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Theme

Indemnities

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Introduction

The theme of this volume concerns indemnities and provisions for insurance. The latter are, of course, closely connected with the former since modern contracts require insurance to be taken out to back up the indemnities that are given.

The publication of this volume coincides with the passing of the Unfair Contract Terms Act, 1977. This Act is directed to clauses which not only seek to restrict liability or to avoid it altogether but also to many indemnity provisions. The Act is of major importance and ought to be read carefully since some provisions (both in contracts and outside contracts) are wholly prohibited whilst others are subjected to the 'requirement of reasonableness' (in the case of England, Wales and Northern Ireland). Separate but equivalent measures are made in the Act for Scotland.

In determining whether an indemnity or insurance clause meets the requirements of the Act it will obviously be necessary to consider what its effect would have been but for the Act. The collection of cases in this volume may help this exercise. However we must emphasise that each contract made after 1 February 1978, (when the Unfair Contract Terms Act comes into force) is likely to be judged on its own merits and the fact that a provision is well understood (because of judicial decisions) and is widely used is no guarantee that it will satisfy the Act or meet 'the requirement of reasonableness'.

The volume begins with two cases on a topic related to indemnities and insurance – bonds or guarantees. The first, *Edward Owen Engineering Ltd v Barclays Bank International and Anor* (which was decided by the Court of Appeal in July 1977 and is to be found at page 1) is a salutary example of pitfalls in bonds which require no proof of default to become operative. The second case *General Surety & Guarantee Co Ltd v Francis Parker Ltd*, a decision of Donaldson J in April 1977 shows the other side of the coin. (It is to be found at page 16 of this volume.)

The theme of this volume is first presented by *Walters v Whessoe Ltd and Shell Refining Ltd* at page 23. This was a decision of the Court of Appeal in 1960 which had not been fully reported elsewhere. It illustrates the important general proposition that indemnity clauses in contracts will be strictly construed by the courts, and that an indemnity will not be allowed in respect of a loss due (in whole or in part) to the negligence of the indemnified party unless very clear words are used to bring about such a result (or unless the indemnity could not reasonably have any application in the cricumstances in question). The decision was relied on by Mocatta J in *AMF (International) Ltd v Magnet Bowling Ltd and G. P. Trentham Ltd* [1968] 1 WLR 1028 when the effectiveness of clause 14(b) of the 1939/1957 edition of the RIBA form of contract was considered. That clause was, of course, the predecessor of clause 18(2) of the current Standard Form of Building Contract.

The next case – *Sims v Foster Wheeler Ltd and Another* (which has been previously reported at [1966] 1 WLR 769) – is included (at page 39) because it shows that, in circumstances when a contracting party is not able to rely on an indemnity clause because of the rule in *Walters v Whessoe (supra)*, he may nevertheless be able to recover damages for breach of some term or terms in the contract, and that the damages may (subject to the ordinary rules of remoteness of damage) include the amount of damages and costs awarded against him in respect of his own negligence, which contributed to some other person's suffering loss and damage, and which prevented his being able to rely on the indemnity clause.

The judgments of the Court of Appeal in *James Archdale & Co Ltd v Comservices Ltd* (at page 55) illustrate the relationship between clauses 14(b) and 15(B) of the 1939/1957 edition of the RIBA form (and also their successors in modified and clearer form, clauses 18(2) and 20[C] of the current form). This case is reported at [1954] 1 WLR 459.

Richardson v Buckinghamshire County Council and Others which was reported at [1971] 1 Lloyd's Rep 533 is to be found at page 58. This case is concerned with the liability of main contractors employed under the ICE Conditions of Contract (fourth edition – although also relevant to the fifth edition) to indemnify their employer under clause 22 of those conditions, and also with the liability of their sub-contractors to indemnify the contractors under the terms of a sub-contract. The judgments are also helpful on other parts of the ICE Conditions.

This volume concludes with the *City of Manchester v Fram Gerrard Ltd* (at page 70). This is a previously unreported decision of Mr Justice Kerr and it illustrates very clearly the courts' adherence to the general rule of construction enunciated by the Court of Appeal in *Walters v Whessoe Ltd (supra)*. It also discloses a possible flaw in clause 18(2) of the current Standard Form of Building Contract. The main contractor may be held liable for the activities of his 'servants or agents or of any sub-contractor his servants or agents' but do these words include sub-sub-contractors and even lower species of contractor?

