Neutral Citation Number: [2016] EWHC 1893 (Comm)

Case No: CL-2015-000762

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 29/07/2016

Before :

MR JUSTICE KNOWLES CBE

- -

Between :

(1) C1 **(2) C2** **(3) C3**	**Claimants**
- and –	
D	**Defendant**

- -
- -

Mr Toby Landau QC and Mr Siddharth Dhar (instructed by **Stephenson Harwood LLP**) for the **Claimants**
Mr Daniel Toledano QC and Mr Nicholas Sloboda (instructed by **Hogan Lovells International LLP**) for the **Defendant**

Hearing dates: 12 and 13 April 2016

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE KNOWLES CBE

Mr Justice Knowles :

Introduction

1. On 22 July 2005 the first and third Claimants ("C1" and "C3") entered into a Production Sharing Contract (the "PSC") with the Defendant ("D") in respect of two oil mining blocks offshore from Nigeria.

2. In due course D and C1 entered into a Sale and Purchase Agreement (the "SPA") dated 29 December 2011, and amended on 28 June 2012, by which D agreed to sell to C1 its interest in the blocks and the PSC, with completion on 28 June 2012.

3. The second Claimant ("C2") is the ultimate parent of C1 and C3. On 28 June 2012 and in connection with the SPA, C2 entered into three guarantees in favour of D, the "Adjustments Guarantee", the "Deferred Payments Guarantee" and the "Services Guarantee".

4. Under the SPA (as amended) the consideration payable to D comprised (a) an Escrow Amount of US$100 million, (b) Deferred Payments of US$150 million payable in 3 instalments and (c) Adjustments (which might be positive or negative).

5. Disputes arose between the parties and an arbitral tribunal was constituted. The arbitration is an LCIA arbitration with its seat in London. The tribunal comprises Mr Thomas Webster, Professor Julian Lew QC and Lord Hoffmann. These proceedings before the Commercial Court concern a Second Partial Award issued by the tribunal and dated 23 September 2015 ("the Award").

Challenges under the Arbitration Act 1996 to the Award

6. In the Award the tribunal:

   a. declared that D served valid written demands on C2 under the Adjustments Guarantee on 7 December 2012 and 28 February 2013, and under the Deferred Payments Guarantee on 7 January 2014 and 7 January 2015;

   b. ordered C2 to pay to D US$51,255,819.24 under the Adjustments Guarantee, and US$100 million under the Deferred Payments Guarantee;

   c. reserved its decision with respect to all other issues (as further defined in the Award).

7. In these proceedings before the Commercial Court, C2, C1 and C3 invoke sections 33, 67 and 68 of the Arbitration Act 1996. They contend:

> "The Tribunal's decision that [D] had served valid demands on [C2] under the Adjustments Guarantee, and thus that it was entitled to grant the relief it did, suffered from a serious irregularity which has caused and/or will cause the Claimants substantial injustice."

> "The Tribunal's decision that it had jurisdiction over the Deferred Payments Guarantee and/or that it had jurisdiction over [D]'s claims under the Deferred Payments Guarantee, and thus that it was entitled to grant the relief it did, was wrong and/or was in excess of its putative powers."

The claim under the Adjustments Guarantee

8. The SPA provided for D to serve an Estimated Adjustments Statement and a Final Adjustments Statement ("FAS") showing the Adjustments. If C1 disputed any Adjustments it was to serve a Dispute Notice and the dispute between it and D would be resolved in accordance with a procedure under the SPA.

9. Clause 1 of the Adjustments Guarantee is, so far as material, in these terms:

> "[C2] irrevocably and unconditionally undertakes to pay [D] immediately upon receipt of a written demand of [D] which states that, in the opinion of [D], [C1] has failed to comply with the [SPA], such sum or sums which [D] may demand provided [C2]'s maximum liability under this GUARANTEE shall not exceed the GUARANTEED SUM …"

10. D served the FAS, on 24 July 2012. C1's case is that it sent a valid Dispute Notice dated 8 August 2012. The procedure under the SPA for resolving a dispute between C1 and D signified by a Dispute Notice was not undertaken.

