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INTRODUCTION

"Dietro ogni impresa di successo c'è qualcuno che ha preso una decisione coraggiosa"

Peter Druker

Doing business means taking brave choices every moment, believe in them and push forward. This is what businessmen and companies do day by day. They try to fight in a jungle made of competitors, laws and new technologies. No one can survive without the right skills and abilities in the today world ever faster and ever more complex. But, it is not right to think that traders are alone dealing with these elements; in fact, a good organization, a detailed planning and some well-known procedures are fundamental to contribute to the business growth but, sometimes, an external assistance is necessary.

Starting from this point, it is important to focus on international sales as the intricate mechanism of trade in which businessmen and companies are involved at international level to sell goods to a wide range of customers out of national borders. The explanation of why companies must trade at international level seems superfluous; nowadays, the trade is pushed by globalization and market development that oblige traders to be open to objectives and achievements out of national territory. But, be international involves a broad gamma of possibilities as well as a wide range of risks that bring traders to look for security instruments able to safeguard their businesses. So here, it is explain the role of bank guarantees as a tool able to provide the requested and needed security.

In particular, the so-called independent guarantee is a relatively new type of guarantee that comes from the American usage of standby letter of credit and from a development of the older suretyship.

The scope of the thesis is that of provide an extensive knowledge about these instruments of protection for businesses and focusing, in particular, on independent guarantee as a bank guarantee's evolution based on its peculiarities and characteristics capable to be distinguished from the other typologies unable to provide the same level of assurance. A large part describes the international organizations that try to manage the questions related to bank guarantees; try to set the rules to solve disputes, for a good drafting of the guarantee's contract and to settle down events of fraud. A special attention is given to the Italian panorama considering the evolution of law and the controversial and difficult acknowledgment of these new forms of guarantees.

After this brief introduction, it can be described the structure of the thesis that involves in every part references to national and international case law supported by the words of international authors and legal scholars.

The first chapter provides an introduction on those fundamental themes necessary to explicate the nature of a bank guarantee until its drafting and issuance. For this reason, the chapter is focused on the guarantee's provider: bank. After a bank's overview about its social and economic role, it is described the function of bank within international trade as "support for business". Another subparagraph is about the potential risks faced by traders at international level that are the main reason of guarantee's creation. Then, the "interest of parties" explains the subjects involved and the related intentions with a focus of those of bank that acts only as an intermediary and guarantor between the two main parties: account party and beneficiary.

The second chapter is a wide overview over the legal instruments necessary to manage the international sales and the same bank guarantees. The first paragraph outlines the supranational organizations that operate with the aim to assure an easier international trade defining rules and standard procedures for every kind of trader. Below, carrying on with the private international law as the set of rules provided to solve dispute between parties placed in different countries. In particular, private international law represents an instrument useful to determine the applicable law and jurisdiction when disputes under private contracts arise. The last paragraph is oriented to bank guarantees and presents the main four international applicable laws specifically drafted to provide consistency to every parts of the contract of guarantee.

The next chapter is totally focused over the Italian scenery. A substantial part encloses the discussion about the acceptance of this new form of guarantee by the Italian law and its definitive acknowledgment passing through the matter of its separation (autonomy) from the underlying contract and the question of its legitimacy. Another part concerns the potential exceptions available that account party (the weaker party of the contract) can arise to avoid a fraudulent behavior from the beneficiary and the preliminary protections that can be used to stop the beneficiary's enforcement. The last part includes a short introduction that brings to light the evolution of Italian law occurred in these years about private international law and bank guarantees as well an Italian overview about applicable law and jurisdiction and, finally, a description of performance bond that is a particular form of bank guarantee specially utilized in the building industry.

Lastly, the chapter four resumes fraud explaining its role within bank guarantees and its functioning involving, in particular, the beneficiary. It argues the problem of identify the standard of proof of fraud and its connection with the underlying contract. After, it is more deeply listed and explain by international case law the types of different fraud or events through which a fraud arises. A following paragraph considers the role of bank in case of fraud as reviewing body with the duty to identify the fraud and consequently stop payment due to the beneficiary. The last part outlines the applicable law in case of fraud and court's judgments about its existence, account party's protection and the stoppage of beneficiary's payment.

The core of the thesis is to show the importance of bank guarantees at international level where trade and the economic development are the lifeblood of every country, focalizing on the security provides by these types of guarantees and the role of the principal parties involved: banks and traders.

Chapter 1

ROLE OF BANK IN INTERNATIONAL SALES

1.1 BANK BETWEEN THE NEEDS OF BUSINESSES AND THEIR PROTECTION

1.1.1 Bank: purpose, services and its economic entity

Banks have come a long way from the temples of the ancient world, but their basic business practices have not changed. Although history has altered the structure of the business model, a bank's purpose is to make loans and protect depositors' money. In doing so, banks have become a system that brings together savers and borrowers. Even if the future takes banks completely off your street corner and onto the internet or to do shopping for loans across the globe, the banks will still exist to perform this primary function. In fact, banks perform their activity within the credit sector with a brokerage role between who has funds to keep and manage and who has investments to do. Also, banks played an important role in providing their customers with payment services to facilitate trade. In one word this is called “”banking” that is regulated through a national law. For example Italian law provides a “Consolidated Act of the banking” called the TUB (Decreto Legislativo 1° settembre 1993, n. 385)[1] that within its art. 10 “Attività bancaria” explains the meaning of banking as:

1. *La raccolta di risparmio tra il pubblico e l'esercizio del credito costituisce l'attività bancaria. Essa ha carattere d'impresa.*
2. *L'esercizio dell'attività bancaria è riservato alle banche.*
3. *Le banche esercitano, oltre all'attività bancaria, ogni altra attività finanziaria, secondo la disciplina propria di ciascuna, nonché attività connesse o strumentali. Sono salve le riserve di attività previste dalla legge.*

Over time, this set of services became more and more diversified, from checks to bank transfers or from debit cards to credit cards to digital wallets. With multiple means of access

[1] Banca d’Italia, (February 2016) “*Testo unico delle leggi in materia bancaria e creditizia*” . Updated version to the Decreto Legislativo 16 novembre 2015, n. 180. Available at: https://www.bancaditalia.it/compiti/vigilanza/intermediari/TUB_febbraio_2016.pdf [date of access: 05/10/2015]

to stored wealth, consumers are able to make purchases more often and in more places. This allows businesses to employ more land, labor and capital which in turn results in a fully employed economy.

Considering this historical evolution, banks traditionally are assumed different forms focusing on: specific sectors of operations, the client served or the products offered. For instance, considering the *ownership,* they are divided in public, private and cooperative; there are banks structured by *function*: commercial, industrial, agricultural, foreign, saving and central; or by *structure:* unit, branch, group and correspondent.

Furthermore in the recent decades, the line between these different typologies of banks wasn't so well defined because the conceptualization of the banking business that has radically changed. The largest banks in many countries have transformed themselves into multiproduct financial service conglomerates with offerings including retail banking, asset management, brokerage, insurance and investment banking. In the light of these considerations, the bank can be defined as a *financial intermediary* that means acting as a financial go-between: taking in deposits from those who save and making loans with those deposits to qualified borrowers. Beyond this basic role, the evolution within the banking system leads the banks to become a mean of economic development and to act as a community's economic engine.

Nevertheless, bank is also a so-called "*corporate entity". I*t is formed by shareholders and it is governed by a board of directors elected by shareholders to protect their interests, who are ultimately responsible for the conduct of the bank's affairs.

These two faces of the same medal, such as viewing bank as provider of services and as a business, identify an organization that is structured to fulfill economic and profit objectives but doing so dealing with a wide range of customers with different types of needs. The pursuit of these objectives leads to a more complex structure able to exercise several functions. A m*onetary function* is the creation of money used by financial operators in international exchange. The bank money includes check, credit cards, bank transfer, etc..; a c*redit function* that comes from the brokerage activity performed by bank able to harvest credit under the form of saving and deliver it to people who need it. *Investment functions,* such as the consequence of large investments made by banks as institutional investors, whose finance the economy. An indirect function is the *transmission of the economic policy of the government*. Even if, at secondary level, it is an important function performs unawares by banking system because it represents the link between the monetary policy and population. Another indirect

function is the *investigative cooperation* against money recycling, banks had been obliged to assume an important role in the emersion process of subjects and operations considered suspicious.

The *Supply of services function* is very important because it's the function directly addressed to the customers. Bank has combined the traditional activity of credit brokerage with the supply of services that represent an important contribution for the development of the economic system. The services supplied by bank are divided in: monetary, safekeeping, advice and financial.

A service is defined in overall sense as *an intangible product such as accounting, banking, cleaning, consultancy, education, insurance, expertise, medical treatment, or transportation*[2].

The peculiarity of the service is that no transfer of possession or ownership takes place when services are sold and they cannot be stored or transported as happen with goods, they are instantly perishable and come into existence at the time they are bought and consumed; In our contest, bank services are those provided by bank.

As well the Italian TUB defines, in an overall sense, bank services as "payment services"[3] as those provided by different entities among which banks and, afterwards, it outlines the "*exercisable ancillary activities*"[4] indicating that "*Gli istituti di pagamento possono esercitare le seguenti attività accessorie alla prestazione di servizi di pagamento: a) concedere crediti in stretta relazione ai servizi di pagamento prestati e nei limiti e con le modalità stabilite dalla Banca d'Italia; b) prestare servizi operativi o strettamente connessi, come la prestazione di garanzie per l'esecuzione di operazioni di pagamento, servizi di cambio, attività di custodia e registrazione e trattamento di dati; c) gestire sistemi di pagamento…*".

Despite the matter of banks' categorization, each bank must be able to offer a wide range of services to fulfill the needs of their customers, especially the newest ones; and to compete with competitors that, nowadays, are represented by, not only banks, but even non-financial providers becoming more clever in providing services that are cheaper and easier than those provided by banks.

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[2] http://www.businessdictionary.com/definition/services.html

[3] Art. 114-sexies "Servizi di pagamento" TUB.

[4] Art. 114-octies "Attività accessorie esercitabili" TUB.

Indeed, because of this reason, an enhancement and improvement of bank services has been necessary and it has been, in particular, driven by several improvements. Improvement of technology that allows offering services that would have been too much complex and expensive in the past. Secondly, by an enhancement of customers' needs: they start to ask more services to combine with their bank account; and driven by financial innovation explains through the appearance of new financial firms able to offer alternative services than those offered by banks.

It is possible to divide bank services in three main categories:

Complementary: used in union with the management of the bank account. In exchange of a monthly fee, the bank provides different services, with the main scope of improve the performance of the bank in favor of clients. Types of services are: bank transfer, check, credit card, etc…

Traditional: they are the typical services provided by banks and available in all the physical offices as safety deposit boxes, various payment services available at every bank office.

Innovative: these are particular services of which clients can benefit. They represent an advantage for bank whether it decides to offer them since they are accessorial services, such as financial advice and brokerage. This category includes the new services offered by bank directly or through other providers.

Every typology of bank service is targeted for a specific type of client. For example, there are bank services for person, business or family. In fact, it's possible to consider set of services focused on the needs of particular customers: payment services (issuance of checks, credit cards, remote banking, etc…); Proceeds services (commissions, fees); financial services (leasing and factoring); Keeping services (safe-deposit boxes); other services (trade solutions, insurance, accounting and data processing).

Of course, banks are "economic entities": they need to make profit; thus, each bank works and develops its services with the aim to offer them to its customers to obtain something in exchange. As aforementioned, banks work as any other business: banks profit by earning more money than what they pay in expenses. This concept is recovered in the Italian "Testo unico bancario" in which at the Art. 10 (2) is stated, within the definition of banking, as bank acts as any other type of business entity: "*Essa ha carattere d'impresa"*. This paragraph

underlines how bank operates at the same level and under the same purpose of any other type of firm.

The bank's profit is strictly connected with the *pricing mechanism* used by bank to define the price of its services. It depends on client relationship and on the nature of the transaction. The pricing can be derived from profiling customers into different segments.

The large corporate segment comprises the highest amount of value transactions and it is characterized by multiple service relationships. The pricing policy in this segment depends on the size of the transactions and on the banks' relationship with the corporate. Hence, the pricing is decided on a one to one basis and the pricing is public.

The other segments comprise the brokers, small and medium enterprises (SME), other banks and the retail segment. In each of these cases, the pricing is not made public (except in the retail segment) and is determined on the basis of the nature of the transaction and the banks' relationship with the client, on a one to one basis. Typically, high volumes and low value characterize the SME segment. Therefore the pricing for this segment differs from that of the large corporates. Similarly the pricing for the banks is very different.

In particular to providing services bank obtains two main advantages:

1. **Direct**: these services are upon payment and then represent an income for bank and it leads to enhance profitability and financial stability of bank.
2. **Indirect**: reinforce the image of the bank and improve the financial loyalty of customers.

The supply of these services influences the bank's income. The major portion of a bank's profit comes from the fees that it charges for its services and the interests that it earns on its assets. Fee-based income constitutes a major portion of a bank's other income. The ratio of other income to total income is an indicator of the size of fee-based income. The non-fund based income comprises of revenues from both financial commitment and services rendered. Financial commitment includes our core issue: guarantees, letters of credit and banker's acceptances etc.

Each bank chooses procedures and costs for each service. The cost of complementary bank services are including in the monthly or annually fee already paid for the bank account. About the other services, costs depend of the needs of the client.

In this bulk of services provided by bank, a wide range is focused on the needs of businesses which constitute a big part of the bank's income. Doing business concerns the challenge of deal with a wide range of other: firms, laws and markets not always known. Instead, often businesses are not completely aware about what they are going to face or do. For this reason, companies must be very careful in every aspects of their job and, why not, considering the possibility to ask for support to those organizations able to perform it. This is the reason why a relationship between bank, as provider of services and business support, and business comes into existence very often.

1.1.2 International trade

"International trade has been an engine for global growth for the last several decades. It has a real impact on the day-to-day lives of people and businesses in Europe and around the world".[5]

The WHO (World Health Organization) in its web site describes briefly but exhaustively the "globalization phenomenon" as:

"*Globalization, or the increased interconnectedness and interdependence of peoples and countries, is generally understood to include two interrelated elements: the opening of borders to increasingly fast flows of goods, services, finance, people and ideas across international borders; and the changes in institutional and policy regimes at the international and national levels that facilitate or promote such flows. It is recognized that globalization has both positive and negative impacts on development".*[6]

At economic point of view, it is becoming today a changing process able to influence all the rules of the economy and those of the competitiveness leading firms to adopt an international overview. Countries trade with each other when, on their own, they do not have the resources or capacity to satisfy their own needs and wants. Likewise each company seeks abroad suppliers and customers to improve their performance, to smooth their income over the year, to look for new resources and products. Goods and services are likely to be imported from

[5] The European Commission's "International Trade" definition. Available at: http://ec.europa.eu/economy_finance/international/globalisation/international_trade/index_en.htm [date of access: 11/11/2015]

[6] Detailed in WHO (web site), *Globalization.* Available at: http://www.who.int/trade/glossary/story043/en/ [date of access: 21/05/2016]

abroad for several reasons: imports may be cheaper or of better quality. They may also be more easily available or simply more appealing than locally produced goods. In many instances, no local alternatives exist and importing is essential. This is highlighted today in the case of Japan, which has no oil reserves of its own, it is the world's fourth largest consumer of oil and must import all it requires. The exchange of goods or services along international borders allows for a greater competition and more competitive pricing in the market. Over the past 20 years, trade has been influenced by many factors including advances in information technology, financial crises, natural disasters and geo-political tensions. These have led to volatility in commodity prices, changes to the leading traders and trading partners and to a growing importance of services trade. Over this period, trade has been an important factor in helping to boost economic growth and to lift millions of people out of poverty[7].

It seems clear the advantages achievable nowadays trading abroad and how it is crucial for firms to open themselves internationally. The most important benefits that lead business toward trading internationally start with the possibility of business growth. When a firm trades internationally the "universe" of potential clients and suppliers will increase significantly. Just imagine increasing the number of potential clients by 100 percent each time you start selling in a new country. In all likelihood, this will probably be much easier than trying to expand your market place in your "home" country.

Furthermore, it is possible to focus on the idea that a business relies solely on one market and directs all its resources into a single currency may prove to be more risky because create a dependence on one local market. Just look at the number of unprecedented global "disasters" (financial meltdown, earthquakes, etc…) over the last few years and the drastic impacts these have had on markets. The home market could contract or even disappear but your business may be saved by the revenue it generates overseas.

As well as seeing increased sales, you may well enjoy better margins. In support of this, UK Trade and Investment claim that companies who go global are 12% more likely to survive and excel than those who choose not to export. When working with companies abroad, the parties involved want to execute the transaction in the safest and most efficient manner possible. One

[7] Reviewed from COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE Trade, growth and developmentTailoring trade and investment policy for those countries most in need, 2012. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52012DC0022&from=EN [date of access: 21/11/2015]

of the many advantages when trading internationally is that overseas payers often pay upfront. This reduces payment risk and may well help your working capital.

The ability to stand out amongst competitors is a crucial factor in business. When there are fewer competitors, this task is made easier. When placed in a larger and more diverse environment, business could turn out to be a unique product or service, thus creating another life line for the business. This will in turn boost sales potential and allow your business to grow and thrive.

It is also relevant to consider the benefit from the economies of scale that the export of your goods can bring. Go global means a better use of the excess capacity of your business, smoothing the load and avoiding the seasonal peaks and troughs. Businesses are exporting to a wider range of customers. It means that companies will receive as well a wider range of feedback about your products. In fact, the UK department for trade & investment (UKTI) statistics[8] show that businesses believe that exporting leads to innovation through product development to solve problems and meet the needs of the wider customer base. 53% of businesses say that a new product or service has evolved because of their international trade.

Despite the benefits, trade can also bring some disadvantages including the fact that trade can lead to over-specialization with workers at risk of losing their jobs should world demand fall or when goods for domestic consumption can be produced more cheaply abroad. The loss of jobs through such changes cause severe structural unemployment.

Certain industries do not get a chance to grow because they face competition from more established foreign firms, such as new infant industries which may find it difficult to establish themselves. Local producers, who may supply a unique product tailored to meet the needs of the domestic market, may suffer because cheaper imports may destroy their market. Over time, the diversity of output in an economy may diminish bacause local producers leave the market. To understand the intricate environment faced by businesses when they decide to enter in international trade, it's important to examine the significantly fluctuation occurs in the trade of goods over the last 20 years.

Trade experienced fairly strong growth from 1995 to 2001, followed by a boom from 2002 to 2008 accompanied by rising commodity prices. Following the financial crisis in 2008, trade

[8] See HM Government, "*Export guide*", 2015. Available at: https://www.exportingisgreat.gov.uk/wp-content/uploads/2015/10/Your-essential-guide-to-exporting3.pdf [date of last access: 29/03/2016]

fell steeply in 2009 before rebounding strongly in 2010 and 2011. Exports of goods rebounded in 2010, with a growth rate of 14 per cent in volume terms. Debt crises and geo-political tensions intensified in 2014, causing world trade to slow to a crawl over the last few years.

World merchandise exports (excluding significant re-exports from Hong Kong, China) have experienced strong growth over the last 20 years, climbing to US$ 18,494 billion in 2014, almost four times the value of US$ 5,018 billion recorded in 1995.

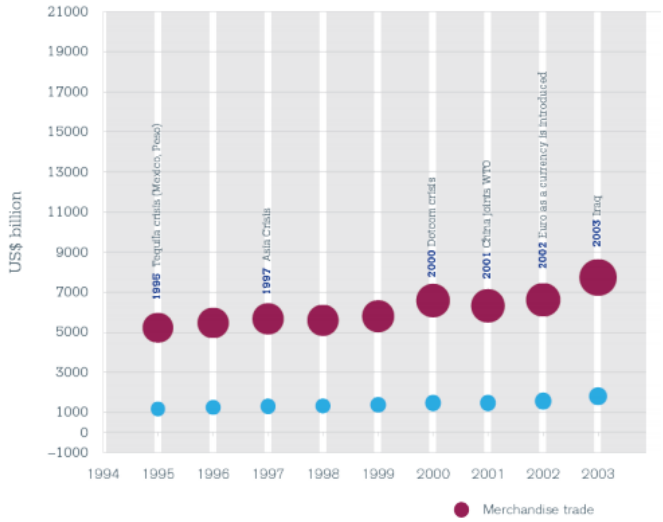

FIGURE 1 WORLD MERCHANDISE TRADE, 1995-2014

Europe has been the leading destination of exports over the past 20 years followed by Asia which has greatly increased its importance as a trading region. The top 10 traders in merchandise trade accounted for a little over half of the world's total trade in 2014 and considering the members of WTO they export about US$ 18 trillion.[9] The EU is the largest trading power in the world but emerging economies are capturing an increasing share of the global market.

To facilitate international trades between companies from different countries a new organization is born at international level. The World Trade Organization is the most powerful legislative and judicial body in the world. By promoting the free trade agenda of multinational corporations above the interests of local communities, working families, and the

[9] Report International Trade Statistics 2015, WTO. Available at: https://www.wto.org/english/res_e/statis_e/its2015_e/its2015_e.pdf [date of access: 12/11/2015]

environment, the WTO has systematically undermined democracy around the world. Where countries have faced trade barriers and wanted them lowered, the negotiations have helped to open markets for trade. But the WTO is not just about opening markets and, in some circumstances, its rules support maintaining trade barriers, for example, to protect consumers or prevent the spread of disease.[10] The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. It is a forum for governments to negotiate trade agreements. It is a place for them to settle trade disputes. It operates a system of trade rules. Essentially, the WTO is a place where member governments try to sort out the trade problems they face with each other.

Research shows that businesses that export improve their financial performance, enhance their credibility and company profile and are more likely to stay in business. Even if, the WTO and other sovereign organizations were born with the aim to regulate and settle the agreement between traders, the business needs to rely on someone able to provide them more safety and assurance. Getting the right support for your business is crucial when it comes to international trade. Gain access to experienced advisers who will act as your guide to help develop your export strategy and give you the confidence to expand your business in overseas markets.

Looking at this, banks are capable to provide international services, financial solutions, guarantees and support when a company decide to enter in the complex and quite risky international trade world. As already mentioned, banks deal with many types of customers and they give them different kind of services based on their specific needs. By the way, companies are one of the most important customers for a bank because of the high level of trades and amount of money they are capable to move every year. On the other side, even banks represent an important support for companies. When a business turns to a bank, it expects to find a range of services suited for its needs: management of payment and income, investment, on-line operations, international trade solutions. Especially this latter category includes important services necessary when companies need to trade internationally.

[10] See WTO web-site, *What is the World Trade Organization?* Available at: https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm [date of access: 13/01/2016]

1.1.3 Bank as support for business

When a business decides to enter for the first time in international trade, it must be prepared and ready against potential obstacles and risks. The international trade could become very complex when, furthermore, some problems are faced, for instance, the different legislation and contracts between countries, the lack of knowledge about the exchange market and the connected risks, the involvement in a global market with different degrees of economic risk, the use of an international language, different customs rules, the presence of linguistic barriers, different commercial customs and traditions and the distance that can compromise the delivery[11]. Here because, before requiring the participation of a third expert party, is crucial for the business to be aware and prepared to review your export potential, develop an action plan, research and prepare to visit a market, explore routes to market entry, find out about selling and marketing your product overseas, think about cultural and linguistic challenges, prepare to manage finance, payment and risk, prepare to protect your intellectual property, prepare to fulfill your orders and get your documentation right, choose your distribution, shipping and delivery methods.

Underestimate this process is not desirable, thus the UKTI[12] drawn up the consecutive steps to follow whether a business wants to have success at international level. The first step includes a research to find the target market. It means to be aware about the business industry's structure, market's culture, kind of competitors, the business market niche and the potential modifications to be allowed to get in. A central part of your research must be focused on culture that incorporates languages, traditions and ways of doing business. Other time must be spent to analyze its own business and its own knowledge and the measure taken, to be sure firm is ready to export. It's important asking and answering questions about the potential demand available in this new market, the legal issues to know, what types of resources are available inside the company (time, skills, finance), whether a partner might be desirable for an effective communication, what are the potential risks, etc.

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[11] Translated by Unicredit, *Le garanzie nel commercio internazionale.* Available at: http://www.confindustria.venezia.it/development/2K14/venezia/istituzionale.nsf/attach/AC0ADE7F0BFE6AD7C1257D790031961D/$File/Corso_Le_garanzie_nel_commercio_internazionale.pdf?OpenElement [date of access: 11/10/2015]

[12] Reviewed from HM Government, "*Export guide*", 2015. Available at: https://www.exportingisgreat.gov.uk/wp-content/uploads/2015/10/Your-essential-guide-to-exporting3.pdf [date of last access: 29/03/2016]

When the research seems to be completed, business starts to make a plan. Understand and comply with the customs rules about taxation, with local laws, standards and regulations. Write an export plan to underlying all the main procedures to come in the new market successfully. It should encompass: a marketing strategy, any modifications of your product to make it more appreciable, find out the best distribution channels, make a choice about the best business model to adopt (agent, B2B, joint venture, etc…) and relevant information about the new target market business wants to achieve.

The third step involves the efforts of business to look for funds to invest in customization, advertising, research and for anything else necessary to be successful. As well as, modifying product and marketing will be vital to reflect and fulfill the personal preferences of international customers. As latter point of this step, there is a logistic choice about the selling methods. Some businesses could prefer a direct, online or local channel; otherwise it might be possible to rely on a partner who is familiar with the target market or an agent allows selling products on business behalf. Here, the possibilities for a business are many, then firm has to analyze and understand the pros and cons of everyone.

The last step is focalized in doing business and grow. Taking care of its customers is real important for a business, specially in a high-competitive market. Nowadays, in a digital world, feedback can make or destroy a business's reputation in a short time; business has to offer a good standard of customer service in your country as well as abroad.

Get paid on time is very important to avoid financial risks, here because a firm must be aware about market conditions and customers' creditworthiness. Business must protect itself by agreeing only acceptable payment methods and terms and with the use of specific insurance[13]. This latter matter requires business asking, to a third party, to obtain some products to ensure business's credits and performance.

As Barclays' web site sponsors[14], the trade solutions are the best tools for business to:

- Enhance your trading status, reassure the counterparty facilitating the conclusion of possible transactions;
- achieve your domestic and international trade objectives;

[13] Reviewed from "Export guide". Available at: https://www.exportingisgreat.gov.uk/wp-content/uploads/2015/10/Your-essential-guide-to-exporting3.pdf [date of last access: 29/03/2016]

[14] Available at: https://www.barclayscorporate.com/products-and-solutions/trade-solutions/bonds-guarantees-and-indemnities.html [date of access: 10/11/2015]

- helping to mitigate risk and negotiate credit terms;
- helping to trade confidently and efficiently overseas.

Trade solution is a specific topic within the financial services industry. It's much different if compared with commercial lending, mortgage lending or insurance. A product is sold and shipped overseas; therefore, it takes longer to get paid. Extra time and energy is required to make sure that buyers are reliable and creditworthy. Also, foreign buyers, just like domestic buyers, prefer to delay payment until they receive and resell the goods. Due diligence and careful financial management can mean the difference between profit and loss on each transaction. The main problem is the will of the parties involved to achieve their personal goals. All sellers want to get paid as quickly as possible, while buyers usually prefer to delay payment, at least until they have received and resold the goods. This is true in domestic as well as in international markets.

Increasing globalization has created intense competition for export markets. Importers and exporters are looking for any competitive advantage that would help them to increase their sales. With this assumption, the world of international trade might look like very complex and risky, where all the parties try to achieve their goals without worry about who is damaged.

A wide range of solutions are offered by banks. Banks are able to provide services that can support every business by demonstrating your financial credibility and ability to meet contractual obligations. Through expertise, bank understands the needs of a business, it has the tools, the resources and the knowledge to provide this security, that otherwise, would not be possible to achieve. Moreover, with the development of the international commerce, the birth of new bank's services was crucial because connected with the increase of international commercial exchanges. In the light of this, the parties involved needs safety and protection against all these possible risks. A "solemn commitment" called nowadays **guarantee**, starts to be released by a third party acting as a guarantor towards who's expecting the performance of the contract. For example when running a business, firm might come across a situation that the client may ask to provide a financial guarantee from a third party. In such circumstances, the firm can approach its bank and ask it to stand as a guarantor on its behalf. This concept is known as bank guarantee (BG).

The guarantee defends the punctual execution of the **contractual obligation** that can regard:

- the commitment of the buyer to pay the amount of money determines in accordance with the terms of the contract;

- the commitment of the seller to deliver goods paid in advance;
- the commitment to ensure the functioning of good or the commitment of other contractual obligations.[15]

The "guarantee" is similar to fiduciary obligations because it doesn't involve an outlay of money, but only a service of assistance by the third party, a bank in this case. It needs a signature to guarantee contractual obligations undertake toward a beneficiary on behalf of the principal debtor. When this service is provided, an out of money usually doesn't happen if the guarantee operation is fulfilled and completed. Anyway remains a risk of insolvency in case of the enforcement of the guarantee against the principal debtor.

Taking an example[16]:

It's possible to consider a company XYZ that it was able to bag a project from the Government of Ethiopia to build 200 power transmission towers.

In this case, companies all over the world would have applied. The selection would be made on the basis of lowest cost and track record as submitted in the proposal form.

However, the government has limited ability to assess all companies for financial stability and credit worthiness. To ensure the project is done satisfactorily and on time, the government puts a condition that company XYZ will have to furnish a guarantee given by one or more banks (in banking nomenclature, company XYZ is an applicant, its bank is the issuing bank and the Government of Ethiopia is the beneficiary).

Usually, the BG is for a specified amount, which is a percentage of the total money required for the contract.

The bank does its own thorough analysis of the financial well-being of company XYZ to assess the amount of guarantee it can issue. After all, the bank is at a risk too, in case the client defaults. This amount is called a limit.

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[15] Translated by Unicredit, *Le garanzie nel commercio internazionale.* Available at: http://www.confindustria.venezia.it/development/2K14/venezia/istituzionale.nsf/attach/AC0ADE7F0BFE6AD7C1257D790031961D/$File/Corso_Le_garanzie_nel_commercio_internazionale.pdf?OpenElement [date of access: 11/10/2015]

[16] Reviewed from http://wap.business-standard.com/article/pf/how-bank-guarantees-work-110082900033_1.html [date of access: 04/03/2016]

The bank will issue guarantee provided the company has not exceeded its overall limit for BGs. and if the Government of Ethiopia is not satisfied with the performance of the contract at a later date, it can invoke the BG. In this situation, the bank will have to immediately release the amount of the BG to the government. Bank guarantees can be broadly classified into Performance and Financial BGs. As the name suggests, Performance BGs are the ones by which the issuing bank, also known as the guarantor, guarantees the ability of the applicant to perform a contract for the satisfaction of the beneficiary.

Anyway, when the parties involved decide to protect themselves with a guarantee, they have to bear in mind some important points:

First of all, it is important to be aware of the conditions and any cultural differences in the countries you trade with and that you make your own terms and conditions clear before you sign a contract.

Secondly, guarantees are sometimes issued subject to local rules and regulations. Local conditions and regulations influence whether it is your bank that will issue the guarantee or a local bank, in the beneficiary's country, against your bank's counter guarantee. If a guarantee is issued by a local bank in the beneficiary's country, it will not be subject to your country law. This would mean that although the expiry date has passed, the local laws in the beneficiary's country may fail to recognize this and hold that the guarantee may be valid for claim beyond the expiry date. If a guarantee is issued by a local bank, you would be liable to pay its commission and fees.

The order and importance of sequence of events is another important point. Indeed, the order of individual banking transactions is very important in relation to projects abroad. The latter matter is the payment under international guarantees. It is important that both the parties involved in the trade agree on the conditions in the event of a claim being served under a guarantee. A payment may be made under a guarantee against a simple declaration of breach of contract (i.e. guarantee payable on first demand) or the bank may wait for a settlement between the parties or alternatively, a court decision (i.e. guarantee payable by agreement between the parties or a judicial decision). This must be clearly stated in the text of the guarantee so that all parties know when a claim must be met.[17]

[17] Reviewed from Credit Suisse (10th revised edition, 2010), *Bank Guarantees – your protection against non-performance and non-payment*. Available at: http://www.proassociati.com/upload/documenti/8/47_bank-garantee-credit-suisse.pdf [date of access: 01/01/2016]

1.1.4 The risk faced in international trade

Just after, a business decides to operate in international markets and it has inevitably to deal with a major risk, therefore it is too important for a firm to be aware about what it could face out of its country borders. The risk in international trade is becoming a factor of increasing significance and concern due to the growth of transactions and investments. As results of their size and complexity, the execution of many of these transactions takes a considerable period of time and a wide range of events could obstruct the fulfillment.

What types of risks the parties face during an international trade?[18]

FIGURE 2 REVIEWED FROM "I RISCHI NEL COMMERCIO INTERNAZIONALE", UNICREDIT

Counterpart risk: The credit risk is about buyer's insolvency or credit risk refers to the inability of the buyer to honor full payment for goods or services rendered on due date. This is a risk of seller associated with selling or supplying a product or service without collecting full payment or experienced late payment. Besides, there is a good collection risk within which is possible to find the buyer's acceptance risk refers to the buyer's non-acceptance of goods

[18] Reviewed from Unicredit, *Le garanzie nel commercio internazionale,* sez. I rischi del commercio internazionale. Available at: http://www.confindustria.venezia.it/development/2K14/venezia/istituzionale.nsf/attach/AC0ADE7F0BFE6AD7C1257D790031961D/$File/Corso_Le_garanzie_nel_commercio_internazionale.pdf?OpenElement [date of access: 11/10/2015]

delivered or services rendered. Unaccepted goods or services may create difficulty for the seller to dispose the goods to another buyer or encounter working capital problem.

On the other side, a delivery risk **(**seller's performance risk**)** is faced when seller may fail to carry out his obligations in a sales contract due to one or more reasons and such non-performance by the seller may have adverse consequential impacts on the buyer's business. It could be expensive for the buyer to take legal actions against the seller in his country.

Contract Risk: legal risk is the potential for financial loss arising from uncertainty of legal proceeding or change in legislation, such as a foreign exchange control policy. A sales contract could be frustrated due to changes in laws and regulations.

