attempting to prevent payment, that this new breed of independent guarantee began to attract the attention of lawyers and the courts. This period marked the beginning of the development of the law in this new area, although some exploratory legal writing and a few court decisions had already paved the way.

1.2 Terminology. Guarantee = independent guarantee

1-2 Both terminologically and conceptually, the entire area of guarantees is, or at least was, marked by confusion, uncertainty and inconsistency. The adoption of English and American terminology by Continental banking practice also added to the confusion. In this study, the term guarantee means the modern type of independent guarantee, as opposed to the traditional accessory (or conditional or co-extensive) guarantee, also known as suretyship. The perhaps best known type of independent guarantee is the so-called (first) demand guarantee, but it should be noted that there are independent guarantees with different types of payment mechanism (see Chapter 4). When put in inverted commas (guarantee), the term is used in a neutral sense and includes both the independent and the accessory (or co-extensive or conditional) type of personal security.

The modern independent guarantee originated from practice, and the concept, as it functions today, was unknown in law until, say, 1980. Practice drew and elaborated on the related, and also familiar and well-established type of personal security, namely the accessory type which is known as 'suretyship' (*borgtocht*, *Bürgschaft*, *cautionnement*), although commercial and banking practice also employed the term guarantee when in fact meaning the accessory type of security. This accounts for the terminological and conceptual confusion.[4] After some initial confusion, Continental law now reserves the term guarantee for the concept of independent guarantee, while the term suretyship refers to the accessory type, but practice continues to use the term 'guarantee' indiscriminately. American law and practice have been and are more consistent in this respect. The term guaranty or guarantee expresses that the obligation of the guarantor is co-extensive with or accessory to that of the principal debtor. This was one of the reasons why another term, namely the standby letter of credit, came to be used when parties envisaged the independent type of security. This concept is equivalent to the Continental independent guarantee.[5] English law and practice do not principally distinguish between the two concepts. Traditionally, the term guarantee ordinarily denotes the accessory (or 'conditional' or 'co-extensive') type of security, and as a rule of construction, guarantees were presumed to be co-extensive with the underlying relationship. The term 'suretyship', which unequivocally denotes the accessory type, appears to have become obsolete and is, at

4 See further ch. 12.1.2, ch. 8.2, paragraphs 8-2/3 and ch. 12.3, paras. 12-16 and 12-17/21.

5 See further paras. 1-3 and 1-4.

any rate, used infrequently. At present, the notion of guarantee in English law has possibly a neutral meaning while the specific nature of the security is to be gathered from the specific terms and conditions of each individual instrument. The term 'letter of credit' to describe an independent guarantee is also found. In many other countries and regions, a clear distinction in concept and terminology is still lacking.

As a result of the prevailing uncertainty, several other terms are used which express or purport to express independence. Thus, in English and American legal language, the obligation of the independent guarantor is often described as 'primary' as opposed to the 'secondary' obligation of the surety. The term 'autonomous' is also often used. Other adjectives which purport to express independence are 'irrevocable', 'abstract' or 'unconditional', or the instrument may state that the guarantor pays the debt as his own debt. All these terms and phrases are rather confusing, and they are often inadequate.[6] Moreover, it is a misconception to assert categorically or assume that independent guarantees are always payable on demand without any evidence of default. Although this is indeed the prevailing type of independent guarantee, there are other payment mechanisms, such as payment upon the submission of third-party documents or a court or arbitral decision.[7]

This study avoids the term 'bond'. It has no defined meaning in law, and it may refer to any kind of financial undertaking. The term 'performance bond' is especially precarious. In the United States, Canada and England, performance bonds (also called 'surety bonds') are typically issued by specialised insurance and bonding companies, in connection with construction contracts. They assure the employer that in the event of default by the construction firm, the project will be completed, for example by another contractor, or that the employer will receive financial compensation. These performance bonds are a hybrid form of security, and they cannot be circumscribed in terms of independence or co-extensiveness. They are never payable on mere demand by the beneficiary, and they always require (some) evidence of default, while the degree of (non-)co-extensiveness and (non-)likeness with the contract of suretyship entirely depends on the terms and conditions of the bond.[8] The rights and obligations of both parties are contained in instruments which tend to be rather lengthy and detailed, and which are, because of their archaic eighteenth-century English language, difficult to comprehend.[9]

6 Rule 1.10(a) ISP98, therefore, dissuades the use of terms such as 'unconditional', 'abstract', 'absolute' and 'primary'. English case law does not attribute any particular significance to these phrases either way, see ch. 12.3, para. 12-21.

7 See ch. 4.

8 See Dolan, § 1.05, for the differences between performance bonds and standby letters of credit/independent guarantees.

9 See *Trafalgar House Construction (Regions) Ltd v. General Surety and Guarantee Co. Ltd.*, [1995] 3 All ER 737. See further Andrews/Millet, no. 16-004, discussing other English case law involving bonds with obscure language. The Association of British

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3.2 TENDER GUARANTEES

3-2 Construction contracts and major contracts for the supply of capital goods are often, especially in the public sector, awarded through tender procedures. The conditions or regulations governing the invitation for tenders invariably require bidders to furnish a tender guarantee (or bid bond or guarantee for preliminary deposit) for a certain percentage, which ordinarily ranges from 1% to 5% of the project value. The tender documentation sometimes fixes the text of the guarantee and the guarantee format, i.e., a direct or indirect guarantee. Tender guarantees are typically payable on first demand.

The purpose of a tender guarantee is to ensure that the bidder does not withdraw or alter his tender before adjudication, and that he will accept and sign the contract if and when awarded to him. The tender regulations regularly require bidders also to furnish a performance guarantee within a certain period after adjudication to the successful bidder.[1] It is not unusual to require that the tender must be accompanied by a letter of commitment or a binding letter of intent to this effect from a bank. The employer or buyer/beneficiary is entitled to call the tender guarantee when the bidder fails to fulfil said obligations stemming from his submitting a tender.[2] Payment serves as compensation for the loss of time and expenditure incurred as a result of the employer having to re-examine the tenders submitted by other contractors. In a broader sense, requirements in respect of tender guarantees and letters of commitment are aimed at ensuring that only serious, reputable and financially sound contractors respond to the invitation for tenders, which greatly facilitates the procedures and evaluation of the various bids.

Tender guarantees usually contain a fixed expiry date which corresponds with the expected date of adjudication. However, the guarantee or the rules for submitting tenders may allow the beneficiary to have the validity period extended, or they may provide for a 'extend or withdraw' mechanism.[3] Extensions of the validity period are a constant cause of concern, and bidders should provide for this contingency in their tender, especially in respect of the computation and indexation of the contract value. It is noted that tenders which are stated to be valid for a limited period of time are often unacceptable.

By their nature, tender guarantees cease to be capable of fulfilling their function, and they cannot be called once the contract has been awarded to another bidder.

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1 In the Middle East, tender guarantees are often referred to as the 'initial' guarantee and performance guarantees as the 'final' guarantee.

2 *Cf. Paris, 13 December 1984*, D. 1985 I.R. p. 239, upheld by *Cass., 10 March 1987*, D. 1987 Somm. p. 172, von Westphalen, p. 12, in respect of the beneficiary's right to call the tender guarantee when the bidder fails to furnish the required performance guarantee.

3 See further ch. 12.4.3, para. 12-42.

Tender guarantees sometimes state explicitly that they must be returned to the unsuccessful bidder.

In Europe, tender guarantees are often replaced by a letter of commitment or a binding letter of intent only. In such an instrument, the bank irrevocably undertakes to issue a performance guarantee in accordance with the requirements as stated in the tender documentation if and when the employer awards the contract to the contractor. These letters provide the same degree of protection to the employer as a tender guarantee, because upon adjudication of the contract to the contractor the bank must and will issue the performance guarantee which can be called by the employer at once, if the contractor fails to sign the contract or does not complete the contract. The advantage for the contractor is that the costs may be reduced, but the disadvantage is that the maximum amount of the performance guarantee tends to be higher than that of a tender guarantee.

3.3 PERFORMANCE GUARANTEES

3-3 Apart from judicial guarantees (see paragraph 3-9), performance guarantees are the type used most frequently. They can be characterised as the counterpart of a documentary credit. A documentary credit assures payment in anticipation of proper performance by the seller, as evidenced by the tender of the documents specified in the credit. In contrast, a performance guarantee assures payment to the buyer or employer in the event that the seller or contractor has not, not timely, not completely or not properly fulfilled his obligations from the underlying contract. As a matter of fact, many contracts for sale provide for the issuance of two security instruments: a documentary credit in favour of the seller and a performance guarantee in favour of the buyer.