Finally, we regret that the publication of this volume has been delayed by the late arrival of a transcript for one of the cases. This was due to an unfortunate combination of factors beyond the control of our publishers or ourselves, but, we hasten to add, no factor constituted either 'negligence' 'omission' or 'default'.

H. J. LL.
C. R.

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Index prepared by Christopher Lewsley BSc(Hons), PhD, C.Eng, MIStructE, of Lincoln's Inn, Barrister-at-Law.

EDWARD OWEN ENGINEERING Ltd v BARCLAYS BANK INTERNATIONAL Ltd and UMMA BANK

20 July 1977 *Court of Appeal*

Lord Denning MR, Browne and Geoffrey Lane LJJ

The plaintiffs were contractors who contracted to supply and install greenhouses in Libya for a Libyan state enterprise. The total contract price was £502,030 payable (in Libyan dinars) in instalments by means of an irrevocable confirmed or confirmable (there was some dispute) letter of credit which was to be opened in favour of the plaintiffs payable at the first defendants.

The plaintiffs' Libyan customers instructed the second defendants (a Libyan state bank) to open an irrevocable documentary credit in favour of the plaintiffs. The letter of credit which was sent by the second defendants to the plaintiffs via the first defendants was not a confirmed letter of credit but instead provided that payment was to be made only if the plaintiffs' customers authorised it.

Before the contract between the plaintiffs and their customers had been concluded, the plaintiffs had, at the request of their proposed customers, obtained a guarantee or bond in favour of the customers securing their due performance of the contract for 10 per cent of the total contract price (£50,203). It was a term of this guarantee or bond that the sum secured was payable by the first defendants on demand without proof or conditions. In turn the first defendants obtained a counter indemnity from the plaintiffs in the following terms:

> 'In consideration of your procuring the giving by Barclays Bank International Ltd of guarantee in the terms of the copy attached hereto . . . we agree to keep you indemnified . . . and we have hereby irrevocably authorised you to make any payments and comply with any demands which may be claimed or made under the said guarantee . . . and agree that any payment which you shall make . . . shall be binding upon us and shall be accepted by us and conclusive evidence that you are liable to make such payment or comply with such demands.'

The plaintiffs were not satisfied with the letter of credit offered on behalf of their customers. They wished to have an irrevocable confirmed letter of credit as envisaged by one of the provisions of the contract. They viewed their customers' failure to provide such a letter as a breach of the contract and accordingly, on 27 March 1977, with the assistance of the first defendants, they wrote to their customers informing them that they rescinded the contract and the guarantee. On 16 May 1977 the second defendants, on behalf of the customers, called on the first defendants to make payment of the sum secured under the guarantee.

The plaintiffs then took steps to obtain an injunction restraining the first defendants from paying the second defendants.

Kerr J discharged an *ex parte* injunction obtained by the plaintiffs against the first defendants, holding that the first defendants should pay the second defendants and that the plaintiffs should pursue their claim against their erstwhile customers.

The plaintiffs appealed.

HELD: dismissing the appeal

1. The opening of a confirmed letter of credit imposes on a bank an obligation to pay if the documents are in order, irrespective of any dispute that there may be between the bank and the person in whose favour the letter of credit has been opened (other than where fraud had been established.)

2. A guarantee or bond payable 'on demand without proof or conditions' imposes an obligation on the guarantor to pay irrespective of whether or not the person whose performance was guaranteed has in fact performed his obligations or was in default, except in cases of fraud of which the guarantor had notice.

3. The court would not therefore interfere with the obligations of the first defendants.

C. Ross-Munro QC and P. Ground appeared on behalf of the plaintiffs, instructed by Louch Belcher.
N. Tapp QC and P. Cresswell appeared on behalf of the first defendants, instructed by Durrant Piesse.

Commentary
This case is reported in [1977] 3 WLR 764.
The reason for the plaintiffs' action was presumably that recorded by Lord Denning MR, in two passages at the end and in the middle of his judgment:

> 'Seeing that the bank must pay – and will probably come down on the English suppliers on their counter-guarantee – it follows that the only remedy of the English suppliers is to sue the Libyan customers for damages. The contract contains a clause giving exclusive jurisdiction to the courts of Libya. But we are told that it is not practicable for the English suppliers to invoke the jurisdiction of the Libyan courts.
>
> The Libyan customers are a department of the Libyan State: the Umma Bank is a State Bank. It would be in practice impossible to obtain a visa for the purpose of bringing a claim against the Libyan customers and the other bank.'

