

WHY IS A REFUND GUARANTEE INDEPENDENT FROM A SHIPBUILDING CONTRACT?

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Abstract: A typical shipbuilding contract requires a refund guarantee independent from a shipbuilding contract. The purpose of a refund guarantee is to indemnify a buyer for losses resulting from a shipbuilder's default under the shipbuilding contract. A typical refund guarantee is independent from the shipbuilding contract and is payable on a simple demand. The primary purpose of independence nature of a refund guarantee is to secure refund of the instalments paid. In addition, a loan agreement for a new shipbuilding project commonly requires a refund guarantee with independence nature as a security for ship financing (pre-delivery loan). Although a refund guarantee is independent from the shipbuilding contract, the extent of independence relies on the terms and conditions of an individual refund guarantee. This paper will review why a refund guarantee is independent from a shipbuilding contract and the extent of independence by analysing various refund guarantees and shipbuilding contracts, and also the loan agreements concerned.

Key Words: refund guarantee (RG); shipbuilding contract; independent guarantee; ship financing; bank guarantee; independence nature; demand guarantee; shipbuilding

1. INTRODUCTION

In a typical shipbuilding contract, a shipbuilder is paid in five instalments¹: the first to fourth instalments are paid before delivery ("pre-delivery instalments"), and the fifth instalment is paid at the time of delivery ("delivery instalment"). A buyer (or owner) is entitled to repayment of those instalments paid where a shipbuilder is in default under a shipbuilding contract.² A shipbuilding contract requires, as a security for such repayment, a refund guarantee (also referred to "refundment guarantee", "advance payment bond", or "advance payment guarantee") issued by a financial institution in favour of a buyer for the account of a shipbuilder.³ An issuance of a refund guarantee is usually required as a condition precedent to the payment of the first instalment in a shipbuilding contract or to effectiveness of a shipbuilding contract.⁴ Therefore, a shipbuilding contract may not be effective or go utile unless a refund guarantee is issued.

A financial institution, a guarantor in a typical refund guarantee, irrevocably and unconditionally undertakes to pay on a simple demand for repayment by a beneficiary, normally a buyer in a shipbuilding contract. When a buyer is entitled to repayment of the pre-delivery instalments under a shipbuilding contract and is not repaid, a beneficiary under a refund guarantee demands for repayment against a guarantor. A guarantor's obligation of payment in a refund guarantee shall be solely subject to the terms and conditions of a refund guarantee, not to the terms and conditions of an underlying shipbuilding contract. Once a guarantor receives such a demand for payment by a beneficiary, they will be entitled to immediate recourse against a shipbuilder under an arrangement⁵ for an issuance of a refund guarantee between a guarantor and a shipbuilder. Thus a refund guarantee is treated as a shipbuilder's contingent liability. Therefore, a financial institution, in practice, issues a refund guarantee within the credit limit of a shipbuilder.

When the amount of a refund guarantee applied for exceeds the credit limit, a financial institution will require security such as mortgage, a personal guarantee by a parent company, an export bond insurance, etc. An export bond insurance, a kind of export credit insurance, by an export credit agency is well accepted as a security for an independent guarantee⁶ or a refund guarantee with a shipbuilder without credit limit available.⁷ A refund guarantee is considered as a significant financial risk in shipbuilding industry.⁸

Such a refund guarantee (or an advance payment guarantee) is, in reality, of no difference to an independent guarantee (also referred to “independent bank guarantee”, “bank guarantee”, “demand guarantee”, “first demand guarantee”, or “on-demand guarantee”) in international trade.⁹ And a standby letter of credit is used for the same purpose as an independent guarantee, and represents conceptually and legally the same device as an independent guarantee.¹⁰ As a typical refund guarantee falls in an independent guarantee, it shares the characteristics of an independent guarantee, in particular, independence nature.

This paper will review independence nature of a refund guarantee, why a refund guarantee is independent from a shipbuilding contract, and the extent of independence by analysing the various expressions and phrases in refund guarantees actually issued in the various shipbuilding projects and referring to the clauses in the various shipbuilding contracts and the loan agreements concerned.

