

Abusive Exercise of the Right to Make a Demand Against an unconditional Bank Guarantee

Ahmed Abdelnabi - Senior Associate - Litigation
a.abdelnabi@tamimi.com - Dubai International Financial Centre

Introduction

The issuance of letters of guarantees (bank guarantees / bonds) is one of the most common financial services that is being rendered by banks and financial institutions in the UAE, especially in the construction sector. It is one of the tools on which employers heavily rely to secure and maintain a strong position over contractors during and after the lifetime of a project.

The relevant law governing bank guarantees is set out within Article 411 to 419 of Federal Law No. 18 of 1993 on the Commercial Transactions Law (the “**Commercial Code**”).

Nature and Definition of Bank Guarantees

Article 411(1) of the Commercial Code defines a bank guarantee, in general, as an undertaking issued by a bank to settle its customer’s debt to a third party beneficiary, in accordance with the conditions agreed and included in the guarantee, which may be for a fixed or indefinite term. Further, Article 411(2) stipulates that a bank guarantee is a joint liability (i.e. between the bank and its customer towards the beneficiary).

Additionally, Article 412 of the Commercial Code identifies the forms a bank guarantee may take, which include a letter of guarantee (Article 412(3)) being a letter of guarantee that is addressed by the bank to the customer’s creditor pursuant to which the bank guarantees its customer’s fulfilment of its (i.e. the customer’s) obligations.

Article 414 defines a letter of guarantee as an undertaking issued by a bank (the guarantor) at the request of one of its customers (the person requesting the guarantee) to pay unconditionally and without restrictions, a certain specified or determinable sum to another person (the beneficiary), unless the letter of guarantee is made subject to certain conditions. Article 414 requires that the letter of guarantee shall state the object/purpose for which it has been issued.

Mandatory Nature of the Law and the Application of Good Faith and Equity Principles

Article 417 of the Commercial sets out a pivotal provision, which states as follows:

1. The bank **may not** refuse payment to the beneficiary on grounds concerning the bank’s relationship with the person making the order **or the relationship of the latter with the beneficiary.**

2. ***In exceptional cases***, the court may, ***at the request of the person making the order***, levy seizure on the guarantee amount with the bank, provided that the person making the order relies for his claim on serious and sure grounds.

As such, the legislator's intention in Article 417 of the Commercial Code is clearly to prevent the issuing bank from withholding payment from a third-party beneficiary of a letter of guarantee, unless a court order levying a seizure on the value of a letter of guarantee is obtained. However, the only party that may apply to the court for such an order is the party providing the letter of guarantee (i.e. the bank's customer) and not the bank itself.

That said, and since the letter of guarantee is a contract which imposes a unilateral obligation on the issuing bank to pay to a beneficiary upon its demand a sum of money that shall not exceed the amount of the guarantee, **are there circumstances in which the issuing bank could argue that a beneficiary's demand constitutes an abuse of rights or bad faith under Articles 106 and 246 of the UAE Civil Code respectively?**

In response to this question, one may argue that the ability of the issuing bank's customer to obtain an order preventing the issuing bank from making payment under a letter of guarantee is an exception to the general rule and that the issuing bank's obligation to pay is a certainty. Consequently and pursuant to Article 30 of the UAE Civil Code, such an exception may not be used by analogy, nor may its interpretation be extended.

However, others may also argue that where an employer's demand is clearly made in bad faith or constitutes an abuse of rights, such conduct cannot be tolerated particularly where the value of the letter of guarantee is significantly high.

The position under UAE law is that **no person who lawfully exercises his rights shall be liable for any harm arising therefrom** (Article 104 of the UAE Civil Code). Accordingly, by virtue of Article 104, where the beneficiary of an unconditional letter of guarantee lawfully exercises its right to make a demand, it cannot be held liable for any damages to others (bank or otherwise) resulting from such lawful exercise of its rights.

Conversely, under Article 106 of the UAE Civil Code a person who unlawfully exercises a right may be held liable for damages. Article 106(2) sets out the circumstances in which such liability would arise, which are as follows:

1. **If there is an intentional infringement (of another's right);**
2. **If the interests which such exercise of right is designed to bring about are contrary to the rules of the Islamic Shari'ah, the law, public order, or morals;**
3. **If the interests desired are disproportionate to the harm that will be suffered by others; or**
4. **If it exceeds the bounds of usage and custom.**

Therefore, it is clear that the exercise of a right would not constitute an abuse of rights under Article 106 unless it falls within one of the subsections ((a) to (d)) set out above.

In their rulings, the higher Courts of the UAE have addressed the issue of abuse of rights and, in particular, have interpreted Article 106(2)(a) as requiring **an intention to cause harm or trespass**.

When considering the requirements set out in the subsections of Article 106(2) of the UAE Civil Code, it can be concluded that:

1. It is significantly difficult to prove that when making a demand under an unconditional letter of guarantee, a beneficiary's intention is to cause harm to the bank or the party providing the guarantee as it is the beneficiary who will benefit from the demand;
2. It is unimaginable that the interests which a demand made against an unconditional letter of guarantee

- are designed to bring about could be contrary to the rules of the Islamic Shari'ah, the law, public order, or morals;
3. It is difficult to prove that such interests are disproportionate to the harm that will be suffered by others, especially the bank, since it will require that the person requesting the guarantee provides some form of security in consideration for the bank issuing the guarantee itself (Article 415 of the Commercial Code);
 4. Demanding payment under an unconditional letter of guarantee does not in any way exceed the bounds of usage and custom, as this is what such instruments are designed for in the first place.

As for the application of Article 246 of the UAE Civil Code, it is highly unlikely that a UAE Court would uphold an objection to a demand on the grounds of good faith where the party raising such objection is seeking to avoid the performance of its own contractual obligations. This is because Article 246 should only be invoked to determine how a contract must be performed (in a manner consistent with the requirements of good faith).

Conclusion

Despite the fact there may be some merit in a bank's objection to a demand made under an unconditional letter of guarantee, it would be very difficult for the bank to discharge the burden of proving that such demand amounted to an abuse of rights. It follows that it would be very difficult for a bank to convince a court/tribunal to suspend the bank's obligations to satisfy a demand or to order a beneficiary to repay any amounts it had received pursuant to a demand.

For further information, please contact [Ahmed Abdelnabi \(a.abdelnabi@tamimi.com\)](mailto:a.abdelnabi@tamimi.com)