

# Construction Newsletter – Important Decision from the Qatar Financial Centre Court of Appeal

Demand guarantees, strict compliance, and preclusion: Qatar Financial Centre Court of Appeal upholds enforcement of guarantees and provides guidance on the interpretation and application of the URDG.

## *Key points*

1. The Court of Appeal of the Qatar Financial Centre (part of the Qatar International Court and Dispute Resolution Centre) has decided its first case relating to demand guarantees;
2. In the judgment, the appellate division gave important guidance on the proper interpretation of the ICC Uniform Rules for Demand Guarantees;
3. The judgment is understood to be the first to recognise the application of the principle of strict compliance to a demand guarantee; and
4. Given the likely effect of both COVID-19 and the Oil Price on economies in the region, this decision is both timely and potentially important.

## *Introduction*

1. In a decision handed down on 16 March 2020, the Appellate Division of the Civil and Commercial Court of the Qatar Financial Centre<sup>1</sup> has dismissed an appeal by the Doha Bank Assurance Company LLC (the “Bank”) against an earlier judgment in favour of Leonardo S.p.A (“Leonardo”), given in respect of calls made on two demand guarantees that had been provided by the Bank.
2. 4 Pump Court advocates [Simon Hale](#) and [Sanjay Patel](#) appeared on both sides of this dispute, before a distinguished international tribunal consisting of Lord Thomas of Cwmgiedd (President), Justice Chelva Rajah SC and Justice Ali Malek QC. The judgment suggests that it will be difficult to challenge calls made on demand guarantees in this Court unless a guarantor can establish a clear breach of an express documentary term of the instrument, particularly if the ICC Uniform Rules on Demand Guarantees (ICC Publication 758) (“URDG”) have been incorporated.
3. The judgment contains the most detailed treatment of the URDG by an appellate court to date and therefore has an importance beyond the Qatar Financial Centre. It is notable as: (1) the first judgment to recognise expressly that the principle of strict compliance applies to demand guarantees that incorporate the URDG; and (2) the first judgment to consider the operation of URDG Article 24 – a preclusion provision that imposes important obligations upon issuers who contract on those terms, and corresponding important rights upon their beneficiaries.

## *Background*

4. Leonardo is an Italian company which operates in the aerospace, defence and security sectors. In July 2015 it entered into a contract with the Qatar Armed Forces to provide a low-level radar system. In March 2016 and in order to provide the radar system, Leonardo entered into a subcontract with PAT Engineering Enterprises Co WLL (“PAT”) for the provision of engineering, procurement and construction of infrastructure and plant.

5. PAT's subcontract required it to provide an advance payment guarantee ("APG") and a performance bond ("PB"). In April 2016, the Bank (of which PAT was a customer) therefore provided the APG and PB, referred to collectively as the "Guarantees".
6. On 13 May 2016 Leonardo paid PAT some €12.2 million as an advance payment under the subcontract. Over time, Leonardo became dissatisfied with PAT's performance on the project. By a letter dated 14 May 2018, Leonardo terminated the PAT subcontract pursuant to Article 16 of the same.
7. On 2 August 2018, Leonardo made a demand on the APG for some €10.5 million and a demand on the PB for some €4.07 million (a total of c.€14.6 million). Both demands were rejected by the Bank. The precise grounds upon which it did so became a key focal point of the appeal.
8. Leonardo insisted that the Bank was contractually bound to honour the demands, and that its grounds of rejection were not valid. A dispute therefore arose between the parties, which was referred to the Court.
9. After a first instance hearing in July 2019, another distinguished panel of Justices Bruce Robertson (New Zealand), Frances Kirkham (England & Wales, UK) and Arthur Hamilton (Scotland, UK) gave judgment for Leonardo for the total sum it claimed. The Bank appealed that judgment. Its appeal was unsuccessful.

#### *The Guarantees and the Issues on Appeal*

10. The issues considered on appeal were: (1) the validity of the demands made by Leonardo under the Guarantees; and (2) the validity of the Bank's rejections of those demands.
11. In particular, the Appeal Court considered:
  - 11.1. whether on the proper interpretation of the Guarantees, the demands complied therewith as required by (among others) URDG Articles 12 and 15 (the Court referred to this as the "interpretation issue");
  - 11.2. whether, notwithstanding the Court's conclusion in respect of the interpretation issue, the Bank was precluded from challenging the demands under the Guarantees under URDG Article 24 (the "preclusion issue"); and
  - 11.3. whether, in relation to the APG only, the demand made was excessive, and therefore was invalidated by Article 17 of the URDG (the "excessive demand issue").