11. D made written demands on C2 under the Adjustments Guarantee on 7 December 2012 and 28 February 2013.

12. In the arbitration C2 raised in response what has been termed "the Bad Faith Defence". That Defence is summarised as follows by Mr Toby Landau QC and Mr Siddharth Dhar, for C2 (the italics are in the original). Their summary is in terms that are slightly, but not materially for present purposes, adjusted from the terms recorded by the arbitrators at paragraph 232 of the Award:

> "(1) pursuant to Clause 1 [of the Adjustments Guarantee], it was a condition precedent to the validity of a demand by [D] that it *'would contain [D]'s genuine and rational opinion, arrived at honestly and in good faith after due consideration, that the sums which had fallen due to be paid by [C1] had not been paid'*; (2) in circumstances where [C1] had issued a valid Dispute Notice in relation to the FAS, or where that Dispute Notice had been treated as valid by [D] under the SPA (and where the specific SPA procedure for resolution of those issues had not been followed) it was *'self-evident that [D] could not have issued a valid opinion that sums had fallen due to be paid by [C1] but had not been paid'*; and (3) the effect of [D]'s breach of Clause 1 was to invalidate the demands made on 7 Dec 2012 and 28 Feb 2013 vis-à-vis [C2]."

13. In the arbitration the issues between the parties included whether the Dispute Notice from C1 was valid, and whether any deficiency in this respect had been waived by D.

Its validity was disputed as to time and it was also contended that there was an error in computation.

14. The tribunal focussed (at paragraph 245) on the issue "whether there is a legal doctrine that would entitle C2 to refuse to make payments under the Adjustment[s] Guarantee in the circumstances alleged by [C2, C3 and C1]". Given the issues as to whether the Dispute Notice was valid and the FAS was in error, the tribunal asked itself this question (see paragraph 245, although I paraphrase a little): assuming (without deciding) that the Dispute Notice was valid and the FAS was in error, were the demands under the Adjustments Guarantee valid and if so in what amount? The assumptions were described as the Interim Assumptions.

15. The tribunal noted (at paragraph 217) that it had held in an earlier award (the First Partial Award) that the Adjustments Guarantee was a first demand guarantee. The tribunal then explained (at paragraph 218; the italics are in the original):

> "… the first demand guarantee has the additional and most important purpose of protecting the creditor against *cash flow risk*, that is, against the possibility of delay in obtaining his money. It introduces liquidity into the transaction by enabling the creditor to obtain immediate payment, even if there is a dispute with the party to the underlying transaction which may result in his eventually having to pay some of the money back. It operates on the principle of "*pay now, litigate later*" and the liquidity which it provides is the reason why Kerr LJ famously referred to such documents as "*the life-blood of international commerce*". …"

16. The tribunal had been provided by C2 with an opinion of Mr Richard Millett QC putting forward legal arguments on (among other things) the issue of lack of good faith. C2 tendered the opinion, and the tribunal treated the opinion, on the basis that it was admissible as additional submissions on the law (and not as expert evidence): see paragraph 141. The tribunal said (paragraph 220-221):

> "We have read with care Mr Millett's opinion. Its most striking feature is that nowhere does he acknowledge these distinctions between a first demand guarantee and other forms of liability for the debt of another. …
>
> The distinctions to which we have referred are critical to the attitude of the courts and arbitral tribunals to provisions whereby a creditor may certify what is owing to the other party. It is one thing to be obliged unconditionally to pay what is demanded (subject generally only to a fraud exception) if the accounts can be sorted out later and money which was not actually due repaid. It is quite another if the creditor is able to give a certificate which is binding once and for all upon the debtor in determining his debt. Not surprisingly, in the latter category of cases the courts have been willing to examine fairly closely whether the power to certify has been reasonably exercised or whether it contains a manifest error. But the adoption of such an approach to first demand guarantees would destroy their commercial purpose and there is no authority for doing so."

17. Examining the Adjustments Guarantee, the tribunal stated (at paragraphs 246-252):

> "… to make a valid demand in accordance with the terms of the Adjustments Guarantee, [D] must state that, in its opinion, [C1] has failed to comply with the SPA.
>
> [The] parties have not drawn the Tribunal's attention to demand or performance bonds with similar provisions. Usually, one would expect simply a notice of default with no reference to the beneficiary's opinion with respect to liability under an underlying contract.
>
> The Tribunal must of course interpret the terms of the Adjustments Guarantee in the light of one another. In this respect, Clause 7.2.1 of the Adjustments Guarantee provides that [C2] is not entitled "*to require [D] to justify its opinion as stated in any demand.*"
>
> Therefore, [D] is required to state its opinion as to [C1]'s breach of the SPA but is not required to justify it.
>
> Based on the Millett Opinion, [C2, C3 and C1] advance what has been termed the "Bad Faith Defence" based at least in part on the reading of the terms of Clause 1.
>
> The Tribunal has no difficulty accepting that, where a party is required in a document to state its opinion as to breach of an underlying contract, that opinion must be honestly held. Otherwise, a party could seek to restrain payment on the grounds of fraud.
>
> However, as a general matter with demand performance bonds, the fraud exception is extremely narrow because it takes into account the cash flow and liquidity purposes of a first demand bond. They are intended to be the equivalent of cash, recoverable from the guarantor by summary process. The principle of 'pay now, litigate later' would be frustrated if it was easy to raise a defence which required the whole question of the actual liability of the buyer to be litigated before the first demand bond could be paid."

