Reef Shipping Co Ltd v Prime Minister of Tonga

Privy Council
App 6/1980

22 May 1981

Agency - shipping company whose contractual obligations were guaranteed by the Government was not an agent of the Government.

Contract - deed of guarantee of performance of obligations under a contract held not to include arbitration award.

Contract - deed of guarantee of performance of obligations under a contract does not extend to include obligations arising under subsequent material variations to the contract which have not been consented to by the guarantor.

Guarantee - deed of guarantee of performance of obligations under a contract does not extend to include amount of arbitration award not consented to by the guarantor.

Pacific Navigation Co Ltd entered into an agreement on 15 December 1975 with Reef Shipping Co Ltd to charter a vessel, and on 12 January 1976 the Government of Tonga entered into a deed of guarantee whereby it guaranteed to the Reef Shipping Co Ltd the full performance by Pacific Navigation Co Ltd of its obligations under the charter agreement.

On 9 February 1977 Pacific Navigation Co Ltd and Reef Shipping Co Ltd entered into a further agreement to vary the charter agreement by adding two clauses: one, which provided for all disputes between the parties under the charter agreement to be determined by arbitration in Auckland, New Zealand, and another which provided that the proper law applicable to the charter agreement shall be New Zealand law.

Disputes did arise between the parties and were referred by them to arbitration in Auckland on a result of which Pacific Navigation Co Ltd was ordered to pay $NZ 165,114.79. The company then made a demand upon the Tonga Government, which had not been a party to the aribitration, for payment of this sum, but this was refused.

Reef Shipping Co Ltd brought proceedings in the Supreme Court based on the guarantee given by the Government, but the claim was dismissed. The company then appealed to the Privy Council.

HELD:
Dismissing the appeal.

(1) The guarantee given by the Government in the deed of 12/1/1976 was confined to the obligations of Pacific Navigation Co Ltd under the agreement of 15 December 1975, and did not extend to include any liability under the arbitration award.

(2) The contract of guarantee comprised both the deed of 12/1/1976 and the agreement between the shipping companies of 15/12/1975 and there had been a material variation of the latter without the consent of the Government which was not bound by them.

(3) The Pacific Navigation Co Ltd was not an agent for the Tonga Government, and was not held out to be such.

Cases considered
In re Kitchin (1881) 17 Ch D 688
The Vasso, Bruns v Colocotronis [1979] 2 Lloyds Rep 412
Moorgate Mercantile Co Ltd v Twitching [1975] 3 All ER 314
Smith, Stone & Knight v Birmingham [1939] 4 All ER 116
Winstone Ltd v Bourne & Anor [1978] 1 NZLR 94

Privy Council

Judgment

This is an appeal against the dismissal of an action brought by appellant for the recovery of the sum of $NZ165,114.79 which was the amount awarded to appellant in arbitration proceedings between appellant and a registered company named Pacific Navigation Company Limited (hereinafter called PNCL). Appellant and PNCL entered into a Bareboat Charterparty Agreement on December 15, 1975 in which appellant was the owner of the vessel and PNCL the Charterer. On January 12, 1976 the Government of Tonga entered into a deed which, after reciting the said Charterparty, provided that:

> "THE GOVERNMENT OF TONGA HEREBY GUARANTEE the full performance of the Charterer of its obligations under the said Charterparty AND DECLARE that the guarantee is entered into on the faith of the said Charterparty and not otherwise."

The Charterparty was later varied by a written document dated February 9, 1977. The original document has been lost. According to the evidence and documents produced, the heading of the variation agreement was as follows:

> "Agreement made this 9th day of February 1977 between A W Ellem, Administrator of Pacific Navigation Company Limited of Nuku'alofa Tonga and Thomas McNicholl representing Reef Shipping Company Limited, Norfolk Island."

This document will hereafter be referred to as "the arbitration agreement". The added clause read as follows:

> "Clause 34
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> All disputes arising from time to time out of this contract shall unless the parties agree forthwith on a single arbitrator, be referred to the final arbitratement of two arbitrators in Auckland, New Zealand who shall be commercial men employed under the terms of the Arbitration Act 1908, one to be appointed by each of the parties with power to such arbitrators to appoint an umpire. Any claim must be made in writing three months of final discharge, and where this is not complied with, the claim shall be deemed to be waived and absolutely barred. No award shall be questioned or invalidated on the grounds that any of the arbitrators are not qualified as above unless objections to his acting be taken before the award is made.
>
> Clause 35
>
> The proper law applicable to this Charter Party shall be New Zealand Law".