The percentage of the contract value covered by the guarantee, as expressed in the maximum amount, varies. It usually ranges from 5% to 10% or 15%, but this could be higher depending on the payments made by the beneficiary to the applicant pursuant to the underlying contract. In most situations, a buyer could obtain the same benefits as those accruing from a first demand guarantee by withholding part of the contract price as security for proper performance. However, as sellers usually prefer to receive the full contract price at once, this security can be replaced by a performance guarantee. This underscores that performance guarantees could also operate as financing instruments. If, especially in relation to construction contracts, the applicant (contractor) is assured of payment as the performance of the contract progresses, the maximum amount of the performance guarantee may also increase. Cases have been known whereby the maximum amount of the guarantee increases with an amount equal to the sums paid by the beneficiary in accordance with the underlying contract.

The text of performance guarantees nearly always describes the object of the guarantee in general wording, namely cover by means of compensation in the event

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CHAPTER 6
PARTIES TO THE UNDERLYING RELATIONSHIP

6.1 ALLOCATION OF RISKS

6.1.1 From the viewpoint of the beneficiary

6-1 The independent guarantee, as a contract between bank and beneficiary, is a product of the underlying relationship. When parties to the underlying relationship agree that a guarantee will be furnished, they agree to a certain allocation of risks with respect to the realisation of claims concerning breach of contract. The way this allocation operates can best be illustrated by contrasting the situation where no guarantee has been furnished with the situation where a guarantee has been issued.

Take a contract for the supply of machinery between a seller, located in Continent X, and a buyer, located in Continent Y, providing for full payment through a documentary credit. Upon tender of the documents, the seller receives full payment from the bank, but for the buyer's account. Should the buyer find the machinery defective, he will then face some formidable obstacles on his way to obtaining proper compensation. If the seller disputes the claim, the buyer will be forced to embark on a protracted, costly and particularly uncertain expedition. First, there is judgment risk. The claimant/buyer may lose the case on some procedural issues or because he is unable to prove his claim to the court's satisfaction or because the court takes a different view as regards the merits of the case. Proceedings might have to take place in the defendant/seller's country, and the buyer may find that the administration of justice there is slow, inadequate and malfunctioning, or that the local courts are not free from bias, especially when government agencies or state-controlled companies are concerned. Should the final judgment eventually be given in his favour, he then faces execution risk. If the judgment has been obtained in a jurisdiction where the seller has no assets, there is a considerable risk that the judgment is not enforceable in a country where the seller does have assets. He may have to start all over again. There could also be exchange control regulations which prevent the transfer of money to the buyer's country, and worse, the seller may have become insolvent in the meantime.

Apart from judgment and execution risks, there are some other factors that render the position of the claimant most precarious. The costs of litigation tend to be huge. They have to be advanced, and even if all other hurdles described above are overcome, experience shows that only a fraction of these costs are compensated. In the face of all these risks, obstacles and uncertainties, the buyer may well decide to abandon legal action and cut his losses. Under favourable conditions, he might

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discussed in Chapter 11.3.3, paragraph 11-27. Moreover, the guarantee may also contain an extension clause, see paragraph 8-13.

8.5.2 Expiry date – calendar date, expiry event, or a combination

8-12 The inclusion of an expiry date in the guarantee is the rule, the absence thereof being a real exception. There are three basic methods for formulating the expiry date, which can also be found in the definition of the term 'expiry' in Article 2 URDG and Article 12 UNCITRAL Convention.[19]

First, the most common technique is the mention of a calendar date. This provides the greatest clarity and certainty for all parties concerned. The expiry date will be attuned to the contractually fixed or projected period for performance of the secured contract or tender period plus an additional period of a number of months, which may vary from three to twelve months depending on the nature of the underlying relationship. Guarantees sometimes state that they are valid 'for X months after issuance'. This variant affords less certainty than does the mention of a calendar date. It could result in unnecessary disagreements as to the precise date of commencement and termination.

Second, the expiry of the guarantee can also be expressed in terms of a certain event which is linked to the underlying relationship. For instance, a tender guarantee could state that it is valid until final award of the contract by the beneficiary/employer plus X months. A warranty, maintenance or retention guarantee could refer to the warranty or maintenance period of the underlying contract (plus X months). Linkage to completion of the principal contract plus X months can regularly be found in performance guarantees where the performance of the contract will take a considerable length of time and where the final date of completion is difficult to project, as is the case in major construction projects. Linkage to the secured contract also occurs frequently in respect of long-term leases. On account of the absence of a fixed calendar date, this second method is apt to give rise to disagreements between all parties concerned as to whether or not the underlying relationship – and with it the guarantee – has terminated. The obvious solution to these difficulties is to turn the expiry event into a documentary event. Thus, a performance guarantee may provide, for example, that 'it ceases to be in force one month after completion as evidenced by the beneficiary's protocol of (provisional) acceptance', or 'it expires one month after completion as evidenced by a written statement from … (e.g., an independent surveyor) to the effect that the equipment has been delivered and installed in accordance with the contract'. Since the bank may not be aware of the release of such documents, it is advisable that the guarantee states that the expiry event clause only

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19 The ISP98 does not have a specific provision in this respect, but it clearly allows for all three methods provided that, in the event of an expiry event, it is in a documentary form, see also ISP98 Commentary on Rule 9.01.

becomes operative as far as the bank is concerned if and when the relevant documents have been presented to the bank. It will ordinarily be the applicant who submits this kind of document.

A third method, which remedies the possible drawbacks of the two previous ones, consists of a combination of the two. Thus, a performance guarantee may provide that 'it terminates X months after completion of the main contract as evidenced by …, but not later than, for example, 10 January 2015, whichever is the earlier', cf. the definition of 'expiry' in Article 2 URDG.

Most guarantees expressly state that calls must be made on or before expiry, and that they become null and void or cease to have any effect upon expiry, pursuant to the terms of the guarantee. Such clauses are intended to clearly dispel any notion that the beneficiary could lodge a valid claim under the guarantee after the expiry date if the default of the principal debtor has occurred within the validity period, as may be the case with a traditional suretyship.

Guarantees regularly expressly state that the request for payment must have been 'received by us (the bank)' on or before expiry. The 'received by us' phrase avoids the problem of whether the date of despatch or the date of receipt of the call is to apply as a yardstick, since this question is answered differently by the laws of various countries. It is also advisable that the guarantee states the hour of the day on the expiry date on or before which the demand must have been received. A mere reference to 'banking hours' is inappropriate as it will often be unclear for the beneficiary what these are in the bank's country.[20]

Some guarantees distinguish between, or at least refer to, two dates: the expiry date and the last date for claim, which is, for example, two weeks or three months later.[21] Whatever the underlying motives for such a dual system may be,[22] the second date is the effective date.[23]

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20 See ch. 13.2.2, para. 13-22, for the ensuing problems if the expiry provision lacks the specifications mentioned in this paragraph.

21 This can be found in guarantees issued in, for example, Greece, Indonesia, Asia, the Indian Sub-Continent and the Middle East.

22 There are some indications that the system originates from the local law on suretyship. Another explanation is that the first date tallies with the last date for lodging complaints and claims under the terms of the secured contract whilst the second effective date mentioned in the guarantee allows the beneficiary thereof a further period for calling under the guarantee.

23 This system is sometimes referred to as a 'grace' period, but this term has also another meaning, see para. 8-20.

great caution, as the bank in the case of *Trib.com. Versailles, 17 September 1981* had to find out.[43] Such a request was made by a French exporter to his regional branch office, which transmitted the request to the central department of the bank which, in its turn, requested a Dutch bank in the beneficiary's country to issue a first demand guarantee covering repayment of the advance payment. The underlying contract stated that the guarantee was to cease to have any effect once the exporter had carried out work in excess of the advance payment. Somewhere along the line, this clause was mislaid and did not reach the Dutch bank. The Dutch bank proceeded to pay upon the demand of the beneficiary, while the restrictive condition had been fulfilled. The court held that the French bank had failed to carry out the instructions, and that accordingly the exporter/applicant was excused from reimbursing the bank.

