



CONSTRUCTION
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ENFORCEMENT OF GUARANTEES IN CONSTRUCTION CONTRACTS

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Profile

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Current Positions:

- Chairman, Chartered Institute of Arbitrators – Uganda Chapter.
- Director, Chartered Institute of Arbitrators – Kenya Branch.
- Executive Director, Construction Law Institute.
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Memberships:

- Fellow: Chartered Institute of Arbitrators (FCIArb)
- Fellow: Institute of Construction Claims Practitioners (FICCP)
- Member: Society of Construction Law (UK)
- Member: London Court of International Arbitration (LCIA)
- Member: International Center for Mediation & Arbitration in Kampala (ICAMEK)
- Member: Center for Arbitration & Dispute Resolution
- Member: International Bar Association.
- Member: Uganda Law Society and East Africa Law Society

WHAT ARE PERFORMANCE GUARANTEES?

Guarantees are of two types.

- An **on-demand guarantee** is a security that unconditionally requires a Bank or other surety to pay the beneficiary a sum of money once a demand has been made and, on occasion, on the presentation of certain documents.
- A **normal guarantee** usually requires the beneficiary to prove a liability against the obligor/debtor who is entitled to the guarantee.
- Bonds and guarantees will usually be required in any major construction project, and they are a requirement within FIDIC standard forms.



TERMS OF THE GUARANTEE

Example of the Wording of an On-demand Guarantee

- “Upon receipt by us of your demand in writing and your written statement indicating in what respect the Applicant is in breach of its obligations under the Contract.”
- In the FIDIC Sample of the demand guarantee, the Performance Security is subject to the Uniform Rules for Demand Guarantees (“URDG”) Revision 2010, Publication No. 758 by the International Chamber of Commerce.
- A call on a guarantee under URDG No. 758 states that the demand must state in *“what respect the applicant is in breach of its obligations under the underlying contract.”*



PRINCIPLES OF ON-DEMAND GUARANTEES

- The guarantee is equivalent to cash.
- The party providing the guarantee has agreed to payment being made, notwithstanding the existence of a dispute.
- The bank or guarantor has made a promise to the beneficiary in its capacity as a guarantor.



