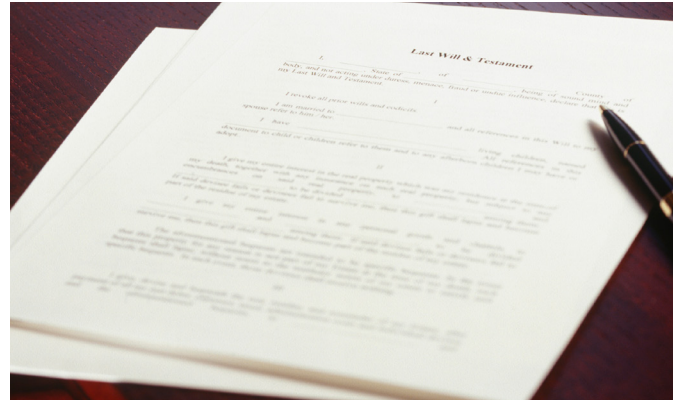


This year, we have noticed an increase in the number of queries on letters of guarantees. This issue of the Global Newsletter will focus on the legal position relative to letters of guarantees in Qatar, and provide practical guidance when calling up a letter of guarantee and what actions are available if your letter of guarantee is being threatened or called up.

When undertaking construction and infrastructure projects in Qatar, it is customary for contractors, subcontractors and consultants to provide one or more forms of security. The most common form of security required is a letter of guarantee (often referred to as a “performance bond”) for approximately 10% of the contract sum.¹

Those familiar with bonds in the US should note, however, that the term “bond” means something quite different in Arab Civil Law jurisdictions. In the US, bonds are similar to policies of insurance obtained primarily as a means of completing the project. In Arab Civil Law countries, a “bond” equates more to a stand-by letter of credit or guarantee and is often relied upon as a way to apply pressure on contractors and consultants, as opposed to a means of completing the project.

For the purposes of this article, the “**guarantor**” is the party issuing the letter of guarantee (i.e. the bank); the “**beneficiary**” is the party named in the letter of guarantee as the party who would receive sums in the event of a demand; and the “**debtor**” is the party who procured the letter of guarantee.



Qatari Law

The Qatari Commercial Code² applies to “letter[s] of guarantee” issued by a bank. Article 406 states that a “letter of guarantee” is:

“...an irrevocable written pledge[s] issued by the bank at the request of its client, known as the applicant, to pay a certain amount to be specified to another person, known as the beneficiary if the beneficiary so requests within the period specified in the letter and **without regard to any rejection**. The purpose for which the letter of guarantee is issued shall be explained there.”³

Due to the words “without regard to any rejection”, it is clear that a guarantor cannot take account of any disputes or differences between the debtor and the beneficiary in the underlying contract. This is supported by Article 409 of the Commercial Code, which confirms that a bank (i.e. the guarantor) may not refuse to pay the beneficiary of a letter of guarantee due to its relationship with the debtor (or the debtor’s relationship with the beneficiary). A demand would, however, be rejected if it was not made during the validity period of the letter of guarantee.⁴

In that instance, the guarantor is “absolved of responsibility to the beneficiary”.⁵

Standard Forms and International Rules

FIDIC Red Book⁶ is one of the most heavily used standard forms of contract in Qatar.

Clause 4.2 of FIDIC Red Book⁷ allows a beneficiary to make a demand for payment under the letter of guarantee following a qualifying event of default (such as a failure of the debtor to remedy a default within 42 days after receiving notice of the same).⁸ This is also reflected in the example letter of guarantee annexed to FIDIC Red Book which requires the beneficiary to provide a written demand for payment of sums under the letter of guarantee along with a statement confirming:

- The debtor is in breach of its obligation(s) in the underlying contract (i.e. Red Book); and
- Details of the debtor’s breach.

It is also important to consider Article 413 of the Commercial Code to establish what is required to make and respond to a demand under a letter of guarantee.

Article 413 states that the rules prevailing in international transactions on letters of guarantee will apply to letters of guarantee in Qatar to the extent that the international rules are not in conflict with Articles 406 to 413 of the Commercial Code. Several international rules have been listed below.⁹

- The Uniform Rules for Demand Guarantees (**URDG**)
- The Uniform Customs and Practice for Documentary Credits
- The Uniform Rules for Contract Bonds
- The Uniform Rules for Contract Guarantees
- The International Standby Practices

Before a set of international rules can apply, they will typically have to be expressly referred to in the text of the letter of guarantee. Failure to incorporate a set of international rules may not, however, prevent a debtor or guarantor from arguing that international rules should apply as a matter of applicable custom and practice.

For example, the letter of guarantee annexed to FIDIC Red Book expressly incorporates URDG. As a result, and in an abundance of caution, a beneficiary may elect to follow URDG if the underlying contract or letter of guarantee fails to provide any guidance on how to make and respond to a demand for payment. On that basis, it should be noted that Article 15 of the URDG requires the beneficiary to:

- Prepare the demand in accordance with the requirements contained in the letter of guarantee (if any);
- Provide supporting documents required under the letter of guarantee (if any); and
- Include a statement confirming the nature of the debtor’s breach which has prompted the demand.¹⁰ Alternatively, a supporting statement is not necessary if this requirement is expressly excluded in the letter of guarantee.¹¹

After a demand has been presented, the guarantor may reject the demand under the URDG if the guarantor has examined the demand and (on its face) the demand fails to comply with the terms and conditions of the letter of guarantee or the URDG.¹²

Similar to Article 409 of the Commercial Code, the URDG does not allow defences or claims to be made in respect of a “relationship other than a relationship between the guarantor and the beneficiary”.¹³

As a result, any dispute or difference between the debtor and the beneficiary in the underlying contract (such as a delay or variation claim) is not relevant and shall not be taken into consideration by the guarantor when examining the demand. This position is also reflected in Article 6 of the URDG, which confirms: "Guarantors deal with documents and not with goods, services or performance to which the documents may relate".

