

Documentary Credit

WORLD

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■ **SIGNIFICANT LC ISSUES IN 2019**

In his annual study of the most significant letter of credit topics addressed in court cases, James G. Barnes first examines pre-honor cases in which a dispute arises before a demand for payment under an LC has been honored. These cases are grouped in two categories: discrepancy defenses & preclusion and fraud defenses & injunctions. Barnes then analyzes post-honor cases in which disputes surface following issuer honor of an LC. These cases involve matters regarding applicant and beneficiary recoveries. The pattern is clear: there are fewer U.S. court cases involving LCs. Barnes attributes this to the clarity of U.S. U.C.C. Article 5 and industry efforts to further elucidate standard LC practice. In his article, Barnes also addresses other developments in 2019, including release of the BAFT Guidance Paper for Auto Extensions.

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LITIGATION DIGEST

**Leonardo S.p.A. v. Doha Bank Assurance Co. LLC
Civil and Commercial Court of the Qatar Financial
Centre (Appellate Division),
[2020] QIC (A) 1 (16 March 2020) [Qatar]**

Summarized by Dr. Karl MARXEN*

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- Topics:** Independent Guarantees; Performance Guarantees; Advance Payment Guarantee; Independence Principle; Independence Principle, Strict Compliance; Reduction Clause; Excessive Demand; Notice of Rejection; Discrepancy; Non-Documentary Condition; Preclusion; Qatar International Court Procedural Rules; URDG 458; URDG 758 Articles 5, 6, 7, 15, 17, 19, 24, and 34
- Type of Lawsuit:** Beneficiary sued Issuer for wrongful dishonor of demands for payment under two independent guarantees.
- Parties:** Claimant/Beneficiary/Main Contractor – Leonardo S.p.A.
Defendant/Appellant/Issuer – Doha Bank Assurance Co. LLC
Applicant/Subcontractor – PAT Engineering Enterprises Co. WLL
- Underlying Transaction:** Subcontract agreement to provide engineering, procurement and construction of infrastructure works and plants for radar system installation in Qatar.
- Instruments:** Advance payment guarantee for maximum amount of EUR 12,210,000 and performance guarantee for maximum amount of EUR 4,070,000. Both guarantees subject to URDG 758.

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Decision: First Instance Circuit Court of the Qatar Financial Centre gave judgment in favor of Beneficiary. Civil and Commercial Court of the Qatar Financial Centre (Appellate Division) dismissed appeal and confirmed judgment against Issuer to honor the demands on the two guarantees.

Rationale: If an independent guarantee includes a condition without specifying the document with which the condition can be satisfied, the condition is non-documentary. According to URDG 758 Art. 7, such non-documentary conditions are to be disregarded when determining compliance. Further, if an issuer rejects a demand due to alleged non-compliance, it must specify all discrepancies it relies on in its timely notice of rejection. The issuer is precluded under URDG 758 Art. 24 (f) from relying on any discrepancy not stated in its notice of rejection. Also, the reduction clause in a guarantee can only be triggered if the condition for the reduction mechanism in the guarantee is met. If in the guarantee's terms the presentation of a certain document is necessary to do so, only presentation of this document will reduce the amount available under the guarantee. Failing that, the full amount of the guarantee continues to be available to the beneficiary.



Factual Summary:

Leonardo S.p.A., an Italian defense and aerospace services company (Beneficiary/Main Contractor/Claimant) entered into an agreement with the Qatar Armed Forces to provide a radar system. It then subcontracted certain engineering, procurement and installation works to a local company called PAT Engineering Enterprises Co. WLL (Applicant/Subcontractor). The subcontract obligated Applicant to obtain two guarantees in favor of Beneficiary: an advance payment guarantee to secure repayment of a cash advance of EUR 12,210,000 that Applicant received from Beneficiary, and a performance guarantee for the maximum amount of EUR 4,070,000 to ensure Applicant's overall performance under the subcontract. The independent guarantees were issued to Beneficiary by Doha Bank Assurance Co. LLC (Defendant/Appellant/Issuer) and subject to the ICC's Uniform Rules for Demand Guarantees (URDG 758).