#### *Approach to Application of the URDG*

12. In its judgment, the Court reviewed the three core principles which it considered underpin the URDG. It noted the URDG's emphasis on the separate status of the demand guarantee from the underlying contract (the independence or autonomy principle), the central focus upon documents as dictating the rights and obligations of the parties to the guarantee contract (the documents principle) and the requirement for strict adherence by both transacting parties to the terms of the guarantee (the strict compliance principle). The Court noted that each of the three core principles were intended to provide certainty and predictability to commercial parties, often trading or partnering internationally, and who place considerable value upon an assured right to be paid in the event of non-performance by a counter-party to the underlying contract (see paragraph 38 of the judgment).
13. With that in mind, the Court: (1) emphasised that the URDG concern a form of finance which underpins international trade and commerce, and sought to harmonise international practice in respect of demand guarantees; and (2) concluded that this required that the URDG should not be interpreted in a literalistic manner or by adoption of rules of national law.
14. In particular, the Court:
  - 14.1. drew an analogy with letters of credit which incorporate the ICC Uniform Commercial Practices for Documentary Credits (UCP 600), and noted that a similar approach should be taken to both ICC codes where they are incorporated within relevant instruments; and

- 14.2. concluded that the strict compliance principle applied to both the PB and the APG. The Court expressly adopted this approach in the instant case. It noted that the demand guarantees were “the lifeblood of commerce” and that their purpose was to “provide security for payment which can be called on promptly” (paragraph 41).
15. The Court’s adoption of the principle of strict compliance when construing the demand guarantees will be of wider interest to banking lawyers, particularly those dealing with international trade:
- 15.1. In English law, the received wisdom had been that the strict compliance principle applied to letters of credit but not demand guarantees (see the distinction drawn by Staughton LJ in *IE Contractors v Lloyds Bank* [1990] 2 Lloyds Rep 496).
- 15.2. However, the appropriateness of the distinction had been doubted in a more recent English Commercial Court judgment (see *Teare J in Sea-Cargo Skips v State Bank of India* [2013] EWHC 177 (Comm)).
- 15.3. Further, Georges Affaki and Sir Roy Goode’s official ICC commentary to the URDG states in terms that its intention was that the principle of strict compliance should apply both to letters of credit incorporating UCP 600 and demand guarantees incorporating URDG.
- 15.4. As a result, while the judgment may be the first to recognise that the principle of strict compliance applies to demand guarantees, this part of the judgment appears consistent with both the intention of the drafters of the URDG and international banking practice.
16. Of interest to international lawyers conducting cases in the region, the Court noted that since the URDG provided a clear code of principles to be applied in relation to the demand guarantees, it would generally be unnecessary to refer to pre-existing national case law where the dispute concerned an international set of principles (paragraphs 43-44). The Court further noted that this approach was consistent with the Courts approach to interpretation of QFC Regulations (paragraph 45).

#### *The Three Issues*

17. The Bank’s appeal was unsuccessful on the three issues which were considered on appeal. The Court held as follows:
- 17.1. The interpretation issue: contrary to the Bank’s contention, and based on the terms of the Guarantees and the provisions of the URDG, there was no requirement for Leonardo to have made a prior claim in writing against PAT in respect of the liability for which it made its demands on the Bank, or to produce a copy of that claim in writing to the Bank when making its demands. The Court arrived at this view after construing problematic clauses in the Guarantees which defined their scope as covering “claims in writing” by Leonardo. The demands therefore complied with the terms of the Guarantees in this respect (see paragraph 58 of the judgment);
- 17.2. The preclusion issue: in any event, the Bank would have been precluded from relying on its assertion that the demands were invalid as they were not supported by a prior claim against PAT in writing. This was because the Court found that, properly construed, the Bank had not provided notice of that ground for rejecting the demands when it served notice denying liability. It had been required to given notice of each and every ground for which the demands were being rejected, in accordance with Article 24(d) of the URDG (paragraph 72); and
- 17.3. The excessive demand issue: the demand under the APG was held not to be excessive. The Court rejected the Bank’s case that the guaranteed amount had been reduced by independent actions of the parties prior to the demand on the APG. As such, the full amount demanded in the APG demand was available and should be paid (paragraphs 78-79).

#### *The Interpretation Issue*

18. The Court found that the interpretation issue could and should be determined solely by reference to the terms of the Guarantees and the URDG which they incorporated (paragraph 52).
19. In particular, the Court noted the importance of Articles 7 and 15 of the URDG, the cumulative effect of which was that:
- 19.1. the demands under the guarantees were to be supported by a statement indicating the breaches of the

underlying subcontract which Leonardo relied upon as entitling it to make the demand under the guarantees, and, if applicable, by copies of any other documents that were “specified” in the terms of the guarantees as being required for a complying presentation (see Article 15 and paragraphs 53-54 of the judgment); and, to similar effect,

19.2. the guarantees were not to contain any condition, other than a date or period for compliance, without “specifying” a document to indicate compliance with that condition. Should such a condition be included, it would be void and disregarded (Article 7 and paragraphs 56-57 of the judgment).