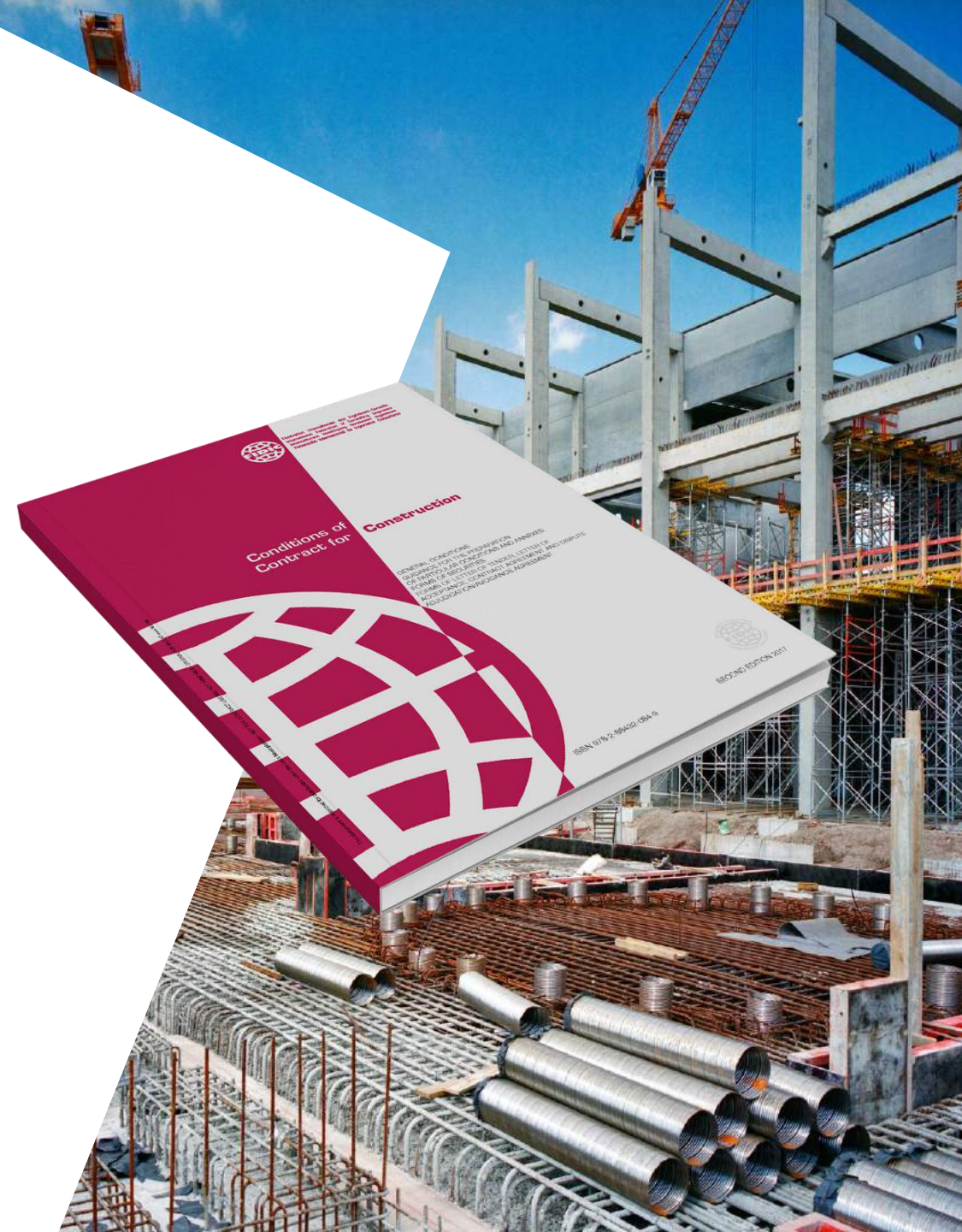
EXCEPTIONS

- Failure to comply with a condition precedent.
- Fraud.
- The underlying contract exception.
- Unconscionability.



