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# Jurisdictions of interest when defending calls against demand guarantees

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# Agenda

- What is an on-demand performance guarantee?
- The autonomy principle
- Defending against a draw in different jurisdictions
  - Canada, UK/Australia, Singapore and Malaysia
  - Brazil
  - Japan
  - UAE
  - India
- Discussion

# Jurisdictions of interest when defending calls against demand guarantees – experience in Canada and other common law countries

**Michael Valo**, Glaholt Bowles LLP, Toronto, Canada

# Performance Guarantees

What are they?

- Guarantee performance of a contractor's non-monetary obligations, like a performance bond, but without the options open to a surety on default
- In Canada, generally take the form of an on-demand letters of credit
- Performance guarantees are **autonomous** from the underlying contract



# Autonomy principle

Canada

*“The fundamental principle governing documentary letters of credit [...] is that the obligation of the issuing bank to honour a draft on a credit when it is accompanied by documents which appear on their face to be in accordance with the terms and conditions of the credit is independent of the performance of the underlying contract for which the credit was issued.”*

***Angelica-Whitewear Ltd. v. Bank of Nova Scotia, [1987] 1 S.C.R. 59***

# Autonomy principle

- The autonomy principle creates **opportunity for abuse**:
- Because the LC is payable on first demand, it is possible for a beneficiary to make premature, unfair, or bad faith claims on the LC, and the bank must honour the demand.

# Autonomy principle

- If a performance guarantee is autonomous from the underlying contract, is there ever a basis to prevent an improper or bad faith draw?
- In Canada, the only established exception to the autonomy principle is in the case of a strong *prima facie* case of **fraud**
  - An injunction will be granted against the issuer in the case of a *strong prima facie* case of fraud



# Injunctions

Test for interlocutory injunctions in Canada:

- *Prima facie* case of fraud
- Would the applicant suffer irreparable harm if the application were refused?
- Which of the parties would suffer greater harm from the granting or refusal of the remedy pending a decision on the merits?
  - *RJR – Macdonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311



# Injunctions Issuers v. beneficiaries

- Should beneficiaries be treated the same as banks?
- Beneficiaries are bound by the underlying contract, and the conditions for restraining their behaviour ought to be different than those of the bank, which is not party to the underlying contract
- Outside of Canada, jurisdictions are distancing themselves from the traditional approach, recognizing fundamental differences between issuers and beneficiaries, and treating them differently

# England / Australia

- As between applicant and the beneficiary, the autonomy principle may be displaced.
  - *Sirius International Insurance Company v FM General Insurance Ltd.*, [2003] EWCA Civ 470
  - *Simon Carves Ltd. v Ensus UK Ltd*, [2011] EWHC 657 (TCC)
  - *Doosan Babcock Ltd. v. Comercializadora de Equipos y Materiales Mabe Limitada*, [2013] EWHC 3201 (TCC)
  - *Simic v New South Wales Land and Housing Corporation*, [2016] HCA 47

# Singapore / Malaysia

- No difference in the principles applicable where an injunction is sought against a beneficiary instead of a bank
- But, rather than fraud, the test for court intervention is **unconscionability**, which if proven, may justify an injunction restraining a beneficiary of an on-demand guarantee from drawing on the guarantee
  - *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd*, [2012] SGCA 28
  - *Sumatec Engineering & Construction Sdn Bhd v Malaysian Refining Company Sdn Bhd*, [2012] 2 MLRA 289

# Singapore

- In Singapore, unconscionability is generally understood to mean "unsatisfactory conduct tainted by bad faith" and also incorporates an element of "unfairness". Examples:
  - a demand under a guarantee stemming from non-delivery of goods due to natural disasters, despite a force majeure clause in the underlying contract (*Min Thai* case);
  - in light of the revision of the value of the contract demand under the performance guarantee for the *full amount* (*GHL* case); and
  - *prima facie* gross exaggeration of the costs of rectification in support of the beneficiary's call under the guarantee (*JBE Properties*).



