

# International Arbitration Alert

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## International Construction: On-Demand Bonds & Guarantees - First Judicial Guidance on URDG 758

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In *Leonardo S.p.A v. Doha Bank Assurance Company LLC*<sup>1</sup> the Appellate Division of the Qatar Financial Centre in a Judgement handed down by Lord Thomas of Cwmgiedd, Justice Chelva Rajah SC and Justice Ali Malek QC stressed the fundamental importance of incorporating by reference Uniform Rules for Demand Guarantees (URDG) 758 into so-called on-demand bonds and guarantees. This is an important judgement. The URDG International Chamber of Commerce (ICC) Publication 758, known internationally as URDG 758, became effective on July 1, 2010, but there were no reported cases dealing with its application and practical effects. In *Leonardo S.p.A* the court explained:

- As URDG 758 is intended to be an instrument underpinning international trade and commerce and to harmonize international demand guarantee practice, it is important URDG 758 is not interpreted in a literalistic manner or by adoption of rules of national law.
- Courts must interpret URDG 758 in accordance with its underlying aims and purposes reflecting international practice and the expectations of international bankers and international traders.
- Courts worldwide ought to follow the same approach, not least because demand bonds and guarantees incorporating URDG 758 “are the lifeblood of commerce. Their purpose is to provide security for payment which can be called on promptly.”

*Leonardo S.p.A v. Doha Bank Assurance Company LLC* will be monitored in Singapore and Malaysia. This is because in these jurisdictions the courts have routinely restrained calls on on-demand bonds and guarantees on the basis that the call was unconscionable. Incorporation of and following the procedures in URDG 758 coupled with the court’s jurisprudence in *Leonardo S.p.A* may, now, give beneficiaries in such jurisdictions more certainty that a call will be paid out and the autonomy principle will be upheld.

### What is URDG 758?

The URDG 758 are a set of contractual rules that apply to demand bonds and guarantees and counter-guarantees. As the URDG are contractual by nature, they

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apply only if the parties to a demand bond, guarantee or counter-guarantee incorporate the URDG 758 into such instruments. The URDG 758 has been endorsed by the World Bank, the International Federation of Consulting Engineers (FIDIC), the Organization for Harmonization of Business Law in Africa (OHADA), the U.N. Commission for International Trade Law, the Bankers' Association for Finance and Trade (BAFT) and the International Financial Services Association (IFSA).

There is often a debate or dispute around procedural and documentary compliance: For example, do the procedures in the on-demand trump the terms of the underlying contract? In this context, Articles 15 and 23 of URDG 758 are often discussed. Put shortly, Article 15 requires that the demand be supported by a statement by the beneficiary "indicating in what respect the applicant is in breach of its obligations under the underlying relationship." If requested in the demand, Article 23 dealing with "extend or pay" permits the guarantor to extend the validity of the bond or guarantee "for a period not exceeding 30 calendar days following its receipt of the demand" as an alternative to immediate payment.

Perhaps the most important aspect of URDG 758 is the independence or autonomy principle, which insulates the bond or guarantee from the terms in the underlying contract. This is important because the autonomous nature of the bond or guarantee means that conditions giving rise to the obligation to pay are found exclusively in the bond or guarantee. This independence principle is embodied in Article 5(a) of the URDG 758:

"A guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary."

As discussed in by the Privy Council in *Alternative Power Solution Ltd v. Central Electricity Board*<sup>2</sup>, there is of course the fraud exception<sup>3</sup> to the strict general rule that the court would not intervene to prevent a guarantor from making payment under a demand bond or guarantee following a compliant presentation of documents. As discussed further below, certain jurisdictions have added unconscionability as another exception.

### **The Importance of *Leonardo S.p.A***

The court stressed that there are three core principles that underpin URDG 758: the independence or autonomy principle (discussed above), the documents principle and the strict compliance principle. The documents principle is related closely to the autonomy principle. Article 6 of URDG 758 provides:

"Guarantors deal with documents and not with good, services or performance to which the documents may relate."

The court explained, "Article 6 is an application of the principle in Article 5. The guarantor is only concerned with the issue of whether the documents presented conform with the terms and conditions of the guarantee and not with whether the

goods and services conform with the underlying contract” and that Article 12 was also relevant. Article 12 of URDG 758 provides:

“A guarantor is liable to the beneficiary only in accordance with, first, the terms and conditions of the guarantee and, second, these rules so far as consistent with those terms and conditions, up to the guarantee amount.”

