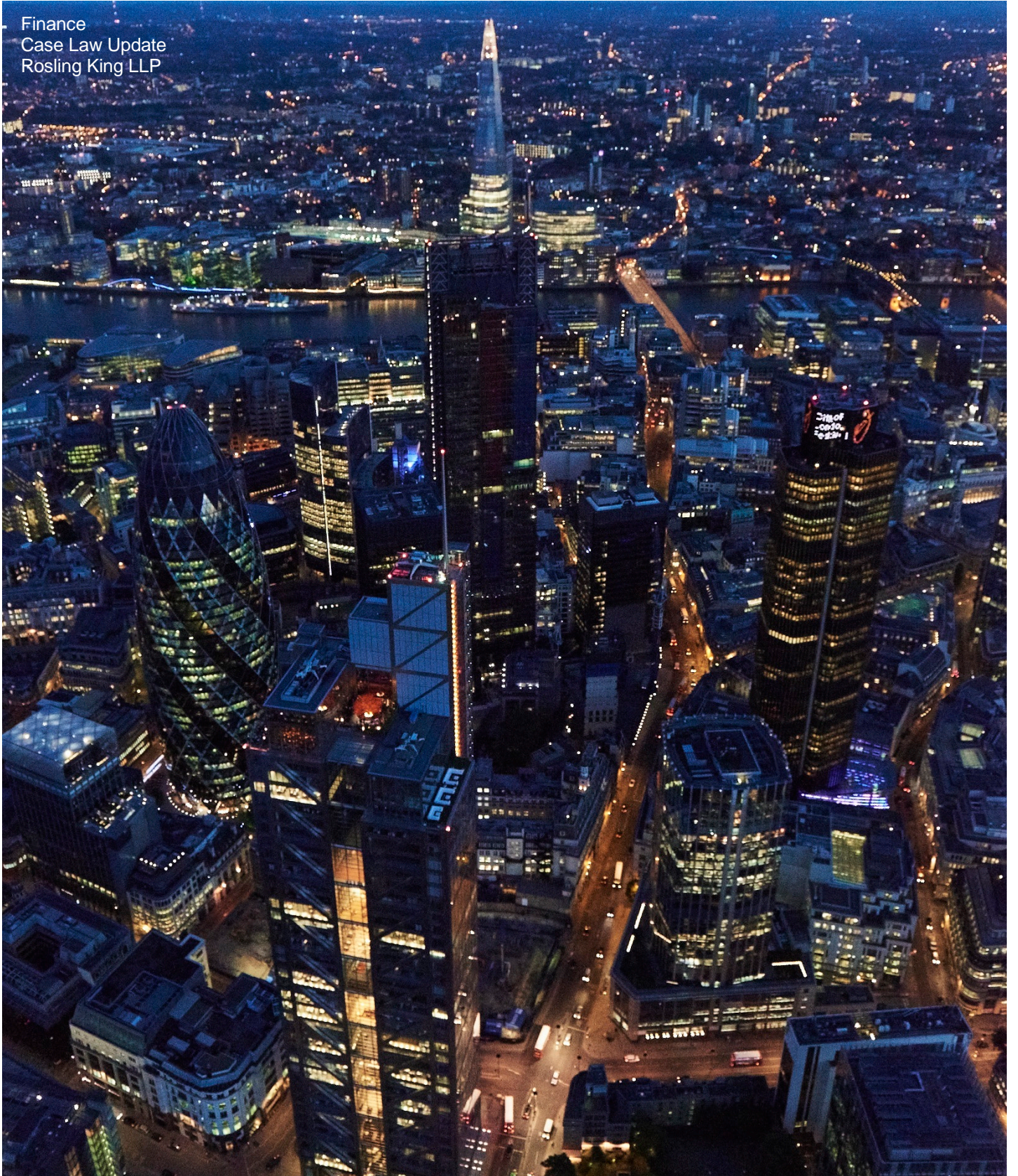


Finance
Case Law Update
Rosling King LLP



Background

In 2011, Lukoil Mid-East Ltd (“Lukoil”) entered into an agreement for works with a contractor whereby the contractor would drill and complete 23 production wells in an oil field in South East Iraq (the “Contract”). The contractor was required to supply an ‘on demand bond’ to Lukoil, as security for its performance under the Contract. Barclays Bank (“Barclays”) issued the bond for the contractor, which would expire on 31 October 2015 (the “Bond”).

The contractor was liable under the Contract to pay monies to Lukoil. The contractor failed to make the payment, so Lukoil issued a demand to Barclays for payment in the amount of USD 7,115,034, as provided for in the Bond. Barclays responded to Lukoil, to say that the demand was not valid. By the time Lukoil received this letter from Barclays, the Bond had expired.

Lukoil issued proceedings claiming payment under the Bond, and subsequently applied for summary judgment. Barclays made a cross application for summary judgment, on the basis that Lukoil’s demand was defective.

The Bond

Lukoil’s claim came before the Technology and Construction Court. The Court held that it would be the terms of the bond itself that determine the formal requirements, if any, with which a demand must comply in order for it to be valid. The Court considered the terms of the Bond, and in particular, the following two conditions:

- Condition 4 which made it a condition that ‘no amendment has been made to the contract...impacting the timely performance of the contract’; and
- Condition 5, which stated that ‘no amendments nor addenda to the Contract....shall relieve us from our responsibilities under the guarantee, and we waive the right to be notified of such amendments or addenda’.

Barclays’ Submission

Barclays’ submission was that Lukoil’s demand under the Bond was not validly served, because they did not expressly state in their demand that no amendment had been made to the Contract impacting the timely performance of the Contract (Condition 4).

The Court’s Decision

In reaching its decision, the Court commented that Condition 4 of the Bond did not state that any demand made by Lukoil must expressly state that ‘no amendment has been made to the contract...impacting the timely performance of the contract’.

The Court considered Conditions 4 and 5 of the Contract and noted the conflicting nature of the two conditions. Condition 5 made clear that any amendment to the Contract would not relieve the responsibility of Barclays to pay under the Bond. Therefore, to adopt Barclays’ submission would mean that, for Lukoil to serve a valid demand, they would be required to expressly state that no amendment has been made to the contract impacting the timely performance of the contract, despite this information being irrelevant to Barclay’s obligation under the Bond.

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The Court also held that in a contract as large as the one between Lukoil and the contractor, it would be almost inconceivable that there would be no changes to the scope of the works that would impact on timely performance. Therefore, if Barclay's interpretation was correct, and it was a requirement for this statement to be included in any demand made under the Bond, then Lukoil may never be able to make a valid demand, and this would render the Bond 'virtually useless'.

The Court commented that to adopt Barclay's construction of the Bond would be 'commercially absurd'. The Court therefore granted summary judgment in favour of Lukoil, holding that its request for payment was valid.

Commentary

This case does not involve new law, as every case on contract interpretation is fact specific. However the decision of the Technology and Construction Court does include interesting commentary.

Serious disputes, such as that which arose in this case, are common when there is a lack of clarity in the terms of a bond, or where there are conflicting provisions in a bond. This case is a reminder that, when entering into bonds, parties should ensure that the requirements for any demand under the bond are stated expressly and clearly.

For further information, please contact [Georgina Squire](#) or the Partner with whom you usually deal.