Country Risk: economic and political risk refers to unfavorable economic and political conditions in buyer or seller's country which may affect both parties in fulfilling their obligations. On the buyer side, these risks may result in buyer's insolvency or inability to accept the goods or services. Otherwise, the seller may experience difficulty in producing or shipping the goods per se. In addition, it could occur to face a cultural risk whereby different countries have their unique language and culture. The inability to accept and conform to cultural differences or language barrier may result in conflicts and non-completion of the sales contract. Another is the sovereign risk: it refers to the complications that buyer or seller may expose due to unfavorable political decisions or political changes that may vary the expected outcome of an outstanding contract. Examples of sovereign risk are war, riots, terrorism, trade embargoes, etc.

Documentation and goods risk: documentation risk is the risk of non-compliance to specific documentation requirements under a sales contract or documentary credit. Failure in fulfilling documentation requirements may result in seller's inability or delay in obtaining payment for goods delivered or service rendered. Farther, the transportation risk that is the risk of goods being damaged during shipment from the place of origin to the place of destination. Failure in addressing transit risk may result in heavy replacement cost or performance risk.

Financial risk: Within it, a buyer or seller may deal with foreign currencies in their daily course of business. This implies that they are exposed to fluctuations in foreign exchange market resulting in an higher payment (by the buyer) or a less gain (from the buyer) in terms of the local currency.

Each of these risks is brought back to a more overall risk of **knowledge inadequacy**. It means when a buyer or seller who intends to expand his business into another product/service/industry/country may not have adequate knowledge of the risks of the new product/service, local market situation or goods' fashion. The lack of knowledge increases the chances of business failure.

The greater the risks associated with the transaction, the greater the cost. The creditworthiness of the buyer directly affects the probability of payment to an exporter, but it is not the only factor of concern to a potential lender. As aforementioned, a wide range of risks populate the international environment, such as the political and economic stability of the foreign countries. The figure below shows the main risks faced by each party involved.

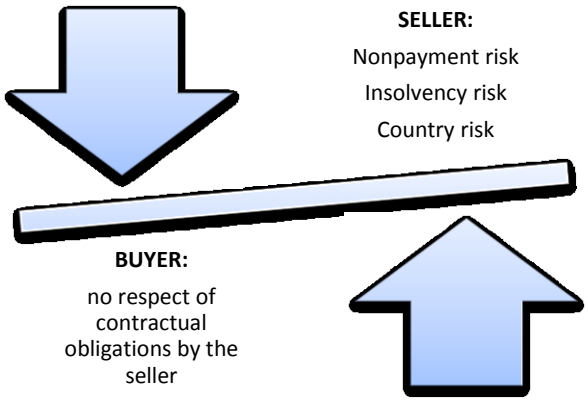

FIGURE 3 REVIEWED FROM "UNICREDIT, LE GARANZIE NEL COMMERCIO INTERNAZIONALE"

The parties implied are generally worried about:

- **Exporter performance:** They want to be sure that the exporter can produce and ship the product on time and that, on the other side, the buyer will accept the goods.
- **Buyer payment:** They want to know the good creditworthiness of the buyer to trust of him. Both they will evaluate any commercial or political risk.

The parties involved try to look for available methods to arrange a safety international trade avoiding all or the most of these risks. But how is it possible to mitigate risks in International Trade? The following list outlines, for buyer and seller, the main elements on which they must be aware when they open themselves to international market.

Some of these advices are useful for both seller and buyer, such as:

- Deal with seller/buyer with sound reputation or established track record;
- Acknowledge and respect cultural differences with the counterparty;
- Buy and sell in same currency to minimize foreign exchange risk. Alternatively, the buyer can hedge against foreign exchange risk by entering a forward or option foreign exchange contract with a bank;
- If financing is needed, enter into a fixed interest rate loan or interest rate swap agreement to mitigate against interest rate risk;
- Ensure sufficient insurance coverage against transit risk;
- Always have a contingency plan against unfavorable event.

Further elements are strictly related to each single party:

For the buyer:

- Request for performance guarantee to avoid non-performance risk.
- Agree on more secure methods of payment such as documentary credit or open account.

For the seller:

- Engage a reputable credit agency or credit insurer to minimize buyer's insolvency or credit risk.
- Engage on more secured methods of payment such as documentary credit or advance payment.
- Avoid granting excessive credit period or limit to the buyer. Ensure that the sales contract or documentary credit does not contain ambiguous or erroneous terms and conditions that are subject to future disputes.
- Acquire sufficient knowledge in document preparation to mitigate against documentation risk.
- Engage a representative in the buyer's country to deal with the goods or relevant parties in case of non-payment or non-acceptance by the buyer[19].

The aforesaid categories of risks and other unpredictable factors increase the risk of non-performance, specially with large amounts at stake. In addition to deal with the other party,

[19] United Overseas Bank. *Risks in international trade & mitigating measures. 2010* http://www.uob.com.sg/assets/pdfs/corporate/corporate/TradeTutorials_RisksinInternationalTrade.pdf [date of access: 05/02/2016]

one of the main points is to rely on a third party for the issuance of a guarantee. The issuance of these instruments is relate to the role of bank when it undertakes to be responsible for the payment of a debt or an obligation with the aim of provide security and to mitigate the risk involved in the transaction.

Even a part of CISG concerns about risk that is used by the law to allocate, between the buyer and the seller, the responsibility for accidental loss or damage of goods. It deals, particularly, with the passage of risk that passes with control or custody of the goods[20].

Since international trade is still concerned in the risk of non-payment, some techniques have been used for a long time in contrast to the traditional means of security, such as accessory guarantee and suretyship. These traditional methods put in a bad position the creditor, in fact they allow the accessory guarantor to invoke every possible defense; this often forces the creditor to initiate legal proceedings involving further inconveniences and risks. Also banks are not very keen to act as accessory guarantors because of the problem of determine in which situations they should proceed to payment and the possibility to be involved in disputes between the parties.

In order to avoid these drawbacks, practice invented the independent guarantee issued by reliable and financially sound institutions such as banks. This new breed operates similarly to a documentary credit and an American variant was created namely standby letter of credit. Anyway, the main characteristic is its independence that puts the beneficiary in a better position compared with the previous one. The beneficiary is entitled to obtain the payment evaluating only if the terms and conditions stated in the guarantee have been fulfilled. Guarantees are security devices: they assure financial compensation in the event of non-performance by the principal debtor. Is also true that independent guarantees have been created when the limits of suretyship has become clear: suretyship wasn't able to meet the needs of firms and banks as well. On one side, firms as creditors were seeking to a quick and sure guarantee's fulfillment. On the other side, banks avoid to be entangled in some disputes between principal debtor and creditor.

Rudolf Stammler, professor of Law at Halle University wrote the "Der garantievertrag" (1886) in which explains the first type of independent guarantees contract. It is an atypical guarantee able to ensure the autonomy of the document from the underling contract. It

[20] See Chapter IV, artt. 66-67-68-69-70 CISG.

relieves creditor from the burden of evidence about the demand's validity and it relieves the bank from the obligation to assess whether there is an effective breach of the contract.

1.2 BANK GUARANTEES

1.2.1 Structure and functions

Starting from the beginning, the simple instrument issued by bank is called generically "**demand guarantee***"* with which bank undertakes itself to pay a sum of money upon the making of a demand for payment by the beneficiary. It must be honored by guarantor if, and only if, the written demand complies with the terms and conditions of the guarantee. A wide definition is provided by ICC (International Chamber of Commerce[21]) in art. 2(a) and the URDG (Uniform Rules for Demand Guarantees[22]) that state:

"*For the purpose of these Rules, a demand guarantee (hereinafter referred to as "**Guarantee**") means any guarantee, bond or other payment undertaking, however named or described, by a bank, insurance company or other body or person (the "**Guarantor**") given in writing for the payment of money on presentation in conformity with the terms of the undertaking of a written demand for payment and such other document(s) (for example, a certificate by an architect or engineer, a judgment or an arbitral award) as may be specified in the Guarantee, such undertaking being given (i) at the request or on the instructions and under the liability of a party (called the "**Principal**"); or (ii) at the request or on the instructions and under the liability of a bank, insurance company or any other body or person acting on the instructions of a Principal to another party (hereinafter the "**Beneficiary**")*".

After an overall explanation, it is important focus on *bank demand guarantee* better called "**Bank guarantee**" that is described as:

"*a personal security (undertaking) in terms of which a bank promises payment to a beneficiary if a principal (often the bank's client) defaults in the performance of his obligation in terms of the underlying contract. The bank has to pay if the documents presented with the demand for payment comply with the documents that are mentioned in the text of the*

[21] See para 1.2 in Chapter 2

[22] See para 3.2 in Chapter 2

demand guarantee… the bank must pay if proper complying documents are presented, even if the beneficiary and the principal have not stipulated that there is a default under the original underlying contract"[23].

The following example shows a normal commercial situation in which a bank demand guarantee is requested:

"Vidonni company" (Vienna) as sellers concluded a contract with the buyer "Smaller Business" (Munich). Under this contract "Vidonni Company" undertook to supply 3 machines to their German customer by May 2 and to effect repairs which might become necessary during the warranty period. This transaction is the first one between the two parties; so that the German buyer cannot be sure whether the Austrian firm is willing and able to fulfil its maintenance obligations. The buyer is also aware of the fact that it may become difficult and to prompt "Vidonni Company" to meet their contractual obligations, or to achieve appropriate compensation by taking legal action. Therefore the buyer insists on a condition in the contract according to which "Vidonni Company" must have a bank guarantee issued in his favour. This enables him to demand payment under the bank guarantee in the event of "Vidonni Company" is not fulfilling their contractual obligations[24].

In the example above a service, the so-called "**bank guarantee**", is requested to and is provided by banks. This specific trade solution is designed for a business, as "Vidonni Company" in the previous example, with particular needs of demonstrate their financial credibility and ability to meet contractual obligations. However, in a more general sense, this service helps business in their international trades when they have to deal with foreign companies, countries and legislations.

A firm should use bank guarantees in its international trades for:

- Provide your buyer with a financial commitment to supply goods or services as agreed under the contract;
- Demonstrate your financial credibility;
- To obtain a more attractive proposition for potential buyers;

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[23] F. De Ly '*The UN Convention on Independent Guarantees and Stand-by Letters of Credit*' (Fall 1999) 33 *International Lawyer* 831 at 832.

[24] Bank Austria- Corporate banking*, Better secured in domestic and foreign business – Bank guatantees.* Unicredit group https://www.bankaustria.at/files/Folder_Bankgarantie_Englisch.pdf [date of access: 17/03/2016]

- The issuance of instrument is made in buyer's currency.

Bank guarantees represent a specific instrument for companies that operate at international level, for those that want expanded their business outside of national borders. A Bank guarantee *is an agreement made by a bank or other financial organization to pay a debt if the person or company who owes the money cannot pay. In addition, a bank guarantee gives you extra authority when dealing with supplier and may allow you to avoid having to pay a substantial deposit* [25]. Thus, bank undertakes the responsibility for the repayment of the liabilities of the party primarily responsible for it and in this way it provides security to that party.

Two different types:

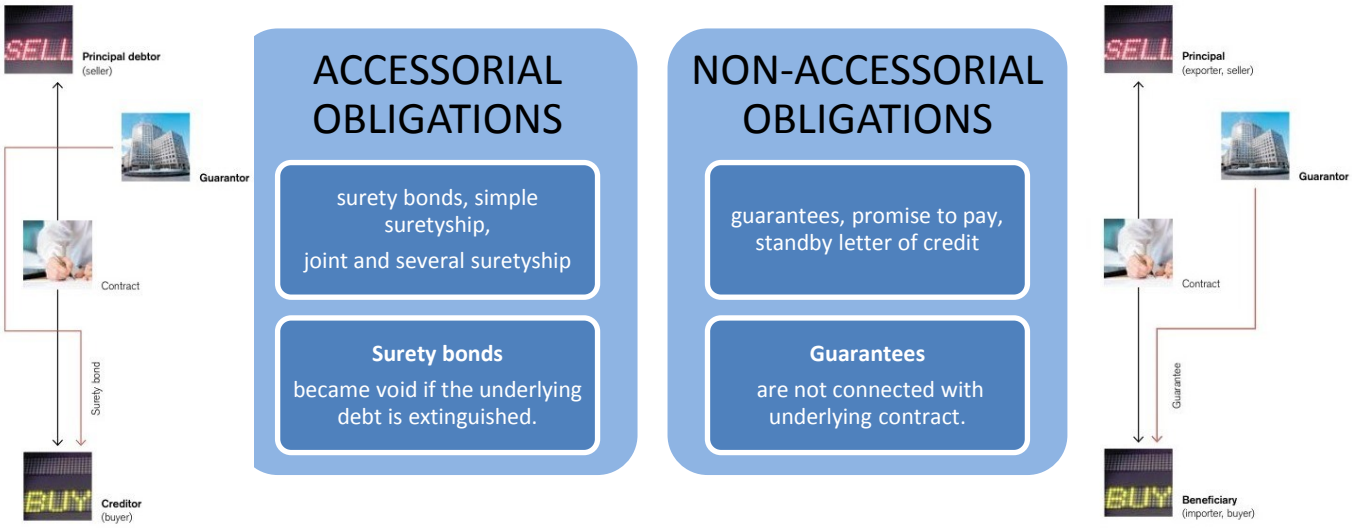

FIGURE 4 BANK GUARANTEES. (CREDIT SUISSE – 10TH EDITION, 2010)

Accessorial obligations include surety bond and suretyship in which the guarantor's obligation goes only as far as that of the principal debtor. As a rule, the guarantor does not make payment unless proof is provided that the principal debtor has failed to fulfill the terms of the contract with the creditor. Surety bonds are typically conditional, already part of the contract when it is stipulated. On the contrary, non-accessorial obligations include guarantees and standby letter of credits where the guarantor's obligation is independent of the existence or continuation of a contractual relationship between the principal and the beneficiary. Bank

[25] Cambridge Business English Dictionary online, *Bank guarantee*. Available at: http://dictionary.cambridge.org/it/dizionario/inglese/bank-guarantee [date of access: 17/01/2015]

guarantees are on demand, in this case is the request of one part that lead the other to subscribe a guarantee. The main differences regard non-accessorial guarantee that contains the commitment of the guarantor to pay at first demand of the beneficiary and this latter doesn't have burden of proof and no exceptions could be opposed connected with the principal relation.

After this short introduction, it is quite important to clarify the terminology underlying bank guarantees. Usually, the term "guarantee" is used in a wide sense and it includes both accessory and non-accessory guarantee, where this latter is better called independent guarantee. At any rate, in this text the term guarantee will be used to identify an independent guarantee (non-accessorial) rather than the accessory one. In the past the entire area of guarantee was marked by confusion, uncertainty and inconsistency but, after this initial confusion, nowadays, law reserves the term guarantee for the concept of independent guarantee, while suretyship is used for accessory type, even if sometimes the term guarantee identify both indiscriminately.

Usually, guarantees are issued by bank, for this reason is used the term "bank guarantee", even if bank can issue other types of guarantees different from the independent ones. In principle, the issuance was allowed to any institution, individual or legal entity. Perhaps, the best known type of independent guarantee is the so-called "first demand guarantee", that is an autonomous, independent and abstract commitment as well as the basic demand guarantee but it is characterized by the fact of being unconditional and payable at first demand. So that, its main feature is a complete reversal of risks due to the beneficiary's right to obtain a reimbursement without bringing any proof of default. Indeed, in the event that the account party should be of the opinion to have correctly fulfill the obligations of the contract, trying to recover the amount paid under the guarantee could turn out difficult because of the nature of the first demand guarantee "pay first, argue later". Through proceedings, in the beneficiary's country, the account party could attempt to obtain the repayment but with the great possibility to face several risks, costs and uncertainties in the final result of the dispute. A further advantage for the beneficiary of a first demand guarantee is the immediate payment collection that is the precise aim of this type of guarantee. Without considering the account party's objections, the beneficiary may obtain the funds directly; this is called the "**liquidity function**" of first demand guarantee. A last benefit for beneficiary is connected with the pressure that beneficiary is able to put on the principal debtor. So, principal debtor tries to do his best to fulfill the contract considering the potential threat of calling the guarantee. In view

of the fact that the number of calls is very small, it is possible to state that the prime purpose of the first demand guarantee is to secure payment, rather than to ensure compensation for non-performance.

Another clarification is required about the America **standby letter of credit** that was created with the purpose of guaranteeing potential debts of their customers. Accordingly, to avoid the confusion between guarantee and accessory security, it was provided that the instrument was expressed in the form of a letter of credit. In order to distinguish the traditional letter of credit, serving as a mean of payment in sale transactions, from this new instrument, serving as security for default, American banks introduce the term "Standby letter of credit". Therefore, they are two different instruments, independent guarantee and standby letter of credit both under the same category of non-accessorial obligations.

Said this, a question arises: Are these two forms of guarantee really different? Although there is a widespread belief that they are different, this is a mistake better explained in this description of the function of an American standby letter of credit that is "*the furnishing of security and its mechanisms, the rule of independence and the documentary nature of the conditions of payment are the same of the European independent guarantee*"[26]. Thus, both represent conceptually and legally the same device, as well as function and mechanism, apart very little practical differences, they are the same. In conclusion, in speaking of guarantee, it is referred to independent guarantee and standby letter of credit indistinctly.

Nonetheless, it could be better, to understand how a bank guarantee works. To do so, it seems important comparing an independent guarantee with documentary credit and further with suretyship.

Independent guarantee vs. documentary credit: they are some aspects in common, such as they operate in a commercial context, their structure and mechanics are similar, there is the presence of the account party and his interests, there is the same allocation of risk and specially the same function, namely the supplying of security. At legal point of view, other similarities are their independence, the examination duty of bank and the strict compliance of beneficiary's claim with the instruments. Apart from this, the differences between both are essential. Documentary credit is used as a mean of payment of the purchase price and then it is used to be exploited in the ordinary course of events. Conversely, a guarantee provides a

[26] Cf. Dolan, 2.03 (2-9), Kozolchyk, 11 Univ. Pennsylvania Jo. International Business Law, at 7-69 (1989).

secondary security and involves payment only if an event of non-performance occurs. A second difference is the nature of the contracts, whereas the documents in a documentary credit have an intrinsic commercial value because it is connected to the relative merchandise. Instead, about guarantee, documents are only related to account party's non-performance without an intrinsic value. Further, at bank point of view, documentary credit is "self-executing" and then the credit of bank can be repaid from the income of goods but with guarantee, the credit risk for bank is higher because a call under the guarantee means an obligation of payment for the bank that is not supported and secured by the goods' value of the underlying contract. In addition, the bank's risk of non-reimbursement is worse because the call may regard financial or technical weaknesses of the bank's customer, such as the account party.

Instead, comparing *independent guarantee and suretyship* brings to light their main difference connect with the concept of independence. The payment obligation of the guarantor is independent of that of the other two parties involved in the underlying contract but this doesn't happen with suretyship in which it is co-extensive. Indeed, when a claim is made, the suretyship can defense itself and, in case of a dispute, beneficiary must be able to fully prove his complaint in support of his demand of payment. Guarantee, conversely, works on independent basis not allowing the guarantor's defense; this is primarily focused on ensuring the payment obligation that is solely determined for a compliance with the terms and conditions of the guarantee.

All of these forms may be used as protection against nonperformance or nonpayment. However, only the use of non-accessorial obligations ensures the beneficiary to obtain, without other complications, the payment due by the bank. This form of guarantee places the beneficiary in a very strong legal position.

The performance of these guarantees is completely released and autonomous, since the mandatory relationship is signed directly between the guarantor and the beneficiary. Indeed, is toward the beneficiary that the bank's mandatory obligation is created. On the basis of a simple payment demand sent to the guarantor by the beneficiary, in which is describe the default, the guarantor must pay the predetermined amount of money to the beneficiary. Anyway, the guarantee's structure is not so simple since it involves more than one party and more than one relationship.

1.2.2 The parties involved and the underlying relationships

It is quite important to focus on each party engaged in the contract that give rise to different links. The following example helps to identify any role and positions of everyone involved:

Company A needs to build a building. Company B is a contractor that company A chooses for the project. Company A does not know company B's creditworthiness or financial strength, two key factors that determine its ability to finish the job.

Company A, the beneficiary, requires company B, the applicant, to get a BG from its bank as a condition of beginning work[27].

Guarantees usually involve a minimum of three parties[28]:

- The beneficiary wishes to be secured against the risk that the principal debtor is not fulfilling his obligations in favour of the beneficiary, that are the obligations derived from the underlying contract for which the guarantee is requested. The guarantee has the role of provide to a beneficiary a quick access to a sum of money in case of non-fulfillment of the principal debtor's obligation. Therefore in the example above, the beneficiary (A) is the party requesting the guarantee and then *the person in whose favour the guarantee has been issued*[29], who requires security against the risk of the principal's non-performance or default under the primary contractual obligation.
- The bank is the issuer of the guarantee in favour of the beneficiary and it would have to pay for the project to be completed if company B fails to do so. The terms of the guarantee involve only the obligation to present a written demand by the beneficiary but they should not require the guarantor to decide whether the beneficiary and principal have fulfilled their obligation under the underlying contract because nowise it is a guarantor's duty.
- The applicant (principal debtor), in the example the company B, only has to prove its creditworthiness to one party: its bank. Afterwards, the principal can expect to be informed, in what respect, it is claimed he is in breach of his obligations.

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[27] Walker S., *What is a bank guarantee?* Available at: http://finance.zacks.com/bank-guarantee-bg-9897.html [date of access: 12/12/2015]

[28] For a more detailed explanation see Art. 2 "*Definitions"* URDG 758

[29] Art 2 URDG 758

Beneficiary knows that if something goes wrong, the bank will pay. By requiring financial BGs, beneficiary is assured to receive the payment without having to analyze financially the different companies with which he would like to establish a commercial relationship. If the applicant fails, the bank will fulfill the BG by paying him the predetermined amount of money.

In the background of a guarantee, there is a multi-party relationship that, apart from the guarantee itself in which the main figures are the bank and the beneficiary (creditor), it includes other relationships such as, principal debtor and creditor in the underlying contract and bank with account party (principal debtor), this latter considered as a customer of the bank. Underscore this background is fundamental because of without these three relationships the guarantee cannot come into existence. Even if they are different, these three relationships are interconnected and therefore they can affect each other. This is the structure of a direct guarantee that represents the basic typology of guarantee widely used at international level; even a more complex architecture can arise in the case of indirect guarantee with the use by bank of counter-guarantee as a form of assurance to obtain its reimbursement.

Firstly focusing on direct guarantee (see Figure 5), the basis of a guarantee is a contractual relationship between principal debtor and creditor. Commonly, guarantees are issued as security for default in connection with contracts for the supply of goods, construction and shipbuilding contracts, large-scale service contracts and technology transfers, take-over contracts and environmental contractual guarantees. They are also used to secure money obligations such as those resulting from payment obligations enclosed in a contract of sales. The underlying contract contains a clause or understanding that one of the parties has to provide a guarantee in favour of the other in order to secure proper performance of his obligations. Relating to the guarantee, the former is called the principal debtor or “account party” and the other creditor or better “beneficiary”. At this stage the agreement may be explicit and detailed or quite vague and inarticulate. Anyway, it’s necessary, at a later time, implement it with the beneficiary and afterwards the principal debtor might instruct his bank to issue the guarantee with their terms and conditions. The bank charges a commission for this service. Whether bank will be called on to effect payment, in accordance with the terms and conditions of the guarantee, in favour of the beneficiary, the principal debtor will be obliged to reimburse the bank. In the relationship with the bank, the principal debtor is called customer, principal or better known “account party”, this term illustrates that even if is the bank responsible for the payment, it acts for the account of the principal debtor. Following the

instructions of its customer, the bank issues the guarantee in favour of the beneficiary, so-called precisely due to the present relationship in place with the bank.

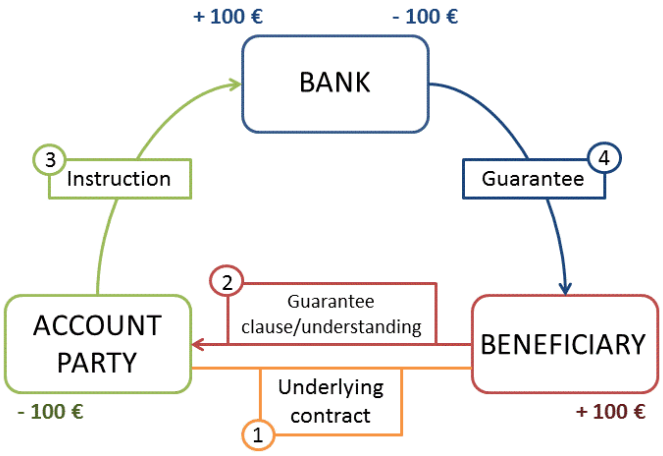

FIGURE 5 MECHANISM UNDER A DIRECT GUARANTEE

In addition, figure 5 shows the payment flow under the guarantee: when a breach of the underlying contract occurs, the beneficiary must be indemnified for the loss of which he has suffered. Fulfillment of the terms and conditions, as expressed in the guarantee and necessary to require payment, triggers off the claim for reimbursement by beneficiary and then actuates the process of payment by bank. Nevertheless, even though bank is suddenly affected by the account party's default, the bank has the possibility to obtain an immediately repayment by the account party.

When it is faced a more complex scheme of an indirect guarantee (see Figure 6) is considering. In this case, beneficiary demands to issue of a guarantee by a bank in his own country because this involves many advantages. Here, the procedure is the same of the previous explained but with a further passage. Account party requests his bank to instruct a bank in the country of beneficiary to issue the guarantee. Considering the terminology, the account party's bank is called "instructing bank" and the latter, such as the bank in beneficiary's country is the "issuing bank". At this point, if an event of default occurs, the beneficiary could only claim payment from the issuing bank and never from the instructing one. Afterwards, issuing bank will be reimbursed by the instructing bank that, in turn, will take recourse against the account party (principal debtor). Clarifying, the guarantee issues by

issuing bank in favour of the beneficiary is considered as a "primary" guarantee well distinct from the counter-guarantee issued by the instructing bank in favour of the issuing bank.

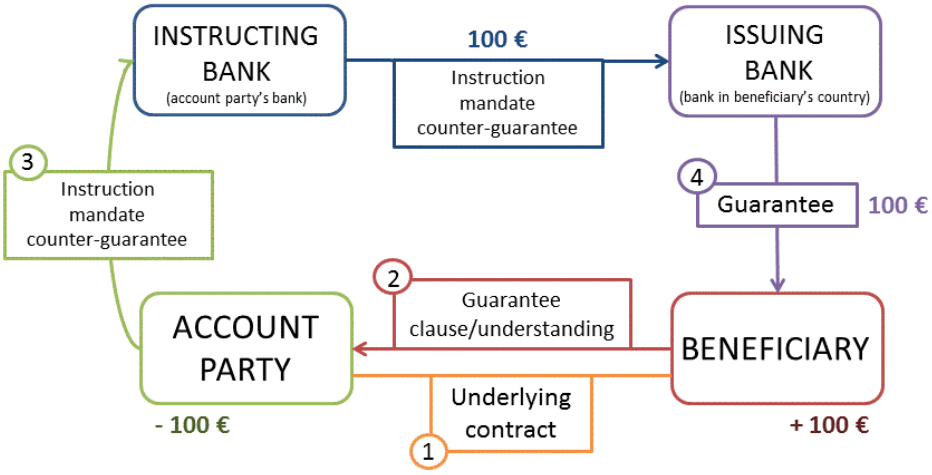

FIGURE 6 MECHANISM UNDER AN INDIRECT GUARANTEE

In both situation, in front of a direct or indirect bank guarantee, the account party's bank might not to be sure about the creditworthiness of its client, here because it can obtain another assurance, for an immediate reimbursement, by a third institutions, such as a bank or financial institution, an export credit insurance company or a company affiliated to the account party. The form used is the counter-guarantee and it might be possible that this institution will look for reimbursement from the principal debtor, depending on the underlying relationship existing among the parties involved.

In conclusion, firms doing business with your neighbors or all over the world but, in any case, they must be confident about obtaining the agreed payment for the goods provided. Business transactions cannot be built on trust alone. For this reason, bank guarantees have become a valuable instrument to provide security. BG can reduce the likelihood of every king of risks for both parties by assuring the transaction will be completed on time and at the previously agreed price. On the other side, bank agrees to pay the necessary amount to complete the transaction, if necessary, asking in exchange a predetermined fee. The bank's participation is requested by parties because international trade means that parties don't know, for example, each other or the laws in the country where they are doing business.

1.2.3 Three fundamental principles

Bank guarantees are based on three related fundamental principles:

The Autonomy Principle:

The autonomy principle is also known as the independence principle, the principle of abstraction or the doctrine of separation. It means that the undertaking of the issuer to the beneficiary is separate from the underlying transaction and from other related contracts.

The meanings of independence vary according to the selected point of view.

Considering the principal relationship bank-beneficiary, it is possible to examine two aspects such as, the absence of a link with the mandate (bank-account party relationship) and, more important, the payment obligation of the bank and the beneficiary's right to payment are, in no way, referred to the underlying contract but only to the compliance with the guarantee's terms and conditions.

The principle requires that the obligation of the bank is not related with any disputes between the applicant and beneficiary not even that it's dependent on performance of the underlying contract. The issuer should not, under any circumstances (a part very rare situations), look to the underlying transaction in order to decide whether or not to pay on the guarantee. In other words, the beneficiary's right to claim payment depends only on the claim's accordance with the terms and conditions of the guarantee. Here because, it is commonly provided for by contract, for example, that the bank undertakes to pay the beneficiary "notwithstanding any objections" or protests by the applicant for the bank guarantee. Banks have to honor the guarantee, first of all, because it represent a good commercial practice, and then, the bank must ensure that the documents or conditions required by the credit are satisfied, because the commercial community relies on bank's undertakings.

URDG 758[30], actively promoted and marketed by the ICC, clearly recognizes within its rules and provisions the guarantor's independent role as detailed in **URDG Article 5(a)** which points out that the guarantee is *independent of the underlying relationship and the guarantor is not bounded in that relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims*

[30] For more detailed information about URDG 758 see para 3.2 Chapter 2.

or defences arising from any relationship other than a relationship between the guarantor and the beneficiary".

In fact, the text of the guarantee invariably contains a reference to the underlying relationship, usually at the beginning, in which there is a short description of the underlying contract that usually confined to the names of the parties, which will be the seller and buyer, the date of conclusion of the contract or the submission of the tender, the reference number of the contract or tender and sometimes a short description of the object, for example the supply of goods. Together with the heading of the document this reference serves to identify the purpose and the risk against which the guarantee provides security. More specifically, the reference to the underlying contract is meant to indicate in respect of which relationship the guarantee can be called and in no way it should turn an independent guarantee into an accessory guarantee that is characterized by a complete absence of this principle.

Several case law treated these matter such as the Supreme Court decision for the case "*Simic v New South Wales Land and Housing Corporation*", in which the Court of Appeal had to decide *whether a mis-description of the beneficiary of a bank guarantee entitled the bank to refuse to pay out the credit – whether regard could be had to the underlying contract to confirm the correct description of the beneficiary – discussion of the scope of the autonomy principle and of the principle of strict compliance*[31]; or Australian High Court case of "*Wood Hall Ltd v Pipeline Authority*" in which Court *upheld the autonomy of the performance and retention guarantees from the underlying contracts, primarily based on the wording of the guarantees that were before the court and their commercial function of being substitutes for cash*[32].

Anyway, there is an exception of fraud that can limit the independence of guarantee (See para 3.2 Chapter 3) between account party and bank. As explained above, this great independence make bank strong. It means bank cannot be implicated in disputes regarding the parties of the underlying contract. For this reason bank has its own interest in the autonomy principle. The same is applicable with an indirect guarantee, where the counter-guarantee issues by instructing bank in favour of the issuing bank results independent of the primary guarantee.

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[31] See "catchwords" of Court of Appeal New South Wales, Simic v New South Wales Land and Housing Corporation [2015] NSWCA 413. Available at: https://jade.io/article/421681?at.hl=bank+guarantee+autonomy+principle [date of access: 23/05/2016]

[32] *(1979) 141 CLR 443: 24 May 1979* HIGH COURT OF AUSTRALIA, *WOOD HALL LTD. v. PIPELINE AUTHORITY*. Text available at: https://jade.io/article/66786 [date of access: 03/11/2015]

Independence must be considered from the point of view of the account party with the expression "**pay first, argue later**" represent another reallocation of risk between the parties of the underlying contract. In other words, the payment to the beneficiary should be made first and the account party will try to recover the moneys only in subsequent proceedings proving that beneficiary has no right to be paid as measured by the underlying contract. In fact, beneficiary should obtain his payment even if there are some pending disputes related to the underlying contract. The payment of the guarantee will be bounded only by the guarantee's conditions that should be fulfilled, for example a simple demand for payment or in addition a statement of default could be necessary to trigger off the compensation, without imposing further conditions connected with the principal contract. About this, the case of "*Itek Corporation v. First National Bank*", on the line of the above explanation, states: "*Parties to a contract may use a letter of credit (first demand guarantee) in order to make certain that contractual disputes wend their way toward resolution with money in the beneficiary's pocket rather than in the pocket of the contracting party*"[33].

As well as for standby letter of credit, the UCP 600 reaffirms the independence within the Art. 4: "*A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary".*

Documentary nature of the instrument:

Article 6 of URDG 758 and Article 5 UCP 600 state:" *Guarantors deal with documents and not with the goods, services or performance to which the documents may relate*".

The practice of bank guarantees is based on dealings in documents whereby an issuer of the guarantee is and wishes to be concerned only with the examination of documents required by the instrument. The issuer is in no way concerned with the delivery of goods or the performance of services in which the parties are involved.