The problem with instructions of this kind is that they cannot be considered ambiguous or incomplete, but they are certainly apt to give rise to errors. Banks are well-advised to insist that the applicant himself should specify all terms and conditions in a straightforward manner without blanket references to other documents. If the bank does not object to instructions of this kind, it may be deemed to have accepted the attendant risks. This might have been the rationale underlying the court's decision.

Speediness as regards the dispatch of the guarantee could be of importance to the applicant in view of the stipulated time of issuance in the underlying contract, but if that should entail summary and deficient instructions, e.g., by telephone, or if the applicant urges the bank just to go ahead, as often happens, he will be estopped from asserting that the bank has neglected its responsibilities as outlined above. Moreover, as long as the bank puts a reasonable interpretation on imprecise instructions when transposing these into the guarantee or if the bank fails to detect ambiguities in the conditions of payment in situations other than those described above, the risk thereof remains with the applicant. In the case of *OLG Celle, 18 March 2009*, the applicant had (initially) requested the bank to issue a traditional suretyship whereupon the bank contacted the applicant by telephone indicating that it would only be prepared to issue an independent guarantee, and then forwarded a copy of the text of the guarantee to the applicant. The Court of Appeal held that the bank had sufficiently informed the applicant of the course of action, and that it was for the applicant to make further enquiries if there was any remaining uncertainty.[44]

It is a sensible practice for banks to forward the text of the guarantee to the applicant prior to its issuance. This will avoid disagreement between applicant and bank regarding the contents of the guarantee, which would otherwise only become

[43] D. 1982, I.R. p. 496.

[44] WM 2009, p. 1408.

apparent at the time of a call by the beneficiary.[45] However, pressure of time does not always allow for this practice.

10.7.5 Advice to the applicant

10-16 Banks regularly draw the customer's attention to the differences between the traditional accessory guarantee and the independent (first demand) guarantee and the attendant risks, as well as to the increased perils surrounding indirect guarantees in relation to certain countries. However, a general legal obligation on the bank to advise and warn its client cannot be said to exist.[46] Nor does the bank owe a general duty to advise its customer how to mitigate the risks, for example by adding protective clauses. A customer who engages in international trade can in general be expected to be aware of these risks or to seek legal advice. Moreover, the applicant can at least be expected to read the text of the guarantee carefully when it has been forwarded by either the beneficiary or the bank, as well as the text of his counter-guarantee in favour of the bank.[47] Another reason for denying such a general duty is the impossibility of defining the extent of it, which then leaves the bank uncertain as to how it is supposed to act. Moreover, advice will often be of little consequence, since the terms and conditions may already have been fixed by the beneficiary, while the applicant, rightly or wrongly, has decided that acceptance is unavoidable in order to win the contract.

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[45] Cf. *Cass. 22 May 1991*, D. 1992 Somm. p. 233; and *Nimes, 27 September 1989*, D. 1990 Somm. p. 200. In both cases, the claim by the applicant, who had given oral instructions, against the bank for not properly carrying out the instructions was rejected.

[46] *Paris, 9 July 1986*, upheld by *Cass., 10 January 1989*, D. 1989 Somm. p. 153; *Cass., 26 January 1993*, D. 1995 Somm. p. 14; *Cass., 3 May 2000*, Droit & Patrimoine, November 2000, p. 98 (no duty to advise where the applicant was a company which was familiar with international trade practices); *OG Austria, 11 September 2007*, 1Ob44/07p, *OLG Celle, 18 March 2009*, WM 2009, p. 1408 (no duty to advise where the applicant was a company which was familiar with international trade practices); Fischer/Schimansky, nr. 85; Staudinger/Horn, No. 326; von Westphalen, pp. 327–328; Zahn/Ehrlich/Haas, 9/81; Dohm, No. 129; Bark, ZIP 1982, p. 415. Contra von Mettenheim, RIW 1981, p. 585 and Nada Nassar Chaoul, Proche-Orient ètudes juridiques 1984/1985, p. 158. See also Beckers, IFLR Oct. 1982, p. 33. In *Brussels, 18 December 1981*, Rev. Banque 1982, pp. 99, 121, it was held that failure to point out the risks and implications did not constitute breach of duty of care, where the bank had mentioned that payment was to be made on first demand without recourse to the statutory provisions of suretyship, while the text of the guarantee was clear.

[47] *Cass., 22 May 1991*, D. 1992 Som. p. 233; *Nimes, 27 September 1989*, D. 1990 Somm. p. 200. In both cases, the text of the guarantee clearly stated that the bank would pay on the beneficiary's first demand regardless of disputes.

beneficiary plus your charges and expenses as determined by you and to indemnify you against any loss or damage whatsoever resulting from issuing your guarantee, notwithstanding any objection and defiance by a third party arising from said obligation', or 'any/and all claims will be paid on first demand despite any contestation between the Principal and Beneficiary or any third party'.[13] In the specimen form of counter-guarantee under the URDG, the counter-guarantee is also part of the instruction for the issuance of a guarantee, and not a separate document or contract.

In addition to the aforementioned hard core provisions, banks in the Middle East and North Africa regularly insist that other clauses be included in the counter-guarantee, and they sometimes prescribe a comprehensive text with detailed provisions. As they are standard texts, it is very difficult to negotiate for changes or modifications. Another reason for this is that in some countries, banks are bound to issue guarantees and to insist on counter-guarantees which conform to local practices and regulations. This is particularly the case if the beneficiary of the primary guarantee is a state agency. Nonetheless, the texts disseminated by the various banks in any particular country often display some differences which it is worthwhile paying attention to. Sometimes the circular letters, instead of specifying the precise text, only state the particulars that have to be included. This permits the instructing bank at least to attempt to draft the counter-guarantee in a fashion which is more satisfactory to it and the applicant. Finally, foreign banks do occasionally, by omitting to raise objections, accept texts which deviate from their standard texts. Accordingly, it could be more profitable just to forward a modified text rather than to attempt to negotiate for modifications.

Sometimes instructing banks merely state that they agree to the counter-guarantee 'as per your usual specimen (as contained in your circular letter of ...)'.

11.2.2 Legal nature and effect of counter-guarantees

11.2.2.1 Introduction. The issue of independence between the primary guarantee and counter-guarantee

11-9 In view of the fact that the majority of guarantees in support of international transactions are furnished in an indirect manner, and as most instructions to the second issuing bank include some kind of counter-guarantee, an appraisal of the legal nature and effect of counter-guarantees is of considerable importance.

[13] These samples have been taken from circular letters from banks in the Middle East, the Indian subcontinent and Latin America. Similar texts can be found in the North African region.

The paramount question regarding counter-guarantees relates to its (in)dependent nature: is the right of the second issuing bank to repayment by the first instructing bank to be defined solely by reference to the terms of the counter-guarantee (independent) or also and in addition by reference to (proof of) fulfilment of the terms of the primary guarantee and/or proper performance by the second issuing bank of its duties deriving from the mandate, notably the duty to adhere to the instructions and the duty of examination in respect of the fulfilment of the terms of payment in the primary guarantee and, if so, in what manner and to what extent? The fundamental purport of this question can be illustrated by the following example. Suppose that, upon the instructions of the first bank, the second bank has issued a guarantee which is payable on demand provided that: (i) the beneficiary submits a statement of default; (ii) the expiry date is 1 May 2014; (iii) the maximum amount of EUR 2 million will be reduced by 50% upon presentation of certain documents by the applicant. The counter-guarantee in favour of the issuing bank provides for payment on first demand without further qualifications. Let us further suppose that the issuing bank has (allegedly) honoured the beneficiary's demand for payment for the full amount of EUR 2 million, although: (i) he did not submit the required statement of default, (ii) he lodged the demand for payment after the expiry date of 1 May 2014, and (iii) the applicant had presented the prescribed documents regarding the reduction clause to the issuing bank in time. The question then is whether or not the issuing bank is entitled forthwith to reimbursement (for the full amount) on the grounds that the counter-guarantee provides for repayment on first demand without further qualifications.

Chapter 11.2.2 aims to give insight into the meaning, effect and limits of the independent nature of counter-guarantees. Paragraph 11-10 describes the view that the counter-guarantee is independent of the primary guarantee, paragraph 11-11 relates to the German view that the counter-guarantee is independent of the mandate, and paragraph 11-12 deals with the established principle that the counter-guarantee is independent of the underlying relationship. Paragraph 11-13 contains a summary and an exposition of the view of this study, while case law is examined in paragraphs 11-14/19, with a summary in paragraph 11-20. Chapter 11.2.2 focuses on counter-guarantees which are payable on demand, as they ordinarily are, because the implications of the principle of independence are greatest in this type. It does not deal with the issue of fraud by the beneficiary, since the central theme of this chapter (11.2.2) concerns the possible impact of the non-performance by the issuing bank of its duty of examination. Fraud by the beneficiary and the possible issuing bank's knowledge thereof is a quite different topic which requires separate discussion.[14] It is only referred to whenever this proved to be unavoidable with a view to legal writing and case law.

