardens Ltd

[2013] EWHC 3275 (TCC)

A competition to develop a 20-acre area of contaminated land in East London was won by LPG. The site was owned by the London Development Agency, which granted a short-term lease to LPG on 2 December 2011, expiring 1 November 2014. The timescale became progressively squeezed and there was a lack of interest from commercial investors.

This created a problem for the London Borough of Newham ("LBN") which was looking strategically for the Olympics to be a powerful stimulus for regeneration and improvement in the Borough. It therefore decided to take on the role of funder and made a loan to LPG to enable LPG to engage contractors to carry out the necessary works on site. The idea was that revenue-generating activities would fund the repayment of the loan.

LPG and LBN entered into the Loan Agreement on 30 March 2012 for the sum of £3 million. The mechanism for the drawing down of the loan had the effect that LBN had control of any payments that LPG wished to make over £10,000 (later reduced to £2,000). In addition to the payment of interest, LPG agreed to pay 20% of its anticipated profits as a royalty to LBN. LBN increased its funding to LPG, providing a total of £3.3 million before deciding in early August 2012 that no further support would be provided.

Squibb contracted with LPG to carry out extensive groundworks on the site. The works were carried out properly and on time, such that the site was open by late June in advance of the Olympics and substantial payment became due to Squibb from LPG under the terms of the contract. Squibb agreed to do some additional works, which did not fall within the terms of the original contract, and for which it was paid in advance.

However, the project was not commercially successful and LPG went into administration in August 2012, after LBN declined further financial support beyond the £3.3 million it had already provided. This left the funder's loan and Squibb's remaining payments under the building contract outstanding. Squibb said that LBN was liable to pay the sums of money that had fallen due for the work it did pursuant to its contract with LPG.

Squibb advanced its claim on the basis of:

(i) A collateral contract arising at the time of the conclusion of the contract between LPG and Squibb on 17 May 2012; and

(ii) A contract or collateral contract on the basis of meetings that occurred on 5 and 11 July 2012.

Squibb alleged that, at the same time as Squibb and LPG entered into the construction contract (known as the "CMTC"), it entered into a collateral contract with LBN (or LBN gave an enforceable contractual warranty) under which, in consideration of Squibb entering into the CMTC, LBN agreed (or warranted) that it would cooperate and/or participate in, and not frustrate, hinder or prevent the performance of the Payment Mechanism established by the CMTC.

Squibb also asserted that LBN further agreed that in the event that Squibb provided an interim valuation application or a Final Account Valuation, LBN would cooperate and participate in the process by giving any necessary approvals and releasing any necessary funds to LPG to enable payment to Squibb and would not frustrate or hinder the process by refusing to cooperate or to release the relevant funds to LPG to enable it to pay Squibb.

While the evidence concerning the building contract negotiations was relatively straightforward, the allegation that a collateral contract arose at the first of two meetings held between the parties depended largely on the evidence of the individuals involved at that time. Mr Justice Stuart-Smith held that the collateral contract did not come into force at the time the building contract was concluded and did not come into force at the meetings. Squibb's purpose as it approached the first meeting was to try to obtain payment of its outstanding account, using the threat or reality of proceedings if necessary, while LBN's primary purpose was to ensure that Squibb took no action that would jeopardise the prospects of keeping LPG as a going concern at least until after the start of the Olympics.

The Judge rejected the contractor's allegation that the funder had agreed to guarantee all sums owing under the building contract. The Judge did, however, hold that at their second meeting the funder did agreed to pay £250,000 of the £424,000 owed by LPG. However, the funder had already made that payment, so no further amount was due from it. The building contract did not subject the funder to any obligations on which Squibb could rely. Likewise, nothing in the loan agreement pointed to the funder warranting or guaranteeing LPG's payment obligations under the building contract.

The funder did not give Squibb any actual or implied assurance that it would guarantee payment or that it would "not allow the project to fail." The problem here for Squibb was the nature of the evidence. As Mr Justice Stuart-Smith noted, although contractually binding assurances could be implied rather than express: *"it would require clear and cogent evidence to establish an implied assurance with suitable and sufficient clarity".*

On the facts of this case, no such assurance was given.

Dispatch is produced monthly by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.

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Edited by Jeremy Glover, Partner, Fenwick Elliott LLP
jglover@fenwickelliott.com
Fenwick Elliott LLP
Aldwych House
71-91 Aldwych
London WC2B 4HN

www.fenwickelliott.com