The strict compliance principle is concerned with the requirement that the documents presented must strictly conform to the requirements of the guarantee; if the documents do not comply, their presentation will be a non-complying presentation even if the discrepancy has no practical effect. The court reasoned that each of the three principles is aimed at the commercial importance of certainty and predictability, commenting:

“As URDG 758 is intended to be an instrument underpinning international trade and commerce and to harmonise international demand guarantee practice, it is important URDG 758 is not interpreted in a literalistic manner or by adoption of rules of national law. A similar approach to the interpretation of URDG 758 should be adopted as that in relation to the Uniform Commercial Practices (UCP), as like UCP, URDG is a code reflecting the views and practices of the market and is kept under review.”

The court continued:

“URDG 758 expressly governs the Guarantees. It sets out in very clear terms the applicable legal principles and international practice. Those engaged in international trade, commerce and finance should be entitled to rely on the terms of URDG 758 interpreted in the way we have explained without having to have in mind national case law which predates it. Moreover, if a dispute arises, it is far more cost effective and speedy to proceed by reference to the principles set out in URDG 758 in the way we have described rather than by reference to case law.”

The court’s guidance is important because it tells beneficiaries and guarantors that the terms and procedures set out in the bond or guarantee are more relevant than the terms of the underlying contract. In *Leonardo S.p.A* the guarantor argued that the demands under the advance payment guarantee and the performance bond were defective because Leonardo was required to make a claim in writing against the counter-party in the underlying contract before making a demand and to record that it had done so in a supporting statement and/or by attaching those claims in writing to the demand. The Court considered that the issue can and should be determined by reference only to the terms of the Guarantees and the URDG 758. In this regard, it was concluded that Article 7 of URDG 758 is of considerable importance:

“It is clear from reading the Guarantees that the reference to claims in writing on PAT does not give rise to a documentary requirement, as it is not expressed as such in the Guarantees. We consider the words are there to refer to the underlying contractual relationship between Leonardo and PAT and restrict the guarantees to such claims as are in writing. However, the Guarantees do not purport to set out a documentary requirement and cannot be construed as such. As Articles 7 and 15 make clear, in considering the Guarantees provided by DBAC to Leonardo, the focus is on the documentary requirements.”

The Court's direct guidance is also important because a demand made commensurate with the procedures in URDG 758 may be less likely to be held to be unconscionable. In this context, following the Federal Court of Malaysia in *Sumatec Engineering and Construction Sdn Bhd v. Malaysian Refining Co. Sdn Bhd*<sup>4</sup>, a number of cases<sup>5</sup> in Malaysia and Singapore<sup>6</sup> have restrained calls on demand bonds and guarantees on the basis that the call was based on unconscionable conduct (which acts an exception to the autonomy principle). At the Court of Appeal stage in *Sumatec* it was said "This additional ground of "unconscionability" should only be allowed with circumspect where events or conduct are of such degree such as to prick the conscience of a reasonable and sensible man." On the corollary, the proposition would be that a beneficiary that has issued a demand commensurate with URDG 758 is not acting unconscionably. Put another way, incorporation of URDG 758 into bonds and guarantees issued by banks in Malaysia and Singapore may decrease the 'fact-sensitive' risk of an injunction based on unconscionability.

<sup>1</sup> [2020] QIC (A) 1 (on appeal from [2019] QIC (F) 6).

<sup>2</sup> [2014] UKPC 31.

<sup>3</sup> In *Alternative Power Solution Ltd v. Central Electricity Board* in the context of the fraud exception, the expression 'seriously arguable' was intended to be a significantly more stringent test than good arguable case, let alone serious issue to be tried; that even where it was possible to establish the test for fraud as opposed to mere possibility of fraud, the balance of convenience would almost always militate against the grant of an injunction.

<sup>4</sup> [2012] 3 CLJ 401 the Federal Court recognised unconscionability as a "separate and independent ground to allow for a restraining order on the beneficiary," that this equitable exception stems from the "general underlying notion ... of equity's traditional jurisdiction to grant relief against unconscientious conduct namely, that a person should not be permitted to use or insist upon his legal rights to take advantage of another's special vulnerability or misadventure for the unjust enrichment of himself ..."

<sup>5</sup> *Maxwell Accent JV Sdn Bhd v. Kuala Lumpur Aviation Fuelling System* [2017] 1 LNS 990; *Target Resources Sdn Bhd v. THP Bina Sdn Bhd* [2017] 1 CLJ.

<sup>6</sup> *CKR Contract Services Pte Ltd v. Aspienium Land Pte* [2015] 3 SLR 1041.

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