Dissatisfied with Applicant's performance, Beneficiary gave notice to Applicant of cancellation of subcontract agreement and presented to Issuer a demand on the advance payment guarantee for EUR 10,549,440 and a demand on the performance guarantee for EUR 4,070,000. After Issuer rejected both demands, Beneficiary sued for wrongful dishonor and to enforce the payment obligations under the guarantees. First Instance Circuit Court of the Qatar Financial Centre granted summary judgment in favor of Beneficiary.¹ The trial court rejected allegations by Issuer against Beneficiary of dishonesty, fraud, and unconscionability.

Permission to appeal was granted and Issuer pursued its argument that the demands were non-compliant, that it was not precluded from relying on the alleged discrepancy, and that the demand

1. *Leonardo S.p.A. v. Doha Bank Assurance Co. LLC*, [2019] QIC (F) 6 (5 September 2019) [Qatar].

on the advance payment guarantee was excessive and therefore not permissible. Analyzing the terms of the guarantees and the demands by the Beneficiary, Civil and Commercial Court (Appellate Division) confirmed the trial court's decision and dismissed the appeal. Therefore, Issuer was obligated to honor both demands on the guarantees and pay Beneficiary the requested total sum of EUR 14,619,440.

Legal Analysis:

On appeal, the court decided three main arguments advanced by Issuer to justify its refusal to pay the demanded sum to Beneficiary.

Compliance: First, the court considered whether the demands were in compliance with the terms of the guarantees. The Issuer argued that the Beneficiary first had to make claims against the Applicant before any demand on the guarantees and subsequently attach a record of such claims against the Applicant to any demands made on the guarantees. Issuer relied on the following wording in the advance payment guarantee: "Therefore, [Issuer] irrevocably guarantee ... any sums up to Euro 12,210,000 ... that [Beneficiary] might have to claim back in writing from [Applicant]." Similarly, the Issuer referred to corresponding wording in the performance guarantee: "Therefore, [Issuer] irrevocably guarantee ... any sums up to Euro 4,070,000 ... that [Beneficiary] might have to claim in writing from [Applicant]." The Issuer argued that a demand on the guarantees always requires a copy of the claim letter previously sent by Beneficiary to the Applicant, so that "double counting" would be prevented.

The Appellate Court asked "whether the terms of the Guarantees requires a statement in the demand or in a supporting document that claims in writing have been made against [Applicant]" (para 56). It examined the condition captured in the guarantees and concluded that "[i]t is clear ... from the Guarantees that no documents were required to be served beyond the demands for payment. They make no reference to anything other than a written demand being served" (para 57). Accordingly, the condition that Beneficiary first has to claim against Applicant was, in terms of the guarantees, a non-documentary condition and applying URDG 758 Art. 7, it was to be disregarded when determining compliance of the demand. Therefore, even if Beneficiary failed to present to Issuer a record that it had first attempted to receive payment from Applicant, this would not render a demand on the guarantees non-compliant.

Preclusion: The second issue related to the doctrine of preclusion in independent undertakings following an incomplete notice of rejection sent by an issuer to a beneficiary. In the case under appeal, the demands by the Beneficiary were both rejected by the Issuer. The rejection notice by the Issuer asserted insufficient information regarding the extent of the alleged breaches of the subcontract and whether Applicant had been allowed by Beneficiary to remedy the alleged breaches within a certain period. At a later stage and in addition to the first objections, the Issuer complaint that the Beneficiary had not claimed money from the Applicant first before resorting to calling-up the guarantees and attached a copy or record of such claim letters. Because the Appellate Court decided the matter already when determining that such a condition was non-documentary and to be disregarded under URDG 758 Art. 7, this particular matter was actually moot. Nevertheless, the judges continued their investigation and held that the Issuer was, in any event, precluded from raising this discrepancy as a defense because of URDG 758 Art. 24(f) as this particular alleged discrepancy was not listed in the earlier notice of rejection.