[14] See chs. 14, 15 and 16.

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occur when, prior to payment under the counter-guarantee, the issuing bank transmits the documents received under the primary guarantee and the issuing bank or applicant finds that the demand under the primary guarantee was, in fact, not compliant. In such a situation, any issuing bank's statement that it has received a complying demand under the primary guarantee would be false, and the instructing bank may, and in its relationship with the applicant, must refuse payment under the counter-guarantee.[44]

In general, it is for the applicant, not for the instructing bank, to adduce the evidence.[45] Mere allegations or insufficiently persuasive evidence of breach of contract by the issuing bank or evidence which cannot be produced forthwith will not suffice. In these situations, the instructing bank must proceed to payment in accordance with the principle 'pay first, argue later'. It is submitted that the degree of evidence of non-compliance by the issuing bank is the same as required in relation to fraud under the (primary) guarantee.[46] If indeed established, such a breach of contract by the issuing bank does not, however, ordinarily amount to fraud by the issuing bank and it seems, therefore, inappropriate to use that term in this context.[47] This would be different if an issuing bank were to demand payment under the counter-guarantee while it had not received any demand for payment under its own primary guarantee at all. Such a demand would clearly be fraudulent.[48]

It is noted that the non-fulfilment of the terms and conditions of the primary guarantee does not automatically warrant the conclusion that the issuing bank has breached its duty of examination. This is especially true for conditions the (non-) fulfilment of which is difficult to ascertain, such as, for example, expiry events or

also *Cass. 30 March 2010,* D. 2010, p. 2274. See for these cases para. 11-20. Cf. von Westphalen, p. 260–261, 263. On p. 253 and p. 257, this author also opines that a demand for payment under the counter-guarantee presupposes a complying demand for payment under the primary guarantee. See also the UNCITRAL Secretariat's second draft for the Draft UNCITRAL Convention ad Art. 19(2)(e) variant Y, doc. A/CN.9/WG.II/WP.76/ Add.1 of 29 Oct. 1992: 'a demand for payment is improper if: (...) In the case of a counter-guaranty letter, the beneficiary (issuing bank, R.B.) has not received a demand for payment under the guaranty letter issued by it, or the beneficiary has paid upon such a demand although it was obliged [under the law applicable to its guaranty letter] to reject the demand [as lacking *conformity* (italics added, R.B.) or as being improper]'.

44 Cf. Affaki/Goode, ch. 4, nr. 15.14 and nr. 22.8.

45 See ch. 11.3.

46 See ch. 14.4.

47 Unfortunately, the case law discussed in paras 11-16/19 sometimes employs the term 'fraud' or 'abuse' both in situations where the issuing bank is aware of the beneficiary's fraud and in situations where the issuing bank has not properly discharged its duty of examination.

48 Cf. Zahn/Ehrlich/Haas, nr. 9/129. See further ch. 13, para. 13-40; and ch. 16, para. 16-13.

reduction clauses which have not been drafted in a documentary fashion. It could, therefore, happen that in actual fact the expiry event has occurred or the conditions for the reduction clause have been fulfilled, and that the issuing bank, nonetheless, pays the full amount of the guarantee because it has not been provided with the evidence of these occurrences. In situations like these, the issuing bank is not at fault[49] and is, therefore, entitled to repayment in accordance with the terms of the counter-guarantee.

Summary. A counter-guarantee is not a guarantee proper but an indemnity as part of the mandate/instructions specifying the terms of reimbursement by the instructing bank to the issuing bank. In accordance with French case law, German doctrine and several authors from other jurisdictions, the URDG and the UNCITRAL Convention, this study takes the view that a counter-guarantee is an independent (or autonomous) undertaking (or indemnity) which operates in a manner similar to an ordinary independent guarantee. The instructing bank as counter-guarantor must, therefore, pay if the terms and conditions of payment as stated in the counter-guarantee have been fulfilled. (Proof of) proper examination by the issuing bank in respect of compliance with the terms of the primary guarantee, c.q. non-fulfilment of those terms is, in principle, not an issue in this respect if the counter-guarantee provides for payment on first demand. The principle of independence is, however, subject to an exception which is similar to that in the ordinary guarantee: the instructing bank is entitled to, and in its relationship with the applicant, must refuse payment if there is clear and immediately available evidence that the issuing bank did not carry out the instructions or did not properly verify compliance with the terms of the primary guarantee. These aspects are, therefore, not without relevance.

Applying the above principles to the example given in paragraph 11-9, the result would be as follows. When the issuing bank requests reimbursement from the instructing bank and if all conditions of payment specified in the counter-guarantee have been fulfilled, especially the submission, as often required, of a statement that it has received a complying demand under the primary guarantee, the instructing bank must forthwith proceed to payment. The issuing bank does not have to prove proper examination in respect of the three conditions of payment mentioned in the example of paragraph 11-9, and the instructing bank may not insist on such evidence or delay payment until it has been provided with such evidence. However, the principle of independence is subject to an exception if the instructing bank (or rather the applicant) is able to produce forthwith clear evidence that the issuing bank has failed to carry out its obligation of proper examination in respect of the (three) conditions of payment of the primary guarantee. This may be the case when, prior to payment under the counter-guarantee, the issuing bank transmits the documents received under the primary guarantee, and the issuing bank finds that the demand under the primary guarantee was, in fact, not compliant. And further, if no such

49 See ch. 10.8, para. 10-26.

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the guarantee is no longer needed.[166] The request may, however, also be inspired by the improper motive of putting pressure on the applicant to agree to what is effectively an extended warranty period or to works in excess of the contractually agreed works or to exact discounts on further contracts.[167]

Since the request must be made within the period of validity as it exists from time to time, it is advisable for the beneficiary to lodge his request well before the expiry date. Thus, for example, the Saudi Arabian Monetary Agency (SAMA) and the Commercial Bank of Syria recommend beneficiaries to request an extension, if necessary, of one month and at least fifteen days respectively, before expiry.[168]

The request for extension is ordinarily granted, since the bank and, especially, the applicant naturally prefer prolongation to actual payment. It remains, however, a fact that the applicant is virtually forced to agree to an extension. The situation is different in the case of guarantees which require the submission of third-party documents attesting to the applicant's default. If the applicant anticipates that the beneficiary will not be able to meet that particular condition of payment within the current period of validity, he will obviously not wish to have that period extended. The text hereafter focuses on first demand guarantees.

12.4.3.2 Legal position

12-41 When the beneficiary secures an extension by means of an 'extend or pay' request, he is effectively exercising a power inherent in first demand guarantees, not a right. As explained in paragraph 12-40, this does not in itself imply any improper conduct on the part of the beneficiary. Only the particular circumstances and motives may render the request oppressive. It should be noted that a beneficiary asking for

[166] In respect of public works in Algeria and the Middle East, 'extend or pay' requests are routinely and successively made until the beneficiary has approved of the works by signing the Final Acceptance Certificate.

[167] Dohm, No. 142, Horn, IPRax 1981, p. 153, and Stumpf/Ullrich, RIW 1984, p. 843, argue that repeated 'pay or extend' requests are a (clear) indication of fraud. This presumption has rightly been rejected in *LG Köln, 11 December 1981*, WM 1982, p. 438; *OLG Frankfurt a.M., 3 March 1983*, WM 1983, p. 175; *Paris, 1 October 1986*, D. 1987 Somm. p. 171; *Trib.com. Brussels, 23 December 1980*, Rev. Banque 1981, p. 627. See also *LG Braunschweig, 22 May 1980*, RIW 1981, p. 789; *Rb Amsterdam, 7 April 1988*, KG 1988, 181. In several of these decisions, the court opined that in the light of the evidence the requests in fact indicated that the contract had not been fully performed. See also von Westphalen, p. 181, 225.

