

# The treatment of performance bonds and guarantees by the DIFC Courts

On-demand instruments such as performance bonds and other forms of documentary credit like guarantees provide essential reassurance to employers against failures in performance or financial default by contractors in engineering and construction projects.

In several recent cases, the DIFC Court of First Instance has considered calls on documentary credits and developed the Court's jurisprudence on their treatment.

In *DIFC Investments Limited v Dubai Islamic Bank* [2020] DIFC CFI 016 (3 June 2020), the Courts considered the relationship between the jurisdiction of the DIFC Courts and the Dubai Courts in respect of a performance guarantee issued by the defendant bank in favour of the claimant employer on behalf of a contractor.

The Court of First Instance adopted the established common law position on the enforcement of documentary credits – described previously, in statements adopted by the Judge, H.E. Justice Shamlan Al Sawalehi, as having a “*status equivalent to cash*” and being the “*lifeblood of international commerce*” – in circumstances where a foreign court had restrained the payments due as consequences of calls on those credits and applied a law other than the law stipulated in the agreement.

## Background

The claimant and the contractor entered into a contract in October 2016 for the design and construction of a new development in the Gate Avenue area of the DIFC.

Under the contract, the contractor agreed to procure, and the defendant agreed to provide on its behalf, an on-demand performance guarantee of almost AED78 million (approximately US\$ 21million) as security for the contractor's obligations to carry out specific tasks on the development.

In January 2020, the claimant made a demand under the performance guarantee which the defendant did not pay, thereby causing the claimant to issue a claim under Part 8 of the Rules of the DIFC Courts in early February. The same day as the claim was issued, the defendant wrote to the claimant saying the Dubai Courts had ordered the defendant to “*freeze and stop*” payment under the guarantee.

The claimant therefore sought judgment for the sum in the DIFC Courts, bringing a primary claim for the payment of a debt with an alternative claim for damages, plus accrued interest.

## Judgment

The Judge made some preliminary comments on the claimant's use of the Part 8 procedure, which is intended for use when seeking the Court's decision on a question which is unlikely to involve a substantial dispute of fact or if required or permitted under the RDC or a Practice Direction (which was not the case here). The Judge agreed that the procedure was “*particularly appropriate*” because of the high liquidity of documentary credits, and because of the urgency of effecting payment: “*any further delay...would indeed*

*undermine the commercial purpose of such instruments”.*

The Judge noted the general context of the claim. There was a practical presumption in favour of upholding the integrity of irrevocable obligations and only if the guarantor had clear evidence of fraud (of which there was none) was it entitled not to pay. Furthermore, there was no dispute that the claimant was not entitled to call on the guarantee under the terms of its agreement with the contractor, nor that the claimant had not made a valid demand under the contractual notification provisions in the guarantee.

However, as the defendant was preparing to pay the sums due to the claimant, the contractor had applied for and obtained from the Dubai Commercial Court of First Instance a precautionary attachment to restrain the defendant from doing so.

The Judge found that the Dubai Courts had no jurisdiction over the dispute and, by inference, had no jurisdiction to make the order it had made, whereas the instrument was governed by DIFC law and stated on its face that any dispute arising from it was subject to the non-exclusive jurisdiction of the DIFC Courts. The Judge held that the claimant was a DIFC Establishment for the purposes of Article 5(A)(1)(a) of the Dubai Judicial Authority Law (Law No.12 of 2004 as amended) and so the dispute was subject to the DIFC Courts' exclusive jurisdiction. The agreement between the claimant and the contractor was also subject to DIFC law and provided for DIFC-seated arbitration under the DIFC-LCIA Rules.

Because of the clear findings on the legality of the call on the performance guarantee and the DIFC Courts' unequivocal jurisdiction over the dispute, the Judge had little difficulty in dismissing the defendant's defence that the existence of the attachment would make performance illegal in the jurisdiction of the Dubai Courts.

Firstly, the attachment was made in proceedings between different parties, namely the claimant and the contractor, which did not engage (let alone bind) the DIFC Court proceedings.

Second, judgments and orders of the Dubai Courts were not automatically or “universally” recognised in the DIFC Courts as a matter of principle, and the attachment order had not in fact been recognised by or enforced in the DIFC Courts.