There is no evidence to show what the form of execution was but it is a fair inference from the above extract that it was never officially sealed and executed but was merely signed by Messrs Ellem and McNicholl as agents for the respective parties.

Breaches of the terms of the Charterparty were alleged by appellant and claims for loss were the subject matter of an arbitration between appellant and PNCL in which appellant was awarded the said sum of $NZ165,114.79. Government was not a party to the arbitration. Appellant then made demand upon Government for payment of the sum so awarded. The Supreme Court dismissed the action and from that dismissal the present appeal has been brought.

The case was argued, almost wholly on the effect of the variation agreement. The general law, when there has been a variation of the terms and conditions of the principal obligations, is, so far as it is relevant to the present proceedings, set out in the following

passage in Halsbury's Laws of England 4th Edition Vol.20 para.253; viz:-

253 "Material variation of terms of principal contract. Any material variation of the terms of the contract between the creditor and the principal debtor will discharge the surety, who is relieved from liability by the creditor dealing with the principal debtor (or with a co-surety) in a manner at variance with the contract the performance of which is guaranteed.

When a person becomes surety for another in a specific transaction or obligation, the terms and conditions of the principal obligation are also the terms and conditions of the suretyship contract, and if the creditor, without the surety's consent, alters those terms to the prejudice of the surety, the surety will be free, it being the clearest and most evident equity not to carry on any transaction without the privity of the surety, who must necessarily have a concern in every transaction with the principal debtor, and who cannot as surety be made liable for default in the performance of a contract which is not the one the fulfilment of which he has guaranteed." (Emphasis has been added)

It will be seen in due course that the question is much wider.

To ascertain the real issue in this case, it is necessary to analyse the amended statement of claim upon which the action was tried. First, the Charterparty was pleaded and then followed a claim that, by the deed of guarantee, dated January 12, 1976, Government had guaranteed full performance by PNCL of the obligations of PNCL under the Charterparty. It was then stated that PNCL had made default in its performance of the Charterparty and that particulars of such default had been given to PNCL and further that such default was subject to express findings under an arbitrator's award dated August 2, 1979 a copy of which award had been delivered to PNCL and Government. Then followed para.5 which reads:

"5 THAT the Plaintiff's claim for damages against PACIFIC NAVIGATION COMPANY LIMITED in respect of its said default was the subject on an arbitration in Auckland, New Zealand as the method agreed to determine the disputes which reference to arbitration was with the Consent of the Defendant (although the Plaintiff does not admit that such Consent was necessary to preserve the guarantee.)"

Particulars of the amount awarded were set out in para.6. It was then stated that PNCL had made default in payment and that demand had been made on Government to pay the amount of the award.

Paragraph 5 above makes specific reference to "default (which) was the subject of an arbitration in Auckland, New Zealand, as the method agreed on to determine the disputes". It will be noticed that the arbitration agreement was not pleaded. There were no particulars given of "the method agreed on" referred to in para 5. It is clear that the documents pleaded do not contain any reference to the determination of disputes by arbitration, so "the method agreed on" does not fall within the provisions of the only documents pleaded. From the course of the action and argument, both in the Supreme Court and before the Privy Council, the only evidence of an agreement to submit disputes to arbitration is that contained in the arbitration agreement to which Government was not a party. Hence it becomes clear that para.5, without expressly pleading the arbitration agreement, relies upon that document as the basis of the award.

From this analysis it emerges beyond any doubt that the only cause of action pleaded

was based on an award made under the provisions of the arbitration agreement. The primary question then is whether or not, under the terms of the guarantee, Government is liable, not for the default of PNCL under the terms of the Charterparty, (because no such issue has been raised in these proceedings), but for the amount of an award (which had already determined all questions of default) made in an arbitration between appellant and PNCL in pursuance of the provisions of the arbitration agreement. The distinction is vital.

No action based on the award could possibly arise under the two documents pleaded so it is idle for appellant to argue that the arbitration agreement was not a material variation of the Charterparty, it was a variation essential to proof of the cause of action pleaded. It was a new and additional obligation upon PNCL under the Charterparty to submit disputes to arbitration and further it changed the law of the Charterparty contract from the law of Tonga to the law of New Zealand. It deprived PNCL of its right to resort to the courts of the original law of the contract. Without question the Charterparty was materially altered and the alteration was an essential element of the cause of action.

The only cause of action accordingly rests squarely on proof that the guarantee upon its true construction, was in terms sufficiently wide to embrace liability for an award which was made under the arbitration agreement, and which had already determined all questions concerning the liability of PNCL to appellant in an arbitration between appellant and PNCL under New Zealand law.