[168] Pursuant to a circular letter of SAMA, No. 2504/M/A 286, dated 9 June 1969, banks are to remind the beneficiary one month before the expiry date of the forthcoming expiry, thus enabling the beneficiary to decide whether to call the guarantee, or to have the validity period extended, or to allow the guarantee to lapse.

prolongation pursuant to an extension clause might abuse his contractual right just as much.

When a beneficiary lodges an 'extend or pay' request, he is, in the first instance, seeking an extension, not payment, as is apparent from the wording of the request. Nonetheless, it would appear evident that, if no extension has been granted, such a request constitutes a proper demand for payment without the need of a further demand, with the result that the bank is obliged to pay. This proposition has been confirmed in *BGH, 23 January 1996*,[169] *Paris, 9 January 1991*[170] and *CA The Hague, 8 June 1993*,[171] and is also laid down in Article 23(d) URDG and Rule 3.09 ISP98. Yet, in some other cases, the 'extend or pay' request was not viewed as a proper demand for payment where no extension was granted.[172] The startling result of these decisions was that a formal demand for payment after the un-amended expiry date was held to be too late, and that the bank's obligation to pay had lapsed in the meantime. Surely, an 'extend or pay' request should result in either an extension or in payment, and not in a lapse of the period of validity.

The fact that, if extension has been refused, an 'extend or pay' request constitutes a demand for payment, does not necessarily mean that the demand constitutes also a valid and complying demand, such that the bank is obliged to proceed to payment. Article 23 URDG, which deals with 'extend or pay' requests, envisages such requests as part of a 'complying' demand. In conjunction with Article 15(a) URDG, this implies that the beneficiary, when lodging the 'extend or pay' request, must also submit a statement indicating in what respect the applicant is in default. *BGH, 23 January 1996*, also ruled that such a request only constitutes a valid demand for payment, in the event that an extension has not been granted, if all conditions of payment as stated in the guarantee, have been fulfilled as part of the 'extend or pay' demand or, if not, in any event on or prior to the non-extended expiry date.[173] The effect of Rule 3.09 ISP98 is the same. One may question the wisdom of this requirement if the result would be that the beneficiary forfeits his right to payment when he submits these unilateral statements after the non-extended validity period.[174]

[169] WM 1996, p. 393.

[170] D. 1991 Somm. p. 196.

[171] KG 1993, 301. See also *Paris, 22 November 1985*, D. 1986 J. p. 213; von Westphalen, p. 181, 222; Kleiner, No. 21.13; RPDB, No. 132; Mattout, No. 238.

[172] *Esal (Commodities), Reltor v. Oriental Credit*, [1985] 2 Lloyd's Rep. 546; *Paris, 28 May 1985*, D. 1986 I.R. p. 155; *Paris, 2 April 1987*, D. 1988 Somm. p. 248, upheld by *Cass., 24 January 1989*, D. 1989 Somm. p. 159; *Paris, 23 June 1995*, JCP 1995, Éd. E II, No. 735, with critical note by Affaki. These cases involved 'extend or pay' requests relating to the counter-guarantee.

[173] WM 1996, p. 393.

[174] Cf. Vasseur, RDAI 1992, p. 270.

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the secured contract and passage of time. Obviously, the applicant should make every possible effort to urge the beneficiary to release a statement of discharge in respect of the primary guarantee.

Clarifying case law concerning the release of security and/or the unblocking of the credit facilities in the case of an indirect guarantee which remains in force until discharge, does not exist.[231]

12.4.7.5 Indirect guarantees. Counter-guarantee valid until discharge. Release of the duty to pay commission

12-65 It would appear that the bank's interest in retaining the security and/or in blocking the credit lines until discharge by the issuing bank is more powerful than its interest in the continuation of the right to commission. The requirements for a release from that duty should, therefore, be less stringent. Moreover, the interests of both parties can be accommodated by means of a release under reserve: the instructing bank's right to claim charges terminates if a call on the counter-guarantee is not likely to occur anymore, but it revives in the event that the issuing bank still validly calls the counter-guarantee. At present, banks regularly agree to such a release under reserve. It could even be argued that a refusal must be considered unreasonable, but this depends on the particular situation.[232] In *Trib.com. Paris, 6 March 1987*, the court, however, ruled that the instructing bank was entitled to claim charges until a release by the issuing bank.[233]

The foregoing remarks do not apply to charges in respect of the counter-guarantee. If the counter-guarantee states that it remains in force until discharge, the applicant continues to be obliged to reimburse his bank for the commission which that bank has to pay to the foreign issuing bank. The reason is that the instructing bank cannot be expected to resist the issuing bank's demand for payment of charges. An example of this rule is provided in *Trib.com. Toulouse, 26 September 1990*.[234]

In relation to counter-guarantees which remain in force until discharge, it has often been reported that some banks in certain regions tend to delay or withhold discharge because of laxness or just for the sake of continuing to charge commission, even in situations in which a valid call on the primary guarantee can no longer be made or

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[231] But see *Cass., 25 January 2000*, Banque & Droit 2000, p. 44, as an example of a case where the applicant's claim against the instructing bank for the release of the security was dismissed.

[232] Cf. Canaris, No. 1159. See also von Westphalen, p. 372; Zahn/Ehrlich/Haas, 9/90-91.

[233] D. 1988 Somm. p. 249, see para. 12-59.

[234] D. 1993 Somm. p. 97. This decision was particularly awkward for the applicant, since the beneficiary of the indirect guarantee was obliged under the terms of the underlying transaction to return the primary guarantee upon completion of the contract. This aspect was, however, rightly disregarded by the court on account of the principle of independence.

where the applicant has fully performed his obligations without complaints by the beneficiary. This would be a most regrettable practice which would call for initiatives as described in paragraph 12-59. The effect of such efforts is often that, while the foreign issuing bank may still withhold discharge, it does not claim charges any more either.

12.4.7.6 Discharge of applicant's liability

12-66 In the case of a direct guarantee, banks do give discharge to the applicant from liability under his counter-guarantee after the expiry date of the guarantee. In the case of the applicant's counter-guarantee in the context of an indirect guarantee, instructing banks regularly provide a similar discharge after the expiry date of the counter-guarantee. However, in relation to certain issuing banks in certain jurisdictions with an immature system of law and practice, some banks sometimes first seek to obtain a formal statement of discharge from the issuing bank, while emphasising that the counter-guarantee has expired according to its terms. Should the issuing bank fail to respond and desist from claiming charges, then such banks are prepared to give discharge to the applicant on a case-by-case basis or to give discharge under reserve of rights. Banks are ordinarily not prepared to issue a formal statement of discharge to the applicant if the guarantee or counter-guarantee does not contain an expiry date, unless they themselves have been released from liability. In exceptional circumstances, for example where there is merely a theoretical possibility of a call on the primary guarantee or counter-guarantee, banks may be willing to give discharge under reserve of rights.

12.4.8 Termination as a result of payment and reduction clauses. Guarantees without expiry provisions

12-66a Apart from expiry, a guarantee also terminates if no amounts remain payable under the guarantee, cf. Article 25(b)(ii) URDG. This may occur on account of payment of the maximum amount, either as a result of one single payment or following multiple drawings which in aggregate total the maximum amount. A reduction to zero may also be the result of reduction clauses taking effect up to that amount.

Apart from the applicant's interests, banks also object to open-ended guarantees.[235] With this in mind, Article 12(c) UNCITRAL Convention provides that, if the guarantee or standby does not contain an expiry date, it expires six years after its issuance. Pursuant to this provision, the guarantee also lapses if it contains an expiry event, and that event has not materialised within a period of six years after its issuance. Under Article 25(c) URDG, guarantees which do not contain an expiry date

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[235] See ch. 8, para. 8-16.

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13.1.2 Bank's examination with respect to compliance with the terms and conditions of the guarantee. Summary

13-2 When the beneficiary requests payment, he must satisfy the terms and conditions of the guarantee. In its relationship with the beneficiary, the bank is entitled to ascertain compliance and, in its relationship with the applicant, the bank owes a duty to verify compliance and a duty to refuse payment if the terms and conditions have not been met. In case of an indirect guarantee, the issuing bank owes this duty of examination towards the instructing bank on the basis of mandate and towards the applicant on the basis of its general duty of care breach of which constitutes a tort.[1] The general aspects of examination with respect to compliance have been discussed in detail in Chapter 10.8. The key features will be repeated here only briefly.