Notwithstanding this point, the URDG requires that the guarantor informs the debtor of any demands made on the letter of guarantee, or any request to extend the validity period of the letter of guarantee;¹⁴ and examine the letter of demand and supporting documentation to determine whether (on the face of it) a valid demand has been made.¹⁵ If there is no valid reason to reject the demand, payment under the URDG shall be made within the period specified in the demand or within five (5) business days following receipt of the demand.¹⁶

Finally, the guarantor is entitled to pursue the debtor for sums paid out to the beneficiary under the letter of guarantee.¹⁷

Practical Guidance

It is vital that demands are made in accordance with the letter of guarantee to avoid the demand being challenged. As such, and before making a demand for payment under a letter of guarantee, we recommend considering the following points:

- Obtain the original, signed letter of guarantee(s) and any subsequent amendments to the letter of guarantee(s).
- Consider whether the letter of guarantee contains any requirements that must be fulfilled before a demand can be made.

- Does the letter of guarantee prescribe the form and content of the demand? In any event, the demand should be drafted in clear and unambiguous terms.
- What supporting documents have to be submitted with the demand? Typically, the demand should be accompanied by the corresponding letter of guarantee (including any amendments to the letter of guarantee); however, there may be other documents or statements that should be included with the demand.
- Does the letter of guarantee incorporate international rules to be applied? If so, the international rules should be considered to establish the form and content of the demand (and if any supporting documents should be provided).
- The expiry date of the letter of guarantee. It is critical to submit the letter of demand in advance of the letter of guarantee expiring. Where possible, the beneficiary should avoid submitting a demand just before the expiry date as the guarantor could reject the demand for being "non-compliant" and request the presentation of a (compliant) demand. This may not be possible if the letter of guarantee expires before the beneficiary can submit a compliant demand. The Ministry of Justice issued an opinion which dealt with this issue and confirmed that demands should be made without delay when a breach has occurred to avoid the validity period expiring on the basis that a letter of guarantee cannot be extended without the consent of the debtor.¹⁸

Defences

When a demand for payment is made in Qatar, it can typically take around five (5) to ten (10) business days for a guarantor to examine the demand and transfer payment to the beneficiary (notwithstanding instances where the letter guarantee requires payment to be made "immediately upon first written demand").

Often, this pause before payment allows the debtor to enter into negotiations with the beneficiary; however, it also provides the debtor with an opportunity to seek injunctive relief through the courts to try and stop payment being on the basis that:

- The beneficiary failed to satisfy a procedural requirement contained in the letter of guarantee; and/or
- The letter of guarantee expired before the demand for payment was made; and/or

- The demand was made fraudulently.

It should be recognised, however, that payment being delayed by several days does not equate to the guarantor refusing to make payment.

In our experience, when a demand is made, payment follows as it is difficult to obtain an injunction in the Qatari courts; and Qatari banks are very reluctant to refuse to make payment following receipt of a demand for fear of breaching the terms of the letter of guarantee, which could have contractual and regulatory consequences.

Take Away Points

In common law and civil law jurisdictions, unconditional letters of guarantee are considered to be “as good as cash” and are often used by beneficiaries as a tactical retaliation to a dispute in the underlying contract (regardless of the merits of beneficiary’s claim). As such, parties who have been asked to provide an unconditional letter of guarantee should (whenever possible) consider alternative forms of security as obtaining injunctive relief in Qatar to prevent payment being made (or prevent the beneficiary from using the money if payment has already been made) is very difficult.

If a letter of guarantee has been provided, beneficiaries who want to make a demand for payment should carefully consider the terms of the letter of guarantee to ensure the demand prepared is valid and enforceable. Particular care should also be taken to establish the expiry date of the letter of guarantee (to avoid running out of time to serve the demand); and whether any international rules apply that might impact the form and content of the demand.

Footnotes

- 1 Which figure may adjust if the value of the underlying contract increases or decreases due to variations to the scope of work or services.
- 2 Law No. 27 of 2006 Promulgating the Trading Regulation Law (the “**Commercial Code**”).
- 3 Commercial Code, Article 406.
- 4 Commercial Code, Article 409.
- 5 Commercial Code, Article 411.
- 6 FIDIC Conditions of Contract for Construction (For Building and Engineering Works Designed by the Employer) (1999) (“**FIDIC Red Book**”).
- 7 1999 edition.
- 8 FIDIC Red Book, Clause 4.2.
- 9 We have not included “The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit” as Qatar is not a signatory to the Convention.
- 10 URDG, Article 15.
- 11 URDG, Article 15(c).
- 12 URDG, Article 2 and Article 19.
- 13 URDG, Article 5(a).
- 14 URDG, Article 16.
- 15 URDG, Article 19.
- 16 URDG, Article 20. The timescale for payment should not be less than five business days.
- 17 Commercial Code, Article 412.
- 18 Ministry of Justice, Legal Opinion No. 218- 1541 of 1996

Contact



Denise McLaughlin

T +974 4453 2503

M +61 4 0278 4097

E denise.mclaughlin@squirepb.com

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