2. INDEPENDENCE NATURE OF A REFUND GUARANTEE

In construction projects or transactions of capital goods, independent guarantees are commonly used to cover the obligations assumed by the other party.¹¹ A typical independent guarantee (including a standby letter of credit) is an irrevocable undertaking to pay on a simple demand presented in accordance with its terms and conditions.¹² A typical independent guarantee is payable on a simple demand by the beneficiary against presentation of the documents specified in it,¹³ and is unconditional and irrevocable.¹⁴ “Unconditional” presumes that an independent guarantee can be called

immediately on a debtor’s default under the underlying transaction without the requirement that the creditor exhausts his remedies against the debtor.¹⁵ An independent guarantee is primary and independent undertaking, while a conditional guarantee or an accessory guarantee is secondary and accessory undertaking.¹⁶ An independent guarantee which is payable on demand began to replaced a cash deposit as security with the expansion of international trade.¹⁷ An independent guarantee is by its nature independent from the underlying contract¹⁸, and independence from the underlying contract is an essential feature of an independent guarantee.¹⁹ A beneficiary is not required to prove that the applicant/principal has actually defaulted on the obligations under the shipbuilding contract.²⁰

In an independent guarantee, a guarantor undertakes to pay a sum of money, but does not undertake fulfilment of the debtor’s obligation under the underlying contract.²¹ The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (the “UN Convention”) provides independence nature of a guarantee (or a standby letter of credit) in Article 2(1) and Article 3 as follows:

“(1) For the purposes of this Convention, an undertaking is an independent commitment, known in international practice as an independent guarantee or as a stand-by letter of credit, given by a bank or other institution or person (“guarantor/issuer”) to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person.” (Article 2. Undertaking)

“For the purposes of this Convention, an undertaking is independent where the guarantor/ issuer’s obligation to the beneficiary is not:

(a) Dependent upon the existence or validity of any underlying transaction, or upon any other

undertaking (including stand-by letters of credit or independent guarantees to which confirmations or counter-guarantees relate); or

(b) Subject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents or another such act or event within a guarantor/issuer's sphere of operations" (Article 3. Independence of undertaking)

The UN Convention is designed to facilitate the use of independent guarantees and stand-by letters of credit.²² The UN Convention was adopted on 11 December 1995 and entered into force on 1 January 2000.²³ The UN Convention applies to an independent guarantee if the guarantor's place of business is in a contracting state, or if the governing law is the law of a contracting state.²⁴ Although the UN Convention is ratified by only 8 states (Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama, Tunisia) as of end of January 2018 and trade volumes of those states are not significant, it could be used to supplement the operation of the rules and laws on a specific independent guarantee.²⁵

The Uniform Rules for Demand Guarantees, ICC Publication No. 758 (the "URDG 758"), and the International Standby Practice (the "ISP98") have also provisions stipulating "independence principle" of a guarantee (or a standby letter of credit) respectively in Article 5²⁶ of the URDG 758 and in Article 1.06²⁷ of the ISP 98 . Those provisions stipulating independence principle of an independent guarantee show that independence guarantees including refund guarantees in international trades are in practice independent from the underlying transaction.

As afore-mentioned, a typical refund guarantee falls in an independent guarantee and it shares independence nature of an independent guarantee. In a typical refund guarantee, a beneficiary is entitled to repayment under a refund guarantee regardless of any dispute as to whether repayment is due under the shipbuilding contract.²⁸ A shipbuilding contract is of course the context and cause for a refund guarantee but is nevertheless a separate contract between different parties.²⁹

A refund guarantee is subject only to its terms and conditions³⁰, not to the clauses of the shipbuilding

contract unless they are incorporated in a refund guarantee and accordingly form an integral part of a refund guarantee.³¹ A beneficiary's right to make a demand for payment under a refund guarantee is to be determined solely by the terms and conditions specified in a refund guarantee.³² A guarantor should pay a demand for payment if the demand is complying solely with the terms and conditions of a refund guarantee. In a refund guarantee with a strong independence nature, a guarantor or a shipbuilder cannot assert any defense arising out of the shipbuilding contract.³³ Therefore, it happens that the demand for payment under a refund guarantee is made notwithstanding repayment by a shipbuilder is not due under the shipbuilding contract, in which case a shipbuilder will be forced to recover the amount paid from the buyer by taking legal proceeding.³⁴ In most cases, a shipbuilder will be forced to file a suit in a buyer's country, which is by nature very disadvantageous and costing.

3. PURPOSE OF INDEPENDENCE NATURE IN A REFUND GUARANTEE

In a large shipbuilding project, both a buyer and a seller assume significant risks of the other's non-performance for a long period commencing from the date of a shipbuilding contract.³⁵ A refund guarantee is required as a security against a shipbuilder's non-performance. Under a shipbuilding contract, a shipbuilder is required to procure a refund guarantee in order to secure a refund of the pre-delivery instalment to a buyer.³⁶ The purpose of a refund guarantee is to indemnify a buyer for losses resulting from a shipbuilder's default under the shipbuilding contract.³⁷ A typical refund guarantee in a shipbuilding project does not contain a reduction clause while a typical advance payment guarantee in a construction project does.³⁸ This is because the buyer in a shipbuilding project does not have ownership of the ship under construction while the employer in a construction project does. See the reduction clause of an advance payment guarantee in FIDIC Silver Book Article 14.2 Advance Payment.:

"The advance payment shall be repaid through proportional deductions in interim payments. Deductions shall be made at the amortization rate

stated in the Particular Conditions (or, if not so stated, as stated in sub-paragraph (d) above), which shall be applied to the amount otherwise due (excluding the advance payment and deductions and repayments of retention), until such time as the advance payment has been repaid.”