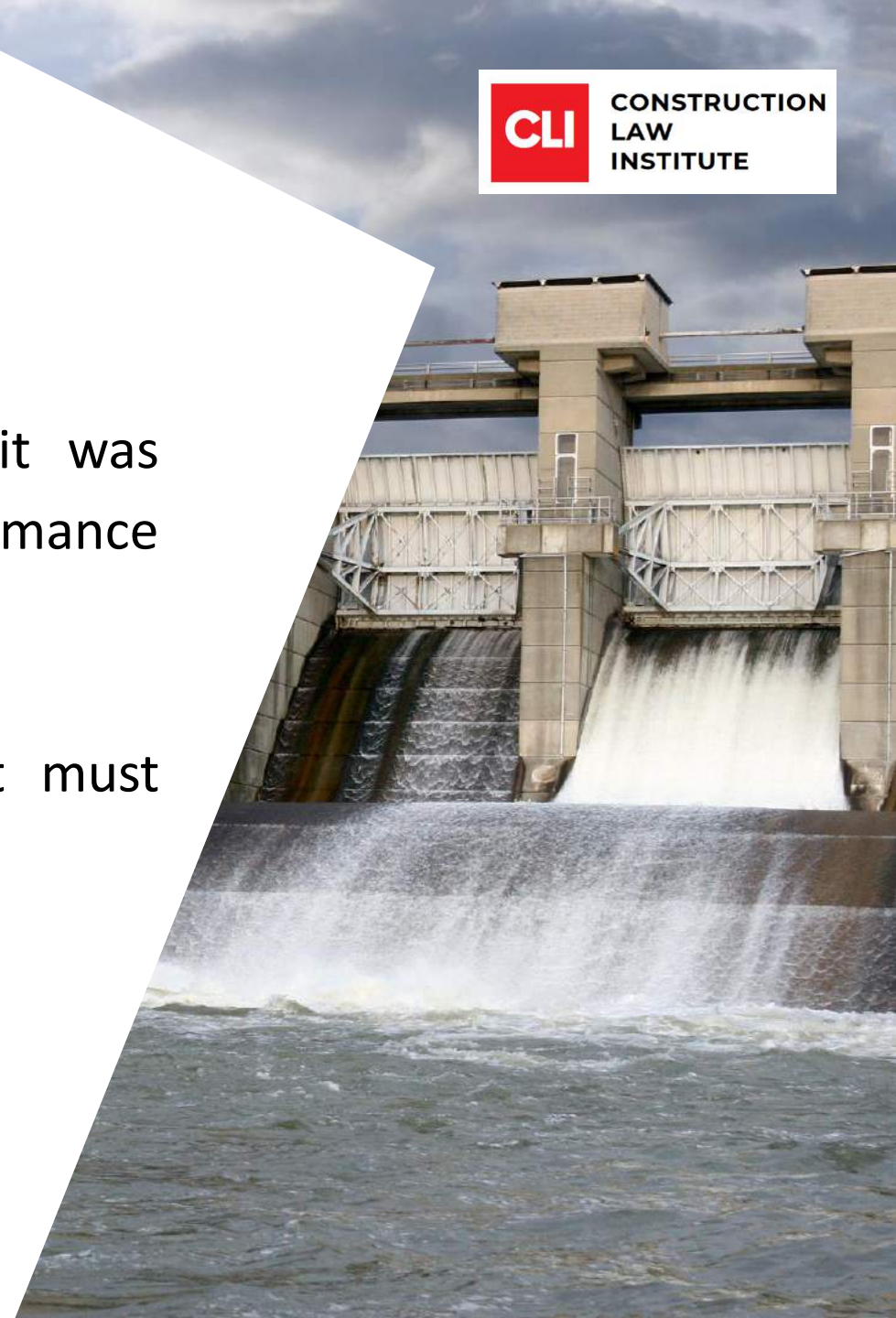
FAILURE TO COMPLY WITH A CONDITION PRECEDENT

- Some guarantees have express conditions that must be complied with, or the conditions are incorporated by reference to other documents.
- A failure to state in which respect the contractor is in breach of its obligations or to include any documents required to be annexed to the demand would make the call non-compliant.



FRAUD

- Fraud means any act of dishonesty.
- The beneficiary could not honestly believe that it was entitled to make the demand, e.g., after the Performance Certificate was issued.
- The bank was aware that the demand was fraudulent.
- Proof of fraud must be established; the claimant must discharge the “enhanced evidentiary standard.”