If the plaintiffs did not prevent the bank from paying the Libyans they would presumably have been liable to meet the bank's obligation under the terms of their cross-indemnity. Nevertheless they might be in considerable difficulties in suing the Libyans. The difficulties might well be legal as well as practicable for, even assuming that they were able to hold the Libyans liable, would they under the terms of the contract have been able to recover the sum payable to the bank as part of their damages? This question cannot yet be answered since not enough is known about the transaction.

Bonds are not, of course, new in the construction industry, nor are bonds of the kind considered by the Court of Appeal quite as new as the Master of the Rolls suggested in his judgment. What is of relatively recent origin is the requirement that the guarantor should pay on demand 'without proof or conditions' (as here), or where the notice of default was conclusive evidence of liability as in *Bache & Co (London) Ltd v Banque Vernes et Commerciale de Paris SA* [1973] 2 Lloyd's Rep 437 referred to in *General Surety and Guarantee Co Ltd v Francis Parker Ltd* (at page 16 of this volume, with which this case should be compared).

The trap set by bonds of this kind is well known and was graphically described by Lord Denning MR when he said that a demand might have to be met by the guarantor:

> 'not only when there are substantial breaches of contract, but also when the breaches are insubstantial or trivial, in which case they bear the colour of a penalty rather than liquidated damages: or even when the breaches are merely allegations by the customer without any proof at all: or even when the breaches are non-existent. The performance guarantee then bears the colour of a discount on the price of 10 per cent or 5 per cent or as the case may be. The customer can always enforce payment by making a claim on the guarantee and it will then be passed down the line to the English supplier.'

Lord Denning went on to say:

> 'This possibility is so real that the English supplier, if he is well advised will take it into account when quoting his price for the contract.'

Geoffrey Lane LJ echoed that observation when he said of the result:

> 'It may be harsh . . . but the sellers must have been aware of the dangers involved or, if they were not, they should have been aware of them, and either they should have declined to accept the terms of the performance bond or else they should have allowed for the possibility of the present situation arising by making some adjustment in the price.'

Guarantees or bonds of the kind considered by the Court of Appeal are prevalent in work outside the United Kingdom but they are also not now uncommon in work within the United Kingdom. This case demonstrates how important it is for the contractor to be aware of the risk attaching to such guarantees or bonds and of the need to take it into account before tendering. This case and the case of *General Surety and Guarantee Co Ltd v Francis Parker Ltd* (at page 16) also show that the terms of the principal guarantee or bond as well as those of the subsidiary counter-guarantee must be carefully drafted so as to ensure that they are effective.

EDWARD OWEN ENGINEERING Ltd v BARCLAYS BANK INTERNATIONAL Ltd and UMMA BANK

20 July 1977 *Court of Appeal*

Lord Denning MR, Browne and Geoffrey Lane LJJ

LORD DENNING MR: This case concerns a new business transaction called a 'performance guarantee' or 'performance bond'. In order to show the nature of the transaction, I will describe the documents in some detail.

The contract between suppliers and customers

First I will describe the principal contract between suppliers and customers. The suppliers are Edward Owen Engineering Ltd who carry on business at Alton in Hampshire. The customers are the Agricultural Development Council of Libya which is a State enterprise of the Libyan Arab Republic whose full title is the Executive Authority for Jabel el Akhdar. Sometimes called the Green Mountain Project.

In November 1976 a contract was made by which the English suppliers agreed to supply and install glasshouses for the Libyan customers. The glasshouses were to be very extensive. They were to cover two hectares (about five acres) and were to be equipped with a complete irrigation system. The materials were to be sent from England to Benghazi on c and f terms: and skilled erectors were to go out from England to Libya to erect the glasshouses and install the equipment. The total contract price was £502,030, payable in Libyan dinars. The shipment of the materials was to be by the end of April 1977, and erection was to be completed by the end of August 1977. Payment was to be made by the Libyan customers as follows: 20 per cent payable in advance of delivery; 50 per cent payable on the presentation of the shipping documents; 10 per cent when the materials were on the site; 15 per cent when there was a provisional handing-over, and 5 per cent on final handing over; thus making it the full 100 per cent. Those instalments were to be payable by an irrevocable confirmed letter of credit which was to be opened in favour of the English suppliers payable at Barclays Bank International. There was an express clause which said:

> 'The contract is construed in accordance with Libyan law. Any dispute arising between the two parties shall be referred to the competent Libyan court.'