Unless a refund guarantee is not independent from the shipbuilding contract, a beneficiary will not be entitled for payment in case the parties in a shipbuilding contract are in dispute with regard to the repayment by a shipbuilder. It takes a very long time for the dispute to be resolved owing to its internationality and the complexity of a shipbuilding contract. This will adversely affect a buyer, and lead a buyer to lose time to find an alternative shipbuilder and to fail to recover the losses arising from a shipbuilder’s breach of a shipbuilding contract. However, the independent nature of a refund guarantee will help a buyer to recover such losses. Recovery in case of a shipbuilder’s insolvency is matter of time, and independent nature of a refund guarantee will also expedite to recover the losses. Independence nature will provide certainty of repayment to a buyer and promote the utility of a refund guarantee.³⁹

In a standard construction project, an employer shall pay the first instalment after receiving an advance payment guarantee.⁴⁰ The same is in practice true to a shipbuilding project. An issuance of a refund guarantee is commonly prerequisite for the payment of the first instalment or for the effectiveness of a shipbuilding contract. See the expressions and phrases in a shipbuilding contract for a vessel of 32,000 DWT between Ocean Lodestar S.A. and Jinse Shipbuilding Co., Ltd.:

“Twenty per cent (20%) of the Contract Price amounting to U.S. Dollars _____ shall be paid within three (3) business days after the effective date of this Contract, or if later within three (3) business days after delivery to the Buyer of the Refund Guarantee referred to in paragraph 8 of this Article and as per Exhibit “A”.”;

“This Contract shall be become effective upon signing by the parties hereto and Refund Guarantee is provided by the Builder. Provided that the Refund Guarantee is not issued within eight (8) months after signing contract, both parties shall reasonably discuss

and agree to the revised terms and conditions of the contract, should the Refund Guarantee fail to be obtained until 2 months prior to the deadline of 8 months.”

See also the expressions and phrases in a shipbuilding contract for container vessel of 8,600 TEU between Hapag-Lloyds AG. and Hyundai Heavy Industries Co., Ltd.:

“20% (Twenty per cent) of the Contract Price amounting to USD _____ shall be due upon signing of the Contract and receipt of Letter of Refundment Guarantee as specified in Exhibit “A” annexed hereto. Within 5 (five) banking days after signing the Contract and having received the Letter of Refundment Guarantee, the BUYER shall remit the amount of this Instalment by telegraphic transfer to the account of Hyundai Heavy Industries Co., Ltd. with the Bank (hereinafter referred as the “BUILDER’s Bank) which the BUILDER may designate in favour of Hyundai Heavy Industries Co., Ltd. under an advice by authenticated cable or fax to the BUILDER’s Bank.”

See also the expressions and phrases in a shipbuilding contract for 51,000 DWT product/chemical tanker between ST Shipping & Transport Pte Ltd. and SLS Shipbuilding Co. Ltd.:

“The First Instalment amounting to _____ shall be due and payable upon receipt of the original texted telex or SWIFT by the BUYER’s Bank of the Letter of Refundment Guarantee provided pursuant to Article X, in the form and contents attached as Exhibit A.”

Another reason for independence nature is that banks are reluctant to issue conditional guarantees which are not independent from underlying transactions because they do not want to be involved in disputes arising from the underlying transactions.⁴¹ This is the same as a documentary credit in that an issuing bank also does not want to be involved in disputes between the seller and the buyer.

There is one more reason which would be more practical in a shipbuilding project. The negotiations as to the substance of a contract including a refund

guarantee are influenced by various factors,⁴² one of which is the requirement by lenders for shipbuilding finance. The financing scheme for capital goods comes into two types of buyer credit and supplier credit by who undertakes to provide the fund required for the performance of a contract.⁴³ In buyer credit, a buyer (or an importer) is responsible for providing the fund, while in supplier credit, a supplier (or an exporter) is.⁴⁴ Buyer credit and supplier credit have also been the financing options for the purchase of a new shipbuilding for a buyer.⁴⁵ Buyer credit is frequently used to finance the transaction of capital goods on medium-long term basis.⁴⁶ A shipbuilder will be paid in full on delivery in buyer credit, while he will be paid on deferred payment terms except the pre-delivery instalments in supplier credit.⁴⁷ Recently, most shipbuilding contracts have been based on a buyer credit⁴⁸, and therefore they are accompanied by loan agreements for the shipbuilding. A buyer, normally a ship owner, is to repay the loan with the revenue from the operation of the ship. Once a ship is built and delivered to a buyer, lenders can acquire mortgage on the ship, and/or create security on the charterage for the repayment. See the expressions and phrases in a loan agreement for Chambal Fertilisers & Chemicals Ltd. and Hyundai Heavy Industries Co., Ltd. to the purpose:

“The Borrower⁴⁹ hereby undertakes and agrees with each of the Creditors that it will execute, and procure the registration of, the Mortgage and Deed of Covenant applicable to each Ship under the laws and flag of the Flag State immediately upon the provisional registration of such Ship and no later than ten (10) Banking Days after Delivery of such Ship;”

See also the expressions and phrases in a loan agreement for for 50,400 DWT class tankers between Abu Dhabi Star Pte. Ltd. and STX Shipbuilding Co. to the same purpose:

“Each Borrower hereby undertakes and agrees with each of the Creditors that they will execute, and procure the registration of, the Mortgage and Deed of Covenant applicable to each Ship under the laws and flag of the Flag State immediately upon Delivery of such Ship;”

However, the repayment under the loan agreement will go uncertain, and sometimes really go utile, if something wrong happens with building a ship or delivery of a ship. To make matters worse, it is practically impossible or of no use to acquire mortgage on a ship under construction before delivery. For instance, a registered mortgage over a ship under construction is not possible under English law.⁵⁰ A refund guarantee is the only security for the repayment of the loan before delivery of a ship. Therefore, issuance of a refund guarantee is very crucial to lenders. Lenders do not want to be involved in the disputes between a buyer and a shipbuilder. Instead, lenders are eager to collect immediately the loan disbursed regardless of any dispute between a buyer and a shipbuilder under a shipbuilding contract. To make sure of repayment of the loan with a refund guarantee, lenders frequently request that a refund guarantee should be absolutely independent from the shipbuilding contract. To meet lenders’ need and requirement, a refund guarantee is in practice issued to be independent from the shipbuilding contract, and the guarantor’s repayment obligation is to be absolute and primary.⁵¹

Thus lenders require that a refund guarantee should be in a form acceptable to them, which will be a guarantee independent from the shipbuilding contract. See the expressions and phrases in a loan agreement for shipbuilding building contracts for 50,400 DWT class tankers between Abu Dhabi Star Pte. Ltd. and STX Shipbuilding Co.

“**Refund Guarantee**” means:

- (a) in relation to Ship A, the letter of guarantee No. ————— issued by the Refund Guarantor in favour of the relevant Seller and assigned to the relevant Borrower pursuant to the relevant Novation Agreement; and
- (b) in relation to Ship B, the letter of guarantee No. ————— issued by the Refund Guarantor in favour of the relevant Seller and assigned to the relevant Borrower pursuant to the relevant Novation Agreement; and
- (c) in relation to Ship C, the letter of guarantee No. ————— issued by the Refund

Guarantor in favour of the relevant Seller and assigned to the relevant Borrower pursuant to the relevant Novation Agreement; and

- (d) in relation to Ship D, the letter of guarantee No. ————— issued by the Refund Guarantor in favour of the relevant Seller and assigned to the relevant Borrower pursuant to the relevant Novation Agreement; and
- (e) in relation to any Ship, any further refund guarantee (if any) provided by the Refund Guarantor in favour of any Seller or any Borrower executed (or as the context may require) to be executed by the Refund Guarantor in a form acceptable to the Agent⁵²;

See also the expressions and phrases in a loan agreement for shipbuilding building contracts for 4,400 TEU class container carriers between Shipping Corporation of India and Hyundai Samho Heavy Industries Co., Ltd.

“Refund Guarantee” means:

- (a) in relation to Ship A, the letter of guarantee no. ————— issued by the Refund Guarantor in favour of the Borrower; and
- (b) in relation to Ship B, the letter of guarantee no. ————— issued by the Refund Guarantor in favour of the Borrower; and
- (c) in relation to either Ship, any further refund guarantee provided by the Refund Guarantor in favour of the Borrower executed (or as the context may require) to be executed by the Refund guarantor in a form acceptable to the Agent⁵³;

To have the value of a refund guarantee maintained, a refund guarantee should not be revoked, cancelled, or rescinded. “Irrevocable” or “non-cancellable” is said to have been driven from article 1c of the Uniform Customs and Practice for Documentary Credits (1974 Revision, ICC Publication No. 290).⁵⁴ A loan agreement requires that a refund guarantee should not be cancelled, rescinded, otherwise terminated, or varied without permission by the lenders. Furthermore, a buyer should not release a guarantor from its obligations under a refund guarantee or waive any breach of guarantor’s obligations thereunder. See the expressions and phrases in a loan agreement for shipbuilding building contracts

for 105,000 DWT class product carriers between Chambal Fertilisers & Chemicals Ltd. and Hyundai Heavy Industries Co., Ltd.