[33] Civ. A. No. 80-58-MA.: 566 F. Supp. 1210 (1983), United States District Court, D. Massachusetts., June 28, 1983, ITEK CORPORATION v. The FIRST NATIONAL BANK OF BOSTON. Full text available on-line at: http://openjurist.org/730/f2d/19/itek-corporation-v-first-national-bank-of-boston [date of access: 01/02/2016]

The doctrine of strict compliance:

The doctrine of strict compliance requires the bank to examine the documents carefully and accept only those that strictly comply with the terms and conditions of the credit. This includes the requirements that the documents should be internally consistent and must be tendered before the expiry date of the credit or bank guarantee. The requirement for strict compliance with the terms of the credit places different duties on the parties involved. The applicant, in instructing the issuing bank to open it, must ensure that the instructions correspond to those agreed upon the guarantee and those agreed upon in the underlying transaction. The account party is the first to be responsible for the instructions provided. In particular, he has to perform his duty complying with the Art. 8 URDG 758 that states: "*All instructions for the issue of guarantees and guarantees themselves should be clear and precise and should avoid excessive detail*".

On the other hand, the beneficiary is required to perform his obligations exactly in accordance with the terms of the guarantee, as there is no cause of action against the bank if it refuses to pay against documents that do not strictly comply with the bank guarantee. Conversely, the bank loses its right of reimbursement and forfeits remuneration from the applicant if it accepts documents that do not comply with the credit and thereby causing loss to the applicant.

The doctrine of strict compliance has been justified on principles of agency law. The issuer must act within the mandate given by the applicant (principal debtor) and obtain documents which comply strictly with the applicant's instructions. Documents which go outside the mandate do not entitle the issuer to reimbursement.

1.2.4 Types of Guarantees

Even though guarantee has one unique purpose, that is the protection against non-performance, the wide range of situations and the variety of risks has led to the creation of a wide range of guarantees. At a general point of view, it is possible to distinguish between two main typologies. First of all, a guarantee that secures financial obligations such as those of the buyer about the purchase price of a contract of sale. The second is for non-financial obligations such as the obligations of the sellers for the delivery of goods or for the fulfillment of a project. This latter can be subdivided in other several categories: tender, performance and

maintenance if regard the following phases of the contract, while repayment and retention regard the payment made by beneficiary to the account party.

Therefore a question arises: What type of guarantee must be used? Fortunately parties can decide freely and, usually, the decision depends of the circumstances of each case, even if it can be noted that some types of guarantees can be used for different purposes.

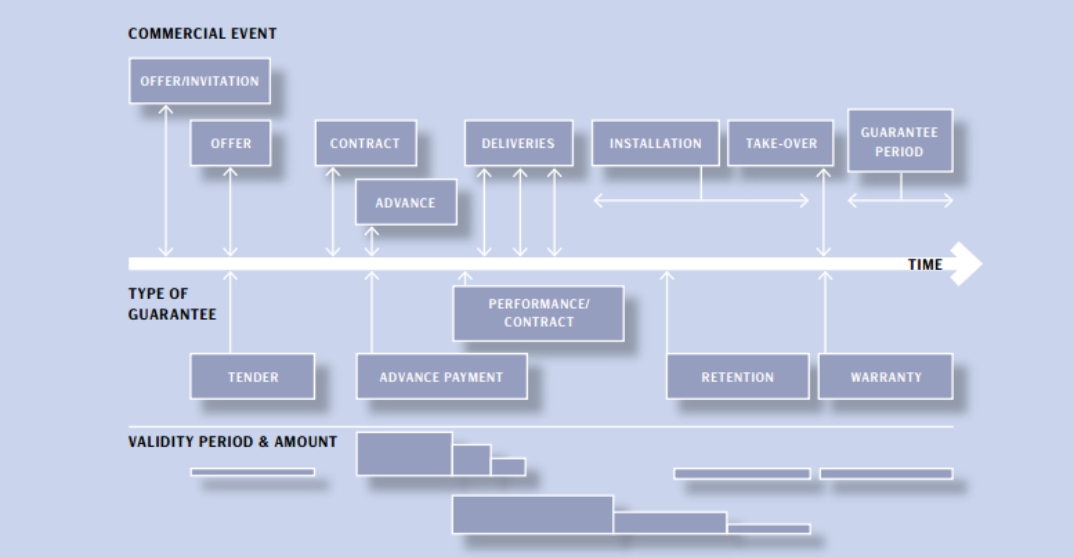

FIGURE 7 TYPES OF GUARANTEES AND THEIR FEATURES[34]

Tender guarantees (or bid bond) are utilized especially for construction contracts or supply of capital goods. It is designed to deter companies (bidder) from making a tender and rejecting the contract after it is awarded to them because the company has lost interest in the transaction. The aim of a tender guarantee is to avoid the possible bad behavior of the bidder, such as the alteration or withdrawal of his tender before the adjudication and the signing of the contract. For this reason a party, normally a bank, guarantees on the order of the seller (bidder) to pay part of the bid price if the seller (bidder), which is the winner of the tender, is not willing or able to conclude and complete the contractual performance. Indeed, the buyer

[34] SEB (Société d'Emboutissage de Bourgogne), Bank Guarantees. Available at: http://seb.se/pow/content/produkter/betalningar/garanti_broschyr_eng.pdf [date of access: 19/03/2016]

wishes to safeguard against inadequately or unqualified tenders. This type is frequently used in connection with international public invitations to tender. The buyer is entitled to call the tender guarantee if the bidder doesn't fulfil his obligations involved in the guarantee. So that the buyer's compensation is given for the loss of time and money incurred due to the new examination made and the choice of a new bidder. In a wider sense, a tender guarantee and its accomplishment is necessary to ensure that only reputable, serious and financially solvency contractors come out as potential bidders.

Tender guarantee has a limited period of validity, usually the contract uses to include a fixed expire date which is the date of adjudication or the day of the signing of the contract, that can be about from three to six months. Bid bond is issued for an amount between 1-5% of the tender price and the claim can be called if the bidder:

- withdraws the tender before the expiry date;
- is not ready to fulfil the order, for example to sign the contract of sale or works;
- or if he cannot provide the necessary performance guarantee[35].

Performance guarantee instead is the most used type of guarantee. It ensures that goods are delivered in accordance with the terms of the contract and at the agreed time. More specifically, the performance guarantee assures payment to the importer whether the exporter has not completely or properly satisfied his obligations arise from the underlying contract. It is also important to keep in mind that a tender guarantee is issued before the tender contract is concluded and then performance guarantee is issued by the winner of the tender after the tender contract is signed. The guarantee tends to cover generally the 5-10 per cent of the total amount. The text of the performance guarantee includes a general description of the object including other accessorial elements, such as installation or contractual warranty obligations as well. The guarantee is running until the fulfillment of the object of the contract and thus it is not easy sometimes to define an expiry date, anyway it must be careful in vague expressions like "until satisfactory operation". At this point, it could be often useful to determine an expire date and extend the validity period of the contract whether it has not been completed yet. A claim, under the performance guarantee, may be made for defects, delays or financial insolvency of the contractor.

[35] Reviewed from Credit Suisse (10th revised edition, 2010), *Bank Guarantees – your protection against non-performance and non-payment*. Available at: http://www.proassociati.com/upload/documenti/8/47_bank-garantee-credit-suisse.pdf [date of access: 01/01/2016]

It is possible that, with a performance guarantee, a maintenance (or warranty) guarantee is issued. It is used to ensure that the exporter remedies any defects occurred after the goods' delivery or that construction firm remedies of damages which become apparent after the completion of the plant. Indeed this guarantee covers the maintenance or warranty period in which the exporter/construction firm remains responsible for the equipment or works done. The percentage of the contract is small than that of a performance guarantee, generally it is the 5% of the value of the contract and running for 1-2 years.

A third type is the advance payment guarantee which purpose is to ensure the right use of an advance payment by the supplier, always in accordance with the terms of the contract concluded between the parties involved. Therefore the exporter (supplier) negotiates for an advance payment to be able to finance the transaction, to obtain funds to purchase materials and components, hire labor or make other preparations for the performance of the contract. The importer (buyer) might require a repayment, thanks to the guarantee, in the event of non-execution which amount correspond to the full value of the advance payment. The specific risk covered by an advance payment guarantee is against non-performance; this broader term includes such a different situations, for example if supplier fails to use the advance payment for specific activities of purchase or manufacture or if the supplier fails to carry on or complete the contract before to run out of funds available thank to the advance payment made by the buyer. The guarantee should expire at the fulfillment of the contract; the period of validity is usually between six months and one year. The amount covered is initially the same of the advance payment but it's going to be reduced at the progress of work or delivery. Further important features regard the timing of the entry into force that is decided among the parties involved to avoid improper claim. For instance, it is decided that advance payment guarantee will enter into force only at the receiving of the advance payment. Secondly, the mechanism of reduction involves in the guarantee; the rate of reduction is based on the rate of progress in fulfilling the contract. As instance: *"The amount of this guarantee will be reduced automatically by 15% of the value of each partial shipment*[36]*"*.

Construction contracts usually involve a retention that is a percentage (often 5%) of the amount certified as due to the contractor (such as the supplier) on an interim certificate, that is deducted from the amount due and retained by the client (the buyer). The purpose

[36] See example from Credit Suisse (10th revised edition, 2010), *Bank Guarantees – your protection against non-performance and non-payment*. Available at: http://www.proassociati.com/upload/documenti/8/47_bank-garantee-credit-suisse.pdf [date of access: 01/01/2016]

of retention is to ensure that the contractor properly completes the activities required of them under the contract. These payments are fundamental because they are used by the contractor as essential funds to carry on his operations and, on the other side the employer is entitled to retain a percentage of the periodical amount as security for potential future defects. A possible alternative to retention is a retention bond, where the client agrees to pay the amounts which would otherwise have been held as retention, but instead a bond is provided to secure the amount that would have been retained. As with retention, the value of the bond will usually reduce after practical completion has been certified. So, retention guarantee is a written document issued by bank in favour of the client (such as the buyer or owner) to guarantee that applicant will continue to fulfill contract obligation after withdrawing final payment of the contract price in advance. It guarantees that the contractor will carry out all necessary work to correct structural or other defects discovered immediately after completion of the contract, even if full payment has been made in favour of the contractor from the client.

Other guarantees are used to ensure payment obligations, in particular those called payment guarantees. It is important to specify that often is applied the term "standby letter of credit[37]". The payment guarantee's purpose is the assurance of payment in sale transactions. This tool has had a growing request in these years, rather than the more traditional letter of credit. The different is that the traditional letter of credit is a means of payment in the normal execution of the transaction, while a payment guarantee (or standby letter of credit) serves as security for payment only in the event of a buyer's default. Another reason is the lower cost of standby letter of credit compared with letter of credit and the low amount of bank charges and the documents examined by bank are less extensive as well.

1.2.5 Payment Mechanism

Independent guarantee shows a peculiar feature that makes it different from suretyship. This diversity regards the already mentioned principle of independence. However, it doesn't determine when and under which circumstances the obligation of payment by bank is due or when beneficiary is entitled to receive his payment. This function is performed by the **payment mechanism**, also called conditions of payment. They are included in every guarantee specifying the type of evidence necessary to identify the principal debtor's default

[37] In this form, it can be subjected to the UCP 600 or URDG 758.

upon which bank has to pay or, in case of first demand guarantee, stating that only a demand for payment is sufficient without any type of evidence. Therefore, this mechanism is able to identify the risk at which the principal debtor is exposed and the benefits for the beneficiary. For example, some clauses can oblige the submission of a simple demand of payment by the beneficiary, without any type of default's proof. On the other side, it can specify the need of an arbitral or court decision before to obtain the payment or even a submission of third-party documents. These examples show guarantees with different degree of proof of default but, likewise, it's possible to face a common characteristic: their documentary nature, such as the requirement, for the beneficiary, to present several documents in order to obtain the due payment.

The prevailing type of payment mechanism at international level is the **first demand**, where the beneficiary is entitled to receive payment without conditions or specific evidence about default of principal debtor. Further beneficiary's benefit, under this mechanism, is the possibility to claim the full amount of the guarantee even if beneficiary's loss regards only a part. At any rate, bank cannot reject to pay and it cannot enquire for proof or other obligations not included in the terms and conditions of the guarantee. Only after the payment, principal debtor could start proceedings against beneficiary if he is sure about the bad faith of beneficiary's claim.

Two variants exist of first demand guarantee. Called simple demand guarantee is that on which only a simple written demand for payment must be submitted by the beneficiary. Other kinds of demand guarantees instead stipulate that further documentation, concerning the account party's default, is necessary, such as a statement to the effect that bidder refuses to sign the contract (tender guarantee); or that contractor fails to fulfill the project (Performance guarantee); or that importer refuses to pay the purchase price (payment guarantee). This statement of default is merely a unilateral declaration of the beneficiary but it is enough to require his bank's reimbursement, if so is written in the guarantee. Anyway, there is a positive feature in favour of the account party; these clauses, regarding the payment mechanism, force the beneficiary to specify the nature of the breach of contract caused by the principal debtor. Thus, in this way, this obligation imposes to the beneficiary to show his position and it might deter the beneficiary to submit a statement when his claim might be untrue.

When the guarantee is made under the URDG, the payment mechanism is outlined in Article 15(a) that is about the "requirements for demand". It specifies the aforementioned elements:" *A demand under the guarantee shall be supported by such other documents as the guarantee*

specifies, and in any event by a statement, by the beneficiary, indicating in what respect the applicant is in breach of its obligations under the underlying relationship. This statement may be in the demand or in a separate signed document accompanying or identifying the demand".

The focal point is the request to submit a statement in which have to be specifically written the nature of principal debtor's default. Its merit is to represent a provision able to mitigate the great advantage of the beneficiary, such as the right to obtain an immediate reimbursement without any essential claim of proof of default and it tries to smooth the disadvantage faced by principal debtor, who needs a safeguard against untrue calls. Exactly for this reason, American people call it "suicide letter of credit". Nonetheless, parties are free to choose a different payment mechanism whether thinking that first demand guarantee isn't the right one.

A second payment mechanism includes the **submission of third-party documents** as a strict condition of payment. The terminology, in this context, is wide and often intricate, for example the term "conditional guarantee" is used to describe this mechanism against the term "unconditional" instead used for first demand guarantee. Unfortunately, this separation is not so well delineate due to the plausibility to call the first demand guarantee "conditional" as well, because it might foresee the submission of a statement of default. Avoiding misunderstandings, this instruments state that payment is given at first demand, where beneficiary needs to submit the third-party documents mentioned in the guarantee. In its application, the same conditions, as a first demand guarantee, can be applied. Therefore, no other evidence of default must be adduced, bank is not entitled to ask for further documentations but it has only to examine the documents in the light of what is stated, as beneficiary's obligations, in the underlying guarantee to obtain his reimbursement. Several examples concerning these required third-party documents involved: a tender guarantee requires a statement from a notary public attesting the acceptance and the following failure of the employer to sign the contract of the contractor's bid; a repayment guarantee could include a statement from a bank; instead within a performance guarantee might be required a certificate from an independent surveyor or an engineer attesting the non-performance/defects of the principal contract. Summarizing, the meaning of a guarantee, payables upon a third-party documents, is that the beneficiary is obliged to furnish an evidence of non-performance on the side of principal debtor. Permitting this, it is possible to better accommodate the principal debtor's interests since a statement proving his default/non-performance is requested. Consequently, the advantages for beneficiary are reduced because he cannot

anymore call the guarantee at his will and further his power to force the principal debtor to perform the contract will be weaker than before.

Third mechanism involved the **supply of arbitral or court decision** by the beneficiary. It goes to affirm the principal debtor's liability to the beneficiary. The decision comes from legal proceedings between the parties of the underlying relationship however bank is out of the lawsuit. The presentation by the beneficiary of the decision triggers off the bank's payment obligation.

1.3 INTEREST OF THE PARTIES: BANK'S POINT OF VIEW

"*The business of banks is to render financial services. One of their services is issuing guarantees and standby letters of credit. Banks are not insurers"*(Bertrams, 1996).

The guarantor bank is not obliged to supply goods or perform work on the principal's behalf. It has not, for instance, to build an airport if its client fails to do so, neither it will produce manufacture or supply looms or chemicals if its client fails to conclude the deliveries. The bank's commitment is solely a financial one, its obligation as a guarantor is limited to the payment of a sum of money as a substitute for performance that has not been rendered. This can be explained by the fact that the performance comes from the underlying relationship and the guarantee is created to give a sort of security if something goes wrong such as non-performance or default.

Since the bank enters into the contract of guarantee for the risk and account of the customer, the bank's own interest in the definition of the terms and conditions of the guarantee is, in general, small. This because, it is primarily of concern to the parties engaged in the underlying contract: the decision about the guarantee format, i.e. a direct or indirect guarantee and the definition of type of conditions of payment, for example a guarantee payable on first demand without any evidence of default or a guarantee requiring the submission of third-party documents evidencing default. In addition, both creditor and debtor have to determine other elements of the guarantee: which provisions will or will not be included, the type of conditions of payment, the choice of using a direct or indirect guarantee, the qualifications of the rights of the beneficiary, the maximum amount, etc…

The bank does ordinarily not intervene in this negotiation phase that is reserved specifically to the parties of the underlying relationship. However, banks aren't totally indifferent to the vast

risks to which its client may expose himself when he deals with the other side to stipulate the guarantee, even because the various clauses on which the parties have agreed must be acceptable to the bank too. Here the bank's main interest is to ensure that the clauses are designed to clearly define the content and extent of its obligations towards the beneficiary. In particular, bank pay attention to those clauses involving the start of its obligations only after presentation of prescribed documents; on guarantees containing specific and clear-cut provisions but less concerned is due to the maximum amount or duration. Nevertheless, bank has a direct interest in what concerned the set-off, jurisdiction and applicable law that are fundamental questions enclose in the guarantee.

As well as, it is of vital importance for the bank that the provisions of the guarantee have been drafted in a way that bank will be able to determine easily and readily when it is supposed or not to effect payment to the beneficiary. Parties have to be aware that specifying the expiry date and the maximum amount is not enough; they must include in the contract a clear identification of what makes active the payment obligation and its limitations through the submission of prescribed documents. The combination of sound self-interest and genuine loyalty towards its client may help the bank to avoid promptly a disaster and making the bank an active in the negotiation and drafting phase. The importance of drafting the conditions of payment in a documentary fashion is also stressed in the URDG providing a detailed list of all the items recommended[38].

Documents are very important where the payment mechanism prescribes the submission of third-party documents evidencing default or an arbitral or court decision. At any rate, they are also relevant in first demand guarantees; apart from a statement of default, if required, a first demand guarantee may be subject to some modifications, for example a reduction or an increase of the maximum amount or an expiry framed in a documentary form.

Of course, it is in the bank's interest to prevent disputes with its customer concerning the correctness of the payment, this because the risk of payment is previously against the account party due to the inclusion on ambiguous provision in the guarantee. The vagueness of the provisions may therefore be a reason for the bank to refuse to accept the text as submitted or to insist on amendments. To avoid these problems, bank uses to employ their own standard texts that come from the experience of the bank in drafting texts with a good degree of clarity and assurance. Another reason for objection happens if they are in presence of a complex

[38] See Article 8 "Content of instructions and guarantees" URDG 758.

situation or there are high risk factors which can be difficult to predict, such as participation in the project by sub-contractors and/or the beneficiary himself, local conditions and the stability in the country concerned. Whenever the bank has reasons to suspect that its customer is likely to encounter serious difficulties in completing the project, it will adopt a rather reserved attitude to protect itself and its customer as well.

Where the prospect of prompt reimbursement and proper completion by the customer is unsatisfactory, the availability of fresh security will usually be sufficient to persuade the bank to decide in favor of issuing the guarantee. For example counter-guarantees obtain by affiliated companies or other financial institutions. A type of security which is particularly suitable consists of the assignment or pledge of the future proceeds of the main contract accompanied by measures assuring actual payment into the customer's account with the bank.

1.4 NEGOTIATION AND DRAFTING

1.4.1 Introduction

Often in domestic business relationship, parties don't need to discuss the legal aspects of their contract and they are limited only in negotiating the basic contents. Anyway, when contracts are more complicated, parties prefer to establish the governing law, their own obligations connected to the contract, while remaining under the framework of the applicable law capable to dictate mandatory rules that reduce the "**party autonomy**". For example, for a contract of sale specific rules are provided by law and, in these cases, parties have only to establish their own rules when the standards provided by law do not align with their needs.

At any rate, a quick reference should be made about the scope of "principle of freedom" of the parties that is a fundamental principle of contract law. It is important to indicate exactly what parties are allowed to do when entering into a contract:

- The freedom to choose with whom to enter into the contract.
- The freedom to choose the content of the contract as well as the form (principle of consensualism)[39].

[39] Société de Legislation Comparée, *Guiding Principles of European Contract law*. Available at: www.legiscompare.fr/web/IMG/pdf/19._Guiding_Principles.pdf

However, drafting an international contract requires the determination of specific contractual rules because of the uncertainty of the legal framework available for cross-border relationships. This uncertainty comes from the lack of worry of the parties about making a clear choice of the applicable law for the contract, in this way, if something goes wrong, it may be difficult to determine, in advance and at the moment as well, which law have to govern the contract and its related obligations.

First of all, as Bortolotti explains, it is necessary to identify the legal framework in which contract is situated[40] and parties can do that following these steps:

- verify the rules applicable to that type of contract within the potential applicable legal system (those of the countries of the parties), in order to compare them with the expected ones used to draft the contract and to verify the presence of mandatory rules that cannot be derogated contractually;
- verify the presence of other rules: currency regulations, antitrust rules, etc., that might affect the contract in the legal system;

These first two steps put the negotiator in a position to make a first assessment about the acceptability of the potential laws of the countries involved. In the meantime, parties normally start to draw up the terms of the contract. As aforementioned, several models are available as essential tools to enclose and to avoid forgetting important key issues. Anyway, it is fundamental that parties adapt the model to their particular needs modifying clauses and opting for lawful and effective solutions. At the same time, the lawyer with his client, the businessman, have to make commercial and economic decisions that affect the allocation of risks and charges between parties. This delicate stage leads to a final reasonable compromise between business needs and legal requirements avoiding unlawful or too much onerous solutions. In addition, it is necessary to work out further alternatives on these issues in case in which the other party will not accept the proposal.

The *negotiation stage* starts with a discussion between parties about their respective positions and needs looking for compromise solutions. Usually, the final result depends on the bargaining power of parties but, nevertheless, even the abilities of the negotiator can make the difference. Anyway, the negotiation stage is delicate because it involves the good faith of the parties, which means that party do not interrupt negotiations in bad faith or that he isn't

[40] Detailed in Bortolotti F., *Drafting and Negotiating and Concluding International Contracts,* Chapter 6, ICC, 2010.

carrying out parallel negotiations. To avoid this conduct, most civil law countries adopt the principle to act in good faith during negotiations and if this doesn't happen, the party may be liable for damages. The same UNIDROIT Principle[41] has worried about the pre-contractual stage in which the pasties must anyway be protected; the art. 2.1.15 "Negotiation in bad faith" states:" *A party is free to negotiate and is not liable for failure to reach an agreement. However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party. It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party*". It represents a sort of limit to the freedom of negotiation based on the respect of the good faith that the official commentary to art. 2.1.15 defines as:" *a party's right freely to enter into negotiations and to decide on the terms to be negotiated is, however, not unlimited, and must not conflict with the principle of good faith… One particular instance of negotiating in bad faith…is that where a party enters into negotiations or continues to negotiate without any intention of concluding an agreement with the other party…*"[42].

Drafting contract requires specific skills, for this reason, the lawyers of the parties have to act as legislators since the contract is "the law of the parties". The scope of the lawyers is the translation of the commercial agreement into clauses with no room for ambiguity. Fortunately, a trend of uniformity of the contracts has favoured the rise of common practices in international trade that makes negotiations easier and more effective. On the other hand, no absolute rules exist to draft a contract but it is possible to outline some general criteria and drafting techniques to bear in mind in drafting an international contract:

- A preamble can be included on the top of the contract. It normally contains statement considered to be relevant by the parties, for example, a description of the qualities of the parties, the reason that lead parties to conclude the contract, etc…
- Another common practice is to define certain terms and use capital letters to identify these terms. The practice is useful to avoid repeating long definitions in the various clauses of complex and lengthy contracts;
- The determination of the language of the contract is another matter because often, in international trade, parties do not speak the same language. To solve this problem there are different solutions: to write the contract in the two languages of the parties, to write it

[41] For a general explanation of the Principles see para 1.3 Chapter 2.

[42] Available at: http://www.unilex.info/instrument.cfm?pid=2&do=comment&pos=28 [date of access: 13/05/2016]

in the language of the stronger party (that with the higher bargaining power), or to use a neutral language, usually English, known by both parties;

- The provisions should be clear and unambiguous not only for the parties involve but also for third-party (judges, arbitrators) that they could interpret them in a different way than that wanted by parties.[43]

The *conclusion of the contract* (or formation) takes place under specific rules. The main example concerns the contracts of sale which are frequently regulated by the UN Convention on the International Sale of Goods (CISG)[44], this because of its acceptance in a great number of countries. The first question of the conclusion is the "acceptance" problem that is examined in the art.18 CISG:" *A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance. Silence or inactivity does not in itself amount to acceptance".* It is clear that a potential acceptance is, in reality, a counter-offer that will be accepted only when the other party will indicate its assent.

Complex contracts need a detailed negotiation, usually for sales contracts it is not necessary because are contracts regarding goods sold on a regular basis, but it is common in the banking and insurance business. As regards the contract of sale, it is the seller that works out the set of clauses to add to the "special part" of the contract containing the issues negotiated case by case between and on will of the parties. Doing so, negotiators have only to deal with the commercial issues leaving the legal issues already define in the general conditions of the contract.

Even if these statements and advices can be indistinctly used for any kind of commercial contracts all over the world, the contracts concerning guarantees, and in particular bank guarantees, need a further analysis and a further definition of particular aspects.

1.4.2 The nature of bank's obligations

Bank's obligation and its entering into force is viewed through two different perspectives. The first point of view intends the obligation as an unilateral engagement and then only the unilateral declaration of undertaking of the bank is considered having binding force. This

[43] Reviewed from Bortolotti F., *Drafting and Negotiating and Concluding International Contracts,* para 4.3 Chapter 6, ICC, 2010.

[44] For an overall explanation of CISG see para 1.1 Chapter 2.

declaration is included in the terms and conditions of the guarantee. The second school of thought considers the bank's obligation as a consensual contract which coming into force after an offer and an acceptance. Here, the issuance of the guarantee is merely considered as an offer which must be accepted by the beneficiary even if this acceptance is commonly tacit.

The European view about the use of these two perspectives is heterogeneous, such as Belgium is oriented toward the first perspective; on contrary, Germany, France and English laws are brought to a contractual point of view. This latter is more considered than the unilateral viewpoint since within the Uncitral Convention (CISG) is outlined something similar, even if specifically concern to the overall contract of sales. The Article 23 of the CISG states that: "*A contract is concluded at the moment when an acceptance of an offer becomes effective in accordance with the provisions of this Convention".* Then, a contract is concluded when the communications and actions between parties establish that there is an effective acceptance of the offer.[45]

Considering the Rules referred to guarantees, the Article 4 URDG states: "*the guarantee is issued when it leaves the control of the guarantor*". It suggests a guarantee enters into force when it is issued and consequently the bank becomes bound by the terms of the guarantee and beneficiary obtains the right to call the payment. The tacit acceptance comes from when beneficiary does not object to the terms and conditions within a reasonable, short period of time after receiving the advice. In this period of time beneficiary verifies whether the terms and conditions of the guarantee comply with those defined between him and the account party. If it is found something wrong, beneficiary will contact the bank and the other party to obtain an amendment.

1.4.3 The form's requirements

Usually, some form's requirements are respected when parties are drafting a contract of guarantee even if the applicable law gives to them a wide freedom about the form of the contract. In fact, CISG affirms this principle of freedom in form requirements that is better described in Article 11: "*A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means,*

[45] Comisión para la Protección del Comercio Exterior de México, Mexico, 29 April 1996, Unilex (contract concluded when acceptance reached buyer-offeror). Available on-line at: http://cisgw3.law.pace.edu/cases/960429m1.html [date of access: 03/03/2016]

including witnesses". The article provides that a contract of sale need not to be concluded in writing and is not subject to any other specific requirement of form[46]. In other words, the contract of sales can be concluded informally, as it is outlined in several cases of law, such as:

"The seller had shipped the goods in response to the buyer's purchase orders before the seller dispatched invoices containing its own terms. The buyer argued that, under the CISG, the terms in the buyer's purchase order were thus necessarily incorporated into the party's contract. The court disagreed. It reasoned that, although it was possible that the seller had accepted offers on the buyer's terms, pursuant to Article 11 CISG the parties may alternatively have formed contracts orally before the buyer's purchase orders were sent".[47]

According to the case law, a contract is valid though it is concluded orally and also that a signature of both parties is not necessary to obtain a valid contract. The Article 11 avoids parties to comply with domestic requirements demanding a written contract in order to be valid, here because under the CISG an evidence of the oral conversation, between buyer and seller, to determine terms and conditions is admitted as an agreement reached between them. This so-called "*principle of freedom-from-form-requirements*" has some limits included in the following Article 12 states that the principle is not apply if one of the party has its place of business in a State that made a declaration under article 96 CISG[48]. Without considering these limits, the article 12 remarks the contractual freedom that not only concern the conclusion of the contract but also modifications and termination of the offer, acceptance or any intentions can be made orally or in any other form rather than in writing, even if it seems inconceivable having a guarantee not in written form.

Anyway, the Article 2 and 3, even though not explicitly, specify that the guarantee must be in writing, including electronic transmissions as well. Usually, it is a device that includes the terms and conditions of the guarantee and it is ordinarily transmitted by letter, telefax, e-mail or through an advising bank. The *device*, under whatever form, is deemed to be the operative

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[46] UNCITRAL Digest of Case Law on the United Nations Convention on the International Sale of Goods. Published on the Internet at: https://www.uncitral.org/pdf/english/clout/08-51939_Ebook.pdf [date of access: 22/10/2015]

[47] Case 847: CISG [6]; 11; [14]; [19]; [35] United States (Federal) District Court for the District of Minnesota. Available on the Internet at: https://documents-dds-ny.un.org/doc/UNDOC/GEN/V09/810/25/PDF/V0981025.pdf?OpenElement [date of access: 22/10/2015]

[48] "*A Contracting State whose legislation requires contracts of sale to be concluded in or evidenced by writing may at any time make a declaration…that allows a contract of sale… to be made in any form other than in writing, does not apply where any party has his place of business in that State"*.

instrument and no further information is required. When the guarantee is issued, it takes effect and the guarantee can be called in every moment (art. 4(c) URDG). Anyway, the terms after which beneficiary has the power to call the guarantee must be postpone after the issuance if the parties have so decided. For example, a guarantee could enter into effect at some later date or it cannot be called before a certain date.

1.4.4 Construction: the importance of a conscious drafting of the contract

A bulk of case law deals with the problem concerns whether a "guarantee" is an independent guarantee or an accessory suretyship. Parties are quite indifferent in giving a clear definition and a clear name of their contracts of guarantee, this because they are not conscious that more than one kind of contract exists that lead parties to different consequences and duties. This matter arises because there isn't a standard form and text for guarantee recognised at international level. Anyway some standard texts are used by bank but they can be modifying to settle down to the needs of beneficiary and account party.

The practical matter consists to identify the words concern whether and in what way beneficiary has to provide proof of default and consequently if bank can defend itself. Moreover, when the guarantee is issued under the UCP, for letter of credit, or under URDG, the independent nature of the guarantee is evident.

At any rate, it is possible to determine what the principal aim of drafting a contract is: to find and understand the real *intentions of the parties* that are primarily those involved in the underlying contract rather than bank and beneficiary. This connection is explained considering that the guarantee is issued by bank as a vehicle to ensure the realization of the agreement made by parties to the underlying relationship. For this reason, in order to establish the intentions of the parties, a glance must be given to the underlying relationship analysing the relevant clauses. This technique has been used in several case law as that of the *French Cour de Cassation in Cass., May 19 1992*[49], in which has been determined that the security was an independent guarantee since in the underlying contract was required the furnishing of a guarantee payable upon the beneficiary's first justified demand.

[49] Cour de Cassation, Chambre commerciale, du 19 mai 1992, 90-15.342. Available at: https://www.legifrance.gouv.fr/affichJuriJudi.do?oldAction=rechJuriJudi&idTexte=JURITEXT000007028405&fastReqId=1564254412&fastPos=1 [date of access: 02/02/2016].

Also further set of international law, such as CISG and UNIDROIT Principles, concern the interpretation of conduct of parties. In fact, they are used to settle some disputes like that between "*Franklins Pty Ltd v Metcash Trading Ltd*" in which "*A dispute arose between the parties centred around the definition of "Wholesale Price" in the Supply Agreement…The judge found in favour of the buyer on the construction of the agreement,... In debating the interpretive approach in relation to later conduct and the construction of written contracts, the Court referred to the UNIDROIT principles of International Commercial Contracts (3rd Ed.), Articles 4.1-4.3, and article 8 CISG. The Court however was of the opinion that "to a significant degree the approach to the construction and interpretation of contracts in the UNIDROIT Principles and the CISG reflects civil law principles*"[50]. The written contract includes the final agreement of the parties that represent the principal device including their intentions.

In determining whether the court is faced an independent guarantee or a suretyship, it has only to consider the text, more specifically the full text and not only some single phrases. In fact, cases law show that ambiguity is caused by the presence of some phrases concern suretyship and other about independent guarantee that are the consequence of a lack of knowledge and awareness of the parties in how a contract of guarantee should be drafted. For instance, the phrase "payment on first demand" is not always a clear sign of being in presence of a first demand guarantee, indeed there are a wide range of examples of cases including this expression but that in every respect are traditional accessory suretyship. Moreover, this matter of ambiguity is due to the past because independent guarantee was an evolution of suretyship: when this form of "guarantee" was drafted, it was normal the use of the already existing patterns adopted for suretyship. As far as the recognition that it was created a new and different type of security. To complicate this recognition, the law of many countries does not recognize the existence of two distinct types of guarantee yet. For this reason, it seems quite important to clearly introduce specific phrases and clauses to avoid misunderstandings. Whether the text involves phrases as: payment on (first) demand; payment without contestation; etc…, or considering the undertaking as unconditional, irrevocable or primary; there is a great assurance to be in front of an independent guarantee rather than a suretyship because these terms are not likely to be found in a suretyship text.