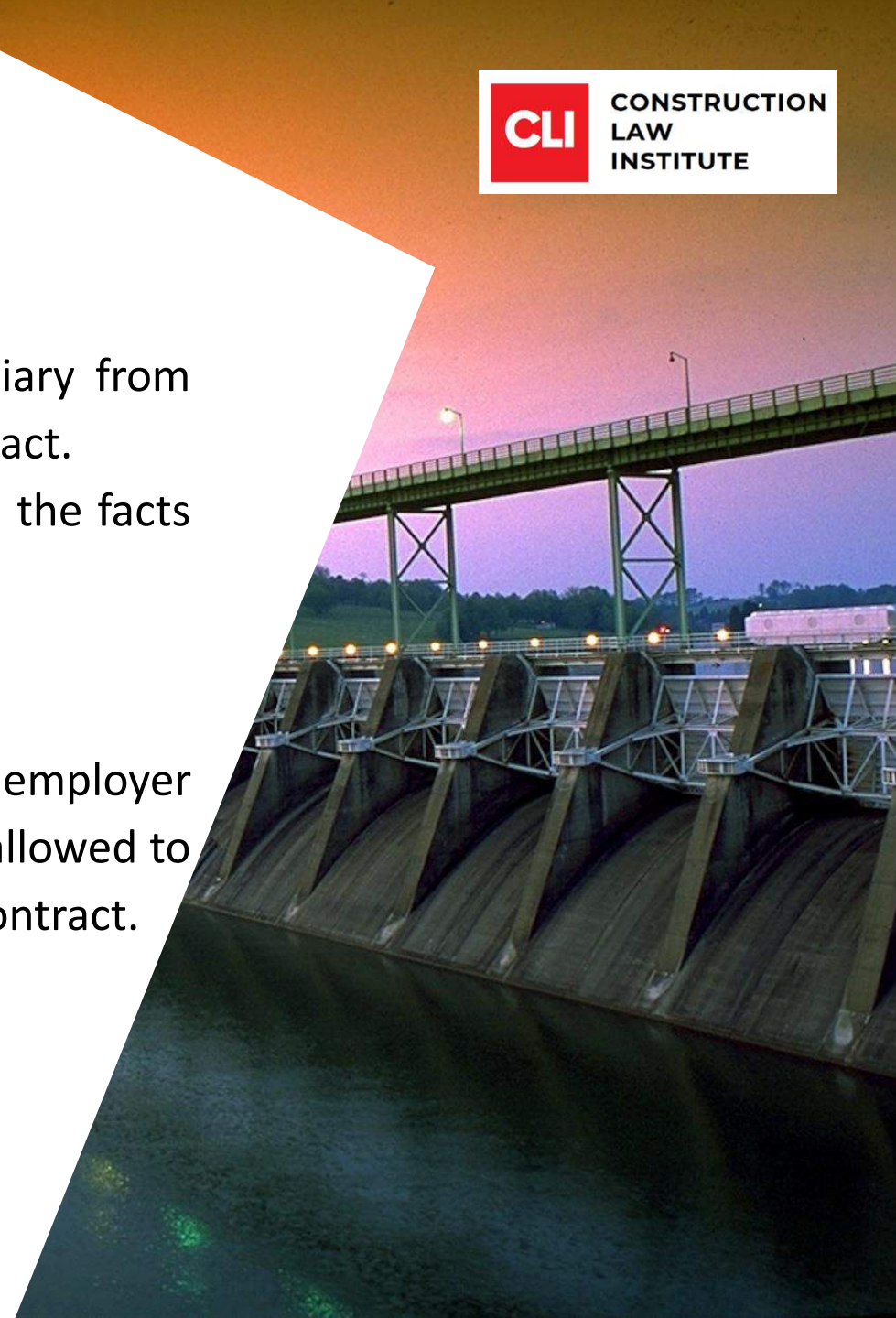


THE UNDERLYING CONTRACT EXCEPTION.

- A court will generally grant an injunction to restrain a beneficiary from breaching an express obligation contained in the underlying contract.
- The obligation must be express and does extend to a dispute on the facts of the case.