The only written document of guarantee pleaded is the deed dated January 12, 1976. In express terms it is confined to the obligations of PNCL under the Charterparty dated December 15, 1975 and further declares that the guarantee is entered into on the faith of the Charterparty and not otherwise. Liability of PNCL to pay the amount of an award can arise only if PNCL entered into an obligation, not contained in the Charterparty but additional to its provisions, to submit disputes to arbitration. The cause of action demonstrably does not come within the express terms of the deed of guarantee, which is confined to the Charterparty in its original form, before the arbitration agreement was entered into.

The argument of counsel for appellant that the provision for arbitration was not material but was merely an alternative method of ascertaining the liability of PNCL under the Charterparty requires further comment. The law is quite clear that, if appellant resorted to Court proceedings to ascertain liability of PNCL for default (which was the only remedy under the documents pleaded), Government would not be liable for any judgment unless it was made an express party to such proceedings. The position would be the same if the parties similarly resorted to arbitration as a result of the arbitration agreement requiring this course. The law is stated in Halsbury's Laws of England 4th Edition Vol 20 para 150 as follows:

> "150 Evidence of Surety's liability. In an action against the Surety by the Creditor, a judgment or award obtained by the Creditor against the principal debtor is not evidence against the Surety."

The case of In re Kitchin (1881) 17 Ch. D. 688 is in point. The guarantor was originally a partner in a firm which had a contract to purchase certain goods. This contract contained a general clause for the determination by arbitration of all disputes between the seller and buyer. One partner, the guarantor, retired from the firm. A new contract was entered into by the remaining partners in exactly the same terms. This was guaranteed by the retiring partner. The Court of Appeal (James, Baggallay and Lush LJJ) held that the

guarantor was not liable to pay the amount of an award made under the arbitration provision. At pages 671-672 James L.J. said:

"The real question is, what is the true intent and meaning of the guarantee? It must be treated, as Lord Justice Lush has already said, as if Mr Kitchin, the guarantor, had been an entire stranger. The fact that he had been a partner in the English firm, or the motives which induced him to give the guarantee, cannot have the slightest effect on its true legal operation. The continuing partners are to pay for the wines supplied, but he will pay for the wines if they do not, or will make good what they do not pay. There are a great number of things which by the agreement they are bound to do; he guarantees that they will do these things, and if they fail to do them, then he is liable in an action against him by Messrs. Cantor for any damages which can be shewn by legal evidence to have been caused to them by that default. That is what he has agreed. It is contended that he is liable to pay any sum which an arbitrator shall say is the amount of the damages. The guarantee must be expressed in very clear words indeed before I could assent to a contruction which might lead to the grossest injustice. It is perfectly clear that in an action against a surety the amount of the damages cannot be proved by any admissions of the principal. No act of the principal can enlarge the guarantee, and no admission or acknowledgment by him can fix the surety with an amount other than that which was really due and which alone the surety was liable to pay. If a surety chooses to make himself liable to pay what any person may say is the loss which the creditor has sustained, of course he can do so, and if he has entered into such a contract he must abide by it. But it would be a strong thing to say that he has done so, unless you find that he has said so in so many words. The arbitration is a proceeding to which he is no party; it is a proceeding between the creditor and the person who is alleged to have broken his contract, and if the surety is bound by it, any letter which the principal debtor had written, any expression he had used, or any step he had taken in the arbitration would be binding upon the surety. The principal debtor might entirely neglect to defend the surety properly in the arbitration; he might make admissions of various things which would be binding as against him, but which would not, in the absence of agreement, be binding as against the surety. It would be monstrous that a man who is not bound by any admission of the principal debtor, should be bound by an agreement between the creditor and the principal debtor as to the mode in which the liability should be ascertained. That is enough to dispose of the case."

This case wsa recently followed in The Vasso, Bruns v. Colocotronis (1979) 2 Lloyds Rep. 412..

These authorities emphasise that it is the guarantee document itself which must be expressed in terms wide enough to embrace clearly such a liability for an award by arbitration between the creditor and debtor if it is intended to be included. Knowledge of the existence of the clause in the guaranteed contract is insufficient. Express contractual liability under the deed of guarantee is essential.

There is a further answer to the case of appellant. It is clear from para.253 of Halsbury's Laws of England Vol.20 (underlined supra) that the contract of guarantee is

comprised of two separate documents, namely:

(1) The deed of guarantee dated January 12, 1976 executed on behalf of Government, and,

(2) The principal obligations between PNCL and appellant contained in the Charterparty in its original form as at December 15, 1975.