# Malaysia

- In Malaysia, the definition of unconscionability is like that in Singapore. Examples:
  - demands after completion of the contract;
  - demands on the bond by the owner where the owner owes the contractor money under the contract;
  - demands in the face of ongoing negotiations; and
  - cases in which there simply was no breach by the contractor



# Canada

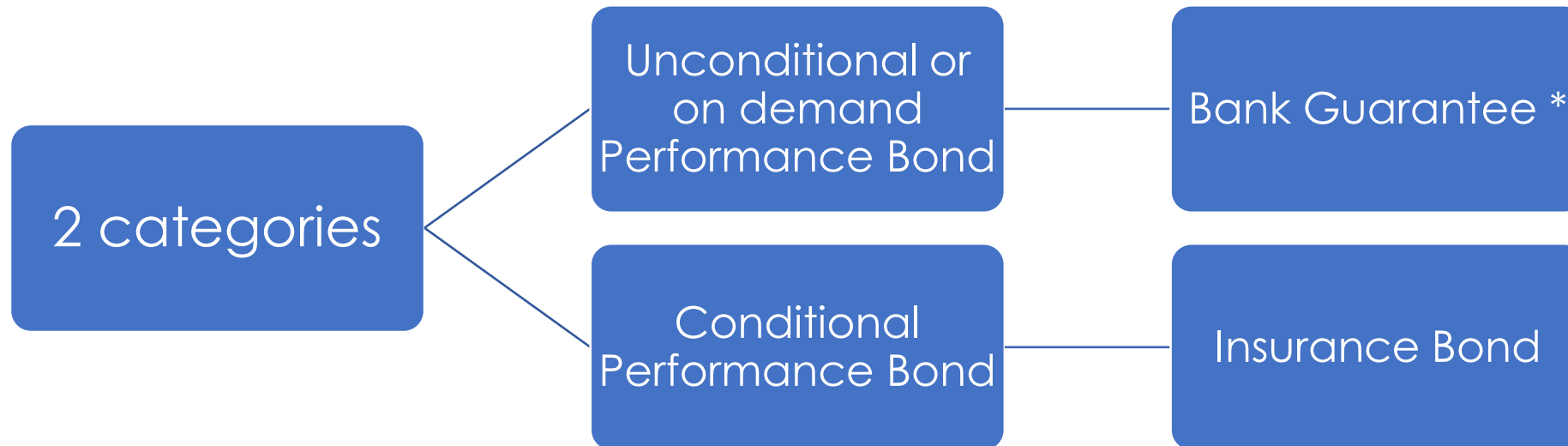
- So far in Canada, fraud remains the exclusive basis for applications to enjoin a draw on the guarantee, whether against the issuer or the beneficiary
- But, change may be coming:
  - *Veolia Water Technologies, Inc. v. K+S Potash Canada General Partnership*, 2019 SKCA 25

JURISDICTIONS OF INTEREST WHEN  
DEFENDING CALLS AGAINST DEMAND  
GUARANTEES  
EXPERIENCE IN BRAZIL

Thaís Fernandes Chebatt  
(São Paulo, Brazil)



# Performance Bond in Construction Projects



\* Letter of Credits are not usually used for Construction Contracts but usually for cross border transactions (for example in case of acquisition and transport of equipment) and/or by banks headquartered abroad.