All terms and conditions have to be complied with. There must always be a demand for payment lodged in the prescribed manner and within the period of validity. Also first demand guarantees can be subject to other terms such as the fulfilment of conditions precedent or advance payments. The guarantee may contain provisions which limit or negate the beneficiary's right to payment, for example reduction clauses or clauses terminating the guarantee upon completion of the secured contract. In this event, it is for the bank and/or applicant, as the case may be, to show that these restrictive conditions have been met.

Undoubtedly, the most outstanding feature of compliance and the ascertainment thereof relates to its *formal* nature. The beneficiary is entitled to payment once the conditions as stated in the guarantee have been met, and he need not establish default of the applicant in any other way than is prescribed by the guarantee. In its turn, the bank is not entitled in its relationship with the beneficiary and owes no duty as regards the applicant to require proof of default. It is not concerned with the rights and liabilities as measured by the underlying relationship, or with disputes between applicant and beneficiary. This aspect is founded on the independent nature of the guarantee.

A third aspect is the rule that the terms and conditions of the guarantee are to be *strictly* complied with. As far as the bank is concerned, there is the further aspect of a certain degree of discretion in appropriate circumstances and reasonable care in deciding whether or not the terms of the guarantee have been met. This is particularly relevant in relation to conditions of payment which, unfortunately, have not been drafted in a documentary manner.

Disputes regarding compliance and proper examination may occur in two sets of circumstances. It is possible that the bank is of the opinion that the conditions have not been fulfilled, triggering off litigation initiated by the beneficiary. It could also be that the applicant takes that view and commences proceedings. He may do this after

1 See ch. 11, para. 11-7.

payment by the bank when the bank has reimbursed itself by debiting his accounts, or before payment in a preventive action, often in conjunction with allegations of fraud. In fact, the majority of litigation concerning compliance is initiated by the applicant.

Specific aspects of compliance with the terms and conditions of the guarantee and the bank's duty of examination are examined throughout this chapter.

13.1.3 Direct and indirect guarantees. Applicable law

13-3 In the absence of provisions to the contrary, guarantees are governed by the law of the country where the issuing bank or the issuing branch of the bank has its place of business. In the case of direct guarantees, this law ordinarily coincides with the law of the applicant's place of business. In the case of indirect guarantees, it nearly always coincides with the law of the beneficiary's place of business. However, the issue of the applicable law is not of great practical significance. There are no indications that the rules of law concerning compliance and examination vary from country to country. Uniformity is also enhanced if the URDG or ISP98 have been made applicable. The issue of applicable law may, however, arise in respect of some ancillary matters, for example interest and damages as well as the requirement of a formal notice of default from the beneficiary in case of non- or late payment by the bank. Uniformity of law in these matters is not essential and can probably not be achieved anyway.

The demand for payment pursuant to a counter-guarantee in favour of the second issuing bank is examined in Chapter 13.3. Most of the aspects discussed in Chapter 13.2 are, however, equally relevant to counter-guarantees.

13.2 Call on the guarantee

13.2.1 The call

13.2.1.1 The guarantee must have been called

13-4 It is evident that the bank is neither to pay, nor to seek reimbursement, if the guarantee has not been called. The applicant is entitled to ask the bank for a copy of the beneficiary's request for payment, cf. Article 22 URDG.

It may happen that the bank solicits a call on the guarantee with a view to serving its own interests, for example when the financial position of the applicant is deteriorating,[2] or when a counter-guarantee is about to expire. In such a situation, the

2 Cf. the case of *Versailles, 29 March 1985*, D. 1986 I.R. p. 156, where the second, issuing bank called the counter-guarantee in view of the liquidation of the applicant, while the

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'Extend or pay' requests made within the validity period of the guarantee constitute a demand for payment when extension has not been granted.[113] In order to be a valid demand, the 'extend or pay' request must, according to Article 23(a) URDG, Rule 3.09 ISP98 and *BGH, 23 January* 1996,[114] comply with all conditions for payment, thus including the submission of a prescribed statement of default by the beneficiary prior to the non-extended expiry date. It has been pointed out that the propriety of this rule might be questioned.[115] Rigid enforcement of the principle of strict compliance in these circumstances may also invite inappropriate delaying tactics on the part of the bank and applicant where, as is often the case, the 'extend or pay' request is made shortly before the expiry date.[116] Nonetheless, as the law stands, beneficiaries are strongly advised to either lodge their 'extend or pay' request well in advance of the expiry date in order to be able to still present the required statements and fulfil all other conditions on time, or to ensure that the request immediately complies with all conditions of payment, including the submission of the statement of default. On the other hand, if the 'extend or pay request' does not also constitute a valid and complying demand, the bank should treat such request as a non-complying demand, and the bank must then notify the beneficiary thereof

payment. In *Trib.com. Lyon*, D. 1990 Somm. p. 206, a demand for payment unless the applicant agreed to modifications in the underlying contract was held to be an invalid call and was in fact considered as fraudulent. In *CA Amsterdam, 20 January 1983*, docket number 62/82 KG, not reported, the Court of Appeal held that a communication whereby the beneficiary requested 'conditional' payment of the outstanding debts without specification of the amount and without the (timely) submission of the required statement of default did not constitute a proper and valid demand.

[113] Ch. 12, para. 12-41.

[114] WM 1996, p. 393.

[115] See ch. 12, para. 12-41.

[116] In the above-mentioned case of *BGH, 23 January 1996*, WM 1996, p. 393, the validity period had been extended several times, lastly until 31 October 1992. The beneficiary made an 'extend or pay' request, without a certain statement, on 15 October 1992, with a reminder on 30 October 1992. Not until 2 November 1992 did the bank inform the beneficiary that it would revert to the matter and as late as 11 November 1992 did the bank reply that the validity period would not be extended. On 15 November 1992, the beneficiary lodged a demand for payment with the required statement. The court's decision that the bank was correct in refusing payment on the ground that a valid call, i.e., with the required statement, had been made after the unamended expiry date, seems rather harsh. This case should be contrasted with *CA Liège, 24 September 1999*, RDC 2000, p. 734, in which the court ruled that the bank could not refuse payment because of certain irregularities in a fourth 'extend or pay' request as it had not objected to three previous requests which suffered from the same defects.

without delay, cf. Article 24(e) URDG, Rule 5.01(a) ISP98, Article 16(2) UNCITRAL Convention.[117]

Mere requests for extension of the guarantee (thus not formulated as an alternative for a demand for payment) may also give rise to precarious situations. It often happens that the beneficiary requests and obtains consent from the issuing bank and/or applicant to an extension of the validity period on a number of occasions, but that, on a subsequent occasion, such consent is not forthcoming at the time of the (current) expiry date and in fact rejected after expiry, with the result that the beneficiary can no longer lodge a valid demand for payment. It is submitted that the mere fact that the bank and/or applicant have agreed to extensions in the past does not by itself give rise to a justified expectation on the part of the beneficiary that the validity period will be extended again, and it does not amount to a tacit consent in this respect.[118] It is also submitted that the bank does not owe a duty to the beneficiary to warn him that extension may be refused, and that the guarantee may expire in the mean time. It is the beneficiary's own responsibility to lodge a proper demand for payment prior to expiry if no response is forthcoming. On the other hand, the bank should pass the request for extension on to the applicant as well as the applicant's response to the beneficiary, in both cases without delay.

In the event of a 'hold for value' request made within the period of validity, the definite demand for cash payment could be made after the expiry date.[119]

It is sometimes not clear from the text of the guarantee whether or not the beneficiary is expected to submit certain statements.[120] Should it eventually be determined that the submission of such documents is indeed a condition of payment and if the bank rejects the demand for payment on this account, it is suggested that the beneficiary is permitted to present these statements after the expiry date, provided that he acts without undue delay after receiving notice of refusal.[121]

[117] See ch. 13.2.11.

[118] *British Arab Commercial Bank Plc v. Bank of Communications, Commercial Bank of Syria*, [2011] EWHC] 281 (Comm), and *BGH, 23 January 1996*, WM 1996, p. 393, show that courts are not readily inclined to find tacit consent. See for these cases also ch. 12, para. 12-41.

[119] *OG Austria, 18 December 1987*, IBL November 1988, p. 92, and see ch. 12, para. 12-48.

[120] See ch. 13, para. 13-13.

[121] If the guarantee is a so-called simple demand guarantee but subject to the URDG, it is suggested that the beneficiary should be allowed to present the statement of default shortly after the expiry date because the requirement concerning such a statement does not appear in the text of the guarantee and will, therefore, come as a surprise, see also para. 13-13, n. 47 and ch. 4.2, para. 4-3a.