The law of the contract of guarantee was the law of Tonga. The cause of action pleaded postulates two new obligations which have their origin in the arbitration agreement and could not arise under the documents above referred to. These new obligations, which are essential to the cause of action are:-

(1) An obligation of PNCL to submit disputes under the Charterparty to a particular form of arbitration under the law of New Zealand in accordance with the arbitration clauses 34 and 35, and,

(2) An obligation on the part of Government to pay the amount of any award so made between appellant and PNCL.

The provisions of the deed of guarantee are not wide enough to include the second obligation above set out. Moreover, the law of the contract of guarantee has been varied in a material respect in that the question of liability between the creditor and debtor is to be determined by a different system of law from that applicable to the original guaranteed Charterparty. The addition of any such obligation to be enforceable is required to be in writing signed by or on behalf of Government and supported by consideration or by deed, and must have legal effect as a variation of the written deed of guarantee executed formally on January 12, 1976 vide Halsbury's Laws of England (supra) para.293. No such document has been either pleaded or proved. The arguments of counsel for appellant that consent to or concurrence in, or knowledge of the fact that appellant and PNCL had entered into the arbitration agreement are irrelevant. It is a matter of contract in which the ambit of liability is strictly construed and confined to the exact terms of the guarantee. The question in a case such as the present one is whether the new and additional obligation is within the terms of the written document entered into by the guarantor. The position is different when there is no more than a departure from the terms of an existing obligation but which is still the basis of an action against the guarantor. No agreement to arbitration was included in the guaranteed contract.

The question of agency, which was strenuously argued by counsel for appellant, will be dealt with although the Privy Council is of opinion that the appeal must fail on the grounds already set out. The scope of the agency, which must be established, requires proof of authority to vary the deed of guarantee of January 12, 1976, by altering the law of that contract in a material respect and also by adding to it an obligation to pay the amount of any award so made between appellant and PNCL. The plea of agency in appellant's reply is not sufficient to allege agency wide enough to authorise a variation of the scope of liability under the deed of guarantee itself which is essential if the cause of action is to succeed. Nevertheless, the Privy Council proposes to deal with the submission that PNCL was the agent of Government with such authority.

The first observation to be made is that PNCL was a contracting party whose obligations to appellant were the subject matter of liability under the guarantee. This proposition requires careful analysis. The relationship, directions and operations of PNCL have all been enlisted in aid of this contention, but the simple proposition is that PNCL was at this time engaged in making a material alteration to its own contract with

appellant. It was the debtor or obligor whose obligations with appellant were guaranteed by Government. The effect of appellant's claim is that by making a material alteration in its own contract, PNCL was also acting as agent or purporting to act as agent for its guarantor for the purpose of making also a material alteration to its guarantor's contract. Counsel claimed that PNCL was an organ of the Government and that it is inconceivable that PNCL was trading as an independent body. These sweeping generalisations do not help. They blur the position almost to the point that, indeed they seem to go so far as to say that, Government would in any event be responsible for the defaults of PNCL under the Charterparty even if there were no guarantee. In short it would mean that even in the case of the Charterparty itself Government would be responsible because PNCL was acting as its agent when entering into the Charterparty. They are separate entities and must be so treated unless the transaction comes within recognised exceptions.

Government had obliged itself to appellant to guarantee the due performance of the Charterparty by PNCL. Each party was a separate entity and was so treated by appellant who now seeks to have that contract of guarantee materially altered by an agreement which was clearly made between only appellant and PNCL without any reference at all, according to the evidence, to the existence of the contract of guarantee which appellant knew existed additionally between itself and Government. Appellant's agent never purported to involve the known guarantor in the transaction but appellant now claims that the inference must be drawn that PNCL was acting in the dual capacity as the principal party to the Charterparty and also as agent for Government in the matter of the guarantee so as to impose a new liability on the guarantor. The Privy Council cannot accept that this was so. There is no evidence to support such a claim.

The authorities on agency by estoppel or apparent authority do not help. Appellant had a contract of guarantee expressly made in writing between itself and Government. What has to be shown is that Government held itself out or engaged in some course of conduct which would make it unjust or inequitable for it to say that authority was not given to make a material amendment to the deed of guarantee. Counsel cited Moorgate Mercantile Co. Ltd. v. Twitching (1975) 3 All E.R. 314 where Lord Denning M.R. said:

> "Estoppel is not a rule of evidence. It is not a cause of action. It is a principle of justice and of equity. It comes to this. When a man, by his words or conduct, has led another to believe in a particular state of affairs, he will not be allowed to go back on it when it would be unjust or inequitable for him to do so. Dixon J. put it in these words. The principle upon which estoppel in pais is founded is that the law should not permit an unjust departure by a party from an assumption of fact which he has caused another party to adopt or accept for the purpose of their legal relations."