# Bank Guarantee – main aspects

<b>Legal definition</b>	Personal guarantee.
<b>Main Features</b>	<p>Bank Guarantees are accessory to the guaranteed obligations, the enforcement of which depends on evidence of default of the guaranteed obligations.</p> <p>It may be agreed that the issuing bank has no right to cancel or amend Bank Guarantees without the consent of the Beneficiary.</p>
<b>Governing law and Jurisdiction</b>	Bank Guarantee may be issued in Brazil or abroad. The governing law and jurisdiction depends on where the obligations must be complied with and/or where the parties are located.
<b>Applicable rules if the guarantee is governed by Brazilian Law</b>	Brazilian Civil Code.
<b>Concept</b>	Guarantees the payment of the beneficiary (creditor) of a certain amount as a result of default by the applicant of the Bank Guarantee (debtor) under an agreement entered by and between the applicant and the creditor.
<b>Parties</b>	<p>Bank Guarantee is issued by a bank in favor of the beneficiary (creditor). In general, the debtor and the bank enter into another agreement wherein the debtor undertakes to pay a fee for the issuance of the Bank Guarantee and to indemnify the bank of any losses; the bank commits to issue said guarantee in favor of the beneficiary.</p> <p>If the Bank Guarantee is issued in Brazil, the bank must be licensed by the Central Bank of Brazil (regulated by the Brazilian Central Bank Directive n. 29)</p>

# Bank Guarantee – main aspects

<b>Autonomy</b>	Ancillary nature. The effectiveness of a Bank Guarantee depends on the legality and effectiveness of the guaranteed obligation. The Bank Guarantee is enforceable to the limit which the underlying obligation is due. If the guaranteed obligation is held null and void, the Bank Guarantee cannot be enforced.
<b>Claim</b>	The beneficiary may request the payment of the Bank Guarantee upon notice and evidence of default of the guaranteed obligation, according to its own terms and conditions. The bank does not examine the merits of the default and if there is evidence of the default will proceed with the payment unless there is a judicial order for suspension of the payment.
<b>Payment</b>	Banks usually take from two (2) to five (5) days to pay Bank Guarantee after they are notified of the claim.
<b>Costs</b>	Represent a significant higher cost charged by the banks to be include in the Contract Price as well as a higher degree of difficulty for the Contractors to obtain it from the banks.
<b>Classification</b>	Debt enforcement instrument (título executivo extrajudicial) by Brazilian Civil Procedure Code

# Dispute resolution – Construction Projects

- **Court**
- **Arbitration**
  - The most used dispute resolution method for construction projects in Brazil
  - Parties may seek interim measures from Courts
    - Urgent matters prior to the constitution of the arbitral tribunal
    - Ensure the institution of the arbitration proceeding or the enforcement of the arbitral award

# Interim measure in Brazil

- In Brazil, interim measures are considered measures that are not aimed at the discussion of the merits of the dispute, but should be used in order to guarantee enforceability of the final decision maintaining the *status quo* or providing for a guarantee of actual enforceability
- Party may request that the injunction is granted *ex parte* and this can be granted by the judge, but is not a rule

# Interim measure in Brazil

- The party requesting the interim measure should necessarily demonstrate:
  - ❑ The appearance/probability of the right ("*fumus boni iuris*") and that
  - ❑ Risk of irreparable damage ("*periculum in mora*"), which means that the granting of the injunctive relief sought is needed on an urgent basis in order to preserve the requesting party's rights
- To prevent a payment of a Bank Guarantee, party will need to seek an interim measure in Court

# Interim measure against on demand bond – assessment of the Courts

- Main arguments for granting injunction
  - Non compliance of the obligations by the beneficiary (creditor)
  - Existence of amounts to be received by the debtor from the creditor
- Main arguments for NOT granting injunction
  - Pacta sunt servanda* and free will of the parties in contracting the Bank Guarantee
  - Contractual obligation
  - Knowledge of the debtor of the terms and conditions of the Bank Guarantee
  - Non compliance of obligations by the debtor
  - Risk of not having enough assets from the debtor
  - Notice of similar debtor's behaviour in other projects