[50] Case 1136: CISG 8 Australia: Supreme Court of New South Wales Franklins Pty Ltd v Metcash Trading Ltd [2009] NSWCA 407 16 December 2009. Available at: https://documents-dds-ny.un.org/doc/UNDOC/GEN/V12/521/91/PDF/V1252191.pdf?OpenElement

In conclusion, who is entitled to verify the nature of a "guarantee" cannot stops in front of the heading of the document or on the terms "guarantee" used indiscriminately for both the security in commercial practice, he has to consider the true nature that become apparent analysing the terms and phrases of the instrument.

1.4.5 Clauses of the contracts

Period of validity: the determination of the period of validity is one of the most important provisions that must be included for the assurance of all the parties involved in the contract of guarantee. This because, it defines the period of time in which rights, duties and risks of the parties come to existence and continue to be valid. In fact, in this lapse:

- the account party is exposed to a financial risk and he has to pay the bank charges;
- The beneficiary maintains the right to take advantage of the benefits provided by the guarantee and maintain its related security;
- The guarantor, instead, has its contingent liability for which it has to reserve funds.

The main agreement of the parties regards the definition of the **expiry date** upon which rights and obligations under the guarantee cease to exist. The text of the URDG 758 (art. 2) includes the definition of expiry date as "*the date specified in the guarantee on or before which a presentation may be made*" and it is mentioned again in art. 8 within the list of the recommended items to specify in the guarantee. The inclusion of the expiry date is the rule and the art. 22 of the previous URDG 458 (afterwards substituted by the 758) incorporates three available methods used to formulate the expiry date: the clear mention of a calendar date; expressed in terms of a certain event linked with the underlying relationship (i.e. final award of the contract, completion of the principal contract, etc…); or a combination of the two previous one: "*it terminates X months after completion of the main contract,… but not later than* [for example] *January 10 1996…".* Anyway, especially for tender or performance guarantees, it is possible to include a particular provision to extend the period of validity of the guarantee. This "extension clause" is useful when, for example, the date of the tenders or that of the final completion cannot be determine or it is not knowable in advance. In particular, it accommodates the interests of the beneficiary even if he is bounded because if he fails in request the extension, the guarantee will be expire at the pre-fixed expiry date and it can no longer be called. Finding a guarantee without an expiry date is rare but there are certain situations in which this absence is a regular practice. For example, on guarantees

payable upon submission of a judicial or arbitral award or regards payment guarantees in favour of tax. These guarantees cease to have effect upon the guarantee document or upon a statement of release. Generally speaking, banks strongly object to guarantees without an expiry date because a lot of problem can arise every time, just think of the account party's risk to be continuously subjected to a call of the guarantee by the beneficiary even when the obligations have been completely fulfilled.

Currency and amount of guarantee: all guarantees state the maximum amount of the guarantee and its related currency. This threshold cannot be overcome by the request of the beneficiary even though this latter will be able to demonstrate the damage or the interest measures through the underlying relationship would involve a higher amount. About currency, it is not necessary that the currency of the guarantee have to be the same of the underlying contract. At any rate, the guarantee can include the possibility of reduce or increase the amount through a specific clause as explained in the art. 13 URDG 758: "*A guarantee may provide for the reduction or the increase of its amount on specified dates or on the occurrence of a specified event which under the terms of the guarantee results in the variation of its amount, and for this purpose the event is deemed to have occurred only when a document specified in the guarantee as indicating the occurrence of the event is presented to the guarantor, or if no such document is specified in the guarantee, when the occurrence of the event becomes determinable from the guarantor's own records or from an index specified in the guarantee"*. For example, a reduction could take place, in respect of a construction contract, upon presentation of shipping documents or third-party documents attesting the delivery of the goods or the completion of the initial stage of the project.

Force majeure: Parties and in particular account party has to negotiate to include in the guarantee a clause to suspend the rights of the beneficiary if an event of force majeure takes place. The art. 26 URDG lists the potential event called force majeure, for example *acts of God, riots, civil commotions, insurrections, wars, acts of terrorism or any causes beyond the control of the guarantor or counter-guarantor that interrupt its business as it relates to acts of a kind subject to these rules.* This incorporation is uncommon because of the difficulty of the bank in ascertaining whether and when the clause would be activated due to the obstacle in determining the real happening of the event. To relieve this burden on bank's shoulders, it would be possible to foresee in the guarantee the requirement of documentary evidence by third-party: engineer or expert; and thus, shift the problems and risks to account party or beneficiary. Anyway, the entitled third-party should provide the certificate in a very short

period and this could affect the quality of their conclusions that, however, will be important to determine who has the reason to complain. When an event takes place and a *request of payment is presented under that guarantee, the guarantee should be extended for a period of 30 calendar days from the date on which it would otherwise have expired, and the guarantor shall as soon as practicable inform the instructing party or, in the case of a counter-guarantee, the counter-guarantor, of the force majeure and the extension, and the counter-guarantor shall so inform the instructing party"*[51].

Time of payment: guarantees can state that payment is effected within a certain period of time but this clause is not often included. It could be useful to determine the interests in case of a late payable of the bank or to determine the rate of interest or it could be a good way to discourage account party to delay payment. Usually, the clause determines a period of time for payment from three to thirty days, which start after the request and the bank's assessment of compliance.

Transfer of guarantee: art. 33 URDG 758 affirms the right of beneficiary to "transfer" the guarantee if is in it specifically state that it is "transferable". The article clearly explain the meaning of transferable guarantee as: "*A guarantee that may be made available by the guarantor to a new beneficiary ("transferee") at the request of the existing beneficiary ("transferor")*". Even if, it is permitted, the transferability of the guarantee increase the likelihood and the risk of a fraudulent call since this proceedings turn the guarantee into a "negotiable instrument".

1.4.6 Issuing a bank guarantee

Any person or corporate entity can apply to issue a bank guarantee by asking directly to their bank in which they have a bank account. The account holder has only to make a request for a bank account explaining briefly the reason for the issuance. Banks, considering its role of provider of payment services[52], it will provide a simple application form to the applicant that he has to fill-in with several details: the duration of the guarantee, if there are some payment conditions, the amount of currency, the beneficiary and his bank details. The bank in turn requests to the applicant to enter into a sort of pledge agreement that is a necessary condition

[51] Article 26(b) URDG 758

[52] Detailed in Art. 114-sexies and Art. 114-octies TUB (See para 1.1 Chapter 1).

to accept his request for the issuance. The bank in particular would require a pledge or lien over assets of the applicant's bank account to secure the guarantee. Usually, bank consider better assets as cash, stocks, shares and bonds because they are liquid assets and then they can instantly liquidated; or sometimes bank can accept as well less liquid assets such as real estate property. Once the bank has blocked the assets, it issues the guarantee in accordance with the account holder specifications. The issuing bank remits the guarantee to the beneficiary bank by SWIFT and, often, also an original paper copy by post is sent to the beneficiary's bank.

When the guarantee is issued, it is a document (See Figure 8) that should enclose some essential elements:

- Preamble: it defines the applicant and the beneficiary, a brief description of the underlying relationship and the related goods, etc… it is important because include the main elements from which the bank commitment takes place. Anyway, it is not necessary to include all the elements but only the most important ones and write them synthetically. For example, the description of the goods can be made by reference on the underlying contract "*as per contract number… dated…*".
- The undertaking of the bank: the issuing bank defines the terms and conditions of its commitment (independence from the underlying contract, the amount guaranteed,…);
- Particular provisions: whether the bank's undertaking will be reduced in time or extinguished;
- Expiry date and place: in which the commitment of the bank ceased to exist. It is fundamental determine the date within which beneficiary can enforce the guarantee and the related place;
- Precautionary clauses: in transferability, return of the original documentation, etc… these clauses represent a security for the parties to avoid a transfer of the debit/credit to a third-party; or the bank that requires the original documentation when its commitment was fulfilled;
- Applicable law and jurisdiction clauses: it is determined the applicable law and the jurisdiction in case of disputes. In the majority of the situations, bank prefers the definition in the contract of the applicable law and a tribunal of its own country, even if it especially depends from the will of the parties and international rules.[53]

[53] Reviewed from Confindustria Vicenza, *Crediti documentari e garanzie bancarie internazionali: manuale operativo,* pag. 69, 04/2015. Available at: http://www.confindustria.vicenza.it/pdf/guida_1565.pdf [date of access: 17/05/2016]

Dear Sirs,
We are informed that on ..... Messrs ..... (hereinafter referred to as the "Buyer") have concluded with you Messrs ..... (hereinafter referred to as the "Seller") a contract for the supply of ....., delivery terms ....., to be paid, as per contract terms, by Swift Bank Transfer within ..... (.....) days from the date of written declaration, issued by Seller and communicate by fax to the Buyer, stating that the goods are at Buyer's disposal, in Seller's warehouse) *9 with partial shipments allowed.
According to contract terms, the Buyer is requested to provide You with a Bank Guarantee up to the amount of ..... (.....).
We, (Banca del cliente) ....., by order of the Buyer, hereby irrevocably undertake, waiving all rights of objection and/or defence, to pay You immediately, on Your first written demand certifying that the Buyer has failed to perform his obligation to pay you any sum (s) up to the global maximum amount of ..... (.....) .
For identification reasons, Your demand for payment, including Your certification of non-performance, shall not be considered valid unless we receive it through the intermediary of (Vostra banca d'appoggio italiana.....), which must certify that the signatures on Your demand are authentic and made by the authorised signatories.
All of Your obligations arising from this guarantee will terminate on ....., regardless of whether or not this document has been returned to us and even if You have not specifically discharged us from our obligations towards You arising from this guarantee.
Any demand for payment will have to reach us in writing on or before the aforementioned date of ..... failing which any claim towards us arising from this guarantee shall become automatically null and void.
This original document must be returned to us after its expiry or as soon as we will fulfilled all obligations arising from it, whichever shall occur first *10.
Partial drawings are allowed *11 and every payment effected under this guarantee shall automatically reduce the total value of the guarantee by the same amount.
This guarantee is not assignable or transferable to a third party.
All the disputes arising and/or in connections with the present guarantee shall be regulated by the Italian Law. The Court of jurisdiction shall be ..... Court. *12

FIGURE 8 SAMPLE OF A STANDARD BANK GUARANTEE[54]

The issuance of a bank guarantee represents a service that a bank provides upon request of its client. As any other kind of bank service, it is costly for the client that has to pay to benefit from it. In case of guarantee, the client is the account party who has to pay *bank commission* for the services provided, for the credit risk taken by bank and for reserving or capitalizing liquid means in the event of default. Usually, commission is a certain percentage of the amount of the guarantee and it is owing for the entire period from the issuance of the guarantee until its expiry date. In addition, bank faces other expenses in the course of carrying out the contract that are called "*incidental expenses"* (telephone calls, postal, telex, telefax and similar). They are, according to the general terms of the guarantee, charged to the account party through a lump sum based on a flat rate or they are charged only if they represent a considerable amount. Any bank can independently decides its costs and commissions for these services; the following tables represent some examples of national and international

[54] Confindustria Vicenza, *Crediti documentari e garanzie bancarie internazionali: manuale operativo,* 04/2015. Available at: http://www.confindustria.vicenza.it/pdf/guida_1565.pdf [date of access: 17/05/2016]

bank's price lists. Table 1 shows the economic conditions of two different Italian banks, including commissions, several fees and expenses; instead table 2 shows the price list of a foreigner bank: the HSBC[55] that is one of the biggest bank in the world with its headquarter in London.

[55] HSBC Commercial Banking, *Business Banking Price* List, 1 December 2014. Available at: http://www.business.hsbc.co.uk/1/PA_esf-ca-app-content/content/pdfs/en/bus_bnkg_price_list.pdf [date of access: 13/04/2016]

TABLE 1 ECONOMIC CONDITIONS OF ITALIAN BANKS[56]

INTESA SANPAOLO

Garanzie Internazionali emesse.

Spese fisse.		
Spese di emissione	€ 100,00	
Spese di preavviso	€ 15,00	

A queste spese vanno aggiunte le spese e i costi (telefoniche, postali, telex, ecc.) sostenuti a fronte dell'operazione o dello specifico Intervento, come previste nella sezione "Commissioni comuni alle garanzie internazionali - spese fisse e commissioni".

Commissioni.		
Commissione di emissione per ciascun mese o frazione	0,3750 %	(1)
minimo	€ 100,00	
Diritto fisso per modifica o proroga	€ 60,00	
Costo emissione comunicazione di legge cartacea	€ 0,70	

Nota: nel caso di emissione di garanzia indiretta (controgaranzia) sono a carico dell'ordinante le eventuali spese e commissioni reclamate dalla Banca estera, incaricata della emissione dell'impegno diretto nei confronti del beneficiario.

Valute.

In caso di escussione dell'impegno di firma, alle operazioni di pagamento si applicano le condizioni e norme previste nel contratto di conto corrente su cui le stesse vengono regolate.

BCC CREDITO COOPERATIVO

SPESE	
Spese di istruttoria	fino a € 9.999,99 FISSE € 50,00 fino a € 19.999,99 FISSE € 100,00 fino a € 29.999,99 FISSE € 150,00 oltre 0,50% minimo € 50,00 massimo € 9.000,00
Spese di rilascio	€ 200,00
Recupero spese per comunicazioni (escluse quelle previste dall'art. 118 TUB)	€ 10,00 invio postale € 0,00 posta elettronica
Spese invio comunicazione trasparenza	€ 2,00
Commissione annua sull'importo garantito	4,00%
Spese di notifica a carico del beneficiario	€ 50,00
Commissione di modifica a carico del beneficiario	€ 100,00
Tasse, imposte e bolli	Come previsto dalla normativa vigente, a carico del cliente.

[56] Available at: http://www.bccflumeri.it/documenti/trasparenza/Fogli-Informativi-Bcc/Fogli-Informativi-Bcc/ESTERO/FIDEIUSSIONE-ESTERO.pdf and http://docplayer.it/3494171-Foglio-informativo-n-302-014-operativita-con-l-estero-garanzie-internazionali.html [date of access: 18/05/2016]

TABLE 2 PRICE LIST OF HSBC

HSBC
Commercial Banking

Issuing fee*[1]	2.2% p.a. (0.55% per quarter), calculated on the amount at risk, minimum £75.00 per quarter
Amendment fee	£40.00, plus additional commission charges if the amendment involves an increase in the value of the guarantee
Reduction fee	£50.00, where documents are checked to prompt a reduction in the guarantee value
Cancellation fee	£40.00 for cancellations prior to expiry date, plus transmission costs
Execution/payment of a claim	£50.00, one-off fee
Passing forward another bank's guarantee/ amendment direct to the beneficiary	£50.00, unless charges are stated to be for the account of the beneficiary, in which case the fee is £75.00
Claim documents despatched to issuing bank on behalf of beneficiary	£50.00, one-off beneficiary fee
Additional charges	• Communication charges (eg, SWIFT, telex, fax, mail and courier) • Ancillary expenses, charges and interest incurred by HSBC when undertaking this work on your behalf • Management time (if charged), for additional work involved • Any charges levied by other banks or other offices of HSBC Bank outside the UK
Guarantees issued in replacement of existing items	If a new guarantee replaces an existing one, future commission will be charged on the replacement item only, once the former guarantee is cancelled

*[1]Guarantees will attract a commission charge for a minimum period of one full quarter, payable in advance from the date of issuance. Commission will cease following cancellation of HSBC's guarantee (or its counter-guarantee to another bank). Pro-rata refunds are not made.

Chapter 2

LEGAL INSTRUMENTS FOR INTERNATIONAL SALES AND BANK GUARANTEES

2.1 THE ORGANIZATIONS ACTIVE IN INTERNATIONAL COMMERCIAL LAW

2.1.1 UNCITRAL: the convention for the international sales of goods (CISG)

The drafting of legal instruments is part of the activities of a wide number of international organizations, however only few of them are involved in the field of commercial law. The growth of international trade has created a growing awareness of the advantages obtained through the harmonization of international trade law. Transnational commercial law *consists of that set of rules, from different sources, which governs international commercial transactions and is common to a wide range of legal systems*[57].

The United National Commission on International Trade Law (UNCITRAL) was created with the aim of create an harmonization and unification of international trade law. Nowadays, the Commission conducts several activities; it's engaged in drafting texts and documenting and in making accessible sources relevant for the harmonization of trade law. As the UNCITRAL web site sponsors "*The contract of sale is the backbone of international trade in all countries, irrespective of their legal tradition or level of economic development*"[58]. In the past, as well as today, an international convention exists to regulate international sales: The Vienna Convention on Contracts for the International Sale of Goods (CISG). The immediate origin of the CISG is to be found in the work of the UNCITRAL that was able, in 1980, to produce this documentation that is nowadays still considered one of the most important international trade law conventions whose universal adoption is desirable.

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[57] Roy Goode/Herbert Kronke/Ewan McKendrick*, Transnational Commercial Law – Texts, Cases, and Materials,* Oxford University Press, Oxford, 1st edition 2007, 2nd edition 2015, p. lxv. Cit. also available at: Transnational commercial law teachers meeting http://www.ipr.uni-heidelberg.de/tcl-teachers/definition.html [date of access: 02/03/2016]

[58] UNCITRAL (web site), *United Nations Convention on Contracts for the International Sale of Goods* (Vienna, 1980) (CISG). Available at: http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html [date of access: 07/12/2015]

The CISG is the result of a legislative effort that started at the beginning of the twentieth century. The resulting text provides a careful balance between the interests of the buyer and of the seller.

Small and medium-sized enterprises as well as traders located in developing countries typically have reduced access to legal advice when negotiating a contract. Thus, they are more vulnerable to face several problems caused by inadequate treatment of some contract's issues relating to applicable law. The same enterprises and traders may also be the weaker contractual parties and they could find difficulties in ensuring the maintenance of a fair contractual balance. Therefore, merchants could derive particular benefit from the default application of the fair and uniform regime of the CISG to any contracts falling under its scope.

The purpose of the CISG is to provide a modern, uniform and fair regime for contracts for the international sale of goods and to contribute significantly to introduce certainty in commercial exchanges and decreasing transaction costs. In effect, the CISG preamble sets out its purposes: "*...Considering that the development of international trade on the basis of equality and mutual benefit is an important element in promoting friendly relations among States; Being of the opinion that the adoption of uniform rules which govern contracts for the international sales of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade…".*

Art. 1(1) of the CISG describes the sphere of application of the convention:

"This Convention applies to contracts of sales of goods between parties whose places of business are in different States: when the States are Contracting States; or when the rules of private international law lead to the application of the law of a Contracting State".

The CISG governs contracts for the international sales of goods between private businesses, excluding sales to consumers and sales of services and sales of certain specified types of goods.[59]

[59] Detailed in Art. 2 and 3 of the CISG.

Two important aspects are underlined in Article 1:

first, the definition of "contract of sales of goods" the Convention does not provide a definition of "contract of goods"; nevertheless the general rule is that *contracts for the supply of goods to be manufactured or produced are to be considered as contracts of sale* (Art. 3(1)). Anyway, this definition has never avoided the arising of several disputes that European Courts had to be settled. For example the case law "*Thermo King v. Transports Norberts Dentressangle SA, et al*[60]":

A French company, acting as sole distributor on behalf of a U.S. company, sold a freezer to another French company, which in its turn sold it installed on a thermostatic truck trailer to a French transport company. The transport company carried a load of nuts and fish which thawed during carriage. The consignee refused to take delivery. The transport company commenced a legal action against the U.S. company, claiming damage. At first instance the Court decided in favor of the transport company, without applying CISG.

The Court of Appeals (Cour d'Appel de Grenoble, 15-05-1996) stated that, as the U.S. company had granted directly to the transport company a document of guarantee containing the transport company's name, the parties were bound by a contractual relationship, that the Court considered to be a sales contract. The Court of Appeals held that this contract was governed by CISG, as the parties had their places of business in contracting States (France and USA). The case was decided in favor of the French transport company. The U.S. company appealed to the French Supreme Court.

The Supreme Court annulled and reversed the judgment of Court of Appeals. Citing Art. 1 CISG, which states that the Convention applies to contracts for the international sale of goods, and Art. 4 CISG, which states that the Convention governs only the rights and obligations of the seller and the buyer arising from a contract of sale, the Supreme Court held that the contractual relationship between the U.S. company and the French transport company was not a sales contract governed by CISG. This all the more so since the grounds of action of the French transport company was a guarantee for lack of conformity (garantie des vices cachés).

A second key aspect is the term "international" that regards the matter about the place of business of the parties rather than whether the goods cross international borders. About this, it is possible to analyze the Austrian Court decision about an Austrian seller and buyer, this latter with its place of business in Italy, concerning the dispute about the validity of an oral notice of non-conformity and the consequently application, decides in appealing, of the Austrian law that affirms the need of a written statement for this type of notice. The supreme Court states that *the citizenship of the parties (in the case at hand: both Austrian) is not relevant in order to determine whether CISG is applicable. Since the parties had their place of business in two different contracting States (Austria and Italy), CISG was applicable (Art.*

[60] Case 2P: CISG [1]; [4] France Cour de Cassation; 05.01.1999. Available at: http://www.unilex.info/case.cfm?id=362 [date of access: 24/05/2016].

1(1)(a) CISG). Therefore, the Art. 39 CISG has been applied determining that *notice of non-conformity may also be given orally*[61].

It's quite important to distinguish between international and domestic sales because a uniform law, applicable in both situations, cannot be desirable. The question is about the amount of problems that could occur at international level caused by a conflict of laws, whereas it does not generally arise in domestic law. Furthermore at domestic point of view, an international Convention is considered an intrusion into national sovereignty. At international level the need is the creation of a common bulk of rights and obligations for parties who come from a wide variety of legal and commercial backgrounds that is the purpose of the Convention.

It's very important to bear in mind that the Convention is not mandatory, then parties involve in a contract of sales can decide freely whether or not exclude the application of the Convention. Accordingly, parties must be careful in drawing up the contract, indeed, the Art. 3 of the Uniform Law of International Sales of Goods states that the "*exclusion may be express or implied*"; otherwise the CISG is considered applied.

The problem of a common law at international level is recovered in Art. 7(1): "*In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade".* Even if these words seem clear, they explain the existence of an "autonomous interpretation" defines by M. Gebauer as an interpretation that doesn't proceed by reference to the meanings and particular concepts of a specific domestic law[62]. It means, whether the Convention is drafted in more than one language, autonomous interpretation requires that the literal meaning of a term is taken into account in all authentic versions.

In conclusion, the CISG is applied only to international transactions and it avoids the recourse to rules of private international law for those contracts falling under its scope of application. International contracts falling outside the scope of application of the CISG, as well as contracts subject to a valid choice of other law, would not be affected by the CISG. Purely domestic sale contracts are not affected by the CISG and remain regulated by domestic law. The CISG has obtained a considerable success because it has been ratified by

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[61] Case 2 Ob 191/98: CISG [1]; [39] Austrian Oberster Gerichtshof **;** 15.10.1998**.** Available at: http://www.unilex.info/case.cfm?id=386 [date of access: 24/05/2016]

[62] M. Gebauer , *Uniform law. General principles and autonomous interpretation*, 2000, 5 Unif Rev 683,686-7

the major part of nations around the world and, then, it has proved to be a good instrument which produces sensible results in its use in practice and case law.

Considering the parties point of view, it's important to focus on the central role of the contract. Businesspeople have been able to overcome the difficulties, when they are engaged in international trade, because they found e method to fill the gaps of the system through the so-called "party autonomy", such as the freedom to establish the rules governing their relationships. In fact, when there is a lack of uniform and predictable legal environment, parties tend to create their own framework by using their freedom of contract.

"*Since the legal framework of international contracts is uncertain, parties will, as far as possible, work out contractual solution that can increase certainty and predictability by choosing the applicable law, by determining in advance the way to solve possible disputes and by defining in detail in the contract their rights and obligations*"[63].

The main aspects of party autonomy concern the choice made by parties about the best domestic law to include in their contract about the choice of the institution capable to solve disputes arising between parties and the definition of specific clauses and the right set of rules for their needs. Through these means, the parties can overcome many of the obstacles that come from the absence of a unique and well define legal environment. Anyway, the freedom of contract is not absolute. Every legal system has mandatory rules able to limit the autonomy of the parties involved with the purpose to avoid conflicts with other interests at stake. Here because parties must be careful when negotiating and drafting international contracts. It's fundamental to identify the sphere of application of the autonomy, especially in choosing the law and jurisdiction. A further attention is necessary in identifying the most appropriate contractual solutions to protect the interests of the parties.

2.1.2 The International Chamber of Commerce (ICC)

First of all, considering the key role of international trade as one of the most important driving force of the economy and, on the other hand, the wide range of risks faced by the parties involved, it was necessary the presence of a sovereign organization able to deal with the parties, enforce rules at international level and capable to solve disputes. This role was taken by the International Chamber of Commerce (ICC) that was founded in 1919. The ICC is "the

[63] Fabio Bortolotti, *Drafting and Negotiating international commercial contracts. A practical guide,* at 21, Paris, International chamber of Commerce, 2008.

voice of international business"[64] and its main objective is "*to serve world business by promoting trade and investment, open markets for goods and services, and the free flow of capital*"[65]. Through its various committees and commissions, the ICC works in areas spanning arbitration, banking, competition, e-business, customs and trade regulations, financial services and insurance, taxation, trade policy and transport and logistics. In these areas the ICC undertakes research and develops international commercial, legal and banking standards and guidelines that can be applied by the private sector worldwide.

It is one of the largest representative business organizations in the world with hundreds of thousands of member companies in over 130 countries spanning every sector of private enterprise.

Many of the rules, standards and guidelines developed by the ICC have a trade facilitation impact. Relevant works include the ICC Incoterms, the ICC Customs Guidelines and the ICC Uniform Customs and Practices for Document Credits (UCP). The following committees/commissions of the ICC are of particular importance: *The Committee on Customs and Trade Regulation* focuses on obstacles to trade related to Customs policies and procedures and works on issues such as Customs reform, modernization and transparent; simplified and harmonized Customs policies and procedures. *The Commission on Banking Technique and Practice* is a leading global rule-making body for the banking industry, producing universally accepted rules and guidelines for international banking practice, notably letters of credit and demand guarantees for bank-to-bank reimbursement. ICC rules on documentary credits, namely UCP 600 are recognized as the most successful privately drafted rules for trade ever developed. *The Commission on Commercial Law and Practice* facilitates international trade and promotes a balanced self-regulatory and regulatory legal framework for international business-to-business transactions, by creating model of contracts that facilitate trade between countries at all stages of development and between companies of all sizes and sectors.

[64] For details ICC website http://www.iccwbo.org.

[65] UNECE (2012), *Trade facilitation implementation guide: ICC*. Available on: http://tfig.unece.org/contents/org-icc.htm [date of access: 15/01/2016]

The main objectives of the ICC are: the promotion of trade and investment, open markets for goods and services and the free flow of capital for the overall world business. It tries to encourage a self-regulation of the business and defends the private enterprise system.

Nevertheless, it is important to bear in mind the contribution of underlying institutions. The ICC Banking Commission Opinions operates for educational purposes and to facilitate proper use of ICC rules (UCP, URR and URDG, Incoterms, as well as the ISBP); anyone can submit a query relating to ICC rules to the ICC Commission on Banking Technique and Practice. The Commissions' responses are called "opinions" and are routinely published by ICC Business Bookstore. Also, The ICC Banking Commission offers a service called "DOCDEX" (short for Documentary Instruments Dispute Resolution Expertise) that is a swift process for resolving disputes involving: a documentary credit incorporating the ICC Uniform Customs and Practice for Documentary Credits (UCP), the application of the UCP and/or of the ICC Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR); a collection incorporating the ICC Uniform Rules for Collections (URC) and the application of the URC; a demand guarantee incorporating the ICC Uniform rules for Demand Guarantees (URDG) and their application. The objective of DOCDEX is to provide independent, impartial and quick expert decisions about how the dispute should be resolved on the basis of the terms and conditions of the documentary credit, the collection instruction, the demand guarantee and the applicable ICC rules. The ICC charges a fee for handling cases under the DOCDEX system and a submission will be subject to the ICC Rules for Documentary Instruments Dispute Resolution Expertise.

2.1.3 UNIDROIT for the Unification of Private law: UNIDROIT Principles

"*The International Institute for the Unification of Private Law (UNIDROIT) is an independent intergovernmental organization located in Rome. Its main purpose is to study the needs and methods for modernizing, harmonizing and coordinating private and commercial law between states*" (Bortolotti, 2010).

The Institute drawn up different conventions with the aim to establish a set of uniform laws capable to be applied to international contract and, in this way, to simplify trades for businesses and traders. In particular, these conventions are:

- The 1964 Hague conventions for the drafting of a Uniform Law on Contracts for the International Sale of Goods that they were the basis for the following CISG that replaced them;
- The 1988 UNIDROIT Convention on International Financial Leasing;
- The 1988 UNIDROIT Convention on International Factoring.

Even if, the most important achievement was the set of Principles on International Commercial Contracts (**UNIDROIT Principles**) that become a powerful instrument for the development of international commercial law.

The UNIDROIT Principles were published in 1994 and they were updated in 2004 and more recently in 2010 with a new edition. The preamble affirm as these Principles "…*represent a system of principles and rules of contract law which are common to existing national systems or best adapted to the special requirements of international commercial transactions*"[66] and that they are a general set of rules for international commercial contracts applicable when parties agreed on their application or, simply, when they agreed the contract is governed by general principles of law or, finally, if parties have no made a choice about governing law. The Principles may be used also to interpret or supplement international or domestic law and they can serve as a model for national and international legislators[67].

The UNIDROIT Principles try to define the formation, validity, performance and all the other general rules concerning contracts. They obtain a wide and rapid success at international level because they fill an important gap, such as the need of a set of rules to apply at international level to create a uniform and transnational law that is different from the domestic law of each state. The Principles were drafted for the business world to provide a set of private rules that parties might decide to incorporate in their contracts. In fact, the UNIDROIT Principles are applied when are the same parties that expressly submitted their contracts to them, i.e. parties wishing governing their contract with the Unidroit Principles, they should include these words: "*This contract shall be governed by the UNIDROIT Principles (2010)".* Nevertheless, they could be applied even when no choice between parties is made. For example in the ICC

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[66] UNIDROIT, *Unidroit Principles of International Commercial Contracts,* Rome 2004. Available at: http://www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf [date of access: 01/03/2016].

[67] Reviewed from UNIDROIT, *Unidroit Principles of International Commercial Contracts,* Preamble pag.1, 2010. Available at: http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf [date of access: 01/03/2016].

case 7110[68], a contract refers to "natural justice": the arbitrator concludes that the parties intended to have their contract governed by general rules and principles rather than their respective domestic laws. Indeed, the arbitrators state: "*…this Tribunal finds that the Contracts are governed by, and shall be interpreted in accordance with, the Unidroit Principles with respect to all matter falling within the scope of such principles…"*

Anyway, parties can freely decide to choose the Principles as the "applicable law" to govern their contract instead of the rules of the domestic law system to determine through the use of rules of private international law. This decision made by parties can be an interesting solution since Unidroit Principles represent a balanced system of law easy to understand and capable to be used as an appropriate legal framework for international contracts.

2.2 THE RULES OF PRIVATE INTERNATIONAL LAW

2.2.1 Introduction

Several cases of civil law involve "foreign elements", such as: foreign residence, a contract made in a foreign country, etc… considering these cases, the application of the *lex fori* seems not feasible as well as the arbitrary choice of applying one of the foreign legal systems. Solving these issues is the role of the "private international law" (PIL) consisting in legal norms that determine three types of issues:

1) which state court has jurisdiction in private matters having cross-border implications;
2) which state law is applicable in such matters: what law (domestic of foreign) have to regulate a dispute, a contract or some events include foreign elements;
3) under which conditions may a foreign decision be recognised and enforced in another country.

About this, an Italian Court's ruling "Cassazione 8 febbraio 2001 n. 46[69]" affirms: "*Funzione propria di ogni norma interna di diritto pubblico privato è quella di individuare, in base a predefiniti criteri, la disciplina applicabile dal giudice italiano in rapporti di diritto privato che presentino un qualche elemento di estraneità rispetto all'ordinamento dello Stato, id est*

[68] Case 7110: ICC [17] ICC Arbitration Rules; ICC International Court of Arbitration (First Partial Award); 06.1995. Available at: http://www.unilex.info/case.cfm?id=713 [date of access: 22/12/2015]

[69] Case 46: Cass. (S.U.) 8 febbraio 2001, in Rdipp, at 137, vol. XXXVIII, 2002.

di internazionalità, in ragione della nazionalità di una delle parti o della ubicazione all'estero dei beni oggetto della controversia".

The problem of applicable law occurs because of the disparities between the substantive rules regulating certain issues in different legal systems that might cause problems to commercial entities since they may be confused about the law under which they should act. Keep going on this way may create an obstacle to proper functioning of the internal market. The solution has to be found through the unified conflict-of-law provisions. The need of the international legal trade has been satisfied through the private international law that provides the conflict-of-law-provisions with the aim to evaluate all the relationships and events under a unique law even if they take place beneath different law systems. Otherwise, the citizens would be encouraged to engage in **forum shopping**, i.e. choosing the courts of one Member State rather than another just because the law is more favourable there, obtaining in this way an advantage because he might choose to regulate the dispute under the law system that best suits his purposes.

The structure of the rules of the private international law is the same of the *normae agenda*. In fact, they include a "precept" used to identify every case (i.e. adoption, contractual obligations, the capacity, divorce, etc…) and a "consequence" that outlines the rules applied in those cases. They are "complete" but as Barile said: "*Le conseguenze giuridiche della regola di diritto internazionale privato hanno questo di peculiare, invece di essere costituite dal regolamento diretto, costituiscono nell'indicazione dell'ordinamento (interno o esterno) che deve regolare le fattispecie*" (Lezioni, cit. at 84). Concerning the nature of these cases, the major opinion considers them as "facts and relationships of the real life". Without doubt, it is sure that the rules of private international law are used in those cases (real facts and relationships) when they present foreign elements.

A further clearly explanation is that provided by Morris:" *The conflict of laws is a part of* the private law *of a country which deals with cases having a foreign element. It means simply a contact with some system of law other England law… if an action is brought in an English court for damages for break of contract made in English between two Englishmen and to be performed in England, there is no foreign element,… and the English court will naturally apply the domestic law… if… the contract was made in France between an Englishman and a Frenchman but was to be performed in England, then the case is a case in the conflict of law*

... and the court will have to decide whether the French or the English are the more significant law to apply"[70].