“Termination or variation of Refund Guarantees: any Refund Guarantee is cancelled, rescinded or otherwise terminated or is varied in any manner not permitted by or pursuant to this Agreement or the Pre-delivery Security Assignments;”

If a refund guarantee is cancelled, rescinded or otherwise terminated or is varied in any manner not permitted by lenders or a loan agreement, this will constitute “event of default”. After the happening of an event of default, lenders are entitled to declare that the loan and interests have become due and payable. In such case, a buyer should be entitled to demand repayment under a refund guarantee to repay the loan and interests. See the expressions and phrases in a loan agreement for shipbuilding building contracts for 4,400 TEU class container carriers between Shipping Corporation of India and Hyundai Samho Heavy Industries Co., Ltd

“10. Events of Default

10.1.29. Termination or variation of Refund Guarantees: any Refund Guarantee is cancelled, rescinded or otherwise terminated or is varied in any manner not permitted by or pursuant to this Agreement or the Pre-delivery Security Assignments and alternative security arrangements acceptable to the Agent (acting within their sole discretion) are not in existence within fifteen (15) days of such cancellation, rescission or other termination; or;”

“10.2 Acceleration

The Agent may and shall (if so directed by the Majority Lenders), without prejudice to any other rights of the Creditors, at any time after the happening of an Event of Default which is continuing by notice to the Borrower:

10.2.1 declare that the obligation of each Lender to make its Commitment available shall be terminated, whereupon the Total Commitments shall be reduced to zero forthwith; and/or

10.2.2 declare that the Loan and all interest and Commitment fee accrued and all other sums payable under the Security Documents have become due and

payable, whereupon the same shall, immediately or in accordance with the terms of such notice, become due and payable.”

Furthermore, in many instances, lenders request a buyer, usually a borrower under a loan agreement, to assign a refund guarantee to them for the security of repayment of the loan. See also the expressions and phrases in a loan agreement for shipbuilding building contracts for for 105,000 DWT class product carriers between Chambal Fertilisers & Chemicals Ltd. and Hyundai Heavy Industries Co., Ltd.

“Pre-delivery Security Assignment” means, in respect of a Ship, the first priority assignment of the Contract and each Refund Guarantee applicable to that Ship executed or (as the context may require) to be executed by the Borrower, in favour of the Security Agent in the form set out at Schedule 8;”

4. EXTENT OF INDEPENDENCE OF A REFUND GUARANTEE

Admitting that a refund guarantee, a kind of an independent guarantee (or demand guarantee), is in practice is in theory independent from a shipbuilding contract, the extent of independence relies on the terms and conditions of an individual refund guarantee. The more independent a refund guarantee is, the more beneficial to a buyer’s perspective it would be and the more disadvantageous to a shipbuilder’s perspective. Therefore, the respective parties’ interest concerning the terms and conditions of a refund guarantee will be naturally in conflict. Therefore, the terms and conditions of a refund guarantee is product of negotiation between a buyer and a shipbuilder. A buyer and a seller usually engage in detailed negotiations as to the substance of a contract.⁵⁵ A refund guarantee with independence nature is commonly used when a shipbuilder has great bargaining power and imposes it as a “take or leave” option.⁵⁶ The fact that current shipbuilding industry has been buyer’s market rather than seller’s market, and that most shipbuilding contracts are based on a buyer credit, brings a buyer more bargaining power in negotiating the terms and conditions of a refund guarantee as well as those of a shipbuilding contract.

If a refund guarantee is callable upon a buyer’s simple demand for payment or completely independent from a

shipbuilding contract, it will secure a repayment of the instalments paid to a buyer. Thus a buyer will prefer a refund guarantee completely independent from a shipbuilding contract. On the other hand, if a refund guarantee is callable only after a shipbuilder’s repayment obligation is determined in arbitration or court litigation, it may not secure the repayment. The followings are examples of the expressions concerning independence nature in some refund guarantees.

Example 1)

“This Letter of Guarantee is available against Buyer’s first written demand and Buyer’s signed statement (or that of Buyer’s assignee/transferee) certifying that Buyer’s demand for refund has been made in conformity with Article 10 (f) of the Contract and the Builder has failed to make the refund within twenty one (21) days of the Buyer’s demand to the Builder. Such written statement shall identify (p!) the number and amount of Installments in respect of which repayment has not been received and (q!) the total interest payable in respect of the same on the assumption that payment of the principal sum outstanding is made by us five (5) Banking Days from the date of receipt of such statement. Refund shall be made to the Buyer within seven (7) days from the Buyer’s demand by telegraphic transfer in United States Dollars to an account designated by the Buyer.” (in a shipbuilding contract for 50,300 DWT Product Oil / Chemical Tanker between Proteus 6 Ltd. and SPP Shipbuilding Co. Ltd.)