The Libyan customers instructed the Umma Bank at Benghazi (which is a state bank of Libya) to open an irrevocable documentary credit in favour of the English suppliers for payment of those instalments. The letter of credit was sent by the Umma Bank in Libya to their London correspondents, who sent it on 6 January 1977 through Barclays Bank International to the English suppliers. But it did not comply with the contract. It was not a confirmed letter of credit. It was not confirmed by a bank. This was made clear by the advice itself. The correspondents in London said:

> 'Although our principals make provision for us to add our confirmation to this credit kindly note that we are unable to effect such action in view of the payment terms which are subject to instruction from our principals, upon presentation of documents.'

That was indeed the case. The letter of credit expressly provided that payment was only to be made when the Libyan customers authorised it. So the letter of credit was plainly not a confirmed letter of credit.

As soon as the English suppliers got that notification, they made every effort to get the Libyan customers to amend the letter of credit so as to enable the contract to be fulfilled. They sent a long telex on 18 January 1977. They sent one of their staff, a Mr Cowley, out to Libya to press the Libyan customers to make the required amendments to the letter of credit. But he was unable to get it amended. On his return, the English suppliers consulted their bankers, Barclays, and wrote a letter which was drawn up with the assistance of those bankers. It was dated 29 March 1977 by the English suppliers to the Libyan customers and is of much importance. It said:

> 'The letter of credit is still not acceptable to us for three main reasons – (1) Our contract with you dated 9 November 1976 provides for the letter of credit to be confirmed. The advising bank in London refuses to confirm the letter of credit because of the way in which it is drawn up.'

There follow two other reasons and then this significant paragraph:

> 'Since the letter of credit is not operative, it obviously follows that our guarantee has no effect.'

That is a reference to the performance guarantee to which I will come shortly.

So there is the position. The English suppliers quite reasonably said:

> 'We cannot go on with any obligations under this contract because the letter of credit which would guarantee us payment has not come forward. We have not even got the 20 per cent in advance.'

It looked very much as if the Libyan customers were in default. They had not provided the stipulated letter of credit. That is why the contract went off.

The performance guarantee

Second, I will deal with the contract between the banks. This is where we come to the 'performance guarantee' or 'performance bond'. That is a guarantee by a bank that the suppliers will perform their obligations under the contract. The Libyan customers, before any contract was concluded, stipulated that there should be a performance guarantee. It was to be a condition precedent to their entering into any contract at all. The English suppliers wrote this letter on 4 November 1976 to the Libyan customers:

> 'Upon agreement of the final Contract sum and approval of a draft Contract, we will arrange for a Letter of Guarantee to be issued by Barclays Bank International and lodged at the Umma Bank, Benghazi, for 10 per cent of the total Contract price and valid up to the final delivery date. On receipt of the Letter of Guarantee at the Umma Bank, Benghazi, we will sign the Contract and the Authority (the Libyan customers) will immediately open a Letter of Credit to our benefit for the full Contract price.'

So even before the contract was actually signed, the English suppliers agreed to arrange for a performance guarantee to be given for 10 per cent of the contract price. The contract was signed on 9 November 1976 and the performance guarantee given on 15 November 1976. It was given in this way: The English suppliers instructed their bankers, Barclays Bank, to give the performance guarantee. Acting on those instructions, on 15 November Barclays Bank International in England sent a cable to the Umma Bank in Benghazi in these words:

> 'Upon our responsibility and on behalf of Edward Owen Engineering Ltd please issue, in form required, performance bond in favour of Executive for Jabel el Akhdar el Marj Libyan Arab Republic for pounds sterling 50,203 being ten per cent of total contract value for supply of greenhouse equipped with drip-overhead irrigation system contract dated 9 November 1976; performance bond to be valid for claims on you until 31 August 1978 and is to be handed to Mr N. Cowley accredited representative of Edward Owen Engineering Ltd, who will contact you: we confirm that United Kingdom exchange control regulations satisfied and that our maximum liability is limited to the sum of pounds sterling 50,203.'

On 17 November 1976 Barclays Bank International confirmed that cable by letter to the Umma Bank and added:

> 'We look forward to receiving in due course two translated copies of the actual guarantee issued.' (It was not in fact received until May 1977).