These unified conflict-of-law provisions have been initially adopted in a form of international convention, the 1980 Rome Convention on the Law Applicable to Contractual Obligations. In recent years, the EU instruments are being adopted in different fields of private international law, for example the Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) that replaced the Rome Convention. This has become possible following the amendments to the founding treaties introduced by the Amsterdam Treaty. In fact, the new provisions, contained in Article 65(b) of the EC Treaty, enabled the European Community to legislate these civil law matters transferring the legislative competences in the field of private international law from the Member States to the Community (the so-called **communitarisation** of private international law). This shift was intended to facilitate creation of the Area of Freedom, Security and Justice, an objective set by the Amsterdam Treaty[71].

2.2.2 A conscious choice: applicable law vs. jurisdiction

It seems crucial to clarify an important point concerns the difference between the choice of the applicable law and that about jurisdiction. The applicable law answers to the question about which rules can govern the contract; instead the determination of the subject entitled to decide potential disputes regards the jurisdiction.

Considering the parties involved, such as business people, the explanation is necessary because often they are convinced that choosing the jurisdiction is, at the same time, the choice of the applicable law and vice versa. This is a clear mistake: when a jurisdiction of a given country is chosen, parties think that the law of such country will be definitely the law governing the contract. Clarify the matter has a great importance because it cannot be wrongly believed that these two elements coincide. In fact, when rightly parties choose both elements separately: the court chosen by parties (jurisdiction) will apply the law (applicable law) chosen by parties even if it might not be the law of the place in which court is placed.

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[70] Morris, *The Conflicts of Laws,* London, p.3, 1980.

[71] Reviewed from Kunda I., *Practical Handbook on European private international law*, Civil Justice programme 2010. Available at: http://old.just.ro/LinkClick.aspx?fileticket=Mx%2BaR1qqfmU%3D&tabid=2285

A well-drafting contract is not sufficient to solve every kind of problem that may arise even if a wide part of traders think it is sufficient. Moreover, they avoid dealing with these rules that govern contracts because they are considered too much complicated. Further, non-lawyers consider the contract a document already full of clauses without considering that it is enclosed in a context of legal rules whose might be really affect their agreements and lead to strong consequences.

A simple example, explains by Bortolotti, involves a German exporter that uses a French company as agent in the French market. During the drafting of the contract they have never dealt with the issue of applicable law. When German exporter decides to terminate the agency agreement, the French company asks for a goodwill indemnity for the two years of commission. Here the problem is that under French law: the company is entitled to receive this indemnity but on the contrary but under German law, nothing is due to the French agent. Finally, the matter will be decided depending on the applicable law previously define. But if German principal had insisted on the choice of German law during the negotiation of the contract, it would have definitely avoided the payment of indemnity[72].

Nevertheless, also when parties pay attention in drafting the contract, there are some contractual rules that could conflict with the defined applicable law. For this reason the awareness and knowledge of applicable law and rules governing contract is fundamental. They can tell if the clauses are admissible or not and how the unchosen elements of the contract will be regulated.

2.2.3 The Rome Convention of 1980

In order to determine the applicable law parties have to choose among one of the national law systems that is the domestic law of the chosen country. Whether parties have made no choice, it is possible to refer to the rules of private international law specifically made to solve the *conflicts of law;* in fact every national legal system provides these rules to apply to international matters. The conflict of law arises frequently because domestic law system differs from a country to another and when a dispute arises between parties from different counties, what happen is that every national court involved would regulate the question under its domestic law. This situation may create uncertainty and provide contradictory solutions

[72] Reviewed from Fabio Bortolotti, *Drafting and negotiating international commercial contracts,* at 32, Paris, ICC, 2010.

due to the variety of national conflict of law rules. For example in solving a case in which parties come from two different countries every court would like to use its domestic rules obtaining so a different outcomes depending on which court will be chosen to solve the dispute.

With the aim of unify the rules of private international law, the Rome Convention of 1980 was the most successful initiative, afterwards enforced in all Member State of the European Union. The Convention specially refers to the applicable law to contractual obligations and it has a universal scope well explains in its preamble that claims the objectives supported by the Economic European Community about the private international law and specifically in regulating the contractual obligations: "…*to continue, ..., the legal unification ..., in particular for the jurisdiction and judgement execution, eager to adopt uniform rules concerning the applicable law for contractual obligations*".

The application of the Convention is explained in the first articles provide a "positive" definition, such as the sphere of application of the convention that is determined in the art. 1:" *The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries"*; instead the "negative" definition is enclosed in the following paragraphs[73] in which are defined the matters excluded from the scope of the Convention[74]. In other words, the Convention focuses on contractual obligations and regulate them only when a conflict of law is faced.

The body of the Convention regulates not only the obligations arising from the contract rather every part of the contract from its existence to its interpretation and execution through the enclosed international private laws. Thus, is recognised the overall sphere of application of the Convention that includes the contract as a whole rather than only the mere contractual obligations. At any rate, there is a gap within the Convention about the absence of a definition of "contract" that creates several problems in the qualification of situations like contractual or not. A consequently issue regards the choice of the legal system entitled to ascertain the contractual or non-contractual nature. The *lex fori* cannot be applied because in this way the scope of the Convention is not considered and its application becomes useless. The scope of the Convention is to assure the application of the same law to similar issues

[73] Art. 1(2)(3)(4) Rome Convention of 1980

[74] "Positive" and "negative" definition of art.1 Rome Convention was reviewed from VILLANI U., *La convenzione di Roma sulla legge applicabile ai contratti*, Cacucci editore, 1997.

whatever is the legal system of the judge. For this reason, it is possible to consider that the **contractual qualification** has to be executed "independently", such as on the light of the same Convention and without considering the domestic law of the appointed judge. The same art. 18 of the Convention underlines the need of a uniform interpretation: "*In the interpretation and application of the preceding uniform rules, regard shall be had to their international character and to the desirability of achieving uniformity in their interpretation and application*". However an independent and uniform interpretation of the term "contract" might be inferred through the elements enclosed in the same Convention, for example the art. 10 defines the "scope of the applicable law" to the contracts considering items and issues governed by the Convention to whom the Convention gives contractual nature[75]because subjected to the governing law of the contract. In other words, if Convention defines a list of elements subjected to the applicable law, it labels these elements as essential items necessary to form the structure of the contract determining just like that their nature of fundamental parts of the contract. At this point, it's possible to affirm that this autonomous interpretation under the Convention of the notion "obligation" can lead to qualify it as *contractual* obligation even if the domestic law of the country of the judge would have determined the obligation as a non-contractual one.

The "conflict of law" is a key aspect of the Rome Convention, as aforementioned it means a situation in which the same contract has connections with more than one legal system everyone entitled to regulate the contract. Since it is not automatic and easy determine whether being or not being in front of a conflict of law, the judge or the interpreter has the duty to ascertain the existence of a conflict of law first of all assessing the existence of relevant connections with other States. In case of a positive response, the Rome Convention will be applied; or, otherwise, ascertaining the fortuity and irrelevance of these connections will lead to exclude the presence of a conflict of law.

An important reference to the Rome Convention is inside the art. 57 l. 218/1995 concerning the Italian "reform of the private international law" that establish the application of the Convention in the cases of contractual obligations: "*Le obbligazioni contrattuali sono in ogni*

[75] Art. 10 "Scope of the Applicable law": *1) The law applicable to a contract by virtue of Articles 3 to 6 and 12 of this Convention shall govern in particular: (a) interpretation; (b) performance; (c) within the limits of the powers conferred on the court by its procedural law, the consequences of breach, including the assessment of damages in so far as it is governed by rules of law; (d) the various ways of extinguishing obligations, and prescription and limitation of actions; (e) the consequences of nullity of the contract.*

caso regulate dalla Convenzione di Roma…, senza pregiudizio delle altre convenzioni internazionali, in quanto applicabili"[76].

2.3 THE INTERNATIONAL APPLICABLE LAW FOR BANK GUARANTEES

When a business relationship takes place parties wish to be sure about the good faith of the other. Often, to enhance this certainty is asked to reinforce the commitment through an undertaking by a third party acting as guarantor. This role is traditionally performed by banks; any bank payment obligation is governed by uniform rules of banking practice published by the International chamber of commerce (ICC) and they are incorporated into all contracts provided by banks for their customers and with beneficiaries of payment undertakings. The increasing importance of guarantee in the international scenery led different organizations to establish rules and practices to safeguard the wide range of interests involved and to develop commercial trading. More than one set of rules governs guarantees, the four sets of rules relating to a payment undertaking are:

- the Uniform Customs and Practice for Documentary Credit (**UCP 600**) (2007 Revision) (ICC Publication No. 600). UCP 600 are universally used for commercial documentary credits but can also be used for standby letters of credit;
- The Uniform Rules for Demand Guarantees (**URDG 758**) (ICC Publication No. 758). URDG 758 consists of a set of rules to govern demand guarantees. They are effective as of 1 July 2010. They replace ICC's first set of guarantee rules: URDG 458;
- the International Banking Standby Practices (**ISP98**). Developed by the Institute of International Banking Law and Practice endorsed and published by ICC. ISP98 are the basic rules for the use of standby letters of credit worldwide. They embody firm directions capable to be incorporated into contracts give rise to legal rights and duties as well good practice that banks are urged to follow;
- the Uniform Rules for Contract Bonds (**URCB**).

[76] See para 3.1 Chapter 3 "The evolution of Italian law: from a national to an international point of view"

2.3.1 The Uniform Custom and Practice for Documentary Credit (UCP 600)

It is essential to analyze the main Rules surrounding the world of guarantees and then it shall be taken into account the UCP 600 that were especially drafted for documentary credits. Although they present several differences from the specific demand guarantees, they have had a role in the regulation of standby letters of credit and thus, it seems fundamental to provide a wide awareness about all the available instruments in order to better explain the legal system in which guarantees are involved.

The 39 articles of UCP 600 are a comprehensive and practical working aid to bankers, lawyers, importers, and exporters, transport executives, educators and everyone involved in letter of credit transactions worldwide[77]. The objective of the ICC was to create a set of contractual rules that would establish uniformity in that practice so that practitioners would not have to cope with a wide range of conflicting national regulations. UCP 600 are the latest revision of the Uniform Customs and Practice, it differs from the old UCP 500 in providing new terminology, concepts and including a re-organization of the rules, substantive & cosmetic changes and an improvement of clarity.

Some fundamental principles of the documentary credit are included in the UCP 600[78]:

- *Autonomy of the credit:* even the documentary credit has its peculiarity in its separation from the sale or other contract on which it is based. It means that no exceptions can be relieved by bank to avoid the beneficiary's payment. The rule is "pay first, argue later" even if cases of fraud represent an exception giving rise to a link between the documentary credit and the underlying contract.
- *A documentary credit takes effect upon issue:* a credit becomes irrevocable upon issue (art. 7(b)), that is upon the control of the issuer without considering when it is received by the beneficiary.
- *Documentary character of the credit:* "all parties deal with documents" rather than with goods, services or performance. Bank has its main obligation to examine the documents if they appear on their face to conform to the credit.

[77] Preamble of UCP 600. Available at: http://www.fd.unl.pt/docentes_docs/ma/mhb_MA_24705.pdf [date of access: 01/05/2016]

[78] Principles reviewed from GOODE R., Transnational commercial law: text, cases and materials, KRONKE H., MCKENDRICK E., at 360, Oxford university press, 2011.

- *Banks are concerned only with the apparent good order of the documents:* as aforementioned, the bank's duty is the examination of any document with reasonable care to determine whether or not they represent a complying presentation (art. 14(a): "*Complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of the UCP and international standard banking practice*"). It should bear in mind that this disposition was created for the protection of the banks, in fact, in no way a beneficiary could obtain payment if documents present some problems.
- *Banks deal as principals rather than as agents:* Bank assumes a payment liability as a principal, when it issues a credit, not as an agent on behalf of the account party. Indeed, bank's duty to pay against documents' presentation is not dependent on its customer's consent. Then, whether the account party asks to withhold payment, bank cannot refuse if documents are in order.
- *The terms strict compliance:* the documents must be conform to the terms of the credit and be presented within the determinate period.
- *Non-transferability of the credit:* the rule affirms that only the designated beneficiary can present the documents and then collect payment. For this reason the credit is not transferable unless it is designated as such (art. 48(b)).

The key documents required to be presented are: a transport document (bill of lading), an insurance document and a commercial invoice; the underlying contract can also require further documents, such as a certificate of origin or quality. Instead, within the art. 10 are qualified the different credits considering the payment methods. For example, a "sight payment credit" entitles the beneficiary to payment only with the documents presentation or a "deferred payment credit" has to be made on the maturity date or on a pre-determined date.

A big change maintained in the current version, UCP 600, concerned the inclusion **of standby letters of credit**, this because especially American banking practices commonly refer to the UCP regulation when banks issue standby letters of credit with the purpose to dispel any doubt about its independent and documentary nature. Focusing on the definition provided by the article 1 that introduces the UCP 600[79] as a "*set of rules applicable to any documentary credit ("credit") (including, to the extent to which they may be applicable, any standby letter*

[79] The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 ("UCP")

of credit) when the text of the credit expressly indicates that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit".

With the coming into effect of the URDG, the standby letters of credit looked like more similar to independent guarantee because they serve the same purposes and operate in the same way rather than documentary credit with which there were several differences. In fact, standby letters of credit better suit to the URDG definition of a demand guarantee and they fit perfectly in the URDG framework. At this point, it seems more appropriate to subject standby letters of credit to the URDG than to the UCP. Even though this change is a bit tricky due to the banks' habits: they ordinarily manage standbys under the same departments that deals with traditional commercial letters of credit. In effect they continue to subject standbys to the same UCP used for documentary credit yet.

2.3.2 The Uniform Rules for Demand Guarantees (URDG)

In addition, the ICC edited in 1992 the Uniform rules for Demand Guarantees. The URDG, instead of the previous URCG[80], recognize the practice of issuing guarantees payable on first written demand without the need of other documents in addition to a simple statement of breach required by the Rules. Regrettably, it has not gained wide acceptance yet because of the hesitation of banking system in adopting the rules. The reason regards the possible conflict that might arise between the URDG and the documentation of the guarantee used by bank or the provisions that bank and client would include or exclude. This fear seems unfounded since the URDG do not include texts of guarantees or specific provisions and, at any rate, every rules can be excluded or modified by contractual clauses in the guarantee at parties' will. Apart this luke-warm reception a global acceptance will take place in view of its authoritative source and because it started already to influence the development of the law where, in several subsequent situations, some courts resolved the issues by express reference to the Rules.

The main features[81] of the URDG include its *Contractual nature (Art.1):* It is *"apply to any demand guarantee or counter-guarantee that expressly indicates it is subject to them"*. The

[80] "Uniform Rules for Contract Guarantees" replaced by URDG.

[81] Reviewed by Bertrams R. (second revised edition), *Bank Guarantees in International Trade*, at 23-25, London, Kluwer Law International, 1996.

URDG does not have the force of law but they require the explicit or implicit consent of the parties, as part of the contractual nature. Secondly, the *independence (Art. 5(A))* from the underlying relationship; it means that the payment obligation of the guarantor is solely determine by the conditions of payment included in the guarantee. A further characteristic involves the *documentary conditions (Art. 6)* which limit bank's obligations to investigate and verify facts that trigger off the bank's payment obligation. Banks can only deal with documents and it is entitled only to check whether the documents tendered are in conformity with the documents prescribed in the guarantee and then, bank has not to deal with the facts underlying the documents. Connected with the previous one there is, as treated in the UCP 600 for documentary credit as well, the *formal examination* that focus on banks. In the relationship with both account party and the beneficiary the bank is concerned whether the documents appear on their face to conform to the documents required by the guarantee. Finally, the *transnational/national use* whereby, even if URDG was created to provide uniformity in law for transnational transactions, the Rules can also be used for domestic transaction and the connected *payment mechanisms* where the focus is based on words. Indeed, the name of the Rules, URDG, states for Demand Guarantee that are commonly understood to refer to guarantees which do not require any types of evidence against account party's default. Conversely, the URDG is related to guarantees with different payment mechanisms which can still require real documentary proof of default and, for this reason, it could be better to name it as Uniform Rules for Independent Guarantees. Apart from this, the URDG allow for the insertion of all kinds of terms and conditions formulated in a documentary fashion.

The need to provide a written statement in case of debtor's default is explain in the art. 20(a) as: "*Any demand for payment under the Guarantee shall be in writing and shall be supported by a written statement (...) stating: (i) that the Principal is in breach of his obligations under the underlying contract or, in the case of a tender guarantee, the tender conditions; and (ii) the respect in which Principal is in breach*". This inclusion is a unique feature provided by the URDG and its aim is to provide check on abusive calling without interfering with the immediacy of the performance of the payment undertaking. Anyway, the check is very limited but it is able to prevent an abusive call since anyone is reluctant to put its name to a false statement.

As stated by Goode, the advantages[82] provided by the URDG are very wide and they affect all the parties involved:

- *Beneficiary's point of view*: firstly, the indisputable independent nature of the URDG guarantee; if the guarantee is found to be a demand guarantee, the beneficiary is entitled to obtain payment only when he presents a complying demand although he has not the evidence of the occurred breach; otherwise with a suretyship, the beneficiary has to prove the principal's breach before.
- *Guarantor's viewpoint*: the main characteristic is its independence; the guarantor's undertaking is insulated from the underlying transaction and it is subjected only to its own terms. It does not mean that assessment of the beneficiary's assertion of breach or the determination of the amount of the exact loss are duties arising from the bank's undertaking.
- *Principal's outlook*: it has been claimed as the URDG sacrificed the principal's interests in favour of those of beneficiary but this is not completely true and, in any case, this weak position has been improved with the introduction of the new URDG 758. the benefits for the principal debtor are enclosed in two categories: 1) *new rights* including the obligation of bank to: provide comprehensive information[83]; a safe regulatory harbor provided by URDG, in this way principal is protected from the risk of dealing under unknown foreign laws; the release from the principal's obligations when an uncontrollable event takes place (art. 13), that is the risk of "force majeure" that falling onto the beneficiary rather than onto the principal on the grounds that an event of force majeure cause the impossibility of calling the payment. For example, under the URDG, uncontrollable events do not give the possibility to suspend or extend the validity of the guarantee; for

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[82] Reviewed from Goode R., *Transnational commercial law: text, cases and materials*, Kronke H., Mckendrick E., at 373-374, Oxford university press, 2011.

[83] The 1995 UNCITRAL Convention, *United nations convention on independent guarantees and stand by-letters of credit,* assigned a particular relevance to the reporting requirements between guarantor and debtor (in *BBTC*, 1996, I, 577 s.); and within the Italian Legge Delega al Governo per le modifiche al codice civile, in materia di disciplina della fiducia e del contratto autonomo di garanzia, ed al codice del consumo (Ultimo governo Berlusconi): "*Il garante avrà l'obbligo di comunicare al debitore ogni circostanza inerente l'esecuzione del contratto autonomo di garanzia, e in specie sarà tenuto a informare il debitore dell'avvenuta escussione della garanzia da parte del creditore. La violazione di quest'ultimo obbligo, preposto a consentire all'obbligato l'avvio di ogni iniziativa a tutela delle sue ragioni, comporterà l'impossibilità per il garante di esercitare l'azione di regresso nei confronti del debitore*", cit. Montanari A., *Il contratto autonomo di garanzia,* Scuola di specializzazione per le professioni legali, Università degli studi Roma Tre, 2014. Available at: http://www.giur.uniroma3.it/materiale/forense/2013-2014/civileII/MONTANARI_SSPL%206%20feb%202014_garanzia%20autonoma.ppt. [date of access: 13/10/2015]

this reason if the beneficiary is unable to present a demand before the expiry of the guarantee, he will not be entitled to claim payment after, even if the delay happens for an event of force majeure. 2) A *flowing negotiation environment* provided by URDG capable to giving benefits to the Principal in saving costs and time. In fact, the URDG offers a framework for the guarantee with which principal increases its possibilities to obtain the beneficiary's consent and consequently both the parties are avoided to draft extensive clauses including all the necessary elements (i.e. the guarantee's irrevocability, the guarantor's duties, the condition to accept a demand for payment, etc…).

Technically the URDG were applicable to standby letters of credit even if the ISP98 have been specifically designed for standbys at a later time.

2.3.3 The international Standard Practices (ISP98)

UCP 600 can be applied to standby letters of credit, when they may be applicable, even though they were especially set for documentary credit. As already mentioned, URDG were more appropriate for standbys since they are almost indistinguishable from independent guarantees. However, standbys were used for a wider variety of purposes and include more techniques coming from documentary credit. For all these reasons, it would be necessary to draft a set of rules involving aspects of UCP but well fitted for standby letters of credit. Thus, in order to satisfy these needs, the International Standard Practices (UCP) was designed for these purposes. The ISP 98 embodies, like UCP and URDG, the elements of irrevocability, independence and documentary nature; further, it contains other rules especially for standbys including provisions for the nomination of a person to advise, receive a presentation, confirm, etc…

Interestingly, the ISP98 describes all the characteristics of standbys but they never give a clear definition. As Byrne claims: "*No definition of a standby letter of credit is provided in these Rules. ... Rather than being overly concerned with a technical definition, ISP98 leaves it to the market to decide with which undertakings it is best used… as recognized in the Rule 1.11(b) (interpretation of this Rules), "standby letter of credit" and "standby" have different meanings in the Rules. A "standby letter of credit" is the type of letter of credit which is understood to be a letter of credit. A "standby" is any undertaking subject to these Rules. Thus, an independent guarantee subject to ISP98 would be a "standby" for purpose of these*

Rules"[84]. Therefore, ISP98 are applied to "standby letters of credit" as recognized by the market as well as any other form of guarantee if it is subjected to the Rules.

Standbys are used in default situations. The Bank of International Settlements classifies them as "performance standbys" to assure performance of various undertakings and for this reason they reflect the characteristics and uses at which independent guarantees are subjected. In conclusion, the only satisfactory definition is that of Goode defining standbys as: "*independent undertakings to pay against the presentation of documents which is not predicated upon payment against documents related to the sale of goods*"[85].

2.3.4 The Uniform Rules for Contract Bonds (URCB)

A brief mention is necessary for a further regulation that was requested from different representatives during the preparations of the URDG. The Uniform rules for Contract Bonds (URCB) have been drawn up by the ICC commission on Insurance in cooperation with the construction industry. Here because, they expressed their concern about the first demand guarantee requiring no evidence of the principal debtor's default and their concern about the risk of beneficiary's abuse. This concern was supported by the representatives of different countries, the insurance industry and by the construction industry because it tended to be on the principal debtor's side. The URCB are a set of contract terms and their incorporation in the contract depends to the will of the parties. They are most likely used in the construction industry but at any rate they can be incorporated in any kind of contract if parties agree. The art. 3 states how the guarantor's liability is accessory and all defences of the principal debtor against the beneficiary are available to the guarantor. In case of dispute, the default must be established through a certificate of default under the form of a certificate issued by a third-party or by the same guarantor or by the final judgment of a court or tribunal as stated within the art. 7. For this reason, URCB are different from URDG because beneficiary has to prove the contractor's default; thus, beneficiary cannot issue a demand for payment accompanied only by a statement of breach. Now, it seems clear that URCB presents the structure of the suretyship bond with an accessorial contractor's liability and the need to provide a proof of default. About its usage, unfortunately, the URCB has a structure and language difficult to

[84] James E. Byrne, *The Official Commentary on the International Standby Practices,* Institute of International Banking Law & Practice, Montgomery Village, 1998.

[85] Roy Goode, *Transnational Commercial Law,* H. Kronke, E. Mckendrick, Oxford, cit. at 381, 2010.

comprehend and, in addition, the URCB do not clearly explain when the beneficiary is entitled to payment.

Chapter 3

BANK GUARANTEES: AN ITALIAN OVERVIEW

3.1 THE ITALIAN DEFINITION AND ACKNOWLEDGMENT

The dynamical and unrestrainable internationalisation of the relationships has made necessary a constant and continuous comparison with the other countries: traders ask and seek for more swiftness and security as well as for the overcome of the so-called atypical risks even more uncontrollable and knowable. It led to set up new typologies of guarantees among which the independent guarantee.

The Italian doctrine outlines the different typologies of guarantees. Some guarantees are on assets and others are personal guarantees. This latter category includes guarantees offered by a third-party rather than the principal debtor. Specifically, it is a guarantor that undertakes to satisfy the creditor whether principal debtor is insolvent. Therefore, it's specifically in this category that a contract of independent guarantee is included.

As well as internationally, also the Italian legislation presents the division between suretyship (the Italian "fideiussione") and the so-called non-accessorial independent guarantee ("garanzie a prima richiesta") even if the principal form of personal guarantee, involved in the Italian Civil Code, has always been the suretyship. Suretyship is characterised by the *accessorial principle* explaining how and in what extent the creditor is subjected to the exceptions of the guaranteed principal obligation (art. 1939 c.c.: validity of the suretyship and art. 1945 c.c. about the principal debtor exceptions against creditor). In other words, suretyship is an accessorial obligation that exists only if the principal obligation exists. This link remains until the conclusion of the underlying contract and, in addition, it suffers every limitation and amendment suffered by the principal obligation.

As aforementioned, at international level, practice gave rise to a new type of security: independent guarantees whose main feature is the separation from the principal obligation. In Italy, the first to argue about the phenomenon was G. Portale in 1978, where in his study[86], he

[86] Giuseppe Portale, *Fideiussione e Garantievertrag nella prassi bancaria*, in Nuovi tipi contrattuali e tecniche di redazione della pratica commerciale, Quaderni di Giur. Comm., Milano, 1978, vol. II, 1053 s.

demonstrated the consistency of this atypical guarantee. This new form involved the undertaking of a part (guarantor) that oblige itself to refund, through an amount of money on first demand/on simple request, the obligation due or payable by the principal debtor when this latter is in default. Independent guarantee is an atypical contract and it comes from international practice but it was fully implemented in the Italian bank practices even though independent guarantee isn't expressly enclosed in the Italian Civil Code.

The independent guarantee was born and was structured to be an assurance requested by the client/beneficiary as condition for the conclusion of the underlying contract. It is provided by bank or an insurance company in favour of the client/beneficiary whereas, in this way, the client is ensure to be indemnified for the principal debtor's default. The principal aim of the contract of independent guarantee is the transfer from a party to another of the economic risk linked with the failure of a contractual obligation. More specifically, this risk is transferred to the bank starting, in this way, to incorporate: the risk of failure in signing the contract (bid bond); the risk of an improper execution of the contract (performance bond); etc…

Anyway, the *causa (*Italian language) or function of the guarantee is to ensure the payment of a predetermined amount of money when a risk, written in the text of the guarantee, is faced by the beneficiary.

The *economic function* of an independent guarantee gives at the guarantee the role of "deposit" but differs from this latter because guarantee is less onerous and avoids a long binding of assets. It just tries to cover the atypical risks of the beneficiary that come from the underlying contract and this coverage is carried out through the transfer of the risks towards the bank. This function is well explained at the point of view of bank because it uses to assign a different meaning to the event: it's not a guarantee for the fulfillment of a third-party obligation but it is an amount of money in favour of one of the parties of the underlying contract[87]. To better explain, Savari writes down the rulings Cass. S.U., 18 febbraio 2010, n. 3947 stating: "*L'obbligazione del garante autonomo è, dunque, qualitativamente distinta da quella principale, non essendo rivolta al pagamento del debito stesso, bensì a indennizzare il creditore insoddisfatto attraverso il tempestivo versamento di una somma di denaro predeterminata, sostitutiva della mancata o inesatta prestazione del debitore"*[88].

[87] Bonelli F., *La garanzia bancaria a prima domanda nel mercato internazionale*, at 29, Milano, 1991.

[88] Available at: http://www.legalionline.com/html/cass3947-2010.html [date of access: 25/04/2016]

At that time, the independent guarantee must be considered, under its genetic profile, as a contract totally different from that of the simple insurance or that of the suretyship. Different from the first because it is focused in fulfilling a third-party obligation rather than a mere shift of risk and it differs from a suretyship for its non-accessory nature and because it is not free, this because the independent guarantee is necessarily onerous. It is stipulated between principal debtor and guarantor having as object an obligation with nature and content different from that of the principal debtor involved in the underlying contract.

Gemma defines independent guarantee as a contract focusing on the obligation, undertaking by bank or insurance company, to pay a previous determinate amount of money to the beneficiary with the purpose of guarantee the fulfilment of the obligation due by a third-party (principal debtor) to the beneficiary and calling it on simple demand if a default event takes place. Moreover, the guarantor will renounce to any claims of the underlying relationship between beneficiary and principal debtor[89]. Another famous interpretation is that made by The Turin Court 2002[90]:

"*un articolato coacervo di rapporti nascenti da autonome pattuizioni tra il destinatario della prestazione (e beneficiario della garanzia), il garante (sovente un istituto di credito), e il debitore della prestazione (ordinante la garanzia atipica) ", in attuazione di una complessa operazione economica destinata a dipanarsi, sotto il profilo della struttura negoziale,…"*

Here the focus is on the different relationships derived from the complex economic operation that is the result of the will and intentions of the parties.

"…attraverso una scansione diacronica di rapporti, il primo (di valuta), corrente tra debitore e creditore, tra cui viene originariamente pattuito l'adempimento di una certa prestazione del primo nei confronti dell'altro, il secondo (di provvista), destinato a intervenire tra debitore e futuro garante, con esso pattuendosi l'impegno di quest'ultimo a garantire il creditore del primo rapporto, il terzo nascente, infine, tra creditore e garante, con quest'ultimo senz'altro obbligato ad adempiere alla prestazione del debitore a semplice richiesta del primo nel caso

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[89] Gemma A., *Contratto autonomo di garanzia, fideiussione a prima richiesta e lettere di patronage*, pag. 8, Lezione 6 marzo 2014, Scuola di specializzazione per le professioni legali, Facoltà di Giurisprudenza – Roma tre. Available at: http://www.giur.uniroma3.it/materiale/forense/2013-2014/civileII/Lezione%20SSPL%20del%206.3.14%20%20Prof.%20Gemma%20-%20Contratto%20autonomo%20di%20garanzia.pdf [date of access: 25/03/2016]

[90] Trib. Torino, 29 agosto 2002 (note of Silvio Pietro Cerri), *contratto autonomo di garanzia (Garantievertrag) – Nozione e caratteri – Differenze rispetto alla fideiussione – Fattispecie*., Rassegna giuridica umbra – diritto civile, at 11, december 2012.

di inadempimento del secondo (rapporti ai quali non risulterà poi inusuale l'aggiunta di una quarta convenzione negoziale collegata, quella tra un secondo istituto di credito controgarante e banca prima garante, avente lo stesso contenuto del primo rapporto di garanzia) ".

The second paragraph better delineates these relationships: a "rapporto di valuta" to identify the economic relationship between creditor and debtor that gives rise to the underlying contract (supply of goods, tender, etc…); "Rapporto di provvista", namely *mandate* between guarantor and debtor; and then the last between guarantor and beneficiary in which the guarantor undertakes to fulfil the obligation with the formula "on first demand" in case in which the debtor will be insolvent.

Now, it is possible to summarise the main characteristics of an independent guarantee:

a) Bank undertakes to fulfil its proper obligation derives from the guarantee; it "*takes the commitment to pay a proper debt"*[91]. The bank obligation is autonomous (not accessory) compared with that of the principal debtor towards the beneficiary and furtherly, it means that bank cannot oppose exceptions (that differ from "literal exceptions" (see following paragraph) able to be contested by the guarantor), derived from the underlying contract, to avoid the accomplishment of its obligations that come from the relationship with the beneficiary.
b) The autonomy of the point a) delineates how the guarantee is not directed to give back to the beneficiary the same exact performance but bank has only to provide a cash refund if a specify event takes place (i.e. the debtor's default).

3.2 THE OPPOSABLE EXCEPTIONS

3.2.1 The literal exceptions

The Italian Suprema Corte di Cassazione settles a dispute[92] outlining these reasons: "*Nel ricondurre il rapporto intercorrente tra le parti al contratto autonomo di garanzia, anziché*

[91] Portale, *Le sezioni unite e il contratto autonomo di garanzia*, Quaderni di banca, borsa, tit. Di cred., Milano,at 136, 1989.

[92] Case 16213; Corte di Cassazione, Sezione I, 31.07.2015. Available at: https://renatodisa.com/2015/08/25/corte-di-cassazione-sezione-i-sentenza-31-luglio-2015-n-16213-il-carattere-distintivo-tra-il-contratto-autonomo-di-garanzia-e-la-fideiussione-e-costituito-dallassenza-dellelemento-dellacces/ [date of access: 21/05/2016]

alla fideiussione, la sentenza impugnata si è correttamente attenuta al principio, costantemente affermato dalla giurisprudenza di legittimità, secondo cui il carattere distintivo della prima figura è costituito dall'assenza dell'elemento dell'accessorietà della garanzia, derivante dall'esclusione della facoltà del garante di opporre al creditore le eccezioni spettanti al debitore principale, in deroga alla regola essenziale posta per la fideiussione dall'art. 1945 cod. civ., e dalla conseguente preclusione della legittimazione del debitore a chiedere che il garante opponga al creditore garantito le eccezioni nascenti dal rapporto principale, nonché della proponibilità di tali eccezioni al garante successivamente al pagamento da quest'ultimo effettuato".

As matter of fact, there is an indisputable principle of independence of the guarantee that gives possibility to the guarantor to oppose at least the exceptions coming from the same contract of guarantee. Every guarantor might therefore, if necessary, raise the so-called "*literal exceptions"* regarding mere mistakes or deficiencies in the text of the guarantee, such as:

a) *A lack of declaration: in* a case guarantee foresaw that beneficiary's demand of payment was anticipated by a written advice stating the failure of the debtor to comply with the contractual obligations. In solving the dispute, the court declared the illegitimacy of the enforcement because the beneficiary never submitted this written requirement (*Trib. Bologna, 27 settembre 1984, Fall. Lenzi costruzioni c. Credito Romagnolo spa e altri*[93]).
b) *A lack of reasons:* here the beneficiary has to provide a more detailed statement affirming the particular breaches occurred to justify the enforcement. For example, a guarantee foresaw for the beneficiary to provide notification to the supplier including the reasons of the complaint and the invitation to eliminate these drawbacks within 30 days. As previously, the praetor excludes the obligation of payment inasmuch neither a statement of the reasons nor an invitation was notified to the supplier (*Pret. Genova, 24 maggio 1978*[94]).
c) *A lack of documentation:* this situation is similar to the previous ones but with a substantial difference: the text of the guarantee required a specific documentation to obtain the bank's payment. In a case mentioned by Bonelli in which the

[93] Radicati di Brozolo L., *Ancora sui profili internazionalistici delle garanzie bancarie*, Borsa Banca e Titoli di credito, 1986, II, pag. 339.