- ***Potton Homes Ltd v Coleman Contractors Ltd***

The court held that if the contractor could not perform because the employer failed to provide the advance payment, the employer would not be allowed to call on the performance security due to a breach of the underlying contract.



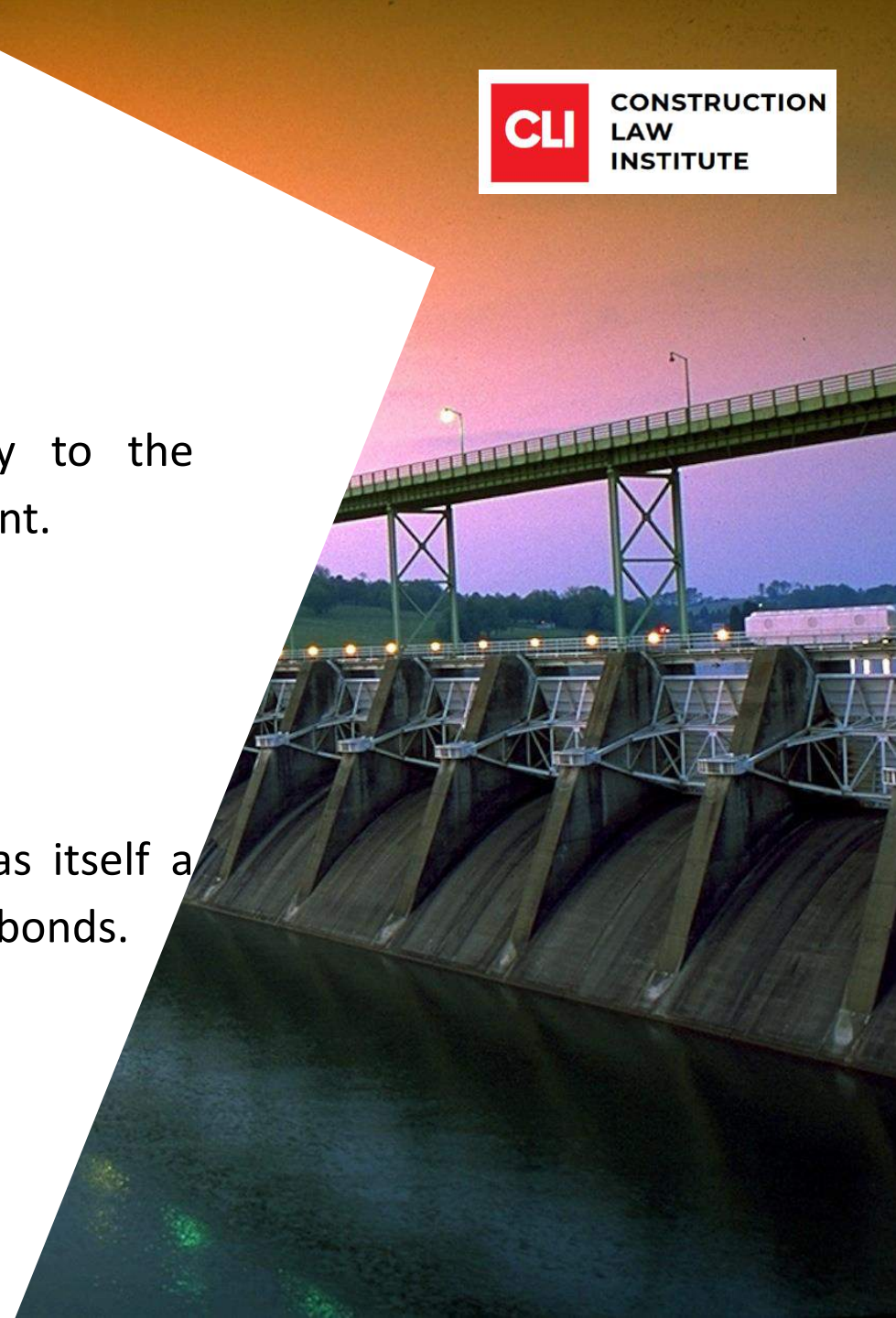
THE UNDERLYING CONTRACT EXCEPTION.