# **Jurisdictions of interest when defending calls against demand guarantees – Experience in Japan**

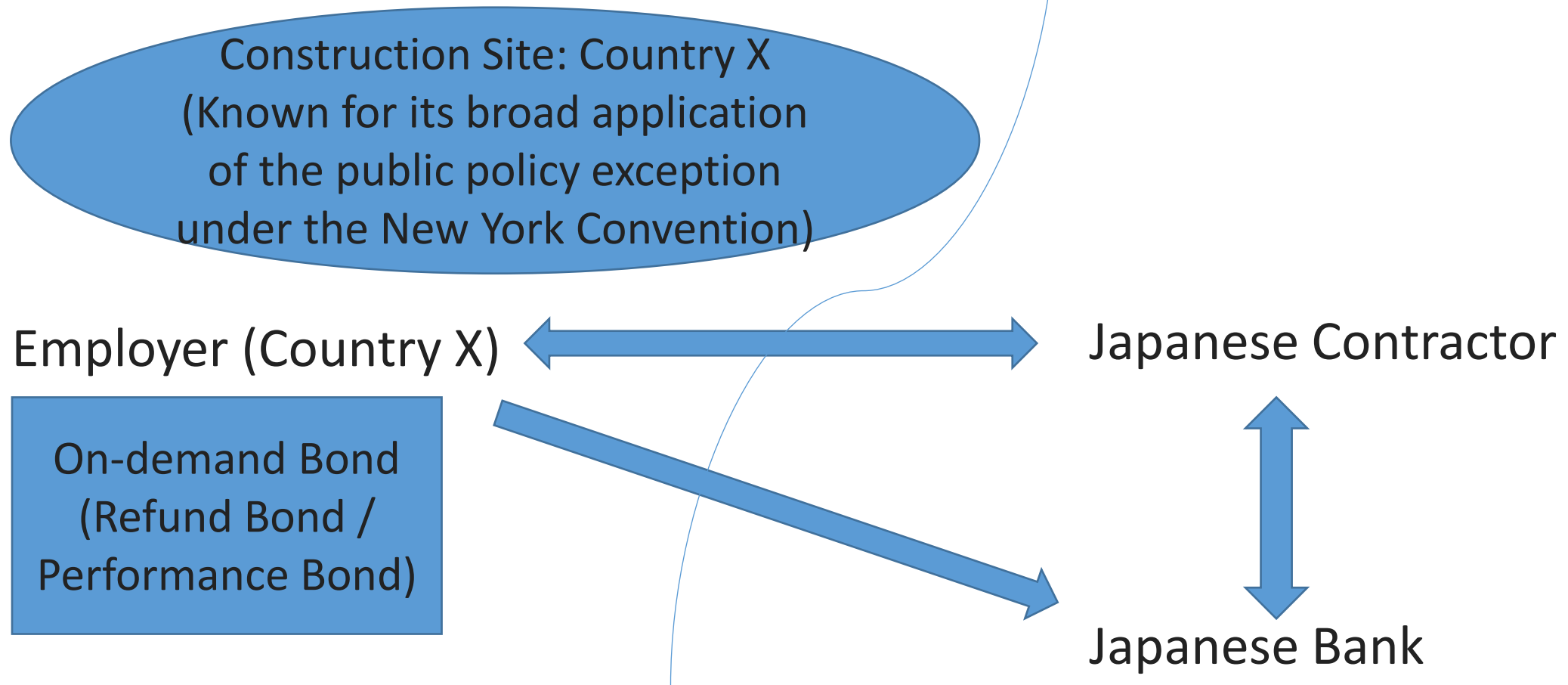
**Akihiro Hironaka, FCI Arb**

**Nishimura & Asahi (Tokyo, Japan)**





# Case Study: Parties



# Interim Relief under Japanese law

Provisional Order - Interim Remedy of a Provisional Disposition to Determine the Provisional Legal Relationship Between the Parties: no *ex-parte* proceedings

Provisional Attachment Order to preserve monetary claims: *ex-parte* proceedings

(To preserve limited types of non-monetary claims) Provisional Disposition with respect to the subject Matter in Dispute: *ex-parte* proceedings