18. The tribunal concluded that D's demands under the Adjustments Guarantee met the requirements of Clause 1 of the Adjustments Guarantee. It reached that conclusion because it was "apparent in this case that [D] … was of the opinion that C1 had breached the SPA" (paragraph 253). D's demands "were not made fraudulently (or in bad faith even though that would not affect the immediacy of a payment of a first demand guarantee)" (paragraph 254).

19. In its reasons the tribunal also stated that not only was it apparent that D was of the opinion that C1 had breached the SPA but it had confirmed this to C1 in a letter of 23 August 2012. The tribunal said (at paragraph 253) of the letter that:

> "[It] flatly contradicts the allegation that [D's] statement in the demands was either fraudulent or made in bad faith. Indeed, in the letter [D] specifically linked its position that [C1] had not contested the [FAS] to [D's] demand for payment of the first instalment of the Adjustments."

20. C2 contends that the tribunal failed to apply the Interim Assumptions when considering the question whether the demands under the Adjustments Guarantee were made fraudulently or in bad faith. It is also said the tribunal failed to deal with the issue of bad faith at the time the demands under the Adjustments Guarantee were made (rather than at the time of the letter of 23 August 2012). And more generally it is said that the tribunal failed to deal with all the issues that were put to it, including the validity of the Dispute Notice. Alongside substantive criticisms it also raises procedural criticisms.

21. In my view there is nothing in these criticisms.

22. The contention that the tribunal did not use or apply the Interim Assumptions is incorrect. The tribunal made the assumptions in favour of C2. It then used or applied them to reach the question whether, if the Dispute Notice was valid and the FAS was in error, that rendered the demands under the Adjustments Guarantee invalid.

23. It concluded, correctly, that it did not. It is here material to note that although the "Bad Faith Defence" was alleged, a wider or more general allegation of fraud was not.

24. Instead, the "Bad Faith Defence" rested, specifically and in terms, on the contention that "in circumstances where [C1] had issued a valid Dispute Notice in relation to the FAS, or where that Dispute Notice had been treated as valid by [D] under the SPA (and where the specific SPA procedure for resolution of those issues had not been followed) it was self-evident that [D] could not have issued a valid opinion that sums had fallen due to be paid by [C1] but had not been paid".

25. The tribunal was clear that the Dispute Notice could be valid and the FAS could be in error, and yet the demands under the Adjustments Guarantee could be valid. Rather than it being "self-evident that [D] could not have issued a valid opinion" in these circumstances, the tribunal appreciated that it was clear that D could.

26. This appreciation is, with respect, correct. What was required was that there was an opinion, and as the tribunal said, it was "apparent in this case that [D] … was of the opinion that [C1] had breached the SPA" (paragraph 253). The (assumed) presence of a valid Dispute Notice or of a FAS that was in error does not mean the opinion was not "honestly held" (to use a term not alleged in the "Bad Faith Defence" but addressed by the tribunal in its review quoted at paragraph 17 above). No other basis on which to question the honesty of the opinion was alleged by C2. The opinion was not (therefore) "invalid" (to use the term used in the "Bad Faith Defence") for the purpose of the agreement that C2 and D had reached in the form of the Adjustments Guarantee.

27. So the contention on which the "Bad Faith Defence" rested fell as regards D's claim, and with it went the "Bad Faith Defence". C2 argues, as part of its criticisms on the procedural side, that the tribunal "ought to have adopted a procedure which allowed [C2] to test the question of Bad Faith after disclosure and cross-examination", but as between C2 and D there was nothing left to test.

28. The tribunal's reference to the letter of 23 August 2012 does not affect these fundamentals. The reference simply adds a further point, namely that D had acted in accordance with its position that C1 had not in fact contested the FAS. The further

point was not essential to the tribunal's conclusion. As Mr Daniel Toledano QC and Mr Nicholas Sloboda described it for D, it was "for good measure".

29. Nor does the further point lead to a conclusion that the tribunal failed to deal with the Bad Faith Defence at the time the demands under the Adjustments Guarantee were made. It simply drew attention to the position D had been taking, with consistency, in advance of making those demands in December 2012 and February 2013.