20. The Court concluded that on their true construction, the Guarantees did not specify any documents to be served by Leonardo beyond the written demands for payment themselves. There was no requirement for Leonardo to have made a “claim in writing” against PAT before enforcing its rights against the Bank, or to produce a copy of that claim to the Bank for its review (paragraph 58).
21. The approach of the Court shows that a distinction needs to be drawn between documents that are simply referred to in a demand guarantee (such as, in the present case, “claims in writing”) and documents that are specified and therefore must form part of a presentation in order for a demand to be valid. In this case, the reference to “claims in writing” in the body of the Guarantees did not specify documents that needed to accompany a valid demand. The judgment serves as a reminder to guarantors that if they intend to incorporate documentary conditions in demand guarantees, they must do so in clear terms – mere references to categories of documents may not suffice.

#### *The Preclusion Issue*

22. As regards the preclusion issue, the Court took a strict approach to the requirements of Article 24 of the URDG. It concluded that it was inconsistent with the language of Article 24(d) to allow a guarantor to raise further discrepancies in the course of a dispute, if those points had not been raised in the Article 24(d) notice. The notice had to be provided by the guarantor within 5 days of the demand and set out each and every one of the discrepancies relied upon for rejecting the demand.
23. This requirement was clear from the terms of URDG Article 24 itself and there was a commercial rationale for that requirement, as had been noted in the Introduction to the URDG and in Affaki and Goode’s Guide to ICC Uniform Rules for Demand Guarantees URDG 758 (see paragraphs 66-71 of the judgment). Just as with the UCP 600, the Court found that a beneficiary should understand every alleged discrepancy for which its demand has been rejected by the guarantor, so that it has the informed opportunity to present a fresh demand which cures the defect, provided it is still able to do so within the term (duration) of the guarantee.

#### *The Excessive Demand Issue*

24. The Bank’s contention here was that prior to Leonardo’s demands, the amount available under the terms of the APG had been reduced by virtue of Leonardo becoming liable to make interim payments to PAT as works on the project had progressed. In particular, it argued that an interim invoice issued in December 2016 showed that PAT had performed services of value in reaching one of the first design milestones, and that Leonardo should not be able to recover the cost of those services (for which it had paid in advance), because those services had been performed. Leonardo disputed liability to pay that invoice, given that there was a “pay when paid” clause in the subcontract and Leonardo had not been paid for the relevant milestone activity by its Employer.
25. The Court applied the autonomy principle and found that regardless of the position under the subcontract (or the main contract), the APG had not been reduced in accordance with its independent terms. Therefore, the full amount of the guarantee was available and Leonardo’s demand was to be paid by the Bank (paragraphs 73 to 78).

#### *Conclusion*

26. The Court’s decision provides an invaluable perspective, from an extremely experienced and specialist panel, on \_\_\_\_\_

- an international Court's approach to the interpretation of demand guarantees which are subject to the URDG.
27. The Court emphasised the strict application of the terms of the Guarantees, including the code set out in the URDG which they incorporated, and correspondingly downplayed the utility of domestic case law (or case law from other jurisdictions) given the need to take a harmonised approach to the application of such international financial rules.
  28. The Court applied the documents and autonomy principles, emphasising the importance of including clear and express terms within demand guarantees when drafting.
  29. Further, the Court found that no lee-way should be given to the guarantor to raise new discrepancies in the course of the dispute if it had failed to raise those grounds clearly in its notice of rejection under Article 24 URDG.
  30. Two key practical lessons can therefore be taken from this case, in relation to demand guarantees incorporating the URDG:
    - 30.1. Drafters of demand guarantees need to ensure that they include clear, express documentary conditions within the instrument if they are to have effect. Mere references to categories of documents may not suffice; and
    - 30.2. Issuers need to ensure that they are able, within the tight time constraints imposed by URDG (and similar instruments, like the UCP 600) to enumerate all the bases upon which they reject a presentation. This then allows beneficiaries to take the opportunity, if appropriate, to correct any defects they consider have been properly pointed out.
  31. Given the current economic headwinds buffeting the region, and the resulting importance of demand guarantees, the case is timely.
  32. The full appeal judgment is available at:  
[https://www.qicdrc.gov.qa/sites/default/files/s3/judgments/english/case\\_no\\_12\\_of\\_2019\\_judgment\\_16\\_march\\_2020.pdf](https://www.qicdrc.gov.qa/sites/default/files/s3/judgments/english/case_no_12_of_2019_judgment_16_march_2020.pdf).

Authors: [Sean Brannigan QC](#) and [Helen Dennis](#)

Editor: [Jessica Stephens QC](#)

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