[94] Pret. Milano, 5 maggio 1986, Borsa Banca e Titoli di Credito, 1987, II, at 57.

guarantee was a performance bond, the parties had agreed that only the presentation of three documents could trigger the bank's obligation: the original contract, a notarized declaration of the default and a proof to be notifying this declaration to the principal debtor. The court has forbidden the reimbursement in favour of the beneficiary because of the absence of the second and third document (*Trib. Bruxelles, ord., 13 marzo e 26 giugno 1984*).

d) *A breach of the deadline:* the ruling of a French dispute states: "*etre invoquèe par le béneficiaire que selon les termes memes dans lesquels elle avait été donnée"*[95]. it means that a guarantee cannot be enforced before its entry into force and even after its expiry date.

The majority of the guarantees contemplates a waiver to oppose generical exceptions (i.e. "first demand" or "without exceptions") but it seems clear how they give the possibility to oppose the non-compliance to the conditions enclosed in the text of the guarantee. The underlying logic is simple: the guarantee is, to all effects, a contract and then it is mandatory to respect the laws which regulate it; furthermore, if the operating conditions have never been observed, it means that guarantee has never worked; not only, but it is to bear in mind as the waiver to raise an exception just regards the exceptions related to the underlying contract and not those included in the guarantee's contract.

Now, without any doubts, it's possible to affirm that guarantor can release any kind of exceptions if and only if they fall inside one of the aforementioned categories belonging to the so-called literal exceptions.

3.2.2 The fraud's exception

The majority of the urgent appeals, to block the payment of the guarantee, are based on the exceptions of the principal contract instead of the exceptions related to the contract of the guarantee. The most common hypothesis is that in which the principal debtor claims the fraudulent enforcement of the beneficiary since the principal obligation was completely fulfilled. In this case, it's necessary to identify under which principle and justification an event related to the principal contract could affect the payment of the distinct and

[95] Case n. 82-15297**:** Cass. Franc., chambre commerciale, 5 febbraio 1985, Banque Mellat et Banque Markazi Iran c. S.A. Banque de Paris et Pays-Bas e S.A. Thomson-C.S.F. Available at: http://www.juricaf.org/arret/FRANCE-COURDECASSATION-19850205-8215297 [date of access: 16/06/2016]

"autonomous" contract of guarantee. Doctrine and case law try with no particular results to identify when the fraud's exception could be released.

The Italian point of view tries to follow two different directions, the first characterised by a real fraudulent enforcement and the other characterised by a simple enforcement of "objective bad faith". Anyway at Italian and international level, the main viewpoint is not to seek a specific notion of fraud but that concerning the necessity to have an irrefutable evidence of fraud. According to this opinion, the enforcement is illegitimate only if the fraud comes from some "objectives and documentary" evidences or if the fraud looks like "clear and non-contestable"[96]. This viewpoint limits the cases in which enforcement could be determined as fraudulent but it doesn't said anything about when the fraud is evident or under what kind of regulation the enforcement should be blocked.

Nevertheless, it's possible to determine several situation of fraud.

First of all, when it is proved the *clear and complete fulfilment of the principal contract's obligations*. Sometimes it was the same beneficiary, directly or indirectly, to recognise the total or partial fulfilment of the principal debtor leading consequently to recognize the enforcement as fraudulent, for example in a performance bond the evidence of the good execution of the obligation can be obtain through documents in which third parties, nominated by the beneficiary, certify its complete and suitable execution. Another performance bond in which the evidence of good execution comes from a beneficiary's letter stating that "the work was accepted, the final acceptance's certificate would be released after getting the required permissions and it was specify the release of the performance bond when the customs and fiscal permissions would be obtained" (*Pret. Roma, 11 maggio 1987*[97]). Here, the letter has been seen as an official document capable to ascertain the complete fulfilment of contractual obligation.

Other situations involve the use of *judicial examination* or a *third-party attestation* to ascertain a complete accomplishment of principal contract as the example of a performance bond, if the buyer claim the unconformity of the goods compared with what was agreed in the contract, the account party to verify its good faith and fulfilment of his obligations, can nominate an expert for an examination and evaluation of the goods. The account party might

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[96] Bonelli F., *Le garanzie bancarie a prima domanda,* at 93, Giuffrè editore, 1991.

[97] Pret. Roma 11 maggio 1987, Foro pad., vol. I, at 384, 1987.

obtain a restraining order in the case in which the expert testified that the defects are not relevant enough.

A third case is that in which the fulfilment can be "*proved presumptively*" considering different elements, for example through a previous clear acceptance of goods by the buyer without claims or signs of the buyer's dissatisfaction followed by a demand for payment that comes from the same subject (buyer/beneficiary). In this case, it can proved that the demand has been made under bad intentions.

Further situations were solved with a *rejection of the principal debtor's demand* to inhibit the bank's payment because the court didn't believe the complete fulfilment was proved through clear and suitable evidences. For example, in a contract for the supply of a telecommunication system, the debtor proved only the invoicing and the delivery of the devices without any evidence that they were accepted by the buyer as in compliance with the stipulated conditions[98].

A particular situation involves the case in which there is the *resolution of the principal contract due to facts out of the will of the principal debtor (*force majeure, fluke, excessive burden, etc…) that they can be used by principal debtor to block the enforcement of the guarantee. For instance, the case in which the Libyan law prohibited any type of commercial activities made by private companies during the execution of a contract between a Libyan and an Italian company. The court accepted the debtor's request because the entry into force of the law brought to the judge's statement that a: "*naturale conseguenza di questo stato di cose è la liberazione dei sub-appaltatori dagli obblighi contrattualmente assunti*" and then "*P.Q.M. dispone che la B.N.L… si astenga dall'eseguire qualsiasi pagamento in base alla garanzia prestata*"[99].

In a further case the reason of the enforcement's block was the outbreak of war that ceases the obligations of the contract. Anyway, there are some cases where these circumstances were not able to convince the judges to block the enforcement. As during the Iranian war, in two cases, judges claimed that in an international contract the principal debtor also has to assume the political risks and then the guarantee must be paid even if the principal contract couldn't be

[98] Pret. Milano, 3 maggio 1982, Samifi Babcock spa c. B.N.L., *Borsa banca e titoli di credito,* vol. II, at 110, 1983.

[99] Unedited case law mentioned by Bonelli F., *Le garanzie bancarie a prima domanda,* at 111, Giuffrè editore, 1991.

executed anymore. For example the American case *American Bell Int. v. Islamic Republic of Iran*[100] in which has been stated: *"...general considerations of equity counsel us to deny the motion for injunctive relief. Bell, a sophisticated multinational enterprise well advised by competent counsel, entered into these arrangements with its corporate eyes open… both Bell and Manufacturers have been made the unwitting and innocent victims of tumultuous events beyond their control. But, as between two innocents, the party who undertakes by contract the risk of political uncertainty and governmental caprice must bear the consequences when the risk comes home to roost*".

Legal scholars are not unanimous about the resolution of these situations because of the difficulty of proving the existence of a fluke or force majeure and for the dilemma about the identification of the effects of these risks over the beneficiary. To find a solution it's possible to affirm that when the beneficiary avoids to raise a claim, the judge recognised a fraudulent enforcement, conversely when a complaint is issued by the beneficiary the enforcement could be consider valid otherwise would be denied the principal function of the guarantee: ensure a payment to the beneficiary separately from the events and the disputes arose under the principal contract.

A third case of fraud concerns the ascertaining of the *beneficiary's breach* as event to block the enforcement. Within a performance bond cited by Bonelli, German supplier sold machinery to a foreign buyer, this latter asked to delay the last deliveries and asked to extend the bank guarantee for its own inability to install the machinery. In front of the enforcement request made by the foreign buyer, the court inhibited the payment because the buyer/beneficiary never raised objections or made requests to the German seller and in addition he admitted his failure in the machinery's installation by himself (*Landsgericht Francoforte, 14 dicembre 1979*[101]). At any rate also under this situation of fraud, concerning the beneficiary's breach, the international jurisprudence was not capable to provide a unique viewpoint since several cases of beneficiary's breach led to accept the enforcement of the beneficiary. Again, in some cases law whether "genuine" disputes exist between the parties of the principal contract, the enforcement of the guarantee is not considered fraudulent and then it cannot be blocked. Otherwise, it will be blocked the primary function of the guarantee, that

[100] Full text available at: http://law.justia.com/cases/federal/district-courts/FSupp/474/420/1964263/ [date of access: 06/05/2016]
[100] 583 F.2d 605, 610 (2d Cir. 1978) Available at: http://openjurist.org/632/f2d/999/caulfield-v-board-of-education-of-city-of-new-york [06/05/2016]
[101] Reviewed from Bonelli F., *Le garanzie bancarie a prima domanda,* at 116, Giuffrè editore, 1991.

is the assurance of a payment, that it strictly connected with the fundamental principle of an independent guarantee: being independent from the principal contract's disputes. On the contrary, in the hypothesis in which the breach of the beneficiary is clear or when the claims of the beneficiary don't seem "genuine" enough, judge inhibited bank to pay beneficiary because the enforcement was considered fraudulent.

The last case is the *invalidity of the principal contract* that exists whether the guarantor or the principal debtor, through the guarantor, is able to certify the "wrongfulness of the *causa*" ("illiceità della causa"[102]) of the principal contract. A clear example is that in which the *causa* was the transformation of poppies into drugs. The invalidity of the guarantee for the wrongfulness of the *causa* of the principal contract works because within the text of the guarantee there is a brief description of the guaranteed contract, so that the wrongfulness of the *causa* of the guarantee brings to an invalidity of the same guarantee.

In conclusion, only when there is certain and substantial incontestable evidence that the beneficiary has no rights towards the principal debtor, in that case the enforcement of the guarantee is fraudulent and then it can be refused by bank or be blocked by a court order. A final explication demonstrates, under the viewpoint of the fraud, as events connected with the principal contract can affect the independent guarantee. in fact, every fraud of the beneficiary determines an exception to the normal independence of the guarantee towards the principal contract: the principal debtor is entitled to release the exceptions originated by the principal contract to avoid the guarantee's payment in the cases of fraud. Nevertheless, the proceeding to identify the cases of *exceptio doli* is not capable to generically affirm the existence of a fraud, conversely it leads to verify the inexistence of any right of the beneficiary in the *ex*-principal contract (because it is completed or resolved due to force majeure); if a clear evidence (positive result) of beneficiary's lack of right is found, the enforcement is considered fraudulent.

3.3 QUESTION OF LEGITIMACY: THE USE OF THE TERM "FIRST DEMAND"

The common feature of all the guarantee's definitions is the presentation of a contract that is atypical and autonomous, this because it has been released from the accessory element and

[102] art. 1343 c.c. "Causa Illecita. *La causa è illecita quando è contraria a norme imperative, all'ordine pubblico o al buon costume*"; art 1344 c.c. "Contratto in frode alla legge. *...quando il contratto costituisce il mezzo per eludere l'applicazione di una norma imperativa"*; art. 1345 c.c. "Motivo illecito. *Il contratto è illecito quando le parti si sono determinate a concluderlo esclusivamente per un motivo illecito comune ad entrambe".*

collocated under the so-called *fideiussoi indemnitatis*, under which the guarantor's obligation is just to refund the unsatisfied creditor[103].

Even if independent guarantee has the form of an atypical contract, such as it is not provided by any type of expressed rule, the prevailing doctrine has considered it worthy to be protected, especially in the underlying interests of the parties. First, the interest of the beneficiary/creditor to obtain a complete fulfilment of his credit and secondly, the interest of the guarantor to have a reimbursement by the principal debtor. Nevertheless, some issues were born about the independent guarantee's worth and validity but, at any rate, several Court's decisions expressed in favour of its legitimacy eliminating the continuous return to a suretyship's structure and trying to outline a clear and well-define collocation inside the Italian legal system. In fact, the *Cass. civ., Sez. 3, Sentenza n. 1420 del 11/02/1998*[104] states how the independent guarantee is the natural expression of the contractual autonomy recognises in the Art. 1322 c.c.[105] and that it is necessary to distinguish this contract from the suretyship just because it is not possible to consider the independent guarantee as an accessory guarantee: the guarantor must pay without any kind of exceptions about the guarantee's validity or about efficacy of the underlying relationship (*Il "contratto autonomo di garanzia", definito anche "garanzia a prima domanda", espressione di quell'autonomia negoziale riconosciuta alle parti dall'art. 1322, secondo comma cod. civ., ... Caratteristica fondamentale di tale contratto, che vale a distinguerlo da quello di fideiussione ..., è la carenza dell'elemento dell'accessorietà: il garante s'impegna a pagare al beneficiario, senza opporre eccezioni in ordine ne' alla validità ne' all'efficacia del rapporto di base*)[106].

Although an extensive law argues about this argument, the matter seems not to be solved, even today where the problem of its validity interests as well the content and some specific

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[103] Case n. 2377: Cass. civ., sez. III, 31 gennaio 2008. Available online at: https://www.iusexplorer.it/Dejure/Sentenze?idDocMaster=2873166&idDataBanks=2&idUnitaDoc=0&nVigUnitaDoc=1&pagina=1&NavId=1024581424&pid=19&IsCorr=False [date of access: 02/04/2016]

[104] Available on-line at: https://www.iusexplorer.it/Dejure/Sentenze?idDocMaster=2539945&idDataBanks=2&idUnitaDoc=0&nVigUnitaDoc=1&pagina=1&NavId=589344703&pid=19&IsCorr=False [date of access: 15/05/2016]

[105] Art 1322 c.c. *Autonomia contrattuale*: "Le parti possono liberamente determinare il contenuto del contratto nei limiti imposti dalla legge".

[106] Available at: http://www.anticorruzione.it/portal/public/classic/AttivitaAutorita/Massimario/MassimarioGiurisprudenza?portal:componentId=26136097&portal:type=render&portal:isSecure=false&action=visualizzaMassima&descrizioneMassima=Corte+di+Cassazione%2C+sezione+civile%2C+Sezione+III+11%2F02%2F1998+n.+1420&idMassima=2022 [date of access: 17/03/2016]

words included in the text of the guarantee. To avoid misunderstandings, various Courts have argued with the purpose to give a clear explanation about the meaning and the magnitude of these words[107]. A quick focus of one of these rulings states that an added provision can provide an immediate payment by the guarantor at "simple demand" or "without exceptions" becoming a derogation to suretyship regulation. The next paragraph underlines how the presence of this provision eliminates the possibility to apply the typical suretyship exceptions. A greater explanation is involved in a further Italian Court ruling stating: "*the inclusion, in a suretyship contract, of a provision "on simple demand" or "without exceptions" has the power, per se, to transform it in an "independent guarantee". This because it is inconsistent and overcomes the accessorial principle incorporated in the suretyship*" (*Cass. civ., Sez. Unite, n. 3947 del 18/02/2010*[108]).

In parallel of this judgement, other disputes underlined a more complex point of view. For example the case treated by Montanari reports the Court declaration stating that: "*Per la qualificazione del contratto autonomo di garanzia non è necessaria la previsione della clausola «a prima richiesta e senza eccezioni», ma occorre verificare, in linea con i canoni sull'interpretazione del contratto, la presenza degli indici che implicano la deroga alla normale accessorietà della garanzia fideiussoria*"[109]; or in the proceedings between Cassa di Risp. Di Pistoia and Pescia s.p.a. c. A. C. s.p.a., the Court of Pistoia faced the challenge of determine if they were in front of a suretyship or in front of an independent guarantee. The final ruling takes part of that prevailing evolution of law outlining the typical features of an independent guarantee. The will of the parties is the main feature that a Court should analyse and then, the focus of the court goes to ascertain the lack of the accessorial feature. It is assessed through a complex bulk of interpretative laws determined by the trial court. Here, the *quaestio voluntatis* of the parties has been solved through the use of a set of accessorial provisions. In particular, this interpretation denies that the provisions "on first demand" or "on simple demand" are sufficient or necessary to qualify a guarantee as independent (*Nappi,*

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[107] *Cass. Civ., sez. III, sentenza n. 10486 del 01/06/2004*, *Polizza fideiussoria e assicurazione del credito tra attività bancaria e assicurativa: funzione di garanzia e profili atipici* (edited by Barillà G. B.), Banca borsa e titoli di credito, vol. 58, file 5, from 508 to 523, part 2, 2005.

[108] Available on-line at: https://www.iusexplorer.it/Dejure/Sentenze?idDocMaster=2778232&idDataBanks=2&idUnitaDoc=0&nVigUnitaDoc=1&pagina=1&NavId=1108446254&pid=19&IsCorr=False [date of access: 05/05/2016]

[109] Case 15108: Corte di Cassazione, Sez. III, 22 aprile – 17 giugno 2013. Available on-line at: https://www.iusexplorer.it/Dejure/Sentenze?idDocMaster=3861503&idDataBanks=2&idUnitaDoc=0&nVigUnitaDoc=1&pagina=1&NavId=305756958&pid=19&IsCorr=False [date of access: 15/05/2016]

1993[110]), even if the inclusion of these provisions represents a strong presumption of the independent nature of the guarantee. The Court in its analysis has to keep in mind the art. 1362 c.c. about the intentions of the contractors stating: "*to interpret a contract, it must investigate the real intention of the parties without limit the investigation at the literal sense of the words. To determine the common parties' intention is necessary to evaluate their overall behaviour"*.

At this moment it is necessary to clarify what of these two interpretations is the prevalent, without doubts the second one represent a wider point of view even supported by legal scholars and law. This dispute brings to light a potential solution when Court tries to determine the layout of an independent guarantee rather than a suretyship. The majority of law is oriented thinking that it's not necessary the use of the expressions "on first/simple demand" but is crucial the relationship in which parties decided to put the principal obligation and consequently the guarantee obligation. It follows that the lack of the "accessorial element" must be explicitly included in the contract with the use of a provision suitable to provide the exclusion of the guarantor's capability to oppose any exceptions belong to the principal debtor. Further evidence was pulled out by the Italian Corte di Cassazione a Sezioni Unite with the ruling n. 3947/2010[111] that had a wide reflection within the juridical sector. The dispute identify an important element, namely the undertaking of the guarantor to pay *illico et immediate*, without exceptions, to the beneficiary.

Then, only with an overall interpretation and analysis of the text of the guarantee, drafted by the parties, it is possible to identify the accessorial or non-accessorial feature.

Under the art. 1322 c.c., comma 2, independent guarantee leads to achieve a worthy interest to ensure an economic satisfaction of the beneficiary and then to give major certainty of every economic relationship. It's now evident the discrepancy between the two form of guarantees identified considering several aspects that court has to bear in mind to determine the intentions of the parties.

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[110] Nappi F., *Burschaft (e fideiussione) "a prima richiesta" tra diritto comune e disciplina delle condizioni generali di contratto,* "Banca Borsa E Titoli Di Credito", II, p. 534, 1993.

[111] Full text available at: http://www.altalex.com/documents/news/2011/09/12/la-polizza-fideiussoria-come-garanzia-atipica [date of access: 25/05/2016]

First of all, the presence of provisions stating the impossibility of the guarantor to oppose exceptions, towards the beneficiary, related to the underlying contract. Again some courts' decisions reaffirm this crucial point:

> Cass. 21 aprile 1999, n. 3964[112] e 19 giugno 2001, n. 8324[113] (Pres. Greco, rel. Macioce): "*…ai fini della configurabilità di un contratto autonomo di garanzia, oppure di un contratto di fideiussione, non è decisivo l'impiego o meno delle espressioni "a semplice richiesta" o a "prima richiesta del creditore", ma la relazione in cui le parti hanno inteso porre l'obbligazione principale e l'obbligazione di garanzia. Infatti la caratteristica fondamentale che distingue il contratto autonomo di garanzia dalla fideiussione è l'assenza dell'elemento dell'accessorietà della garanzia, insito nel fatto che viene esclusa la facoltà del garante di opporre al creditore le eccezioni che spettano al debitore principale, in deroga alla regola essenziale della fideiussione, posta dall'art. 1945 cod. civ*".

Whereas there are other elements that could outline to be in presence of a Garantievertrag: the brief period within which the guarantor has to pay, the start of this period from the beneficiary demand and the clear exclusion of the beneficiary from the prior enforcement. The exclusion of the guarantee's accessorial element and the separation from the underlying contract are the elements of the Garantievertrag, within the main scope is the assurance of a free movement of capital and the satisfaction of the beneficiary's interests.

The juridical and economic relevance of independent guarantee and its full autonomy from the underlying contract due to the overcome of the accessorial element has been recognised at national and European level. This new point of view comes from a fresh awareness of the urgency to provide particular instruments able to meet the needs of the economic operators and to adapt to the development of the surrounded context where globalization is a well-established phenomenon, thank to which it is difficult to defence the relationship when the law of the national territory is overtaken and to conform to an overall law among businesses and between business and public administration with the aim of reaching a law evolution

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[112] Available on-line at: https://www.iusexplorer.it/Dejure/Sentenze?idDocMaster=2803647&idDataBanks=2&idUnitaDoc=0&nVigUnitaDoc=1&pagina=0&NavId=621506071&pid=19 [date of access: 13 maggio 2016]

[113] Available on-line at: https://www.iusexplorer.it/Dejure/Sentenze?idDocMaster=2878344&idDataBanks=2&idUnitaDoc=0&nVigUnitaDoc=1&pagina=0&NavId=480577551&pid=19 [date of access: 13 maggio 2016]

trigged by this new form of guarantee. This evolution of law is better illustrated by Betti as: "something that is not developed by itself but it is made,… in accordance with social, historical and environmental conditions, as well with the economic and market rules"[114].

3.4 (SEMI-)SEPARATION BETWEEN GUARANTEE AND THE UNDERLYING CONTRACT

One of the main features of an independent guarantee is its autonomy; for this reason it seems fundamental to analyse, under the Italian law, whether and in what way guarantee can be considered completely separated from the underlying contract that is the prevailing direction of the today doctrine, even if some elements lead to think that a permanent link remains.

A clue of this latter statement regards the consideration that the independent guarantee is a part of a more *complex operation* that remains essentially unique under the economic aspect. In fact, there is a real connection among the principal contract, the mandate between debtor and bank and the guarantee between bank and beneficiary. Nevertheless, it's the economic connection that involves a juridical connection. This means that they are distinct contracts but the link comes from the different points where the conclusion of a contract is the fulfilment of the obligation of the previous one. In other words, the principal contract includes an obligation (for the vendor, builder, etc..) to provide a bank guarantee. Then, it is the debtor, in the fulfillment of the obligation, who addresses the bank to obtain the guarantee through a contract of mandate. Finally, with the issuance of the guarantee, bank obliges itself to honour the obligation if the default happens.

Some Courts have analysed the problem with the aim to find some possible interpretations in their rulings to affirm again the total independence between guarantee and underlying contract. To enforce the courts decisions, it's to bear in mind the causal nature of the guarantee, in which there is "*an atypical function (*"causa") *of pure guarantee… that is the characteristic able to break off the relationship between principal contract and guarantee* (*Trib. Milano, 25 settembre 1978*[115]). It reaffirms how the security provided by the guarantee is the unquestionable cause of the contract complying with the art. 1325 n. 2 c.c. about the *causa* as requirement for the contract. Here, the focus is given to the contract with is function

[114] Betti, *L'interpretazione della legge e degli atti giuridici*, Milano, 1949, 17 ss., 34 ss.

[115] Traslated from, *Osservazione a Trib. Milano 25 settembre 1978, in tema di contratto autonomo di garanzia,* (edited by Grippo G.) "Banca borsa e titoli di credito", II , pt. 2, at 181-184, 1982.

(*concrete causa*) of security, in which the guarantor has the burden of payment if the principal debtor is insolvent. As well as, it is the law that recognise the authentic scope of the operation that is the assurance of a swift and sure fulfilment of the obligation. Furthermore, concerning the identification of a *concrete causa,* the Garantievertrag falls into the category of a legal transaction with an "*external causa*": the parties within the contract refer to a fundamental relationship able to justify the guarantee's obligation.

Another feature, concerning the presence of this link, is about the *opposable exceptions* of the guarantor when beneficiary claims for his reimbursement. Any time, bank can refuse to pay if it faced an abusive recourse of the guarantee or if there is a breach of the good faith of the creditor towards the guarantor. It's obvious that bank to assess the abusive recourse need to consider the underlying contract here because the abusive recourse and the breach of the good faith happen, for instance, whether the underlying contract has not been concluded or whether it was already completely fulfilled by the debtor. In any case, the bank's obligation to verify an abusive recourse is rare and it's not able to destroy the thesis of the complete separation.

A further brief question is whether the guarantee and the underlying contract should be *subject to the same law*. The *ex*-art. 25, 1° comma, disp. Prel. Cod. Civ. imposes to determine the applicable law to devote to each distinct contract, in particular result necessary to draw a line of demarcation between the law applicable on the guarantee and that applicable to the principal contract. The intent of the Italian legislator was to establish the rights and duties of both, debtor and beneficiary, and the conditions under which this latter might call the guarantee.

Retracing the matter, even some questions can arise about the possible semi-separation of the contracts, legal scholars and law nowadays agree to affirm the autonomy of the guarantee from the underlying contract. An Italian Court decided above a dispute in which the main problem was the applicability of the art. 1957 c.c. "Scadenza dell'obbligazione principale" to the independent guarantee as normally done against suretyship. The judge denied this possibility based on these motivations: "*Accertata la volontà delle parti di rendere la garanzia autonoma dal rapporto garantito, con finalità, dunque, principalmente indennitaria, allora dovranno ritenersi inapplicabili tutte quelle norme codicistiche, dettate per la fideiussione, le quali trovino il proprio fondamento e la propria ragion dell'essere*

nell'inscindibilità del legame di accessorietà fra il rapporto garantito e la garanzia stessa"[116].

3.5 THE PRELIMINARY PROTECTION

3.5.1 The restraining order

Every time debtor requests the guarantee has, in addition, the right to ask to the bank to act and fulfil the obligations of the mandate with a right degree of *due diligence*. The Italian law defines the standard level of diligence as that of the "buon padre di famiglia"(art. 1710 c.c.) and adds a further reinforcement: "*the due diligence must be evaluated and adapted regards to the particular nature of the activity exercised*"[117]. Then, about bank, this natural level is enhanced to reach a professional diligence. Furthermore, the art. 1175 c.c. and art. 1375 c.c. affirm that the debtor activity must be inspired to honesty and good faith and it must be addressed to the fulfillment of the creditor interests through the use of that special diligence and in favour of the account party, bank has to avoid payment when the enforcement is not legitimate. This latter must be observed when beneficiary calls the payment because bank has the responsibility of a prompt assessment if it is facing an unauthorized enforcement. At this point, maintaining its due diligence, bank has the duty to refuse the payment to the beneficiary whether it is ascertained the abusive request and consequently bank shouldn't enforced the value of the guarantee from the debtor's bank account. It must be specify how, the acting of the bank in respect of the right level of due diligence, it is fundamental for the same bank to maintain and reinforce its credibility in front of potential and already clients and towards the other banks and at international level.

This introduction brings to light the problem of manage an abusive enforcement when it occurs. Under the Italian legislation, it is possible for the debtor, when he is convinced that beneficiary made an abusive or fraudulent enforcement, to recur to the ex-art. 700 c.p.c. allowing the enforcement of a "misura cautelare con funzione anticipatoria degli effetti di

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[116] Case 2762: Cass. 12 febbraio 2015. Varazi S., Note to *Corte di Cassazione – terza sezione civile sentenza 12 febbraio 2015, n. 2762*. Available at: http://www.ildirittoamministrativo.it/allegati/Nota%20a%20SC%20Sez%20III,%2012%202%2015,%20n%2027 62%20-%20a%20cura%20di%20SARA%20VARAZI.pdf [date of access: 25/04/2016]

[117] U. Natoli, *L'attuazione del rapport obbligatorio*, II, Milano, 1967, at 118 ss.

merito"[118]. It permits to the principal debtor to ask for a *restraining (*or stop-payment) *order* able to immediately inhibit the bank's payment to the beneficiary. This urgent appeal is subordinated by the presence of a set of assumptions among which: a *periculum in mora* that it must be demonstrated; the presence of the *fumus bonis iuris*; and the irreparable and serious damage[119].

It is the praetor, placed in the same location of the issuing bank (*art. 701 c.p.c.:" pretore del luogo in cui l'istante teme che stia per verificarsi il fatto dannoso"),* who has the competence to issue the interim measure. The praetor can freely decide how to proceed: with an immediate ordinance (*inaudita altera parte*); or he could require the appearance, in front of him, of the parties: not only the bank but also the foreign parties (foreign beneficiary and issuing bank in case of an indirect guarantee). At the end, praetor will decide whether to accept the precautionary demand and thus to set up the preliminary proceedings; moreover, in this case, he should determine the term in which starting the "*value judgement*" (giudizio di merito). On the contrary, whether the praetor rejects the demand, he didn't have to set any term.

Nevertheless, some objections have been raised about the admissibility of the injunction enclosed in the ex-art. 700 c.p.c. Particularly, the objection claims that the inhibition of the payment could determine a violation of the autonomy principle as one of the main characteristic of the independent guarantee. Anyway, it should be bear in mind that in case of "literal exceptions" no particular problem arise and the objection becomes unfounded, this because literal exceptions derive *directly* from the guarantee rather than, as expressed in the objection, from the underlying relationship.

Afterwards, it is considered a further objection in which the person accused is the applicant (such as the debtor or account party by bank's point of view) for the reason that he couldn't ask for the injunction because, in this way, he would be trying to enter into the relationship established between guarantor and beneficiary. The objection based on this point punctuating the fact that applicant might influence this link even if the injunction is not going to affect his personal sphere of interest. Rather he could be affected only when the guarantor will try to exercise the recourse against the applicant (its account party) to obtain the reimbursement. At

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[118] Cecchella C. (edited by), *Ricorso ex art. 700 c.p.c., Il sole 24 ore,* 2012. Available at: http://www.diritto24.ilsole24ore.com/praticanti/primiPiani/2011/08/ricorso-ex-art-700-cpc.php [date of access: 05/05/2016]

[119] Idem

any rate, this objection cannot be accepted at all seeing the same ex art. 700 c.p.c. stating that the inhibitory measure, towards the guarantor, affects directly the guarantee and then its underlying relationship.

3.5.2 The value judgement

The value judgement (*giudizio di merito*) is used to ascertain the inexistence of the bank's obligation to pay. Usually, it's a request of the applicant but sometimes it can be requested directly by the guarantor. Even if in a previously affirmation was declared that is "the praetor that requests the value judgement after his acceptance of the restraining order", it is not the exclusive procedure. In fact, the value judgement can be established without the presence or the achievement, neither previously nor meanwhile, of the restraining order. Although this latter easier solution, applicant prefers to secure his interest thus avoiding the illegitimated enforcement and then he prefers calling the restraining order before. Specifically, the value judgement is established through the analysis of the punctual execution of the debtor's obligation and it is declared admitted whether the investigation provides a positive response.

The Italian judge confirms: "*La clausola con la quale il fideiussore si impegna a soddisfare il creditore su semplice richiesta…, senza possibilità di eccepire l'adempimento del debitore garantito, configura una… autonomia negoziale,… ma il suddetto impegno, non potendo autorizzare il creditore a conseguire due volte la prestazione, non lo sottrae a rivalsa ove sia già verificato l'adempimento dell'obbligazione garantita"* (Cass., S.U., 1° ottobre 1987, n. 7341)[120].

Therefore, it is confirmed the punctual and total execution of the obligations of the contract so that with there is the consequent release of the guarantor, in this case Banco di Napoli, from the issued guarantee. In other words, the value judgement is the negative assessment of the obligation of payment and it cannot be confused with the value judgement between the parties of the principal contract (applicant and beneficiary). This punctuation is important on the light of particular confusing situations as that faced by the praetor of Milan that orders:" *the non-payment until the outcome of the arbitration proceedings ... between the parties of the*

[120] Case 7341: Cass., S.U., 1 ottoble 1987, Banca Borsa e Titoli di credito, II, 1988, at 1.

underlying contract"[121]. Thus, the two judgements are completely different: on one side there are two *different parties* involved (applicant and guarantor vs. applicant and creditor); on the other side, it is considered the type of *contested contract* (mandate and the normal contract of sales or tender) and lastly the *petitum* (the negative ascertainment of payment obligation vs. the observations about the principal contract and the related events).

The only permitted exception concerns the assessment made by the court when it has to verify if the beneficiary's enforcement is fraudulent because this is the exclusive case in which judge should analyse the events of the principal relationship. A typical case of *fraud (see 3.2.2 "Fraud's exceptions)* occurs when a beneficiary enforces a performance bond but the applicant brings the evidence of a complete fulfilment of his contractual obligations. Therefore, the judge can request the stop of the guarantee's payment but only after checking the real accomplishment of the principal contract. In fact, judge has to verify the existence of a certain and uncontested evidence of that accomplishment so that the enforcement will be considered fraudulent and the payment will be blocked.

This link towards the principal contract is however an *incidenter tantum* because it is used only as an instrument for the negative judgement over the obligation of payment of the bank and it is absolutely unsuitable to form judgement over the principal creditor that is out of the dispute.