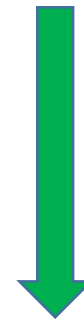
# Scenario 1: Provisional Order against Bank

Employer (Country X)

On-demand Bond  
(Refund Bond /  
Performance Bond)

Japanese Contractor

Claimant



No ex parte proceedings

Japanese Bank

Respondent



## Scenario 2: Provisional Attachment against Employer

Employer (Country X)  
**Respondent**

On-demand Bond  
(Refund Bond /  
Performance Bond)

*Ex parte* proceedings

Japanese Contractor  
**Claimant**

Japanese Bank

**Third Party Obligor**

# What must Claimant show to obtain Provisional Attachment Order?

(a) Existence of Claimant's monetary claim to be preserved.

(b) Impossibility or difficulty of future enforcement of Claimant's claim, in the absence of Provisional Attachment Order.

# Necessity of Preservation

Lack of sufficient assets for future enforcement is generally required.  
However...

*“Even if the Respondent is solvent enough, if the greater part of its assets are located outside Japan, the necessity of the Provisional Attachment Order can be found in Japan.”* Hiroshi Segi, Law on the Civil Provisional Remedies, at 117 (Rev. 2nd ed, 2020)

*“(As an illustration for if the necessity of preservation is found) In case there is a possibility that the Claimant must enforce it outside Japan (emigration of the Respondent, bringing assets outside Japan).”* Teiichiro Nakano, ed., Outline of Law on Civil Enforcement and Provisional Remedies, at 333 (3rd ed., 2006)

# Arguments by Contractor

Claimant's request was to preserve the *status quo*.

Employer would be able to defend it at the following objection proceedings.

Securing future enforcement was the exact purpose of Provisional Attachment.

Provisional Attachment by competing creditors would be allowed.

## Conclusion

*“Pay first, litigate later”* is the spirit of an on-demand bond.

However, what can Contractor do if Employer attempts to prevent Contractor from litigating?



Jurisdictions of interest when defending  
calls against demand guarantees –  
Experience in **the UAE & Middle East**