Reduction Clause: The final matter concerned reduction of the guarantee amount by way of a reduction clause. The advance payment guarantee contained a reduction mechanism that decreased proportionally the available amount after receipt of an invoice that indicates completion of certain milestones by Applicant, and acceptance of such an invoice by Beneficiary in a specific manner. The relevant clause in the advance payment guarantee read: “This guarantee will be automatically reduced proportionally to the value of each partial delivery and/or completion [certain works and installations] upon presentation by [Applicant] to [Issuer] of copies of the above mentioned project’s relevant documents (Progress Invoice) approved, certified and signed by [Beneficiary’s] project representative” (para 21). The Issuer argued that the demand on the advance payment guarantee was excessive, because the available amount was allegedly reduced to below the demanded sum. The Issuer presented an invoice for the amount of EUR 3,874,640 sent by Applicant to Beneficiary after completion of certain sections of the subcontract work and also a separate letter sent in response by Beneficiary to Applicant in which Beneficiary accepted the invoice as due. However, the Appellate Court rejected the notion that “taking these documents together” (para 77) could trigger the reduction clause in the advance payment guarantee. Only “presentation of the invoice approved, certified and signed by [Beneficiary]” (para 78) would make the reduction mechanism operational. As a result, the condition for decreasing the amount of the advance payment guarantee was not satisfied and the original full balance was still available.

The Appellate Court upheld the trial court’s decision that Issuer had to honor the two demands by Beneficiary and the Issuer’s appeal was dismissed with costs.

Comments:

This decision of the Civil and Commercial Court of the Qatar Financial Centre (Appellate Division) is an important judgment. Not only does it explain the basic principles of independent guarantees (paras 29-45) in a fashion typical for judges trained in the United Kingdom, but it does so with repeated and appreciative references to the ICC’s Uniform Rules for Demand Guarantees (URDG 758). The court emphasizes the importance of internationally developed practice regarding independent guarantees and the benefits of the codification of such expectations in balanced practice rules. The need for harmonized international interpretation, without resorting to domestic concepts and legal precedents, is stressed at various points. URDG 758 was praised and deferred to over case law that predates the existence of URDG 758 as codified practice rules.

This case confirms that it is prudent to ensure incorporation of internationally accepted practice rules such as URDG 758. Otherwise, important concepts such as preclusion, the treatment of non-documentary conditions or even the independent nature of the guarantee may be ignored or misconstrued. This advice should not only resonate with beneficiaries but with all parties involved, as internationally accepted practice rules foster predictability and legal certainty. Also, careful drafting of the terms of the guarantee is vital. For example, as the court pointed out at para 57, it would have been easy for the Issuer to insert only documentary conditions when drafting the guarantee (and avoid any non-documentary conditions), and thus protect its own legitimate interests and ultimately those of the Applicant too. Adding this to the incomplete notice of rejection, the Issuer created unnecessary problems for itself.

The judges' willingness to decide important questions of independent guarantee law and practice that arose during the appeal proceedings was also remarkable, even though that was not always strictly necessary. The Beneficiary argued that the demands were compliant and even if not, relying on the particular discrepancy alleged by the Issuer was not permissible due to preclusion to the detriment of the Issuer. Thus, application of the doctrine of preclusion would have automatically brought the dispute to an end. With this in mind, the Beneficiary suggested an efficient approach and requested the Appellate Court to determine the preclusion issue first, as that would potentially render the compliance point moot (para 46). The judges ignored this suggested sequence and decided first the compliance issue – and in fact held that the demands were compliant. This, in turn, made deliberating the preclusion question moot, since in any event the demand was compliant (para 59). However, again the judges seized the opportunity and ruled in detail on this issue – even though the judges could have simply pointed out the fact that the notice of rejection was certainly not made timely as per URDG 758 Art. 24(e), as it was given more than three

Qatar International Court and QIC Rules – Explained

There are two independent civil and commercial procedural rules in Qatar. One applies at the Qatar International Court, while the other applies solely to the other national courts. The procedures at the Qatar International Court differ in a specific way to the ones applied at the other national courts. The Qatar International Court procedural rules (the “QIC Rules”) are also known as the QFC Civil and Commercial Court Regulations and Procedural Rules. The QIC Rules were issued by Ministerial Decision No. 1/2011 On the Procedural Regulations and Rules for the Civil and Commercial Procedure Before the Civil and Commercial Court of Qatar Financial Centre, published in the Official Gazette on 14 February 2011. They entered into force on 14 March 2011.