Example 2)

“The payment by the undersigned under this guarantee shall be made upon simple receipt by us of a written demand from you and signed statement certifying that Buyer’s demand for refund has been made in conformity with the terms of the Contract and the Builder has failed to make the refund within thirty (30) days of the Buyer’s demand to the Builder. Refund shall be made to the Buyer immediately upon demand by telegraphic transfer in United States Dollars for value the day the demand is made to an account and beneficiary designated by the Buyer.” (in a shipbuilding contract for 81,000 DWT Bulk Carrier between Flavio Marine Ltd. and SPP Plant & Shipbuilding Co. Ltd.)

As most refund guarantees refer to the respective shipbuilding contract, we are to clarify whether guarantor's payment obligation is subject to the shipbuilding contract when a refund guarantee refers to a shipbuilding contract. In *Rainy Sky S.A. and others v. Kookmin Bank*, the court held that "the shipbuilding contract is of course the context and cause for the bond but is nevertheless a separate contract between parties" and that "it was common ground that all depends upon the true construction of the bonds and that the terms and meaning of the contracts are only relevant to the extent that they inform the true construction of the bonds."⁵⁷ The URDG 758 also provides that "a reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independence nature of the guarantee." (Article 5.a.) It can be inferred that mere referring to a shipbuilding contract in a refund guarantee does not mean that a refund guarantee is subject to the shipbuilding contract.

Article 1 of the URDG 758 states that "the Uniform Rules for Demand Guarantees ("URDG") apply to any demand guarantee or counter-guarantee that expressly indicates it is subject to them."⁵⁸ Therefore, the URDG, in principle, applies to a refund guarantee provided it is expressly incorporated in a refund guarantee.⁵⁹ As London is one of the world's major shipping centres⁶⁰, most refund guarantees provide that they are governed by the laws of England. See the expressions below in a refund guarantee for building a 50,300 DWT product oil/chemical tanker by SPP Shipbuilding Co. Ltd.

"This Letter of Guarantee shall be governed by and construed with the laws of England and the undersigned hereby submits to the non-exclusive jurisdiction of the courts of England —"

Out of 50 samples of refund guarantee, only five are governed by the URDG, and the rest are governed by the laws of England. Those five refund guarantees are issued for 8,600 TEU class container vessels between Hapag-Lloyd AG and Hyundai Heavy Industries Co. Ltd. See the expressions below referring the URDG in those refund guarantees:

"This Advance Payment Guarantee is subject to the Uniform Rules for Demand Guarantees of the International Chamber of Commerce ("ICC"), ICC

Publication No. 458⁶¹ unless otherwise expressly stipulated herein."

As the URDG 758 is of a contractual nature rather than a law, explicit or implicit consent of the parties is required for its direct application.⁶² The URDG 758 has attempted to codify international practice⁶³, and is expected of global acceptance owing to its comprehensive and detailed nature. And many banks in a number of European countries and the Middle East offer URDG guarantees.⁶⁴ Therefore, the relevant clauses of the URDG 758, as an international rule, might apply to the interpretation of a refund guarantee as a gap-filling rule⁶⁵ for the governing law of a refund guarantee.⁶⁶ Such an interpretation will rely on the individual jurisdiction concerned.

In conclusion, mere referring to a shipbuilding contract in a refund guarantee does not necessarily mean that a refund guarantee is subject to the shipbuilding contract or it is not independent from the shipbuilding contract.

5. CONCLUSION

A typical shipbuilding contract requires a refund guarantee issued by a financial institution in favour of a buyer for the account of a shipbuilder. The purpose of a refund guarantee is to indemnify a buyer for losses ("pre-delivery instalments paid") resulting from a shipbuilder's default under the shipbuilding contract. As a typical refund guarantee falls in an independent guarantee, it shares the characteristics of an independent guarantee. Just like an independent guarantee is independent from the underlying contract, a typical refund guarantee is independent from the shipbuilding contract. A refund guarantee is subject only to its terms and conditions, not to the clauses of the shipbuilding contract unless they are incorporated in a refund guarantee and accordingly form an integral part of a refund guarantee. A beneficiary's right to make a demand for repayment under a refund guarantee is to be determined solely by the terms and conditions specified in a refund guarantee

A guarantor in a refund guarantee irrevocably and unconditionally undertakes to pay to a beneficiary, normally a buyer in a shipbuilding contract, on a simple

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demand for payment presented in accordance with the terms and conditions of a refund guarantee. In a typical refund guarantee, a beneficiary is entitled to repayment under a refund guarantee regardless of any dispute as to whether repayment is due under a shipbuilding contract, if the terms and conditions of a refund guarantee are satisfied. In a large shipbuilding project, both a buyer and a seller assume significant risks of the other's non-performance. Under a shipbuilding contract, a shipbuilder is commonly required to procure a refund guarantee in order to secure a refund of the pre-delivery instalment to a buyer.