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14.3.4.2 Legal writing

14-10 French legal writing is in line with case law as described above.[30] The emphasis is focused on the aspect of evidence,[31] while few attempts have been made to develop a general formula elucidating the notion of fraud.[32]

14.3.5 Belgium

14.3.5.1 Case law

14-11 The rule that a right to payment is to be denied, despite formal compliance with the terms of the guarantee, in the event of fraud or abuse is firmly entrenched in Belgian case law.[33] In a number of cases, the courts have attempted to be more

[30] Prüm, Nos. 429–491, Vasseur, Nos. 119–128, and his annotations to the decisions cited in Chapters 14, 15 and 16 as reported in Dalloz, Cabrillac/Mouly, Nos. 442–446; Stoufflet, JCP 1985 II No. 20436, JCP 1986 II No. 20593, J.D.I. 1987, pp. 277–285; Stoufflet, Garantie Bancaire Internationale, Nos. 55–65; Mattout, No. 254; Rives-Lange, Banque 1986, pp. 711–713; Moatti, Journal des Notaires et des Avocats 1989, pp. 663–672. See for an excellent overview of French and Belgian case law as well as an analysis of the concepts of fraud or abuse: Romain, Fin. Forum/Bank- en Fin. Recht 2002/1, pp. 28–44.

[31] The well-known and often repeated phrase that fraud must 'strike the eye of the beholder' (*crève les yeux*) was coined by Vasseur.

[32] But see Prüm, Nos. 430–483, Romain, cited in the previous footnote, and Stoufflet, JCP 1985 II No. 20436 and JCP 1986 II No. 20593: 'if it is certain and evident that the beneficiary's claim is devoid of any substance'; 'if it is indisputably established that the beneficiary has no right to payment'; 'an intention to inflict harm on the applicant is not necessary'. It is quite likely that the Cour de Cassation, when promulgating its formulas in 1986 and 1987, drew on these statements. Moreover, M. Cabrillac/C. Mouly, Droit des sûretès, Paris, Litec, 1999, nr. 412, pp. 336–337, nr. 429, pp. 346–347 affirm that that the notion of 'fraud' or 'abuse' in respect of first demand guarantees should not be confused with the meaning given to these concepts in the law general.

[33] See, for example, *Trib.com. Brussels, 15 January 1980*, JCB 1980, p. 147; *Trib.com. Brussels, 23 December 1980*, Rev. Banque 1981, p. 627; *Brussels, 18 December 1981*, Rev. Banque 1982, p. 99; *Trib.com. Brussels, 6 April 1982*, Rev. Banque 1982, p. 683; *Trib.com. Brussels, 8 October 1985*, RDC 1986, p. 648; *Trib.com. Brussels, 26 November 1987*, RDC 1989, p. 97; *Trib.com. Brussels, 15 April 1991*, D. 1992 Somm. p. 242; *Trib.com. Brussels, 30 January 1990*, TBH 1992, p. 84; *CA Brussels, 15 December 1992*, RDC 1993, p. 1055; *CA Brussels, 26 June 1992*, RDC 1994, p. 51; *Trib.com. Brussels, 3 September 1993*, RDC 1994, p. 1126 (fraud or abuse does not necessarily imply a fraudulent intent or intent to inflict harm, but encompasses the situation whereby the exercise of the beneficiary's right clearly exceeds the ordinary exercise of a prudent person); *Trib. Com. Verviers, 8 February 1996*, RDC 1997, p. 781 (it must be crystal clear that the beneficiary does not even have 'a semblance of a claim'); *Trib.com. Kortrijk, 21*

specific in respect of the general notions as 'fraud', 'abuse', 'violation of the principle of good faith', 'bad faith' and 'arbitrariness or deceit'. Case law clearly shows that a fraudulent design on the part of the beneficiary is not a prerequisite, that no distinction is made between 'fraud' and 'abuse', and that the abusive or fraudulent nature of the demand is to be determined by reference to the underlying relationship.[34] As regards evidence, the standard of proof is the same as elsewhere: fraud must be clear, manifest or evident, and the evidence must be immediately available.[35]

14.3.5.2 Legal writing

14-12 Belgian authors have taken the same position as case law.[36] In general, they have refrained from attempting to elaborate on the substantive aspects of fraud in order to arrive at a more practicable formula.[37]

October 1996, RW 1996/1997, p. 1447 (fraud must be 'as clear as day' and be proven by immediately available evidence without further investigation); *Trib.com. Brussels, 21 November 1997*, RDC 1998, p. 850 (there is fraud or abuse if there is clear and indisputable evidence, which must be immediately available without extensive investigation, that the beneficiary has no right of payment pursuant to the underlying contract); *Trib.com. Hasselt, 2 October 1998*, TBH 1998, p. 723; *CA Brussels, 2 March 2001*, TBH 2002, p. 494 (fraud must be 'evident, manifest, indisputable and as clear as day'); *Trib. Com. Antwerp, 31 March 1999*, RW 1999–2000, p. 403 (manifest fraud or abuse), *CA Liege, 16 October 2007*, RDC 2009, p. 43 (manifest fraud or abuse).

[34] See the case law cited in the previous footnote. In *Trib.com. Brussels, 26 May 1988*, JT 1988, p. 460, the court described fraud in general as 'intentional disloyal conduct with the purpose of inflicting harm or to secure an advantage' and abuse as 'utilising a right with the sole purpose of inflicting harm or in a manner which clearly exceeds the limits of the normal utilisation of a right by a prudent and diligent person'. When applying these general notions specifically to guarantees, the court merely referred to a situation where the beneficiary has no rights as regards the applicant. This decision provides an excellent illustration of references to evil designs, as are apparent in a few other decisions and legal writings in the various jurisdictions, originating from the general concept of fraud. However, when applied to guarantees, this stringent general notion has clearly been adapted in Belgium and elsewhere to the specific particularities of guarantees. See also Romain, Fin. Forum/Bank- en Fin. Recht 2002/1, nr.10.2-11, 20-21.

[35] See the case law cited above.

[36] See Poullet, thesis Nos. 122–131, 163–170, 219–238, 291–296, 326–338, JCB 1982, pp. 645–662; Simont, Rev. Banque 1983, pp. 595–603; Wymeersch, Hague-Zagreb Colloquium 6, pp. 102–107; TPR, 1986, pp. 494–503; Horn and Wymeersch, pp. 498-500, T'Kint, Nos. 850–852. These articles are mainly a review of Belgian and French case law. See also the comments to some of the decisions cited above and RPDB, Nos. 140-150. See for an excellent overview of French and Belgian case law as well as an analysis of the concepts of fraud or abuse: Romain, Fin. Forum/Bank- en Fin. Recht 2002/1, pp. 28–44.

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fraud results in a cause of action which is limited to the bank forfeiting its right of repayment from the applicant, but the bank cannot be enjoined from proceeding to payment. These decisions are significant because of their more recent date and because they were issued by appellate courts. In view of the criticisms of these decisions,[42] it is still uncertain whether they have finally settled the law to the extent that preventive restraining orders against the bank are impossible. It should also be noted that in none of these cases had the court determined that the beneficiary's fraud had been sufficiently established.

16.3.1.4 The Netherlands

16-6 The possibility of preventive stop-payment orders against the bank in the event that the applicant succeeds in producing clear evidence of the beneficiary's fraud has never been doubted in Dutch case law or legal writing.

While in the past certain authors might possibly have taken the view that, in applications for preventive restraining orders against the bank, the applicant must also demonstrate that the beneficiary's fraud is evident to the bank,[43] the current view is that such evidence is not required in 'before-payment' cases.[44] This approach is in line with Dutch case law. Dutch courts merely refer to the rule that the bank must refrain from payment in the event of established fraud and, then, proceed to examine whether the applicant has indeed succeeded in furnishing clear evidence of the beneficiary's fraud or, in the case of indirect guarantees, clear evidence of the beneficiary's fraud and the second issuing bank's involvement therein. Applications

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p. 1695, although the court in this case recognised the possibility of interlocutory restraining orders against the bank, provided that the beneficiary is joined as co-defendant.