3.5.3 Measures against foreign parties

a) *The applicant's action against the foreign beneficiary*

Cass., S.U., 1 ottobre 1987, n.7341[122] describes a situation in which the applicant sued the guarantor Banco di Napoli and besides the foreign beneficiary asking the positive ascertainment of his correct fulfillment. In this way bank would be released from its payment

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[121] Pret. Milano, 3 maggio 1982, "Borsa Banca e Titoli di Credito", II, at 110, 1983. Also mentioned in the unedited rulings of the Tribunale Civile di Roma, note 2, 2006. With the comment: "*In tale fattispecie, il provvedimento di inibitoria ex-art. 700 c.p.c. è stato concesso in relazione all'escussione di una garanzia autonoma che, sebbene rilasciata a copertura di ipotesi di mancata consegna di merci, era stata escussa… [per] lamentati difetti di funzionamento di un impianto"* also showing an improper call (see para 3 Chapter 4). Available at: http://www.aslaitalia.it/wp-content/uploads/2012/05/2012-VII-Sessione-1-BIS-Memoria-Italia.pdf [date of access: 11/05/2016]

[122] See note 123.

obligation. The applicant's request was accepted because "*it was inadmissible that under the provision of "first demand", creditor was entitled to obtain two times the same performance*".

Indeed, it becomes legitimate the right of the applicant to sue the beneficiary because the aim is that of ascertain its own accomplishment of the contractual obligation and consequently to inhibit the beneficiary's fraudulent enforcement. Anyway, it is rare that the applicant is interested in inhibit the foreign beneficiary considering that he could obtain the same result in an easy way through a simple request of a restraining order against the Italian bank. In fact, there is a lack in the Italian scenery of these cases in which is asked a restraining order against the foreign beneficiary.

b) The applicant's action against the foreign issuing bank

A more intricate situation regards the request versus the foreign bank (this is the case of an indirect guarantee in which the bank is so-called "issuing bank") to refuse to pay the foreign beneficiary whether it was ascertained the fraud. Primarily is the Italian bank (so-called instructing bank) to be entitled to make this request but the Italian law gives as well this possibility to the applicant adopting different solutions: ex-art. 1705[1] c.c. (mandante che si sostituisce al mandatario); ex art. 1717 c.c. (mandante che agisce direttamente contro il sostituto del mandatario); or ex art. 2900 (ordinante-creditore che si sostituisce alla banca mandataria italiana, debitrice, che trascura di agire contro la banca estera). Even though these actions are regulated by law, none of these solutions seem justifiable because the applicant is again out of this relationship that it doesn't affect him directly (an effective damage is going to happen only when the Italian bank will retaliate against the applicant).

c) The Italian instructing bank's action against foreign beneficiary or foreign issuing bank

A further likely situation involves the direct commitment of the Italian bank (instructing bank) to refuse to pay or, if necessary, to inhibit the other party's enforcement. In this case no problem of legitimacy can be raised because the bank is definitely part of the relationship underlying the contract of guarantee.

3.6 JURISDICTION AND APPLICABLE LAW

3.6.1 The evolution of Italian law: from a national to an international perspective

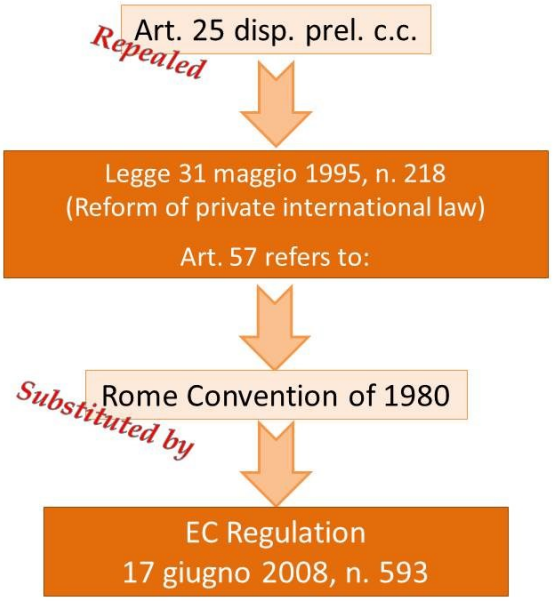

FIGURE 9 THE EVOLUTION OF ITALIAN LAW

The Italian Civil Code was drafted and enforced in 1942 thanks to the "*Regio Decreto 16 marzo 1942, n. 262*". Its structure involves 6 parts and an overall number of 2969 articles. The preliminary dispositions are called "*preleggi*" and they represent a preamble to the Civil Code. The preliminary dispositions include laws about the sources of law and their hierarchy (art. 1-9) and contain rules about the general law application: entry into force, repeal, etc… (Art. 10-31). Focusing on contracts and their related obligations, the **art. 25 Disp. Prel. c.c.** was the rule entitled to regulate the contractual obligations. It was called "***Legge regolatrice delle obbligazioni"*** and stated: *"Le obbligazioni che nascono da contratto sono regolate dalla legge nazionale dei contraenti, se è comune; altrimenti da quella del luogo nel quale il contratto è stato conchiuso. È salva in ogni caso la diversa volontà delle parti. Le obbligazioni non contrattuali sono regolate dalla legge del luogo ove è avvenuto il fatto dal quale esse derivano"*. This rule clearly determined the applicable law that regulates the contractual obligations: first of all, as in every type of contract, the parties can freely determine a particular applicable law but if there is no choice of parties, the law affirms that the applicable law is the national law of residence of the parties if it is the same; otherwise it is applied the applicable law of the place in which the contract has been concluded. Anyway,

this article was repealed by the art. 73 **l. 31 maggio 1995, n. 218** (*Riforma del sistema italiano di diritto internazionale privato*).

The law n. 218/95 reformed the whole Italian legal system refers to the private international law establishing new rules for the choice of the applicable law and jurisdiction. More specifically the art. 1 explains as it: "*Determina l'ambito della giurisdizione italiana, pone i criteri per l'individuazione del diritto applicabile e disciplina l'efficacia delle sentenze e degli atti stranieri*". The law unified these matters that previously were regulated separately: before the reform of the private international law (l. 218/95) the rules for the jurisdiction and for the applicable law were placed in a wide range of regulations, for example the jurisdiction was regulated by the art. 4 c.p.c.[123] and the applicable law within the preliminary dispositions of the Civil Code (art. 17-31) but with the reform came out a single law capable to regulate all these aspects: determining the field of the Italian jurisdiction and the criterions necessary to determine the applicable law.

The major innovation brought by the reform is the complete definition of the cases on which must be determined the applicable law. Indeed, within the reform, the lawmaker includes 44 articles (from art. 20 to art. 63) for determining these cases[124].

Another point is its purpose to determine the scope of the Italian jurisdiction: it defines the hypothesis in which the Italian jurisdiction can be exercised without distinctions between citizens and foreigners. At any rate, it is to bear in mind that the application of law has to take into account also the pre-existing rules and the international and community rules. To give a clear picture of the cases that fall inside the Italian jurisdiction, it must be considered:

a) The general and special criterions of the L. 218/95: artt. 3-12 about the "Italian jurisdiction" involve the general criterions and those useful only under specific situations that are enclosed in the "Titolo III" like for the annulment, dissolution of marriage; filiation; adoption; etc…

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[123] *"Lo straniero può essere convenuto davanti ai giudici della repubblica: 1) se quivi è residente o domiciliato… o vi ha un rappresentante…, oppure se ha accettato la giurisprudenza italiana…; 2) se… riguarda beni esistenti nella Repubblica o successioni ereditarie..., oppure obbligazioni sorte...; 3) se la domanda è connessa con altra pendente davanti il giudice italiano, oppure riguarda provvedimenti cautelari da eseguirsi nella Repubblica…; 4) se,… il giudice dello Sato al quale lo straniero appartiene può conoscere delle domande proposte contro un cittadino italiano".*

[124] For example: Capacità giuridica delle persone fisiche (art. 20), Rapporti di famiglia (Capo IV), Successioni (Capo VII), Diritti reali (Capo VIII), Obbligazioni contrattuali (Capo X).

b) The discipline fixed by pre-existing rules, before the L. 218/95, which are still in force: the art. 14 cod. nav. to solve disputes coming from naval or maritime field; the art. 75 rd 29 giugno 1939 n. 1127 over industrial invention's patents; or the art. 40 L. 184/83 about the adoption of Italian minors by foreigners.
c) the regulation of some community rules respecting the movement of people (Amsterdam treaty of 1997).
d) The international conventions ratified in Italy (i.e. the Hague convention).

Apart these considerations about the reform, it is fundamental to better explain the development of the law concerning the "contractual obligations". The law of the reform entered into force after the **Rome Convention of 1980** but it refers to the Convention for the regulation of the contractual obligation through its art. 57.

Nowadays, the Rome convention was substituted by the **EC Regulation n. 593/2008** directly enforced in the Italian legal system and then the aforementioned art. 57 provides a direct recall to the new EC Regulation. This is well explained by Preite that states: "*...L'art. 57 della legge 31 maggio 1995, n. 218, nel quale si formula, come detto, il noto rinvio "in ogni caso" alla Convenzione di Roma per determinare il diritto applicabile alle obbligazioni contrattuali, trova oggi diretto richiamo per il medesimo "in ogni caso" alla normativa di cui al Regolamento"*[125]. The aim of the lawmaker was to bring the cases to an international law following the purposes of the Regulation n. 593/2008 about the applicable law for the contractual obligations (**Roma I**) that is considered as "parte *di una serie di atti… al fine di istituire un sistema unitario di diritto internazionale privato… che prevalga sulle norme nazionali in materia"*[126].

The new Regulation presents a wider definition already visible in its first article in which declares its application to every contract with a civil or commercial nature (the Regulation does not apply to public law matters, in particular, those concern revenue, customs or administration) that is different from the same statement involves in the previous Rome convention where the focus was over contractual obligation (only) in case of a conflict of law.

Instead, both apply the *connecting factor* represented by the "will of the parties" (art. 3 "freedom of choice" of the Rome Convention). Here, the choice of the applicable law is the

[125] Preite Filippo (edited by), *Atti notarili. Diritto comunitario e internazionale,* Volume 1, cit. at 1091, UTET Giurisprudenza, 2011.

[126] Preite Filippo (edited by), *Atti notarili. Diritto comunitario e internazionale,* Volume 1, note 11, at 1092

connecting factor to link the contract with a particular legal system and it is originated from the *lex voluntatis*. The Rome I Regulation introduces structural changes in the default rules (article 3): the choice of applicable law may be express or tacit (this latter demonstrated by the circumstances of the case: reference to the specific national legal instrument, use of the form contract typical of certain national legal system, use of terms typical for certain national legal system, etc.). Furthermore, the lex voluntatis may capture the whole or only a part of the contract and it may be altered at any time without adversely affect the validity of the contract or third-party rights. Additionally, the parties' choice of law to govern their contract is solely connected to a single country (intra-state situations).

On the other side, in the so-called "absence of choice" specific rules are entitled to determine the applicable law. As the Rome Convention affirms at the art. 4: "the *contract shall be governed by the law of the country with which it is most closely connected*". The EC Regulation provides a more clearly definition: "*Where there has been no choice of law, the applicable law should be determined in accordance with the rule specified for the particular type of contract. Where the contract cannot be categorised…, it should be governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence*". This latter is a more specific definition that qualify a single "closest connection". Whether there is a contract for the sale of goods, it is governed by the law of the country that is the place in which the performer (seller in this case) is resident (*lex firmae habitationis*). Anyway, this definition was expressly extracted from the Convention that within the art. 4(2) outlines the meaning of closest connection presumed as *the country of residence of the party that affects the characteristic performance of the contract*, bringing to light another common point between the two set of rules that has been preserved afterwards the law evolution. This means, for example, that in a contract of sale the characteristic performance is that of the seller, consequently the governing law will be that of the country of the seller.

About the relationship with other legal instruments, the priority is given to international conventions whether one or more Member States were parties at the time when the Rome I Regulation was adopted. When such conventions are concluded exclusively between the Member States, the priority is given to the Rome I Regulation.

3.6.2 The determination of the right jurisdiction

It is possible to explain the jurisdiction considering again the three situations previously outlined. At point a) is explained the legitimacy of the applicant to act against the foreign beneficiary on the base of the principal relationship. Here, the (Italian) applicant might sue the beneficiary in Italy but only if:

- No provision is included that impose to refer the dispute to a court in a neutral country. Usually this type of provision is enclosed (*art. 4, n.2, Legge 31 maggio 1995, n. 218, Riforma del sistema italiano di diritto internazionale privato*).

- There is a **link** (ex-art. 4 c.p.c.[127]*:* Italy is the place in which the obligation was born or it will be executed. Whether the principal relationship is ascertained, Italian law can argue about the related guarantee as well.

  First considering the existing "connection": the resolution of the principal contract solves consequently the related guarantee. With the fulfillment of the principal contract, the beneficiary-creditor can act neither on the base of the principal contract nor to enforce the payment subtended the guarantee. Today, the EC regulation 593/2008 sets a new point of view in the determination of this link that it was changed consistently after the art. 4 c.p.c. repeal and the entry into force of the Rome Convention in 1980. Particularly the art. 19 of the EC Regulation states: "*Where there has been no choice of law, the applicable law should be determined in accordance with the rule specified for the particular type… it should be governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence*".

  A further interpretation better explain the meaning: "*Qualora le parti non abbiano scelto la legge applicabile, sarà la tipologia del contratto a determinare i criteri. Ai contratti di* ***vendita di beni****, prestazione di servizi, affiliazione (franchising) e distribuzione, si applica la legge del paese di residenza del venditore, prestatore di servizi o dell'affiliato*"[128].

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[127] Ex-art. 4 c.p.c. "*Giurisdizione rispetto allo straniero*" repealed by the Art. 73, L. 31 maggio 1995, n. 218.

[128] Obbligazioni contrattuali nell'Unione europea — Determinazione della legge nazionale applicabile, synthesis of EC Regulation 593/2008. Available at: http://eur-lex.europa.eu/legal-content/IT/TXT/HTML/?uri=URISERV:jl0006&from=IT [date of access: 03/05/2016].

Point b) describes applicant's action against the foreign guarantor that is legitimated following two different directions. One involves the direct action of the applicant against the foreign bank (ex-art. 1717 c.c.) where the Italian law can be used if the counter-guarantee of the Italian bank was made and will be executed in Italy. On the other side, when the applicant sued in the same lawsuit both the Italian and the foreign bank, the Italian law can argue recurring to the art. 4, n. 3, c.p.c.: with no doubts about the subjection of the dispute applicant-Italian bank to the Italian law even the dispute against the foreign bank (improper connection) is attracted to the Italian law just because the solution of both lawsuits is related to the same issue. Even this statement comes from the repealed art. 4 c.p.c., the EC Regulation affirms the same idea through the art. 20: "… *Il contratto dovrebbe essere disciplinato dalla legge del paese con il quale presenta il collegamento più stretto. Per determinare tale paese si dovrebbe considerare, tra l'altro, se il contratto in questione sia strettamente collegato a un altro contratto o ad altri contratti".* Then the connection can be based on the existent link between the different contracts because they take part of the same economical operation and for this reason it is possible to subordinate the dispute against the foreign bank to the main dispute between applicant and Italian bank already regulated by the Italian law. Instead, when it's the bank to sue the foreign parties (point c) the Italian law solves the dispute if the party effecting the obligations under the guarantee (direct guarantee) has, at the time of conclusion of the contract, his habitual residence or its office in Italy (art. 4, n. 2 Rome Convention). Anyway under a counter-guarantee (indirect guarantee) the obligation usually comes out in the place where the foreign bank has its office.

A further problem of jurisdiction concerns the determination of the subject entitled to decide about the stop-payment order. The applicant can make his urgent appeal in front of the praetor (before the lawsuit for the value judgement) or going to the judge of the dispute or to the court's president (art. 701 and 673, c.p.c.). The Italian law subsists when the stop-payment order is executed in Italy or if it involves relationships known by the judge. In particular, to assure the Italian law at least one of these two criterions must be presented.

The first criterion has the problem to give a right interpretation of the term "to execute" that is related to a restraining order capable to inhibit the foreigner's enforcement of the guarantee. on the contrary, scholars argue against the necessity to prove the execution because, according to them, judges should have every time and everywhere the power to accord the injunction,

especially because it is carried out with a "notification" that is anyway made in Italy according to the art. 142 c.p.c. (*Notificazione a persona non residente, né dimorante, né domiciliata nella Repubblica. Salvo quanto disposto nel terzo comma, se il destinatario non ha residenza, dimora o domicilio nello Stato [c.p.c. 4, 18, 633] e non vi ha eletto domicilio [c.c. 43, 47] o costituito un procuratore a norma dell'articolo 77, l'atto è notificato mediante affissione di copia nell'albo dell'ufficio giudiziario davanti al quale si procede e mediante spedizione di altra copia al destinatario per mezzo della posta in piego raccomandato*), even if the recipient has neither residence nor domicile in Italy.

A second point of view makes an indirect use of the law that regulates the internal competence: following the ex-art. 701 c.p.c.: "*it must be competent the judge of the place in which the applicant thinks that is taking place the harmful event"* (that is the place in which bank has received the mandate).

In conclusion, without considering the problem to identify the meaning of "to execute", the law and doctrine seem oriented to consider that the jurisdiction of the judge, about stop-payment order, looks like very wide. Nevertheless, it looks like easier for an applicant to request this preliminary proceedings directly towards the Italian bank, without involving the foreign parties that will suffer the related consequences.

Recapping, the applicable law and the identification of the right jurisdiction can be analysed even through the different relationships arise under a contract of guarantee.

In particular with a direct guarantee (that is a trilateral relationship: Italian guarantor, foreign beneficiary and Italian law) it must be analysed:

- *Contract of mandate (*Italian applicant-Italian bank*):* the Italian law is applied because it is the choice of law made by parties and specially because it is the national law of the parties.
- *Contract of guarantee (*Italian bank-foreign beneficiary): the applicable law is that expressly determine (if that is) by the parties within the text of the guarantee (art. 3, libertà di scelta, Convenzione di Roma 1980[129]). Otherwise considering the art. 4 of the Convention of Rome concerning the "applicable law in absence of choice": "*the contract shall be governed by the law of the country with which it is most closely*

[129] The Convention has been substituted by the Regolamento CE, 17 giugno 2008, n. 593 but it left the rule unchanged.

connected. Nevertheless, a separable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country". Here the matter is completely revised and inverted from its previous regulation in the art. 25, disp. Prel. Del c.c. stating that the applicable law was that of the place in which contract was concluded. On the contrary, the new regulation imposes the application of the country's law of residence of the subject entitled to supply the "characteristic performance" (that is the issuing bank); to furtherly validate this interpretation, there is the URDG 758, where at the art. 35 claims:"…*any dispute between guarantor and beneficiary, regarding the contract of guarantee, must be exclusively regulated by the court of the State in which it is placed the office of the issuer of the guarantee*".

- *Contract of sales of goods (*supplier/debtor-buyer/beneficiary): it is possible to find the applicable law of this contract within the CE regulation, 17 giugno 2008, n. 593 that at the art. 4, comma 1 defines as "…*a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence".*

Instead, in the hypothesis of an indirect guarantee (quadrilateral relationship: Italian applicant-Italian instructing bank-foreign issuing bank-foreign beneficiary), it occurs to distinguish among:

- *Contract of mandate* that is the same of the previous hypothesis and then it is regulated in the same way with the application of the Italian law;
- *Contract of guarantee* (foreign issuing bank-foreign beneficiary): here it is applicable the law of the parties' country considering that it's the law potentially chosen by the parties and because it's the law of the place in which the supplier (foreign bank) supplies the "characteristic performance" (art. 4, comma 1, EC regulation, n. 593/2008);
- *Interbank relationship (*Italian bank-foreign bank)*:* in this case, it could be used the art. 1327 c.c. (execution before acceptance of the other party) for which the conclusion of the contract is in time and in the place in which its execution takes place. In fact, when the foreign bank receives the request for the issuance of a guarantee, from another bank, it proceeds with the issuance without giving previously communication to the instructing bank. Therefore, the relationship must be disciplined by the foreign law because it is abroad the place where the execution of the contract starts with the issuance of the guarantee in favour of the beneficiary. Only in the rare case in which

the foreign bank communicate its acceptance, it is instead applicable the art. 1326 c.c. that conversely affirms the application of Italian law because it is the place where the bank has known the acceptance of the foreign bank that is the place in which the contract has been concluded. This issue was further analysed under the Article 35 *URDG* as Baranello states *"it specifies an "exclusive place" for the resolution of disputes, something that may work well where there is a demand guarantee but no counter-guarantee. However, where there are both, the "exclusive place" can be different for the guarantor than for the counter-guarantor (likely, as they will often be located in different countries). This exposes them to the risk of inconsistent judgments (e.g., a court in Country A may hold that the guarantor is obligated to pay under the demand guarantee, but a court in Country B may hold that the guarantor is not entitled to be paid under the counter-guarantee). The parties may wish instead to agree on exclusive jurisdiction in a single jurisdiction for both guarantees"*[130].

- *Contract of sales of goods(*supplier/debtor-buyer/beneficiary): every time a judge has to ascertain (value judgement) over the bank's refusal of payment of the issued guarantee, he can refer to the Italian law because the object of the judgement was the mandate between Italian applicant and Italian bank. The application of a different law could be necessary when, to inhibit the bank's payment, judge has to analyse if the enforcement has been fraudulent. So that, it couldn't be possible to use the Italian law because fraud is ascertain analysing the principal contract that it could be regulated under a different law rather than the Italian one. This reasoning leads to find the law applicable to solve the disputes under the normal contract of sales that, as aforementioned, is regulated by the law of the country in which the seller has its residence, again the art. 4, CE Regulation 593/2008.

3.8 PERFORMANCE BOND

The construction industry is historically and endemically exposed to enormous risks and it's especially for this reason that common law countries gave rise to a particular form of

[130] Baranello J., *Understanding the URDG 758*, Deutsche Bank, Global Transaction Banking. Available at: http://www.fpsc.com/DB/TreasuryPulse/PDF/Fall10_article4.pdf

guarantee named *performance bond* which aim is to provide the industry with a measure of financial stability[131].

This type of guarantee ensures the fulfilment of the specific obligation, so it represents an incisive mean of protection for the client. First of all, it's better to introduce the definition of "bond" provided by the ICC in its "Uniform rules for contract bonds" stating:" *Bonds is intended to operate so as to confer upon the Beneficiary in each instance security for the performance or execution of contract obligations or payment of any sums which may fall due to the Beneficiary as a result of any breach of obligation or default by the Principal under the Contract. The Bond is intended to ensure that… the Beneficiary will recover any sum properly due notwithstanding the insolvency of the Principal or the Principal's failure for any other reason to satisfy or discharge its liability*"[132]. The same URDG gives a little definition of the specific "performance bond" considering it as "*A Bond to secure the performance of any Contract or Contractual Obligation*". Anyway a wider explanation can better identify the performance bond as an undertaking of a bank through which the guarantor commits itself to pay to the beneficiary a predetermined sum of money or to get the execution of the contract if the principal debtor is in default. It always creates a tripartite relationship: there is the "principal" (the general contractor) who assumed a contractual undertaking. Then the "client" (or "oblige") that is the project owner who obtains the benefits of the principal's performance and the "guarantor" that provides the performance bond as guarantee to protect the client and it guarantees to him the principal's performance[133]. Focusing on the role of the guarantor, this type of guarantee involves two different kinds of guarantor's obligation if the principal is in default:

- The guarantor has to pay a sum of money that covers from 5% to 20% of the total value of the contract, usually is about 10%;
- On the other side, the obligation can involve the commitment of the guarantor to provide the execution of the contract's performance. This possibility is completely out of the Italian market and generally abroad it is provided by insurance company rather than by banks because these latter tend to provide only monetary reimbursement

[131] R. Moelmann L., *The law of Performance bonds,* 2009, American Bar Association.

[132] Uniform Rules for Contract Bonds (URCB), introduction.

[133] Reviewed from R. Moelmann L., *The law of performance bond,* pp. 5, 2009

avoiding to be involved in the execution of physical contract, in other words " banks deal in documents and not in goods".

Performance bond is able to assure an high level of security in favour of the client (oblige) about the accomplishment of the performance. In the past the Italian instrument for a tender was a *bailment* but its structure involved some issues because it constituted a simple refreshment, a small reimbursement in case of default. In this way, if the contractor became defaulting, the client wouldn't have the possibility to obtain the fulfilment of the physical obligation.

Within the Italian law, performance bond was regulated through the *Legge Merloni quater* (l. 11.2.1994, n. 109) under the name "Legge quadro in material di lavori pubblici" but today the overall matter is regulated within the "Codice unico degli appalti" (d. legis. 11.9.2008, n. 152[134]). At the art. 113 is defined the obligation of the contractor to provide a guarantee covering the 10% of the value of the contract. Moreover, the art. 129 "*Istituzione e definizione del sistema di garanzia globale di esecuzione"* emphasizes, within the 3° comma, as: " *La garanzia globale è obbligatoria per gli appalti di progettazione esecutiva ed esecuzione di lavori di ammontare a base d'asta superiore a 75 milioni di euro, per gli affidamenti a contraente generale di qualunque ammontare, e, ove prevista dal bando o dall'avviso di gara, per gli appalti di sola esecuzione di ammontare a base d'asta superiore a 100 milioni di euro*"[135]. This guarantee involves the two aforementioned potential obligations: the guarantor's payment or the commitment to provide the execution of the performance. The law requires the satisfaction, for the chosen "substitute", of the tender's requirements, such as it must comply with all the requirements specify in the call for tender of the winning company. Any bank, before the issuance of a performance bond, requires a wide and specific documentation of the contractor because whether a default occurs, the guarantor will be personally responsible for the fulfillment of the contract undertaking one of the two solutions. For this reason, guarantor has a great interest in ensuring expert and competent subjects that it means a further security for the client. In addition, the chosen substitutes present the same characteristics of the winning company and their quality is furtherly guaranteed by the bank

[134] Ulteriori disposizioni correttive e integrative del decreto legislativo 12 aprile 2006, n. 163, recante il Codice dei contratti pubblici relativi a lavori, servizi e forniture, a norma dell'articolo 25, comma 3, della legge 18 aprile 2005, n. 62.

[135] Montani A., *Performance bond quasi raggiunto il traguardo, in "La nuova giurisprudenza civile commentata*", vol. 26, file 10, part 2, pag. 502-517, 2010.

through its international *standing*: banks pay attention in paying its guarantees when the enforcement of an independent guarantee occurs, this because it is under their specific interest to maintain its international fame and reputation of a trustworthy institution. In turn, the specific valuation of the company made by the guarantor leads to provide an higher and better qualification than that provided by the public administration (that is usually the client) thanks to the elevated interest of the guarantor in a good conclusion of the contract.

It is normal in the industry sector, during a contract negotiation and drafting, that the client requests to the contractor a further guarantee in addition of that provided by the underlying contract. The performance bond satisfy this need but seems an independent guarantee, it presents the risk for the contractor of a fraudulent enforcement by the client. The Confindustria of Vicenza provides a text of a performance bond that differs from the standard one provided by the banking system. This sample includes some obstacles to the client's freedom and it is called "Bonded performance bond":

Dear Sirs,
we are informed that on ..... (mese giorno anno) you - Messrs ..... (Cliente estero) (Hereinafter referred as the "BUYER") concluded with Messrs ..... (ditta venditrice italiana) (hereinafter referred to as the "SELLER") contract no. ..... (numero) for the supply of ..... (quantità e descrizione della merce dettagliata*23) (Hereinafter referred to as the "GOODS") at the total price of ..... (divisa e cifre) - (.....) (in lettere).
According to contract terms, the SELLER is requested to provide you with a Performance Bank Guarantee of ..... (divisa e cifre) - (.....) (in lettere) to cover (QUI E' NECESSARIO INSERIRE LE ESATTE E COMPIUTE RAGIONI TECNICHE E /O QUALITATIVE CHE RENDONO LA MERCE CONFORME).

We, ... (nome della banca italiana garante), by order of the SELLER, hereby irrevocably undertake, to pay you against the presentation of the following documents:
- Your written demand certifying that the goods described above have the following technical problems:
CITARE DETTAGLIATAMENTE I PROBLEMI TECNICI E /O QUALITATIVI CHE LA VOSTRA MERCE PUO' PRESENTARE,
- Original inspection certificate issued by an International Society of Inspection (LA COSA MIGLIORE SAREBBE LIMITARE STRETTAMENTE LE SOCIETA ' ISPETTIVE DESIGNATE AL CONTROLLO DELLA MERCE)

As alternative:

- AN ORIGINAL PROTOCOL SIGNED BY THE BUYER AND BY THE SELLER, WHICH SPECIMEN OF AUTHORISED REPRESENTATIVE THAT SHALL BE VERIFY AND CONFIRM BY US, DETAILING..... CITARE DETTAGLIATAMENTE I PROBLEMI TECNICI E /O QUALITATIVI CHE LA VOSTRA MERCE PUO' PRESENTARE, *24
any sum (s) claimed up to the global maximum amount of ..... *(divisa e lettere) - (.....) (in lettere).
For identification reasons, your demand for payment, including all the above mentioned documents, shall not be considered valid unless we receive it through the intermediary of .....(nome e indirizzo della banca intermediatrice), which must certify that the signatures on your demand are authentic and made by the authorised signatories.
This guarantee shall come into force as soon as:
CITARE LE CONDIZIONI PER CUI QUESTA PERFORMANCE VIENE EMESSA E/O (MEGLIO) SUBORDINARNE L'ESISTENZA AL VERIFICARSI DI QUELLO CHE E' STATO CONTRATTUALMENTE PREVISTO (A TITOLO DI ESEMPIO IL PAGAMENTO INTEGRALE DELLA FORNITURA DA PARTE DEL COMPRATORE; L'INCASSO INTEGRALE DELLA L/C ..... ECCETERA)
The failure to comply with one of these requirements is enough to make our undertaking towards you null and void.
All of our obligations arising from this guarantee will terminate on ../../.. "(g/m/a), regardless of whether we receive or not your specific discharge of this undertaking of ours and even if this document has not been returned to us.
Any demand for payment will have to reach us in writing on or before the aforementioned date of ../../.. "(g/m/a) failing which any claim towards us arising from this guarantee shall become automatically null and void.
Every payment effected under this guarantee shall automatically reduce the total value of the guarantee by the same amount.

This guarantee is not assignable or transferable to a third party.
This original document must be returned to us after its expiry or as soon as we will fulfilled all obligations arising from it, whichever shall occur first *25.
This guarantee shall be governed by the Italian law and shall be subject to the sole and exclusive jurisdiction of the Courts of ..... (luogo e paese).

FIGURE 10 SAMPLE OF A BONDED PERFORMANCE BOND[136]

[136] Confindustria Vicenza, *Crediti documentari e garanzie bancarie internazionali: manuale operativo,* 04/2015. Available at: http://www.confindustria.vicenza.it/pdf/guida_1565.pdf [date of access: 17/05/2016]

Chapter 4

THE CONCEPT OF FRAUD

4.1 INTRODUCTION

The issue of fraud has been previously treated in the Chapter 3 specially under the Italian point of view. Instead, in this chapter the matter will be discussed at a wider extent considering fraud under different points of view through international author's opinions and law.

A fundamental feature of independent bank guarantee is its role as financial compensation for the beneficiary without considering potential account party's defences referred to the underlying contract. This is a principle that comes from the natural characteristic of the guarantee based on the allocation of risks between the parties of the underlying contract.

As matter of fact, a breach of contract can occur by a great number of reasons (default of one of the parties, non-completion of the contract, natural disasters, etc…). All these events represent real risks leading to an increase of the likelihood of a call of the guarantee. The principal debtor should be aware about this eventuality and then he should assess in advance the probability that these events occur. In turn, independent guarantee presents a structure and a mechanism that gives a great power to the beneficiary, who will be able to call the guarantee every time without particular obstacles due to the grave difficulties encountered by the account party to obtain the stop-payment order. In fact, another consequence of this allocation of risks is that beneficiary is entitled to compensation without having to prove the default of the other party but only observing a full compliance with the terms and conditions drafted in the guarantee (pay first, argue later). For this reason, it is undeniable the fact that first demand guarantee, by its very nature, is capable of being abused. Then, law tried to create a sort of balance between the maintenance of the international commercial utility of the guarantee and the desire to prevent fraudulent actions of the beneficiary. For this reason, the very first decision of all countries about the law of first demand guarantee was its independent nature but with the recognition of the limits of this independence in case of fraud. Indeed, the wide freedom of the beneficiary presents an exception established by law that is the **fraud**

exception. In the letter of credit's case of *United City Merchants v Royal Bank of Canada*[137], Lord Diplock stated:

"*The exception of fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out the fraud*".

It means that fraud is able to vitiate everything and then to completely upset the normal and well established mechanism of guarantee piercing the veil of its principle of independence. In fact, it brings to block bank to make its payment if the beneficiary is fraudulent. This exception is fundamental to give a foothold for the account party to protect his interests that, by nature of the guarantee, aren't so protected.

To better clarify what this chapter is about it seems important to present an overall definition of fraud that is intended as: *"A false representation of matter of fact, whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed that deceives and is intended to deceive another so that the individual will act upon it to her or his legal injury"*[138]*;* or as define by Professor Goode: "*Fraud should be understood as a false statement knowingly and intentionally included in a document to be used against the deceived party*"[139]

The generic explanation is anyway useful to describe the misleading event accomplished by beneficiary that the account party have to prove to block the natural payment mechanism of the guarantee with the aim to protect himself. A further explanation, more specifically about the fraud on bank guarantee, could be: "*Fraud could tentatively be described as the condition whereby the beneficiary's demand for payment has no conceivable basis under the underlying relationship"* (Bertrams, 1996)

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[137] [1983] AC 168 at 184; Mentioned by Davidson A., *Fraud, the Prime Exception to the Autonomy Principle in Letters of Credit*, 2003. Available at: http://www.austlii.edu.au/au/journals/IntTBLawRw/2003/2.html [date of access: 25/05/2016]

[138] http://legal-dictionary.thefreedictionary.com/specific

[139] Frias Garcia R. L., *The autonomy principle of letters of credit*, Mexican Law Review, Vol. III, no. 1, at 69, Biblioteca Juridica Virtual del Instituto de Investigaciones Juridicas de la UNAM, 2009. Available at: http://biblio.juridicas.unam.mx/revista/pdf/MexicanLawReview/5/arc/arc4.pdf [date of access: 01/06/2016]

The total daily trading volume incorporates every typology of contracts in which also guarantee has its role. The use of guarantee involve the likelihood that a beneficiary demands for payment if he thinks the other party has not fulfill his contractual obligations but could be possible that under the call there are other hidden reasons based on bad faith. However, determining a general estimate of the percentage of fraudulent calls under guarantee is futile and unreliable because of the difficulty to detect suspicious behaviour and determine them as causes of fraud. In addition, the complexity of the projects and the different circumstances in some countries could create difficulties of all kinds that result in a wide difference of opinions about if you are faced a fraud or not, even among judges and legal scholars. Fortunately, an help is given by the rules of UNCITRAL Convention and in particular the art. 19[140] that lists the entire range of situations on which the payment obligation can be stopped. The three principals to invoke a fraud and the related exception involve situations in which: *(a) Any document is not genuine or has been falsified; (b) No payment is due on the basis asserted in the demand and the supporting documents; or (c) Judging by the type and purpose of the undertaking, the demand has no conceivable basis.* In addition, Convention, even if without specify the need of evidence of fraud, define that fraudulent demand can be determine by reference to underlying contract[141].