The Privy Council can see no grounds for holding that the Government, having on January 12, 1976 entered into a deed of guarantee in respect of the obligations of PNCL to appellant, had created by February 1977, any ground for the assumption of fact by appellant that the contract of guarantee could be altered by PNCL in the manner defined by the mere fact of materially altering its own obligations which were the subject matter of the guarantee. The proper inference to be drawn from the evidence is that the parties were entering upon a variation of the Charterparty and that the guarantee was never in their

contemplation. It would be expected that at lease Mr.McNicholl would give some evidence to support appellant's contention. The judge's finding on his evidence will be referred to later.

Reliance was placed on a number of cases some of which ought to be dealt with. First was the case of Smith, Stone & Knight v. Bermingham [1939] Vol.4 All E.R. (Annot) 116 and further cases to the same effect. Each case has its own peculiar facts but in each the Company was little more than a "shell" or a "name" used for another corporate entity. These cases have no application and the Privy Council rejects entirely any claim that a comparable situation existed. PNCL was in every way a substantial, independently operated commerical venture which Government had set up and supported to foster and supply a shipping service which was considered by Government to be essential in the national interest. State industries in many countries are operated by means of a separate corporate entity. The reasons for this are manifold. The Privy Council is satisfied that Government was meticulous in setting up a corporate body in a proper legal manner and that all steps were taken to ensure that it was a fully viable commercial body properly operated and controlled as such an entity ought to be operated and controlled. The deed of guarantee was a natural corollary of such a set-up but it does not confer an agency for the creation in the manner alleged of a new obligation under that deed.

The case of Winstone Ltd. v. Bourne & Anor [1978] 1 N.Z.L.R. 94 calls for short comment. It is sufficient to say that in this case the guarantors were personally involved and took a major part in making a contract of a variation between the creditor and debtor - they being directors of the debtor company. There was no question of an agent acting on behalf of the guarantors. This case, because of its special and essentially different facts, does not assist appellant.

The next contention is that Mr Ellem had authority, either express or implied, to create the obligations upon which it has been shown was the basis of the cause of action pleaded. Mr Ellem undoubtedly had authority as agent to vary the Charterparty on behalf of PNCL but the vital question (apart from the necessity for a written contractual variation) is whether he had authority to vary the deed of guarantee by adding a new obligation to pay and on default by PNCL to honour an award made under the law of New Zealand in pursuance to the added clauses 34 and 35. The Privy Council is of opinion that there is no evidence to support such a contention and further there is no evidence that Mr Ellem even purported to vary the deed of guarantee or that he and Mr McNicholl ever even contemplated such a variation. Their written document (that is the arbitration agreement) clearly defines the limits of their intention.

In dealing with a submission of counsel for appellant that the Supreme Court should infer that Mr Ellem had instructions from responsible persons in Government to enter into the variation agreements, the learned judge said:

> "Such evidence as there is suggests that in fact (the variation) was done on the spur of the moment in a haphazard way. Neither of these gentlemen was very experienced in such matters and neither thought of the guarantor.
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> Mr McNicholl first thought that Mr Ellem had suggested the variation in his Mr Ellem's Office in Sydney, and that he, Mr McNicholl had drafted the variation. However, when he read the variation as recited in the submission

> he said that he could not have drafted it because it was couched in legal language that he would not employ. Whilst it seems extraordinary that neither party has documents proving how the variation came into existence nor showing when they first heard of it; that seems to be the case."

The Privy Council agrees with this finding.

The judgment inthe Supreme Court found that a variation in the method of appointing the Chief Engineer under the Charterparty was a material variation which discharged the guarantor. Nothing now turns on that point.

430 The appeal will fail on the ground that the only cause of action pleaded does not come within the express terms of the deed of guarantee upon its true construction. Further, that no act of PNCL or of its responsible officers, or of Mr Ellem or of any other person had legal effect by adding to or otherwise varying the deed of guarantee so that Government became liable to pay the amount of the award made under clauses 34 and 35 in an arbitration between appellant and PNCL.

The appeal will be dismissed. All questions of costs are reserved.