The Umma Bank wanted, however, a further assurance before issuing the performance guarantee. On 22 November 1976 they sent a telex to Barclays Bank International containing this request:

> 'Please confirm that you will pay total or part of said guarantee on first of our demand without any conditions or proof.'

On the same day, 22 November, Barclays Bank International replied to Umma Bank:

> 'We confirm our guarantee . . . payable on demand without proof or conditions.'

So there it is. Barclays Bank International asked the Umma Bank (the State bank in Libya) to issue the guarantee, and Barclays Bank promised to pay it on first demand by Umma without any conditions or proof.

On receiving that promise, the Umma Bank did issue a guarantee bond in favour of the Libyan customers. It was written in Arabic, but we have a translation of it. It is dated 23 November 1976, Benghazi. It is addressed by the Umma Bank to the Libyan customers under the name of the Green Mountain Project. It says:

> 'Dear Sirs, Whereas the contract in respect of this operation requires the submission of a bank guarantee in the value of £50,203 Sterling . . . We the undersigned stand as guarantors for the company (Edward Owen) to the extent of the above mentioned figure, recognising that this payment would be made upon first request from you, which must reach us during the validity of the letter of guarantee. This guarantee shall be deemed valid until 31 August 1978 after which it will be valueless and should be returned to the Bank.'

That is the performance guarantee. It was handed by the Umma Bank to Mr Cowley in Libya. He was there as the representative of the English suppliers. He handed it to the Libyan customers. Thereupon the English suppliers had done everything necessary on their part to make the contract binding on the Libyan customers. It was then for the Libyan customers to arrange for the confirmed letter of credit for the price. But that they never did. On that account the English suppliers on 29 March 1977 wrote the letter (which I have read) saying that the guarantee had no effect.

It is obvious, of course, that Barclays would only give their guarantee on getting a counter-guarantee from the English suppliers. It is on a printed form dated 17 December 1976 signed by Edward Owen Engineering Ltd. It reads as follows:

> 'In consideration of your procuring the giving by Barclays Bank International Limited of guarantee in the terms of the copy attached hereto' – that is the one of 15 November 1976 – 'we agree to keep you indemnified . . . and we hereby irrevocably authorise you to make any payments and comply with any demands which may be claimed or made under the said guarantee . . . and agree that any payment which you shall make . . . shall be binding upon us and shall be accepted by us as conclusive evidence that you were liable to make such payment or comply with such demand.'

It appears therefore, that, if Barclays Bank International paid under the guarantee, the English suppliers were to indemnify them.

So there was a string of guarantees. The English suppliers guaranteed Barclays Bank International, Barclays Bank International guaranteed the Umma Bank in Libya, and the Umma Bank guaranteed the Libyan buyers.

The claim on the peformance guarantee

On the facts so far known, it appears that the English suppliers had not been in default at all. The only persons in default were the Libyan customers.

They had not issued the confirmed letter of credit as they should have done. Yet the Libyan customers appear to have demanded payment from the Umma Bank on their guarantee. The Umma Bank then claimed on Barclays Bank International. They did so by their telex of 16 May 1977 by Umma Bank to Barclays Bank:

> '. . . we would inform you that beneficiaries request liquidation the amount of said guarantee being STG pounds 50203 stop Please credit our Tripoli head office account with Midland Bank London . . . We issued said guarantee under your full responsibility and your confirmation towards us dated 22 November 1976. Therefore any discussions concerning said guarantee must take place between the concerned parties and our bank not involved in the matter stop Awaiting your urgent tested cable confirmation regards.'

On hearing of that demand, the English suppliers issued a writ in the High Court against Barclays Bank International. They obtained an interim injunction *ex parte* – to prevent Barclays Bank paying the Umma Bank. Barclays sent a telex telling Umma of the injunction. The Umma Bank replied:

> 'We are not in a position to comply with its contents. The subject matter must be settled between the concerned parties. We were astonished from your above mentioned cable as we issued the said guarantee according to your clear confirmation that you will pay the total or part of the said amount without any conditions or proof. Please authorise us urgently. We regret we hold you responsible for any consequences resulting from non-execution.'

So there it is. The long and short of it is that although *prima facie* the Libyan customers were in default in not providing the letter of credit, nevertheless they appear to have claimed against the Umma Bank on the performance bond issued by them; in turn the Umma Bank claimed upon Barclays Bank: who claimed upon the English suppliers.