[42] Von Westphalen, pp. 280–282, 288–292; Schwericke and Regel, WM 1991, p. 1753; Lienesch DZWIR 2000, pp. 492, 496–497. See also Mankowski, EwiR 1998, pp. 833–832, and Edelmann, DB, 1998, pp. 2454–2456 (who suggests, as an alternative, that an application for an order restraining the bank from debiting the applicant's account should certainly succeed). In some recent text books, such as Lienesch (1999), Staudinger/Horn (1997) and Horn (2001), the view that restraining orders against the bank are allowed, is still presented as the prevailing one. Moreover, Horn, No. 586, mentions several appellate decisions in the period 1991–1994 (*OLG Frankfurt* a.M., NJW-RR 1991, p. 174; *OLG Frankfurt* a.M., BB 1993, p. 96; *OLG Stuttgart*, NJW-RR 1994, p. 1204) in relation to the traditional suretyship, in which the possibility of restraining orders against the bank was recognised.

[43] Croiset van Uchelen, WPNR 1989, p. 272; Blomkwist, WPNR 1986, p. 552; Bartman, NJB 1987, pp. 1089–1090.

[44] Bertrams, WPNR 1999, pp. 706–711.

for restraining orders against the bank do not turn on the question of whether the beneficiary's fraud is also evident to the (instructing) bank.[45]

16.3.1.5 France and Belgium

16-7 French and Belgian case law, as well as legal writing, recognise the possibility of stop-payment orders against the bank in the event of established fraud. Interestingly, the Court of Appeal in *Brussels, 5 April 1990*, explicitly rejected the arguments levelled against such measures.[46]

As regards the question of whether the beneficiary's fraud or, in the case of indirect guarantees, the beneficiary's fraud and the second issuing bank's involvement therein should be evident to the (instructing) bank, French and Belgian case law follow the same patterns as Dutch case law and that part of German legal writing which allows preventive restraining orders against the bank. In short, evidence of the (instructing) bank's awareness of fraud is not required in 'before-payment' applications for injunctive relief.[47] As a matter of fact, French and Belgian courts do not refer to the cause of action against the bank when hearing applications for restraining orders against the bank. This issue has not attracted attention in French and Belgian legal writing either.

16.3.1.6 United States of America

16-8 The possibility of restraining orders against the bank in the event of established fraud has always been recognised in American case law and legal writing.[48] This is also confirmed in section 5-109(b) of the 1995 Revised Article 5 UCC. Apart from satisfying the criteria for material fraud and the evidence thereof,[49] two additional requirements for injunctive relief must be met. The first requirement for injunctive relief concerns 'irreparable harm' to the applicant, i.e., the injury the applicant would

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[45] Exceptionally, *CA Amsterdam, 4 February 1993*, KG 1993, 113, did, however, refer to the issue of the (instructing) bank's knowledge of fraud, but the Court of Appeal did not need to elaborate on this aspect since there was no established fraud on the part of the beneficiary.

[46] TBH 1992, p. 82. See also Cabrillac/Mouly, No. 444.

[47] In *Trib.com. Brussels, 26 May 1988*, JT 1988, p. 460, the court, when granting a stop-payment order against the instructing bank, did pay attention to this bank's awareness of fraud. However, the court was evidently content with a kind of imputed awareness. *Trib.com. Brussels, 30 January 1990*, TBH 1992, p. 84, is the only other example in which the court alluded to the (instructing) bank's knowledge of fraud as a requirement for a stop payment order against the (instructing) bank.

[48] See extensively Dolan, § 7.04, and Wunnicke/Wunnicke/Turner, § 8.04[C].

[49] See ch. 14.3.7, paras. 14-14/16.

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18.2 Applicable Law

18.2.1 (In)significance of private international law

18-5 Although a huge body of case law deals with guarantees and counter-guarantees containing cross-border elements, private international law as a technique for selecting the applicable law has not played a significant role.[9] In only a very small number of cases did the court touch, albeit perfunctorily, on the issue of applicable law. In none of these cases was it made clear why this issue was broached, as no mention was made of any speculations concerning possible differences between the various national laws. Nor did the fact that the (counter-) guarantee was governed by a particular system of foreign law have any impact on the outcome of the litigation.[10] In those cases where the (counter-) guarantee was evidently governed by foreign law, such as in the case of a choice of law clause or an indirect (primary) guarantee, courts either ignored this fact or referred to the applicability of foreign law, and then proceeded to apply the notions prevailing in the court's own jurisdiction. The predominance of the concepts and rules originating from domestic sources is especially apparent in German, French, Belgian and English case law which contains frequent references to domestic statutory provisions, case law and legal writing. It must be emphasised, however, that the attitude and perceptions of courts, when evidently applying their own notions, can by no means be described as provincial.

The tendency to disregard the issue of private international law is especially manifest in the following cases. In *Attock Cement Co. v. Romanian Bank for Foreign Trade*, the Court of Appeal referred to the oddity of the situation that the issue of the applicable law was only relevant for the purpose of jurisdiction, while it was unlikely that the matter would be raised at the trial.[11] In *Brussels, 25 February 1982*, involving an indirect guarantee issued by an Indian bank in favour of an Indian

9 Cf. Mattout, No. 222.

10 The only exception appears to be *OG Austria, 10 July 1986*, JIBL 1986 N-140, see ch. 16.4.1.2, para. 16-12. In certain situations, the applicable law might be relevant for the purpose of determining jurisdiction.

11 [1989] 1 All ER 1189, see also n. 3. The Court of Appeal also pointed to an affidavit submitted on behalf of the Romanian bank to the effect that Romanian and English law were believed to be the same. A subsequent attempt to preserve the possibility of their being different was discarded as being motivated by tactical reasons only. See also *ICC arbitration* (Geneva), No. 3316 (1979), JDI 1980, p. 970, where the Mexican beneficiary did not object to the application of Belgian law, stating that all countries apply the same rule. The application of Belgian law consisted of a reference to one Belgian article, which in its turn referred to French sources, and of a few statutory provisions of a most general and uninformative nature. In *OLG Hamburg, 4 November 1977*, RIW 1978, p. 615, the Court of Appeal applied German rules of private international law when answering the question of which law would have been applied by an Egyptian Court. It is also worth

beneficiary – which was unquestionably governed by Indian law – the court tersely observed that the selection of Indian or Belgian law was indifferent because they are the same.[12] Similar observations were made in *I.E. Contractors Ltd. v. Lloyds Bank Plc.*, in *CA Leeuwarden, 12 September 1990* and in *CA Liege, 16 October 2007*, where the court applied the law of the forum because there were no indications that the applicable foreign (Iraqi, Egyptian, and Algerian respectively) law was different from the law of the forum.[13] In *Offshore Enterprises v. Nordic Bank PLC*, the guarantee was governed by Indian law, and expert evidence was adduced to the effect that, under Indian law, guarantees can be called after the expiry date. This argument was brushed aside, which reveals that the Court of Appeal, in fact, applied English law, which, for that matter, is the same as the law in most countries.[14]

In conclusion, case law shows that the issue of private international law and the possible applicability of foreign law is of minor significance in matters concerning guarantees and counter-guarantees. This finding tallies with the view of this study that the technique of independent guarantees and counter-guarantees, as well as the relevant rules of law, have developed on a transnational level, away from domestic concepts and traditional structures, and that it is a fallacy to think in terms of significant divergence of national laws. The transnational character of the law of independent guarantees is especially reflected in *CA The Hague, 8 June 1993*, where the Court of Appeal observed that the meaning of an 'extend or pay' request had to be determined in accordance with internationally accepted notions, and that the applicable law of Yemen was assumed to adhere to these notions.[15]

The issue of applicable law is, however, relevant in respect of the (non-) enforceability of expiry dates and, possibly, in respect of some other specific matters, such as interest and damages in the event of late payment, requirements of a formal notice of default, formation of the contract of guarantee, the place of payment, set-off, assignment and pledge, limitation of actions and the bank's duty of notification before payment.

noting that German legal writing frequently refers to German statutory provisions in relation to indirect guarantees, which are governed by foreign law.

12 JCB 1982, p. 349.

13 [1990] 2 Lloyd's Rep. 496; KG 1990, 316, r.o. 5 which is not published in the KG reports, RDC 2009, p. 43.

14 IBL November 1984, p. 86. See ch. 12.4.5 for the (non-)enforceability of expiry dates.

15 KG 1993, 301. See also *CA Zürich, 9 May 1985*, D. 1987, Somm. p. 177, which referred to the supranational '*lex mercatoria*' and Staudinger/Horn, No. 305, who refers to the diminishing importance of the applicable law because of the increasing transnational uniform law.