Simon Carves Ltd v Ensus UK Ltd

- The employer's failure to return the performance security to the Contractor after issuing the Performance Certificate was fraudulent.
- The Court declared the security null and void.

Doosnan Babcock v Comercializadora de Equipos

- The employer's refusal to take over two units of the plant was itself a breach of contract, and he was not entitled to make a call on the bonds.
- A party cannot take benefit from its own breach of contract.



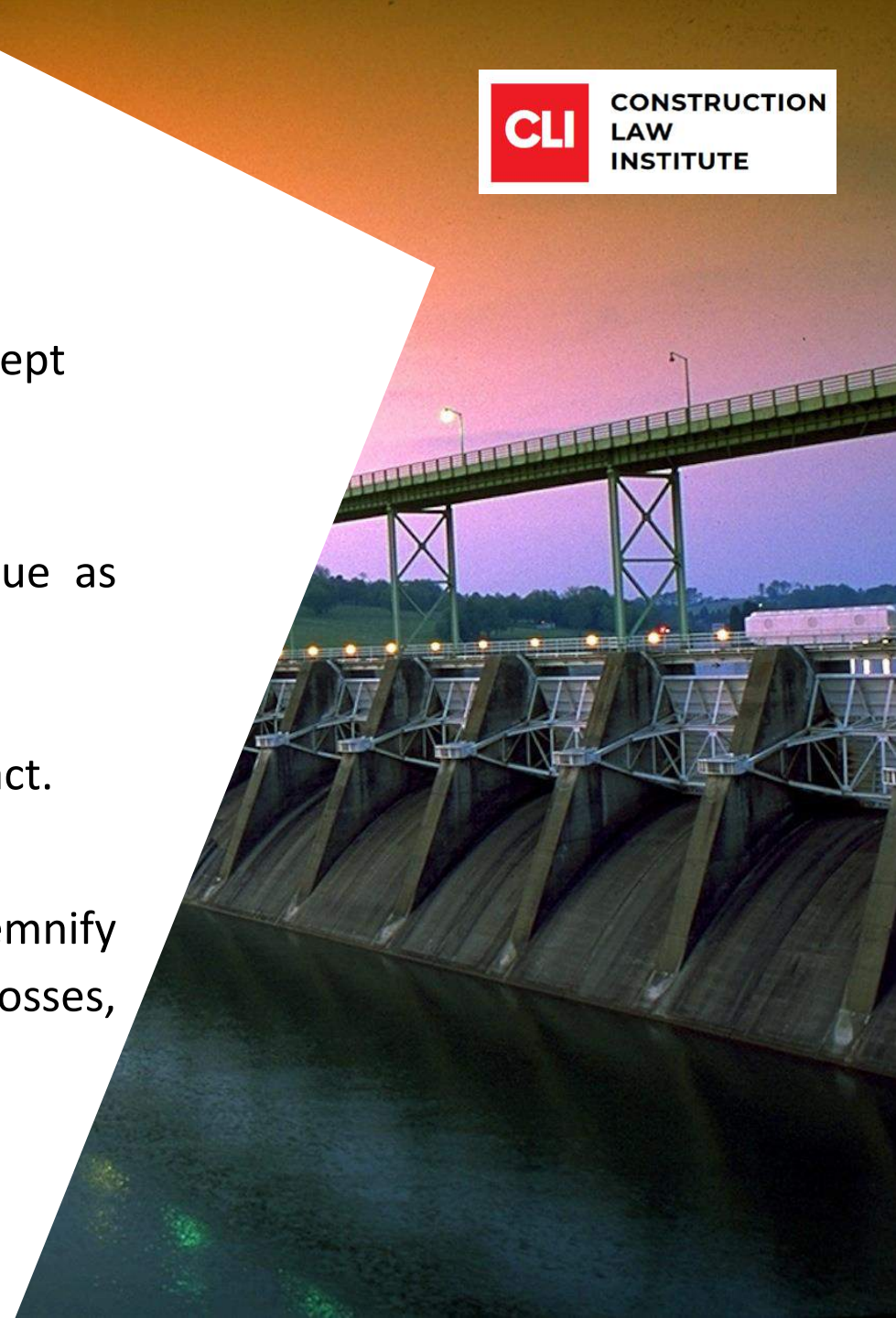
THE UNDERLYING CONTRACT EXCEPTION.