A little later Barclays applied to discharge the injunction. After hearing argument Kerr J held that these performance bonds must be honoured as between banks; and that the relations between the English suppliers and the Libyan customers were no concern of the banks. He held that Barclays Bank International ought to pay the Umma Bank and leave the English suppliers to claim damages against the Libyan customers, presumably in the courts of Libya, because the contract contained a clause giving exclusive jurisdiction to the courts of Libya.

The English suppliers appeal to this court. They ask us to restore the injunction. They say that there is no practical remedy for them in the Libyan courts. The Libyan customers are a department of the Libyan State: The Umma Bank is a State Bank. It would be in practice impossible to obtain a visa for the purpose of bringing a claim against Libyan customers and the Umma Bank.

So the English suppliers ask us to order that Barclays Bank should not pay this amount to the Umma Bank. They wish to join the Umma Bank and Libyan customers as defendants to the action: for by so doing all the matters can be resolved here as to whether or not the Libyan customers should be paid this amount.

The law as to performance bonds

A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit. That was clearly stated in *Malas (Hamzeh) & Sons v British Imex Industries Ltd* [1958] 2 QB 127 at 129. Jenkins LJ, giving the judgment of this court, said:

> '. . . it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice.'

To this general principle there is an exception in the case of what is called established or obvious fraud to the knowledge of the bank. The most illuminating case is of *Sztejn v J. Henry Schroder* which was heard in the New York Court of Appeals in 1941 (31 New York Supplement 2nd series page 631). After citing many cases Shientag J said this:

> 'It is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade.'

He said that in that particular case it was different because:

> 'On the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller.'

That case shows that there is this exception to the strict rule: The bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances when there is no right to payment.

I would in this regard quote the words of Browne LJ in *Bank Russo-Iran v Gordon, Woodroffe & Co Ltd* [1972] 116 SJ 921 [but not reported on this point]. He said:

> 'In my judgment, if the documents are presented by the beneficiary himself, or are forged or fraudulent, the bank is entitled to refuse payment if it finds out before payment, and is entitled to recover the money as paid under a mistake of fact if it finds out after payment.'

But as Kerr J said in this present case:

> 'In cases of obvious fraud to the knowledge of the banks, the courts may prevent banks from fulfilling their obligation to third parties.'

Such is the law as to a confirmed letter of credit. How does it stand with regard to a performance bond or a performance guarantee? Seeing that it is a guarantee of performance – that is, a guarantee that the supplier will perform his contracted obligations – one would expect that it would be enforced in such a case as this: Suppose the English supplier had been paid for the goods and had delivered them, but that the Libyan customer then discovered that they were defective and not up to contract or that they had been delayed. The Libyan customer could then claim damages for the breach. But instead of coming to England to sue for the breach, his remedy would be to claim payment under the guarantee – of the 10 per cent or the 5 per cent of the price – as liquidated damage, so to speak. He claims payment from the Umma Bank. The Umma Bank pay him 'on first request'. They claim on Barclays Bank International. Then Barclays pay 'on first demand without proof or conditions'. And Barclays claim against the English suppliers, the payment being 'conclusive evidence'.

It is obvious that that course of action can be followed, not only when there are substantial breaches of contract, but also when the breaches are insubstantial or trivial, in which case they bear the colour of a penalty rather than liquidated damages: or even when the breaches are merely allegations by the customer without any proof at all: or even when the breaches are non-existent. The performance guarantee then bears the colour of a discount on the price of 10 per cent or 5 per cent or as the case may be. The customer can always enforce payment by making a claim on the guarantee and it will then be passed down the line to the English supplier. This possibility is so real that the English supplier, if he is wise, will take it into account when quoting his price for the contract.

Take the case one stage further. The English supplier is not in default at all. He has not shipped the goods because he has not been paid. The Libyan customer has not provided the confirmed letter of credit. It is still open to the Libyan customer to make some allegation of default against the English supplier – as for instance not doing the preliminary work or not being ready and willing – and on that allegation to claim payment under the performance guarantee. On that request being made, payment will be made by the banks down the line: and be made by them 'on demand without proof or conditions'.

So, as one takes instance after instance, these performance guarantees are virtually promissory notes payable on demand. So long as the Libyan customers make an honest demand, the banks are bound to pay: and the banks will rarely, if ever, be in a position to know whether the demand is honest or