Finally, English law was clear that there was no defence to a failure to carry out performance under a documentary credit based on an injunction issued by a foreign court obtained by one party to restrain the other from paying and applying a law other than the law of the agreement. DIFC law governed the performance guarantee and the defendant was obliged to perform its obligations in the DIFC under Article 69(1)(a) of the DIFC Contract Law (DIFC Law No. 6 of 2004). The fact that making payment would be illegal in Dubai outside of the DIFC (as a result of the Dubai Court attachment) did not provide any defence. The DIFC Court affirmed the decision in *Tamil Nadu Electricity Board v St CMS Electric Private Ltd* [2008] 1 Lloyd's Rep 93, where a DIFC Court Justice, Sir Jeremy Cooke, sitting as an English judge, had held that it was no defence to a claim that performance was illegal under a law which was not the law of the country where the contract stipulated that the act was to be performed.

Accordingly, the Judge found the defendant liable for breach of contract by delaying payment and awarded interest for the period starting when the attachment order expired.

## **A different outcome in a case of a failure to give proper notice**

Whilst *DIFC Investments* is an orthodox application of common law principles, it is not the end of the matter.

Shortly after the decision was handed down, in unreported proceedings, the DIFC Courts issued an injunction in support of arbitral proceedings to prevent the liquidation of two on-demand, unconditional bonds issued by a bank located in Dubai but outside of the DIFC.

The bonds had been made as part of a set of agreements underpinning a construction project located in Dubai. They were governed by a single contract, subject to UAE law and with a dispute resolution clause in favour of DIFC-seated arbitration.

The defendant's main contractor sought to make a call on the bonds and the claimant subcontractor sought urgent interim relief from the DIFC Courts as the curial court.

The Court of First Instance granted an injunction on the grounds that the defendant had failed to give sufficient notice of its intention to call upon the bonds in breach of contract, and because the defendant's assessment of the sums due to it was fundamentally flawed.

The claimant contended, to the Court's satisfaction, that in fact the defendant owed sums to the claimant and so could not have an honest belief that it was entitled to make a demand under the bonds, and its call on the instruments could not be in good faith and was unconscionable.

The Court acknowledged the jurisprudence of the Special Tribunal Related to Dubai World (known as the Dubai World Tribunal) and the decision of then-DIFC Courts Chief Justice Sir Anthony Evans in *Bin Belaila General Contracting LLC v Nakheel PJSC & Standard Chartered Bank* [DWT/APP25/003/2010]. In that case, a call on the bond required the employer to give notice to the contractor of the nature of the fault in respect of which the claim was too made, which the employer failed to do. As the Tribunal said, "*The purpose of such notice...is to restrict the right to demand under the bond as between the employer and the contractor to circumstances where there is a bona fide claim for payment in respect of which the bond provides security, and to restrict the amount of the demand under the bond to the amount of that bona fide claim for payment. Absent bona fide legal grounds to justify the demand for payment under the bond, the contractor is entitled to restrain the employer from making such demand.*"

## Conclusion

These decisions are the latest in a line upholding the integrity of documentary credits. As the DIFC Courts demonstrated in *Amira C Foods International DMCC v IDBI Bank Limited* [2018] DIFC CFI 027 (16 May 2018), the Courts are willing to ensure that valid calls on performance bonds and guarantees can be enforced efficiently and quickly and without undue delay or hindrance.

The DIFC Courts have shown an admirable willingness to robustly deal with collateral actions that are made in breach of contract or Dubai or DIFC law. This matter will be considered in a further Law Update article on the DIFC Courts' anti-suit injunction, restraining the defendant from pursuing proceedings in the Dubai Courts in breach of an arbitration agreement, in the case of *Multiplex Constructions LLC v Elemec Electromechanical Contracting LLC* (unreported; 21 October 2020).

The speediness of the Courts in *DIFC Investments Limited* is also very welcome, as the Judge entered judgment on an urgent basis a little over a month after the claim was issued and handed down his reasons shortly thereafter. The Courts are alert to the need to uphold the obligations of parties and to provide definite answers to both sides quickly.

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