The primary purpose of independence nature of a refund guarantee is to secure a refund in the event of a shipbuilder's default in the shipbuilding contract. To meet the purpose of a refund guarantee, a refund guarantee needs to be independent from a shipbuilding contract, and a buyer normally requests so. Furthermore, most shipbuilding contracts are accompanied by loan agreements, and the lenders require a refund guarantee as a security for the loan before delivery of a ship. Lenders who provide fund for a shipbuilding project request that a refund guarantee should be independent from the shipbuilding contract in order to make sure of repayment of the loan by using it. In addition, banks are usually reluctant to issue a conditional guarantee because they do not want to be involved in disputes arising from the shipbuilding contract.

Although a refund guarantee is independent from the shipbuilding contract, the extent of independence relies on the terms and conditions of an individual refund guarantee. The more independent a refund guarantee is the more advantageous and beneficial to a buyer it would be. Therefore, the parties should be careful about the expressions in a refund guarantee. As the respective parties' interest concerning the terms and conditions of a refund guarantee is in conflict, the terms and conditions of a refund guarantee is product of negotiation between a buyer and a shipbuilder.

NOTES

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2. *Ibid.*; See Rainy SKY SA v. Kookmin Bank, —020090 EWHC 2624 (Comm, —020100 1 All E.R. (Comm) 823).
3. Simon Curtis, *The Law of Shipbuilding Contracts*, 4th ed., informa law from Routledge, 2012, pp.289-291.
4. *Ibid.*; See also Rainy SKY SA v. Kookmin Bank, —020110 UKSC 50; 2011 WL 5077782.
5. This arrangement is commonly attached to an application form of a refund guarantee.
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13. Carole Murray *et.al*, *supra note 9*, p.243.; IE Contractors v Lloyds Bank Plc (1989) 2 Lloyd's Rep. 205.
14. Philip Wood, *Law and Practice of International Finance*, Sweet & Maxwell, 1990, p.303.; Carole Murray *et.al*, *supra note 9*, p. 243.; See Edward Owen Engineering Ltd v Barclays Bank International Ltd., —019780 QB 159.; Carr (n 10 above), p 503.
15. Philip Wood, *supra note 14*, p.303.
16. Anders Grath, *supra note 11*, p.14.
17. Roy Goode, *supra note 10*, p.8.
18. George Affaki, Roy Goode, *supra note 12*, p.7.; Edward Owen Engineering Ltd. v Barclays Bank International Ltd., —019780 Q.B. 159.
19. Roeland F. Bertrams, *supra note 10*, p.11.
20. Jimenez, *supra note 10*, p.156.
21. Anders Grath, *supra note 11*, p.78.
22. UNCITRAL Homepage available at http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1995Convention_guarantees_credit.html.
23. UNCITRAL Homepage available at http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1995Convention_guarantees_credit.html.
24. Article 1(1) of the UN Convention.
25. Ralph H. Folsom. *et. al*, *Principles of International Business Transactions, Trade & Economic Relations*, (St. Paul: Thomson/West, 2005, p 164.
26. Article 3. Independence of guarantee and counter-guarantee
 - a) A guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defenses arising from any relationship other than a relationship between the guarantor and the beneficiary.
 - b) A counter-guarantee is by its nature independent of the guarantee, the underlying relationship, the application and any other counter-guarantee to which it relates, and the counter-guarantor is in no way concerned with or bound by such relationship. A reference in the counter-guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the counter-guarantee. The undertaking of a counter-guarantor to pay under the counter-guarantee is not subject to claims or defenses arising from any relationship other than a relationship between the counter-guarantor and the guarantor or other counter-guarantor to whom the counter-guarantee is issued.
27. Article 1.06 Nature of Standbys
 - a) A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not so state.
 - b) Because a standby is irrevocable, an issuer's obligations under a standby cannot be amended or cancelled by the issuer except as provided in the standby or as consented to by the person against whom the amendment or cancellation is asserted.
 - c) Because a standby is independent, the enforceability of an issuer's obligations under a standby does not depend on:
 - i) the issuer's right or ability to obtain reimbursement from the applicant;
 - ii) the beneficiary's right to obtain payment from the applicant;
 - iii) a reference in the standby to any reimbursement agreement or underlying transaction; or
 - iv) the issuer's knowledge of performance or breach of any reimbursement agreement or underlying transaction.
 - d) Because a standby is documentary, an issuer's obligations depend on the presentation of documents and an examination of required documents on their face.
 - e) Because a standby or amendment is binding when issued, it is enforceable against an issuer whether or not the applicant authorised its issuance, the issuer received a fee, or the beneficiary received or relied on the standby or the amendment.
28. Rainy SKY SA v Kookmin Bank, —020090 EWHC 2624 (Comm, —020100 1 All E.R. (Comm) 823).
29. See Rainy SKY SA v. Kookmin Bank, —020110 UKSC 50; 2011 WL 5077782.
30. Carole Murray *et.al*, *supra note 9*, p.243.

