Pay attention Bond!

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The recent English case *Sumitomo Mitsui Banking Corporation Europe Limited v Euler Hermes Europe SA (NV) [2019] EWHC 2250* (Comm) highlights that where an on demand bond is assigned and a demand then made under that bond, the beneficiary will need to be sure not only that the demand is compliant with the terms of the bond but also that the assignment was effective in the first place.

On demand bonds

A construction contract will often require the contractor to provide security to the employer in the form of bonds or guarantees.

On large international projects, payment under these bonds is almost always "on demand", meaning that – always depending on the wording of the bond – the security provider (typically a bank, specialist surety or insurance company) is required to pay the employer a specified sum of money on the occurrence of a particular event or presentation of a particular document.

If the employer requests payment under the bond (known as a "demand" or "call") the security provider will generally not be obliged or entitled to obtain information about the underlying construction contract or circumstances to determine whether it should make a payment. Instead, the bond will set out the formalities with which the employer must comply before the security provider will pay the bond amount. It may even include a pro forma letter of demand the terms of which are negotiated by the parties before the bond is provided. A simple demand issued by the employer may be all that is required but, usually, a statement that the contractor is in breach of its obligations is also required.

Absent fraud (or, in some jurisdictions, unconscionability) the security provider will be required to make payment if a compliant demand is made. The courts often require that a demand strictly complies with the bond because this is the only protection afforded to the security provider. The extent to which strict compliance is required depends on the interpretation of the bond in question.

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Assignment

In English law, contractual assignment usually involves the transfer of the benefit of contractual rights from a contracting party (the assignor) to a third party (the assignee). The assignee may enforce the rights that have been assigned against the other contracting party.

There are a number of reasons why contractual rights may be assigned. In a construction context, an employer may assign its rights under the project documents – the construction contract, appointments of the professional team and any security provided by the contractor, etc – to its funder by way of security.

The right to assign a contract may be excluded altogether or qualified. A contract may provide that only one of the parties may assign, that only certain rights may be assigned, it may limit the right to assign to a class of third parties, or it may make assignment conditional upon the other contracting party giving consent. Provisions like this may appear not just in the construction contract but also in security provided by the contractor such as performance or retention bonds.

The *Sumitomo* case

In *Sumitomo* the English High Court had to consider whether purported assignments of a performance bond and a retention bond were effective and whether demands made by the assignee on both bonds were valid.

Facts
Resource Recovery Solutions Derbyshire Ltd (RRS) entered into a contraction contract with Interserve Construction Ltd (ICL) for a waste treatment facility in England. Interserve PLC (Interserve) was the guarantor. ICL provided two bonds to RRS, both issued by Euler Hermes (EH).

The first was a **performance bon**d to protect RRS including for an "Insolvency Default" of ICL or Interserve. In such event, a demand for payment of the bond should be "signed by a director of the Employer". The bond defined RRS as the "Employer" and provided that this term included "all permitted assignees under this Bond". Pursuant to clause 8 of the bond, RRS was to repay to EH any payment in respect of a claim under the bond which was held by a court to be higher than the corresponding liability of ICL. Assignment of the bond was permitted by clause 9 "subject to the assignee confirming to [EH] in writing its acceptance of [RRS"s] repayment obligation".

The second was a **retention bond** to protect RRS including upon the occurrence of an "event" which included the appointment of administrators to Interserve. It required a demand for payment of the bond to "bear the signature of a duly authorised officer of the Employer". The retention bond defined RRS as the "Employer" but there was no provision that this term was to include assignees. Assignment was permitted under clause 6 but there was no restriction regarding the repayment obligation like there was in the performance bond.

RRS entered into a borrower debenture with Sumitomo Mitsui Banking Corporation Europe Ltd (SMBCE) on the same date as the performance bond. By this debenture, RRS assigned the benefit of the performance bond and the retention bond to SMBCE and gave SMBCE a power of attorney to perform any act in RRS"s name and on its behalf.

RRS sent EH for each of the performance bond and the retention bond a "notice of assignment and acknowledgement of receipt". EH signed and returned the notice for the performance bond (it did not sign or return the notice for the retention bond but nothing turned on this).

Interserve subsequently entered into administration. It was not in dispute that this constituted an "Insolvency Default" under the performance bond and an "event" under the retention bond.

As a consequence, and shortly before expiry of the performance bond, SMBCE served demands on EH under both the performance bond and the retention bond. A director of SMBCE signed each demand twice; the first signature was for and on behalf of SMBCE and the second was for and on behalf of RRS as its attorney.

EH refused to pay the bond amounts and SMBCE brought proceedings in respect of payment.

The performance bond
In respect of the **performance bond**, EH argued that there had not been an effective assignment. Although the performance bond permitted assignment of the benefit of the bond, this was "subject to the assignee confirming to [EH] in writing its acceptance of [RRS"s] repayment obligation" (clause 9 of the bond). SMBCE had not accepted this repayment obligation prior to the purported assignment or any time after. Moreover, EH had not agreed in writing to an assignment to SMBCE in the absence of such a confirmation.

SMBCE argued that it was not required to accept the repayment obligation before an assignment was effected. This was anyway impossible because the assignment took place on the same date as the performance bond so at that date there was neither an assignee nor a bondsman for the purposes of clause 9. Moreover, the "notice of assignment and acknowledgement of receipt" which EH had signed for the performance bond was either an agreement that there was an effective assignment or a waiver of the requirement to accept the repayment obligation.

The judge rejected SMBCE"s arguments. This meant that there was not an effective assignment vis-à-vis EH and that SMBCE did not become a "permitted assignee".

SMBCE therefore had to rely on its alternative case. This was that if there was no effective assignment, it was RRS which could make the claim on the performance bond and RRS had done just that, because the demand was signed by SMBCE as attorney for RRS pursuant to the power of attorney.

The judge found that the requirement in the performance bond that a demand is "signed by a director of the Employer" covered a case where there was a signature by a director of a company which held a valid power of attorney from the Employer where such power of attorney extended to the execution and delivery of the notice. The demand on the performance bond by RRS through SMBCE as the holder of a power of attorney was therefore valid. Presumably, an order for payment of the performance bond to RRS could be made if RRS was joined to the proceedings.

The retention bond

In respect of the **retention bond**, there was no restriction on assignment comparable with that in the performance bond. It was not in dispute that the retention bond had been effectively assigned to SMBCE. The issue was instead that the retention bond did not include an express extended definition of "Employer" to include permitted assignees. The question was therefore whether a demand signed by the officer of an assignee could count as a duly authorised officer of the Employer.

The judge found that it could. The retention bond specifically contemplated that it may be assigned. It must therefore have been contemplated that, post-assignment, the assignee may potentially make a demand on the bond. The retention bond was accordingly a valid demand by SMBCE as assignee. The fact that the demand was also signed by a director of SMBCE as attorney for RRS meant in any event that there was a signature of a duly authorised officer of RRS.

Conclusion

The failure to comply with the terms of the performance bond in respect of assignment would have been fatal to SMBCE"s recovery under the bond were it not for the "belt and braces" approach taken by SMBCE in signing the demand on its own behalf and also on behalf of RRS under the power of attorney.

With the commercial and financial pressures of today's world, we can expect to see more challenges to bond calls. Great care should be taken to comply with the terms of the bond both in respect of assignment and demands for payment.

In some cases, it may be possible to cure a defective demand by issuing a fresh one. However, if the bond is close to its expiry, as was the performance bond in Sumitomo, it may too late by the time the defect is discovered.

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