**Andrew Mackenzie**  
Head of Litigation, Arbitration  
& Investigations (Middle East)

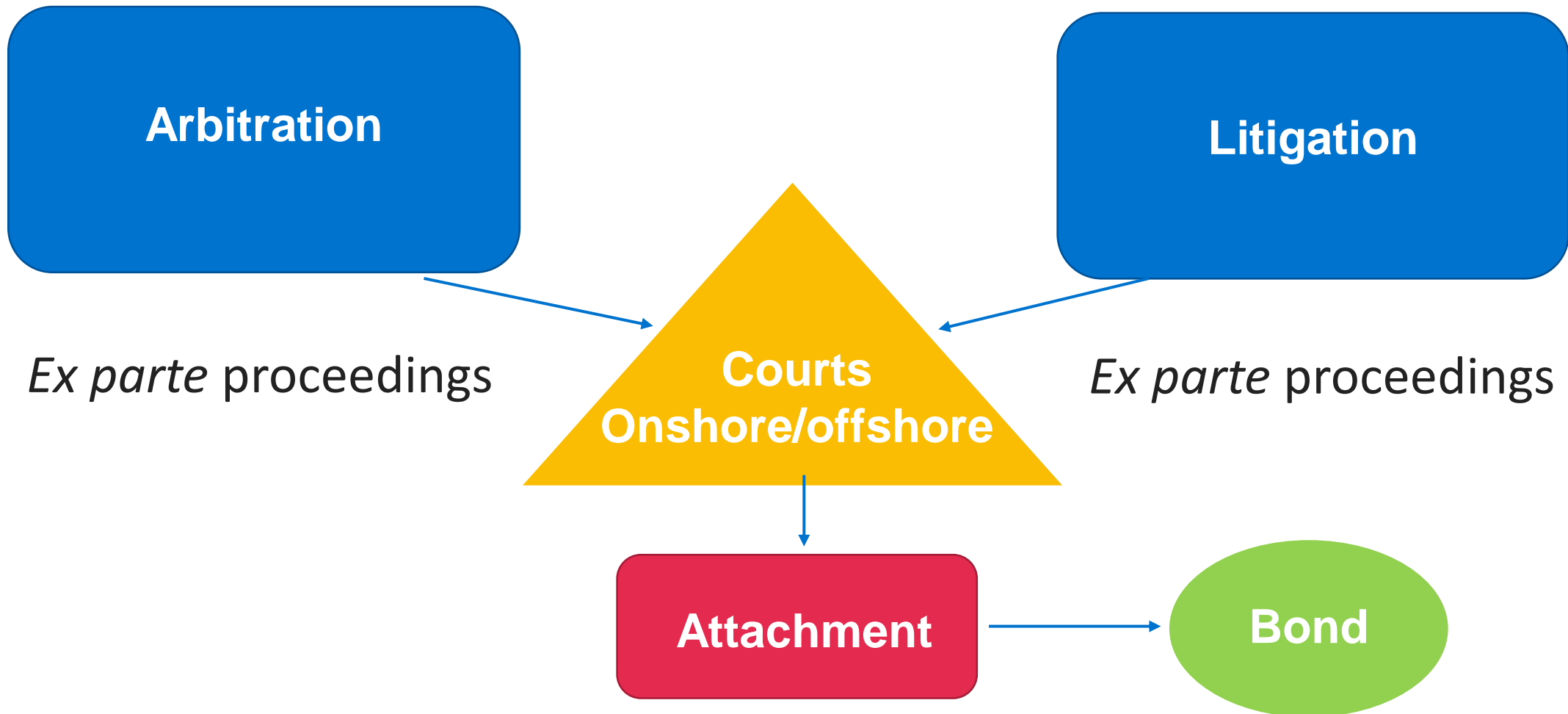
# The Middle East is a diverse landscape...



## Disputes Landscape across the Middle East

- Arbitration remains king
- On demand bonds very common across the region
- **Precautionary attachments (injunctions) are possible**
- “*Onshore*” litigation – the local courts
- “*Offshore*” litigation – English common law
  - **DIFC Courts**
  - **ADGM Courts**
  - **QFC Courts**
  - **KAFD** -King Abdullah Financial District – *watch this space*

# Two Different Avenues: Arbitration & Litigation



# UAE – Precautionary Attachments



## Legal Overview – Onshore Court Proceedings

- Relevant Laws:
  - UAE Civil Procedure Law (Federal Decree-Law No. 42/2022)
- A party can apply for a precautionary application where:
  1. the debtor does not have a stable residence in the UAE;
  2. If the creditor fears on the basis of serious evidence that the debtor will flee or smuggle or conceal their funds; or
  3. If the debt securities are at risk of being lost.
- The law states that an application must be made to the court hearing the case or the **Court of Urgent Matters** if no proceedings have been issued. In practice however applications are made to the Court of Urgent Matters.
- A Power of Attorney is needed to submit an application.
- An application needs to be supported by undertakings that the applicant agrees to indemnify the respondent if their application is not justified.
- The applications are on an *ex parte* basis.
- Proceedings need to be filed within 8 days of the issuance of the precautionary attachment decision and notified to the defendant.
- A precautionary attachment can be obtained within 5 business days.

## Legal Overview – Arbitration Proceedings



- Relevant Laws:
  - UAE Arbitration Law (Federal Law No. 6/2018 On Arbitration), Articles 18, 21, and 27.
- A party can apply for a precautionary attachment to preserve assets and property, which an award may be enforced against. Applications should be **made in the Court of Appeal**.
- A Power of Attorney is needed to submit an application.
- An application needs to be supported by undertakings that the applicant agrees to indemnify the respondent if their application is not justified.
- Precautionary attachment applications need an anchor case. The arbitration itself is an **anchor case**.
- The applications are on an *ex parte* basis.
- The substantive case need to be filed within 8 days of the issuance of the precautionary attachment decision and notified to the defendant.
- A precautionary attachment can be obtained within 5 business days.