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31. George Affaki, Roy Goode, *supra note 12*, p.7.
32. Roeland F. Bertrams, *supra note 10*, p.11.
33. George Affaki, Roy Goode, *supra note 12*, p. 7.
34. Roeland F. Bertrams, *supra note 10*, p.75.
35. Simon Curtis, *supra note 3*, pp.7-8.
36. Carole Murray *et.al*, *supra note 9*, p.247.
37. Roeland F. Bertrams, *supra note 10*, p.11.
38. Roeland F. Bertrams, *supra note 10*, p.40.
39. Sang Man Kim, “The Supreme Court of Korea’s Decisions on the Fraud Exception in a Demand Guarantee: Focusing on East Gas Seeds Industry Co. v. Korea Exchange Bank Case (2014)”, *Journal of Korea Trade Vol. 19 No. 3, 2015*, p.45.; Ralph H. Folsom. *et. al*, *supra note 25*, p.156.
40. See the relevant clause in FIDIC Silver book.
14.2 Advance Payment
“ The Employer shall pay the first instalment after receiving (i) a Statement (under Sub-Clause 14.3 *Application for Interim Payments*), (ii) the Performance Security in accordance with Sub-Clause 4.2 [*Performance Security*], and (iii) a guarantee in amounts and currencies equal to the advance payment. This guarantee shall be issued by an entity and from within a country (or other jurisdiction) approved by the Employer, and shall be in the form annexed to the Particular Conditions or in another form approved by the Employer. Unless and until the Employer receives this guarantee, this Sub-Clause shall not apply.”
41. Carole Murray *et.al*, *supra note 9*, p.243.
42. Simon Curtis, *supra note 3*, p.7.
43. Sang Man Kim, “A Comparative Study on a Supplier Credit and a Buyer Credit in international Transactions of capital goods”, *The International Commerce & Law Review Vol 48, 2010*, p.129.
44. Richard Willsher, *Export Finance*, Macmillan Press, 1995, p.66.; Malcolm Stephens, *The Changing Role of Export Credit Agencies*, International Monetary Fund, 1999, pp.73, 110.,
45. Stephen Harwood, *supra note 1*, p.46.
46. Stephens, *supra note 1*, p.73.
47. Stephen Harwood, *supra note 1*, p.46.
48. Stephen Harwood, *supra note 1*, p.48.
49. A “Borrower” here means a buyer in a shipbuilding contract.
50. Stephen Harwood, *supra note 1*, p.487.
51. Matti S. Kurkela, *Letters of Credit and Bank Guarantees under International Trade Law, 2nd ed.*, Oxford University Press, 2007, p.18.
52. Here, the Agent means XXX Bank, or such other person as may be appointed agent for the Creditors pursuant to the Agency Deed.
53. Here, the Agent means XXX Bank, or such other person as may be appointed agent for the Creditors pursuant to the Agency Deed.
54. Philip Wood, *supra note 14*, p.303.
55. Simon Curtis, *supra note 3*, p.8.
56. Jimenez, *supra note 10*, p.157.
57. Rainy SKY SA v. Kookmin Bank, —020110 UKSC 50., 2011 WL 5077782, para. 16, Para.7.
58. Article of the URDG 458, the previous version of the URDG 758, is the same.
59. Carole Murray *et.al*, *supra note 9*, p.249.
60. Stephen Harwood, *supra note 1*, p.2.
61. ICC adopted the URDG 458 in 1991, and revised it in 2010. The revision of 2010 is called the URDG 758.
62. Roeland F. Bertrams, *supra note 10*, p.31.
63. Carole Murray *et.al*, *supra note 9*, p.249.
64. Roeland F. Bertrams, *supra note 10*, p.29.
65. Most countries do not have specific legislation on an independent guarantee. (Roeland F. Bertrams, *supra note 10*, p.33.).
66. Roeland F. Bertrams, *supra note 10*, pp.29-30.

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