30. As a further part of the criticisms made by C2 on the procedural side, C2 says that the tribunal was also "strictly speaking in breach of s.33 of the 1996 Act by unilaterally introducing the Interim Assumptions in the first place without giving the parties any opportunity to comment upon them".

31. This criticism by C2 is, with respect, neither fair nor accurate. The Interim Assumptions were made in favour of C2. The tribunal explained them and the procedural circumstances in which they arose (paragraphs 114 to 118). The tribunal made clear that the issues that could be assumed in C2's favour to test its defence to D's case would fall for later determination as between D and C1 (the contractual relationships being distinct).

32. A tribunal will find from time to time that its conclusion on one or more issues between particular parties has the result that other issues do not affect the outcome of the reference and therefore do not in the event arise between those parties, and that is what happened here a between D and C2.

33. In the circumstances there is no irregularity in the tribunal's Award as regards the claim under the Adjustments Guarantee, and there was no failure to adopt a fair and appropriate procedure.

The claim under the Deferred Payments Guarantee

34. As mentioned, the tribunal made an award of US$100 million under the Deferred Payments Guarantee. C1, C2 and C3 contend that the tribunal lacked jurisdiction to do so because (they say) there was not a dispute before the Request for Arbitration was filed and there was no subsequent submission to the jurisdiction of the tribunal. They also say that D was not entitled to amend its Request for Arbitration from a claim for a declaration (which is where it began) to a claim to seek monetary relief.

35. In the circumstances of this case, these contentions are wholly without merit.

36. I have mentioned that C2 is the ultimate parent of C1 and C3. The tribunal found that there was correspondence before the Request for Arbitration, between D and C1, but which in fact related "to a dispute as to *all* payments due to [D] with respect to the SPA" (paragraph 167; original emphasis). It found the correspondence reflected "how [D] would be paid with respect to the assets it sold under the SPA" (paragraph 169). The tribunal also found (paragraph 171) that D had rejected an attempt to link payments under the SPA to the success of C1's drilling programme.

37. In the Request for Arbitration, D sought a declaration in these terms (at paragraph 59(a)(vi)):

> "pursuant to clause 1 of the Deferred Payments Guarantee, upon receipt of a written demand of [D] on or after the relevant Deferred Payment Date, which states that, in the opinion of [D], [C1] has failed to comply with the SPA, [C2] is liable to pay to [D] immediately on demand the amounts of the Deferred Payments that are outstanding."

D also (at paragraph 58) reserved its rights to supplement its claims against C2 in the arbitration in respect of payments and/or liabilities to the extent that C2 failed to satisfy "further payments and/or further liabilities as they fall due" under the Deferred Payments Guarantee.

38. C1 and C2 filed a joint Response and Counterclaim. In this they sought a (counter) declaration in these terms (at paragraph 35.3):

> "[D] is not entitled to make demands pursuant to the Company Guarantees [a term that includes the Deferred Payments Guarantee]".

And earlier in their Response, C1 and C2 stated (at paragraph 20), under the heading "Scope of these Proceedings", that "the dispute between the parties" concerned agreements including the Deferred Payments Guarantee.

39. They continued (at paragraphs 23 and 24 of the Response) in these terms:

> "[D] has not identified a provision of the SPA entitling it to insist on the consolidation of disputes arising under the SPA and the Company Guarantees, nor an expression of consent for such consolidation.
>
> Nevertheless, to avoid duplication of cost and effort, the Respondents [i.e. including [C2]] accept that the Tribunal should exercise jurisdiction over [C2] in these proceedings."

40. Mr Landau QC says that this is a narrow concession to in personam jurisdiction, but I think Mr Toledano QC is correct that it accepts jurisdiction because there is a dispute over the Deferrred Payments Guarantee.

41. The tribunal has power under Article 22.1(a) of the 1998 LCIA Rules to allow a party to amend its claim. It exercised that power to allow D to amend to seek orders for payment, reflecting the original declarations sought. This was unarguably appropriate. The amendments were logical steps when they were sought. There was due process in their consideration. They caused no prejudice to any party.

42. In the circumstances briefly referenced above, the tribunal plainly had and has jurisdiction. There was a dispute in respect of the Deferred Payments Guarantee before the Request for Arbitration. C2 expressly recognised and accepted this in its Response. C2 is also to be taken to have submitted to the jurisdiction of the tribunal. The tribunal was entitled to permit D to amend its claim so as to claim monetary relief, and D was entitled (with that permission) so to amend its claim.

Conclusion

43. The applications under the Arbitration Act 1996 will be dismissed.