# KSA – Precautionary Attachments

## Legal Overview



- Saudi law does not classify prejudgment attachments as a form of interim relief. However, Saudi courts have **wide** discretion to what interim relief can be granted.
- A party can apply for a precautionary attachment application where:
  1. The debtor has no fixed residence in Saudi Arabia; and
  2. There is proof that a creditor's assets may disappear or be dissipated.
- The application may be made ensuring the main claim or before the proceedings are commenced.
- The application must be supported by a guarantee to cover any losses if it is found that the applicant did not have the right to make such an application.
- In practice, attachments are generally ordered by the enforcement courts. Therefore, judges seek to expedite the proceedings and grant a judgment on the merits, following which the creditor can seek to attach assets.
- A precautionary attachment can be obtained within 2 days

# Qatar – Precautionary Attachments



## Legal Overview

- A party can apply for a precautionary attachment in the Court of First Instance as a precautionary or enforcement measure.
- A party can apply for a precautionary attachment application where:
  - It is owed a due and payable debt; and
  - The debtor is at risk of fleeing or dissipating its assets.
- **Substantive proceedings** must be filed within **2 weeks** of the order being granted.
- An attachment, if granted, remains in place while the challenge to the attachment is being considered, which can take up to two years.
- A precautionary attachment can be obtained within 2 days



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# JURISDICTIONS OF INTEREST WHEN DEFENDING CALLS AGAINST DEMAND GUARANTEES – EXPERIENCE IN **INDIA**

- Vishrov Mukerjee, Partner

# Performance Guarantees

- Bank Guarantee issued by a Bank on behalf of a Party to secure performance or advance paid.
- Pre-Bid or Post-Bid
- Guaranteeing Performance v. Performance Guarantee
- Substance over Form.
- Unconditional | Absolute | Upon Demand | Without Recourse

# Position in India

- Treated as a separate contract.
- Independent of the underlying dispute between Parties.
- Decision of the Invoking Party absolute and binding on the Bank.
- Legal Recourse: Civil Courts/Tribunals | Arbitral Tribunal | Writ
- Injunctive Action typically against beneficiary. Issuing Bank is made a *pro forma* party.

# Grounds for Injunction

- Three grounds for grant of injunction:
  - Fraud of egregious nature which vitiates the foundation.
  - Irretrievable injustice or injury.
  - Special Equities: In the nature of irretrievable injustice or injury.
- High threshold: Establish *prima facie* case through strong evidence as a triable issue.
- Grant of injunction against invocation of guarantee is rare. Typically reversed in Appeal.

# Different Approaches

- Two types of disputes:
  - Disputes involving private parties.
  - Disputes where the State is a counter-party.
- Private Disputes: Injunctions rarely granted.
- Disputes involving the State:
  - Constitutional Guarantee against arbitrariness extends to contracts where the State is a party.
  - Writ Remedy available in contractual disputes where arbitrariness or unreasonable action is alleged.

# Path to Relief

- Strategically parties seek injunction against “*coercive action*” and to “*maintain status quo*”
- Omnibus relief which is predicated on a lower standard of:
  - Prima facie case
  - Balance of convenience
  - Irreparable loss
- There are instances where such protection extends to performance guarantees as well. Examples include force majeure, cancellation of power purchase agreements etc.

# Time for Change?

- Position in India has been consistent for over 30 years giving primacy to bank guarantees as instruments of commerce to ensure *free flow of commerce*.
- This has resulted in a straightjacket approach to such matters resulting in hardship.
- Underlying dispute/contract should not be ignored.
- Need of the hour is to evolve a flexible approach permitting grant of relief with a higher threshold / burden of proof.



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