Failure to comply with the **FIDIC Sub-Clause 4.2.2** [*Claims under the Performance Security*]

The Employer **SHALL NOT** claim under the Performance Security, except for amounts it is entitled to **UNDER THE CONTRACT** if;

- Failure by the Contractor to extend the validity of the Guarantee.
- Failure by the Contractor to pay the Employer an amount due as agreed or determined by the Engineer, DAAD or an Arbitrator.
- Failure by the Contractor to remedy a default.
- Circumstances which entitle an Employer to terminate the contract.
- The Contractor fails to repair a plant off-site or return it.

In case of a wrongful call on the guarantee, the Employer shall indemnify the Contractor and hold them harmless against all damages, losses, expenses, legal fees and other costs.

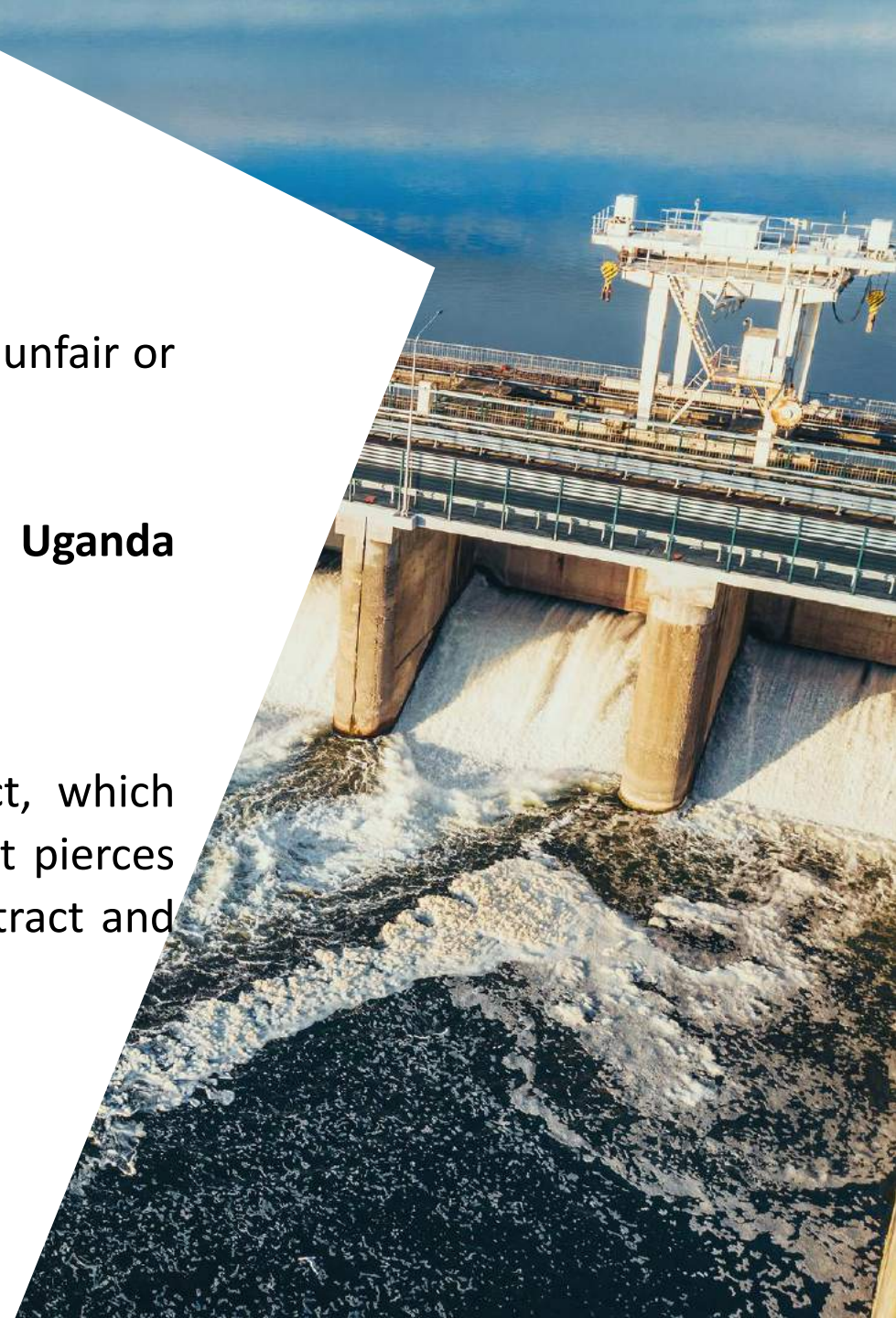


UNCONSCIONABILITY

- Unconscionable means without a conscience; unscrupulous; so unfair or unjust that it shocks the conscience.

Uganda Electricity Transmission Company Limited v Citibank Uganda Limited & 2 Others, Mubiru J.

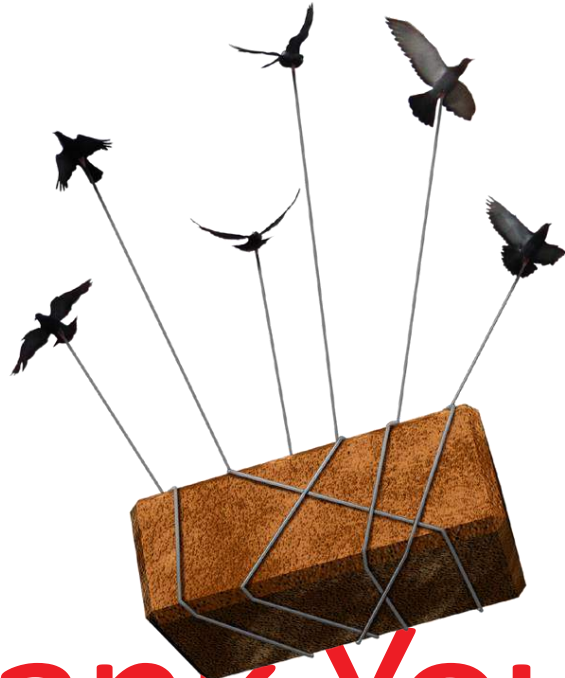
- A party should not profit from its own breach of contract.
- The courts may look to provisions in an underlying contract, which regulate calls on a bond related to such contract in a way that pierces the autonomy between the parties' obligations under the contract and the issuing bank's obligation under the associated bond.



CONCLUSION

- The Court has limited grounds to injunct a guarantor/bank from paying a beneficiary.
- The payment under the guarantee does not absolve the Employer from liability for breach of contract if an Arbitrator or Court finds it wrongful.
- Employers must avoid breaching the terms of the Contract or should mitigate their breach to preserve their right to call on the guarantees.





Thank You!

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