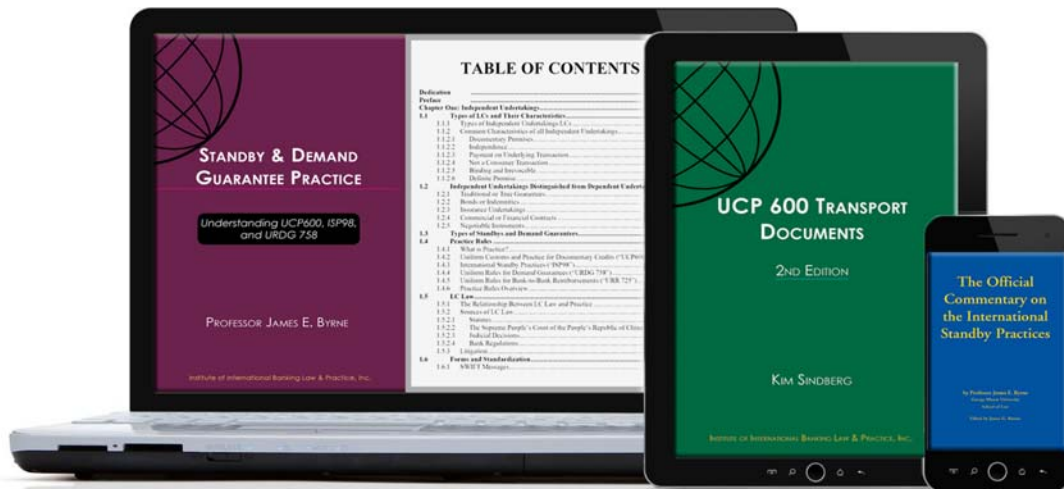
The QIC Rules are inspired by the Commercial Courts Guide for England and Wales, which in practice make the judges' work in a similar legal mindset and manner in conducting all matter pertaining to the court rules and practices. Having said that, the Qatar International Court cannot be considered as a typical and purely Common Law court as it is thought generally. The Court does not routinely apply English case law or precedents in its determination of a case, and is further not bound by such case law or precedent. In addition, it must be noted that what happens in Common Law jurisdictions judicially is not necessarily adopted and applied at the Qatar International Court. In practice, the parties before the Qatar International Court have at times referred to cases in Common Law jurisdictions in order to highlight the approaches that have been applied by courts in those jurisdictions in dealing with similar legal issues. The Qatar International Court might reference such legal matters of other jurisdictions in its rulings, but the Court is not bound by these cases, as it will determine the outcome by applying the specific relevant legislation and the Court's own principles to the merits of the case based on the court's understanding.

Source: Qatar International Court and Dispute Resolution Centre)

weeks after receipt of the demands. The URDG 758 rules require that notice by the issuer “be sent without delay but not later than the close of the fifth business day following the day of presentation”.

The judges’ eagerness to examine matters without necessity is rather unusual yet highly commendable, because the judgment provides valuable guidance for future cases and commercial practice in general. In the above instances, the judges clearly acknowledged that deciding the issues was not strictly necessary. It is humbly suggested that even the third main issue of the case, the allegation of an excessive demand and the reference to the reduction clause (paras 73-79), could have been decided more easily. Since URDG 758 Art. 17(e)(i) stipulates that “[a] demand is a non-complying demand if ... it is for more than the amount available under the guarantee”, the allegation of excessiveness should have been raised by the Issuer in its notice of rejection. It was not, and in any event the notice was not made timely. Therefore any objection based on excessiveness of the demand would have been precluded, too, because URDG 758 seems to treat it as a matter of compliance. Again, the Appellate Court’s guidance on this issue, despite not being strictly necessary, contributes to a better understanding of reduction clauses and their operation in independent guarantee practice.

It should also be appreciated that the judgment refers to established practice rules (URDG 758), case law from different jurisdictions (Qatar, Singapore, Hong Kong, and England) as well as international academic writing. This judgment took a truly international perspective that corresponds to the international character found in many independent guarantee transactions. ■



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