In short, the purposes of fraud rule is the elimination of the loophole in the autonomy principle. That is, although the principle is the main element of distinction assuring its independence and gives to the guarantee the possibility to maintain its commercial utility, when fraud is in the transaction this separation between guarantee and underlying contract gives rise to a loophole in law: the only requirement is a compliance of documents but nothing is requested about the compliance with terms and conditions of the underlying contract (fraudulent documents or demands can occur). Fraud rule try to eliminate this loophole or to minimize its effect.

4.2 THE STANDARD OF PROOF OF FRAUD

As it has seen, when beneficiary calls a guarantee, account party has a limit range of possibility to defend itself and avoid bank's payment. One of the possibilities is requiring a

[140] Art. 19 about "Exception to payment obligation" UN Convention

[141] See Art. 19(2) UNCITRAL Convention

restraining (also called stop-payment) order[142] that can be requested only if a fraudulent call has been made by the beneficiary.

It is clear that Courts consider a fraud exception only under very strict conditions in particular it should be determined with presentation of documents that without doubts proven manifest fraud and consequently the injunction will be used as prevention to avoid a payment not owed to the beneficiary. A further example is the case "*Penn State Construction Inc v Cambria Savings and Loan Association"* in which the court states: "*In light of the basic rule of the independence of the issuer's engagement and the importance of this rule to the effectuation of the purposes of the letter of credit, we think that the circumstances which will justify an injunction against honour must be narrowly limited to situations of fraud in which the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served… here, it is clear that the trial court's determination that Associated East committed fraud was supported by sufficient evidence. The record establishes that Penn State had substantially completed the project when Associated East made the demand on Cambria to honor the credit…*"[143]. Here, the call was made for the breach of the underlying contract when it was caused by the same beneficiary. Analysing the case under the Art. 5 UCC and considering that U.S. Courts should not intervene mandatorily, it can be deduced that United States law values fraud on the basis of the provided evidence of fraud actions and on its effects rather than on the state of mind of the guilty party.

The account party, thus, will raise an exception of fraud and the burden of proof will be on his shoulders. In this sense, is not enough for the account party supplying a mere *allegation of fraud* in the pleadings requesting the court injunction rather is required a *proven fraud*. About this, Ackner L.J. in *United Trading corp SA v Allied Arab Bank Ltd* defines the standard of proof outlining as: "*The evidence of fraud must be clear, both as to the fact of fraud and as to the guarantor's knowledge. The mere assertion or allegation of fraud would not be sufficient*"[144].

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[142] See para 6.1 Chapter 3

[143] Available on-line at: http://pa.findacase.com/research/wfrmDocViewer.aspx/xq/fac.19870106_0040051.PA.htm/qx [date of access: 01/06/2016]

[144] 2 Lloyd's Rep. 554 at 561, 1985. Cit. By Elliott N. (edited by), Banking Litigation, Sweet & Maxwell, Hewetson C. (edited by), at 264, 2011. Available at: https://books.google.it/books?id=hAsncxE70dEC&pg=PA264&lpg=PA264&dq=Donaldson+Bolivinter+Oil+SA

Several Courts tried to outline the degree of **fraudulent conduct** necessary to determine vitiate the main characteristics of a guarantee that must be proved through reliable evidences brought by the seller. These Courts used terms as material, clearly established, obvious, sufficient, etc… to underline the need of a well exposed documentation as in the dispute "*Gillespie v Russel*[145]" the judge stated that the allegations of fraud was "*perfectly clear and explicit in statement*". In effect, it is not enough to infer the existence of fraud, to state that it has been committed the party must state in what the fraud consists and on the base of which elements the existence of fraud is stated.

In practice, account party has to prove the facts which he alleges and he has to demonstrate the legal consequences of these facts, for example his completion of contractual obligations or the breach of contract by the beneficiary should be easy to prove; otherwise force majeure could be more problematic to demonstrate. Finally, in order to determine the presence of fraud, it is necessary to analyse the whole of the circumstances involved in a case. The main purpose of the usage of this high standard of proof of fraud depends on the potential negative consequences that will be occur penalizing the reputation of bank and the business of the beneficiary that was accused of fraud.

4.3 DIFFERENT APPROACHES OF NATIONAL COURTS

Every Court adopts a different approach in the definition of the meaning of fraud and in its determination of the necessary standard of proof to ascertain the fraudulent event.

The abundance of American case law seems to beyond to two main categories: one more strict and restrictive and another less stringent and more flexible. A case enclosed in the first stringent category is *American Bell Int. v. Islamic Republic of Iran*[146] in which the dispute arose from the revolution in Iran and caused strong impact upon contracts made with the ousted Imperial Government of Iran. In the ruling the district judge MacMAHON listed the

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+v.+Chase+Manhattan+NA&source=bl&ots=mqe83mE36z&sig=V8mtCKl7Fqa3QVNSyGC2hJF5gMM&hl=it&sa=X&ved=0ahUKEwiPiMi5q4bNAhXPyRoKHfcIDb4Q6AEIHDAA#v=onepage&q=Donaldson%20Bolivinter%20Oil%20SA%20v.%20Chase%20Manhattan%20NA&f=false [date of access: 31/05/2016]

[145] Case 268263: Wayne Circuit Court, LC No. 04-431052-CK, March 8, 2007. Available on-line: http://law.justia.com/cases/michigan/court-of-appeals-unpublished/2007/20070308-c268263-42-268263o-opn.html [date of access: 25/05/2016]

[146] Full text available at: http://law.justia.com/cases/federal/district-courts/FSupp/474/420/1964263/ [date of access: 06/05/2016]

criteria for preliminary injunction through the reference to another case law *Caulfield v. Board of Education*[147]: "*[T]here must be a showing of possible irreparable injury and either probable success on the merits or sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting the preliminary relief*". After, judge explained every lack of the criteria and affirmed that the plaintiff did not meet them at all. Another strict viewpoint was outlined in the ruling of the US case *Intraworld Industries Inc v Girard Trust Bank* that leading the court to affirm: *"…in light of the autonomy principle and its importance…, an injunction*[148] *is only justified in narrow limited situations of fraud. Those situations involve the wrongdoing of the Beneficiary which has 'so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served'*[149]. Even if, the same case offers afterwards a more flexible explanation: "*An injunction would be proper only if the beneficiary had no bona fide claim to payment* [or] *where the beneficiary's claim has no… plausible basis under the underlying contract*". For this peculiarity, the *Intraworld* case, as many other, is considered positioned in the middle of the two categories, showing at the same time a stringent and a flexible vision. On the other side, a flexible and less restrictive approach is that provided by *Ground Air Transfer v. Westate's Airlines*[150] where the final decision was explained so: "*We have said throughout that courts may not "normally " issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in Itek, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly " show that the underlying contract forbids the beneficiary to call a letter of credit, Itek, 730 F.2d at 24; …; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F.Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served" Itek, 730 F.2d at 25 … then a court may enjoin payment"*.

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[147] 583 F.2d 605, 610 (2d Cir. 1978) Available at: http://openjurist.org/632/f2d/999/caulfield-v-board-of-education-of-city-of-new-york [06/05/2016]

[148] See para 6.1 Chapter 3 "The restraining order"

[149] 461 Pa. 343 (1975), 336 A.2d 316. Available on-line at: http://www.leagle.com/decision/1975804461Pa343_1748/INTRAWORLD%20IND.,%20INC.%20v.%20GIRARD%20TRUST%20BK [date of access: 25/05/2016]

[150] Available on-line at: http://openjurist.org/899/f2d/1269/ground-air-transfer-inc-v-westates-airlines-inc [08/05/2016]

The three aforementioned criterions (success of the merits, possible irreparable injury and balance of the hardship) are used in American case law to identify the existence of fraud and of the elements necessary to accept the preliminary injunction. As Bertrams explains, the first test relates to the probable success on the merits of the case involves two steps: determine the substantive notion of fraud and the degree of evidence of fraud. The second concerns the irreparable harm to the account party that is the injury suffers if a preliminary injunction is denied. The third test is based on the balance of convenience[151]: any type of decision of the court is going to harm someone involves in the contract; here, with the test, the judge might assess the degree of the harm suffer by the party who requests the injunction.

The U.S. bases the fraud regulation on the UCC (Uniform Commercial Code) and in particular on the Art. 5 "Letters of Credit"[152] that is short explains the two main events under which fraud exception will apply: whether a required document is forgotten or is materially fraudulent (fraud in narrow sense); and when fraud depends on the underlying contract (fraud in wide sense). Law shows cases in which courts granted restraining orders with insufficient elements occur, the UCC with the Art. 5 expressed its requirement for a stop-payment order that even them look like a bit much tightened concerning the identification of fraud as "material" and that the plaintiff is going to have high possibility of a success at the trial.

Instead, United Kingdom does not present a statutory law and a fraud rule comes from case law. In particular, the development of English case law about fraud exception is due to an American case: *Sztejn v. Henry Schroder Banking Corporation* (Judge Shientag)[153] in which the applicant of the letter of credit, issued to secure the purchase price, requested an injunction against the issuing bank to stop payment to the seller. This latter, such as the beneficiary, was an Indian merchant and the applicant alleged that the shipped goods were not the same goods defined in the contract. first of all, judge reaffirms the autonomy and documentary principles with these words: "*letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument*

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[151] Reviewed from Bertrams R. (second revised edition), *Bank Guarantees in International Trade*, at 270, London, Kluwer Law International, 1996.

[152] This name is used with a generic meaning by American and English courts because they do not distinguish between documentary credits and standby letters of credit, these latter as independent guarantees.

[153] 177 Misc. 719, 31 N.Y.S.2d 631 Supreme Court, New York County, New York, Special Term. SZTEJN v. J. HENRY SCHRODER BANKING CORPORATION et al. July 1, 1941. Available on-line at: http://uniset.ca/other/cs4/31NYS2d631.html [date of access: 11/06/2016]

for the financing of trade. One of the chief purposes of the letter of credit is to furnish the seller with a ready means of obtaining prompt payment for his merchandise". Secondly, he referred in particular to the present case stating that: "*This is not a controversy between the buyer and seller concerning a mere breach of warranty regarding the quality of the merchandise; on the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller*". This case led to a real development of fraud rule because the judge looked beyond the mere complying of documents towards an exception to the independence due to the guilty of the beneficiary for an intentional and serious misconduct. The case was considered so important as to be codified in the Uniform Commercial Code and even now courts cite it in their rulings.

English courts were always reluctant to interfere in the natural mechanism of a guarantee and *unlike to some United States courts, English courts will not, at present, enjoin payment of an irrevocable letter of credit or demand bond or bank guarantee upon a mere suspicion of fraud*[154], thus they adopted a limited approach towards the application of the fraud rule and *construed it in a more narrow and rigid manner than courts in other jurisdictions*[155]. Anyway, they followed the general principle of fraud: the fraud is related to the underlying contract and when a fraud event occurs, the independence of the guarantee ceases to be applied and the standard of proof should be easily obtainable without deeply investigations and the evidence must be substantive and clear "beyond every reasonable doubt". Bertrams cited a significant case law *Harbottle v. Nat. Westminster bank* related to a request of a stop-payment order, in which the English judge affirmed: "*it is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce… Except possibly in clear case of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the*

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[154] Peter S. O'Driscoll, *Performance bonds, bankers' guarantees and the Mareva injunction,* Northwestern Journal of International Law **&** Business, vol. 7, issue 2 Fall, at 386, Fall 1985. Available at: http://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1201&context=njilb&sei-redir=1&referer=http%3A%2F%2Fwww.bing.com%2Fsearch%3Fq%3Dfraud%2Bin%2Bbank%2Bguarantees%2Bcase%2Blaw%26qs%3Dn%26form%3DQBRE%26pq%3Dfraud%2Bin%2Bban%26sc%3D0-12%26sp%3D-1%26sk%3D%26cvid%3DF5ADE20DB700426BAB6F245ABA676C08#search=%22fraud%20bank%20guarantees%20case%20law%22 [date of access: 01/06/2016]

[155] Yearbook of the United Nations Commission on International Trade Law, vol. XXII, 1991. Available on-line at: https://www.uncitral.org/pdf/english/yearbooks/yb-1991-e/vol22-p352-371-e.pdf [date of access: 01/06/2016]

contracts by litigation or arbitration as available to them … commitments of banks are on a different level" and in addition "*they must be allowed to be honoured, free from interference by courts. Otherwise, trust in international commerce could be irreparably damaged"*. English judges clearly underscore their line of thinking that fraud rule should be used only in very limited cases. This because tries to protect the bank's undertaking and its position that will be compromised in case of loss of the independence principle. The more focused interest towards the bank brings the account party to have the burden to provide a more considerable evidence of fraud able to be clear and evident even for the bank. Anyway, a less rigid approach, to identify the type and level of standard of proof and to determine the evidence required for a preliminary injunction, was found in the UK case law *United Trading Corp. v. Allied Arab Bank*[156] in which it was remarked: "*While accepting that letters of credit and performance bonds are part of the essential machinery of international commerce, ... it cannot be in the interests of international commerce or of the banking community ... that this machinery ... should be* [abused] *for the purposes of fraud… We would find it an unsatisfactory position if, having established an important exception to what had previously been thought an absolute rule, the Courts in practice were to adopt so restrictive an approach to the evidence required as to prevent themselves from intervening. Were this to be the case, impressive ... phrases such as "fraud unravels all" would became meaningless*". The judge Ackner L.J. here took the opportunity to criticise some precedent judicial statements that were readily to determine the insistence of fraud, instead he continued to affirm to importance of being focalised on the standard of proof: "*We would expect the Court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyers…".*

A further Scottish case "*The Royal Bank Of Scotland Plc V Holmes"*[157] submitted the matter of fraudulent misrepresentation in which judge, regarding the determination of fraud and its standard, maintains a less rigid approach stating: *"Held, (1) that in Scotland as in England, in appropriate circumstances fraud was an exception to the rule that a bank was entitled to make payment under a letter of credit or guarantee (dictum in Centri-Force Engineering Ltd v Bank of Scotland, 1993 SLT 190, followed) (p 569C); (2) that allegations of fraud had to be*

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[156] In Yearbook of United Nations Commission on International Trade Law, Working papers submitted to the Working Group on International Contract Practices at its Fifteenth session, at 1, vol. XXII, 1991. Available at: https://www.uncitral.org/pdf/english/yearbooks/yb-1991-e/vol22-p352-371-e.pdf [date of access: 02/06/2016]

[157] 1999 SLT 563, 1999 SCLR 297, 8 January 1999. Available at: http://www.uniset.ca/lloydata/css/1999SLT563.html [date of access: 13/06/2016]

supported by specific averments clearly setting out the acts or representations founded upon, the occasions on which such acts were committed or representations made, and the circumstances relied on as yielding the inference of fraud (p 569K-L); (3) that in averring fraud it was essential to identify the person committing the fraudulent act or making the fraudulent misrepresentation", so he maintains the same line of a less rigid English doctrine adding this statement: "[It is] *not dispute the availability in principle of the fraud exception as a defense to the pursuers' claims, but based her submission that the defences were irrelevant principally on the absence of adequate specification of the fraud founded on*.

Summarising, the English point of view is more oriented to invoke fraud only in very strict situations when: a clear evidence of fraud is provided; the bank obtains a prompt knowledge and accepts the proof of fraud; the fraud involves beneficiary. Consequently, the determination of fraud is quite rare in English case law that in fact happens only in a very limited number of cases.

Considering further European countries could be useful to achieve a global vision of fraud regulation. Even if, there are different concepts of fraud and rules are applied differently in case law, all jurisdictions recognize fraud exception and its peculiarities: the link with the underlying contract and the need of reliable evidence. The Dutch law follows this unique line stating that "under a demand for payment, it could be considered fraudulent if the call is evidently arbitrary or deceitful". The emphasis is on the achievement of clear evidence on facts alleged by the account party that led to identify a beneficiary's fraudulent behaviour. Even the Dutch judge verifies the presence of fraud looking at the underlying contract but without a much deep and unnecessary investigation rather courts wait to obtain good evidence of fraud by the account party.

German legal writing is substantial; a common view is that of submit the contract of guarantee to the good faith principle that correctly prohibit to the beneficiary maintaining misconduct against his debtor, such as bank. In effect, German doctrine considers fraud as something between bank and beneficiary, where proving fraud allows bank to defend it through non-payment. However, also German judges reference to underlying contract to valuate and bring to light the fraudulent events, even though no specific criteria to determine the circumstances or the behaviour in which fraud can manifest have been written by case law or legal writing. Authors are not unanimous in the definition of the term "fraud" but conversely a same line of thinking regards the standard of proof: it must be clear, evident and immediately available

(called "*liquid*"), such as documentary evidence better if provided by third parties, always as principal duty of the account party.

Another flourishing doctrine is that of French courts; the line of the Cour de Cassation is to see fraud as the absence of the beneficiary's right that should be identify looking at the underlying contract and its development. Here, several decisions show that it is not necessary to prove a fraudulent intent because the evidence of proof depends only to the analysis of the underlying transaction. Anyway, it can be affirmed that French law maintains a more flexible and broader approach than other national law (i.e. English law). In fact, it happens that courts *have tended to merely state that the established facts justified judicial intervention, with or without adding that the proven facts rendered the call fraudulent or abusive"*[158]. The French policy of fraud seems completely different from those aforementioned because, even if the evidence of fraud must be evident and clear, however it seems almost all depending on the feeling of the judge and his acumen to identify evidence that must "strike the eye of the beholder" (crève les yeux), without a deep investigation into the underlying contract.

The paragraph presents a comparison among the major national doctrine about acknowledge and regulation of fraud exception. Even some differences have been noticed, there is a total acceptance of the existence of the phenomenon of fraud and there is a broad awareness about the need of controls it and safeguard the other parties involved. Within a bank guarantee, it is specially the beneficiary that can make a fraudulent demand of payment. If this happens, account party can raise the fraud exception and the resolution of the dispute is up to the court. At European point of view, the common feature regards the evidence of fraud that must be clear, evident beyond reasonable doubt and it can be obtain rapidly without a deep investigation.

Lastly, there are some characteristics that are supported by all the jurisdictions, such as:

- The fraud could be determine by reference to the underlying contract;

- A fraudulent intention by the beneficiary is not strictly required to determine fraud;

Instead considering the standard of proof of fraud, it is clear that English courts require the most stringent approach that goes to affect the determination of the notion of fraud as well.

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[158] Bertrams R., Bank guarantees in international trade, at 263, Kluwer Law International, 1996.

The purpose of the English doctrine is to avoid that judges interfere in the normal mechanisms of the commerce exchanges and trade. The other European countries maintain anyway a stringent approach in the identification of the criteria but they tend to be not so scrupulous in it application: they do not reject completely an evidence if it looks like not entirely suitable. A special mention is for France where an higher number of injunction have been granted especially considering the French courts' approach that is more liberal and less bonded than the other.

Overseas, U.S. law has more than one common points with European doctrine. The starting point of fraud determination is the underlying contract even in American law but about the standard of proof of fraud are better outline than in Europe where proof must be provided immediately; conversely American courts allow a lengthy and wide investigation. Concerning the three American criteria, especially the second two, they do not find correspondence in European doctrine and then they are not used in European case law. The last comparison is the important role of UCC in the United States because it expressly recognises fraud.

4.4 TYPES OF FRAUD

According to Davidson the expression 'types of fraud' should be intended as the level and standard of the fraudulent acts arising in the letter of credit/guarantee transaction and that, for their negative connotation, must be treated in case law.

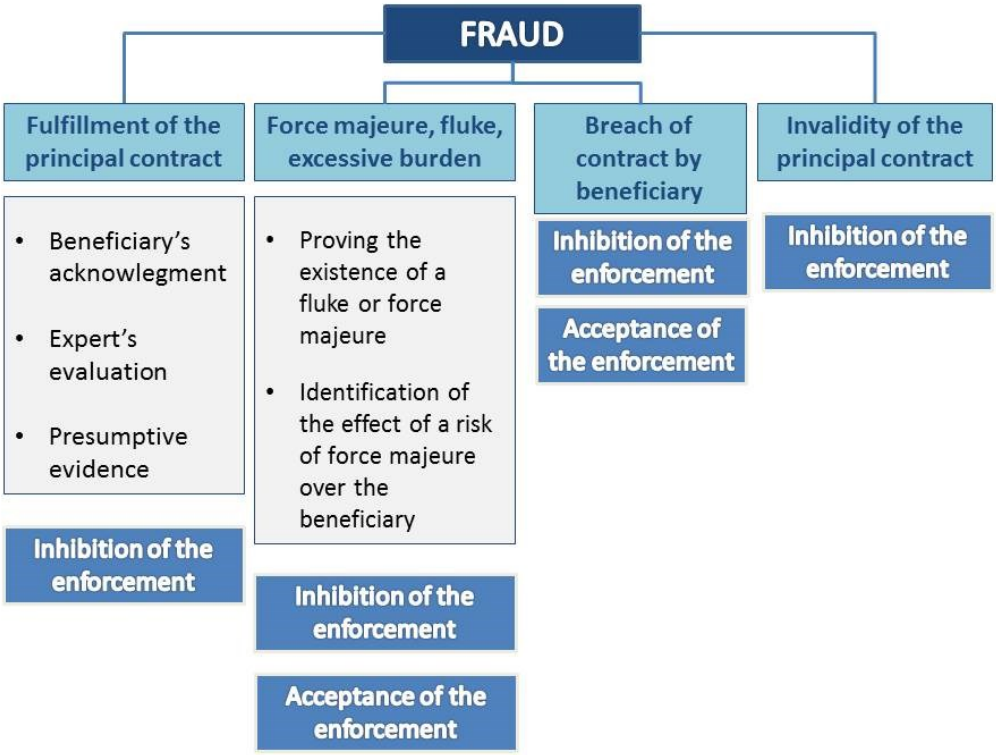

FIGURE 11 MAIN EVENTS OF FRAUD AND THE POTENTIAL CONSEQUENCES ON THE BENEFICIARY'S ENFORCEMENT

The following paragraph analyses a number of situations in which the fraud occurs due to the lack of plausible basis to link beneficiary's demand for payment with the underlying transaction.

Lack of authority: a reason to define the beneficiary's demand as fraudulent involves the possibility that the original contract has been concluded by an officer with no authority to bind the account party. This case in quite rare and consists in complex legal issues. Nevertheless, if this situation occurs and account party is able to prove that he is not bound by contract, even the right to claim of the beneficiary is inexistent.

Mistakes and misrepresentation: they might raise the account party from principal contract's obligations but rarely they could represent a fraud. Anyway, if happens, it might be very difficult for the account party to prove his allegations and at, any rate, these defences are not so serious to deprive the beneficiary to his right to obtain the payment.

Conditions precedent: the non fulfillment of conditions precedent designated by the principal contract can lead to a breach of contract, even if not always the non-fulfillment render the beneficiary's demand fraudulent. An example of fraud occurs when principal contract requires particular obligations for the beneficiary (i.e. the supply of a documentary credit) and he fails to perform it.

Completion of the contract: this implies the most clear and easy case of fraud to demonstrate that takes place when the account party unequivocally proves its completion of the contract's obligations. The only obstacle for account party is to provide clear evidence of his punctual performance through certificates from independent third-parties, especially if nominated by the beneficiary (surveyors, engineers) to present in front of the Court in order to justify his actions and to establish the fraud. Bertrams mentions the case "*LG Frankfurt a.M, December 11 1979*"[159] in which the completion of the obligations of the account party was established through the correspondence between the parties about the stipulation of the principal contract. In further situations the account parties furnishes a protocol of acceptance that confirms his performance; or it was attested by engineers nominated by the beneficiary. On the other hand, there are several cases in which the completion has not been established: where Court rejects the account party's defence because he wasn't able to furnish a clear and undeniable documentation or because he only provided evidence emanating from its own personnel or self-appointed third-parties.

Breach of contract by the beneficiary: the possibility of fraud is recognized even when beneficiary breaches his own contractual obligations or try to obstacle those of the account party. When this happens, the beneficiary's demand will be fraudulent because it has no elements on which to base the request since the breach of the beneficiary or that of account party was caused by beneficiary's fault. In this case, account party can immediately rescind the contract without penalties only providing evidence of the beneficiary's malfeasance. The demonstration of this breach and its legal consequences seem easy to prove because usually it is evident or it derives directly from the contract's provisions. Case law provides examples of both situations in which the stop-payment requested was dismissed because the breach by the beneficiary was not established; or, conversely, there were situations in which the restraining order has been applied successfully thanks to undeniable evidence. The second option, concerning the impossibility of account party's performance due to beneficiary that is also

[159] Bertrams R., Bank guarantees in international trade, at 283, Kluwer Law International, 1996.

mentioned in the art. 19(2) UNCITRAL Convention[160] and generally involves two possibility: first, when the performance becomes physically impossible; secondly, when delay or impossibility are directly connect to the breach of beneficiary's obligations (i.e. failure to supply energy or skilled labour, to procure licenses, etc..) that, if proved, entitles account party to rescind the contract.

Force majeure: account's party is not liable for non-completion of the contract when it is determined and proved an event of force majeure. Consequently, the beneficiary's demand for payment, requested for the non-performance of the account party, is rejected by the Court because it is considered fraudulent. Bertrams mentioned two examples of Swiss decisions in which this request was rejected because no sufficient evidence of force majeure were presented by the account party and, in the second case, the court do not considered the event as force majeure[161]. Otherwise, in other cases, force majeure was proved and accepted by the judge. For example the Iranian revolution given rise to a lot of case law in which court agreed that the performance had been made impossible because of force majeure (the aforesaid revolution) and then the beneficiary's call was considered fraudulent because the account party was not in default. The event of force majeure is not so easy to prove as well as its consequences that render the performance impossible. In fact, courts can argue in favour of beneficiary considering that contract could be completed by alternative measures or that the supervening event could be probably temporary. In addition, the general law requires that, to establish an event of force majeure, the event has not been contemplated by parties in the contract which was beyond their control and out of the normal range of risk. In conclusion, it is possible to affirm that the account party's defence in case of force majeure should be restricted to clear and very exceptional cases.

Annulment of principal contract: cancellation as well as termination or dissolution of the contract can occurs in every moment by both parties. If the termination is made by the beneficiary, it can be follow by the beneficiary's demand for payment that could be fraudulent if account party is able to prove the serious breach of contract and that beneficiary had no reason to terminate it. Conversely, whether is the account party to terminate the contract, he

[160] Art. 19(2)(d): "Fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary".

[161] See Bertrams R.(Second revised edition), Bank guarantees in international sales, at 291, Kluwer Law International, 2006.

has to prove that the cause was attributable to a breach or any kind of beneficiary's misconduct.

Excess amount: beneficiary that asks for payment is entitled to obtain the entire amount of the guarantee whatever is the default of the account party. Considering this general rule, account party has however the possibility to claim that the call for the full amount is excessive because there aren't conceivable elements on which to base it. It means that the beneficiary's demand is fraudulent. It can be the situation in which arbitrators decide in favour of beneficiary for damages for an amount smaller than the total amount of the guarantee, the call of the guarantee ought to be reduced by the amount that he has already received for damages.

Improper calls: the beneficiary's demand for payment can be made if concern losses connected with the underlying contract that is covered by the guarantee. It means that an independent guarantee covers a particular risk coming from a particular contract. Any other type of claim (losses on other contracts, calling on all the guarantee even if the loss regards only one of them, etc…) is consider fraudulent if account party provides the relative evidence. An improper call might be done with the aim of the beneficiary to produce damage and when this misleading behaviour is ascertained there is the assurance to be in front of an **abuse of law**. An example is submitted by the rulings of the *Pretura di Milano 5 maggio 1996.* He states: "*Nel caso in specie il beneficiario, committente di un'opera, aveva chiesto l'escussione di una garanzia per dazi doganali ed imposte diverse, laddove invece la garanzia era stata rilasciata per tenere indenne il beneficiario "a fronte di qualsivoglia danno che possiate subire*""[162].

Court decisions: in case in which is the court that pronounces the dissolution of the underlying contract without any liabilities for the account party, it is clear that any beneficiary's demand for payment has no reason to be raised and then it is considered fraudulent.

In short, considering the fraud exception as the non-acceptance of beneficiary's demand payment every time there are no links with the underlying contract and no plausible reasons. Case law determines the main situations in which the call is fraudulent as those concerning breach of fundamental obligations, misconduct or the judgement of the court and the completion of the contract by the account party. At any rate, law tries to minimize the

[162] Pretura di Milano 5 maggio 1996, "Borsa Banca e Titoli Di Credito", at 57, 1997.

situations in which fraud is called with the aim to protect the interests involved. For this reason, when a dispute occurs is fundamental to verify that beneficiary is really part of the fraud. It means that, even if is found that demand of payment is fraudulent; the judge has, in any case, to verify that the beneficiary has had a role in it and that he has acted in bad faith. For instance, it is ascertained that the cause of fraud is due to a misrepresentation in the documents but it is found that beneficiary had no knowledge about it. At this point, the judge cannot affirm the presence of fraud because of the strangeness of the beneficiary to the fact triggering fraud and consequently, the bank will still be obligated to make payment in favour of beneficiary[163].

4.5 POSITION OF BANK IN CASE OF FRAUD

One of the most important principle about fraud and bank position states that "if *fraud by beneficiary is evident to the bank it owes the duty to the account party to refrain from payment*" (Bertrams, 2006). This brings to light one of the bank's obligations to be carried out when beneficiary presents his demand for payment. When a demand for payment is received, bank as a limited number of obligations to fulfil, such as: verify the compliance with terms and condition of the contract and verify that no evidence of fraud is clearly visible. Even if the few number of obligations, the incorrect performance can lead to severe consequences for the bank. In fact, bank can become liable towards the account party if it decides to pay the beneficiary even though the fraud is absolutely evident. This because, if happens, bank has disregarded its duty and it will be not allowed to receive the reimbursement by the account party. As aforementioned, the bank's duty must be carrying out in good faith and with the due care and it has to be aware that, with a well establish fraud, the beneficiary is not entitled to demand for payment and for this reason bank shouldn't permit the enforcement of the guarantee.

The precedent principle encompasses two main rules: whether fraud is visible no payment must be given to the beneficiary and second when bank proceeds to pay, it becomes liable. Anyway, in its duty, no particular requirements are asked to the bank to identify the presence of a fraudulent demand, this because it is an account party's duty to present clear and

[163] Edited from Longwa Kayembe G. (2008), The fraud exception in bank guarantee, at 49. Master in laws, University of Cape Town. Available at: https://open.uct.ac.za/bitstream/handle/11427/4645/thesis_law_kymgra001.pdf?sequence=1 [date of access: 22/05/2016]

conceivable evidence about fraud. In fact, the risk and concern to prove fraud is an account party's task rather than a bank's one. About this, the words of the Judge Shientag in the ruling "*Sztejn v. J. Henry Schroder Banking Corporation*" defines how a non-timely receiving of proof of fraud by the account party reliases bank from its liability: "*It is true that even though the documents are forged or fraudulent, if the issuing bank has already paid the draft before receiving notice of the seller's fraud, it will be protected if it exercised reasonable diligence before making such payment"*[164]. It is clearly that bank cannot have the knowledge about the beneficiary's default unless the account party is not able to produce clear and unambiguous evidence before the bank's payment providing his complaints and documents to the bank.

The question related to the awareness of bank about fraud involves two main issues that are explained by Bertrams as:

"*It is unfair to burden the bank with this kind of decision and the inherent risks…, at the same time, it is inappropriate to allow the account party to leave the prevention of fraud in the hands of the bank"*[165]

Here, it is considered another point of view that involves a better defence of the bank; it is never liable towards the account party if a fraud is facing and bank has notified the demand to the account party and this latter does not provide plausible evidence of fraud. After the bank notification, account party has few days to request a stop-payment order through interlocutory proceedings and if the account party does not proceed, the bank will be entitled to pay the beneficiary because no evidence of fraud has been furnished. The same UNCITRAL Convention tries to manage this situation through the art 19 that determines the exceptions to payment obligations and specially at point c) describes: "*Judging by the type and purpose of the undertaking, the demand has no conceivable basis, the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment*"; and the following art. 20 that identify the provisional court measures and states: "*the court, on the basis of immediately available strong evidence, may: (a) Issue a provisional order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the*

[164] 177 Misc. 719, 31 N.Y.S.2d 631 Supreme Court, New York County, New York, Special Term. SZTEJN v. J. HENRY SCHRODER BANKING CORPORATION et al. July 1, 1941. Available on-line at: http://uniset.ca/other/cs4/31NYS2d631.html [date of access: 11/06/2016]

[165] Bertrams R. (1996 – second revised edition), Bank Guarantees in International Trade, at 306, London, Kluwer Law International.

undertaking, or (b) Issue a provisional order to the effect that the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/ applicant would be likely to suffer serious harm".

Considering an indirect guarantee, the same principle is apply to issuing bank that has the duty of care towards the account party, even if it presents a different shade instead of the case of a direct guarantee. In fact, a contractual relationship between issuing bank and account party does not exist but is based on the general due diligence that (issuing) bank has to maintain. The issuing bank's knowledge of beneficiary's fraud is based on the restraining order, obtained by account party, against the instructing bank (among which is presented a contractual relationship) in respect of the counter-guarantee in favour of the issuing bank. Anyway, banks try every time to take care of their clients and, as in these cases of fraud, the applicant provides plausible evidence of fraud bacause bank is willing to postpone payment and assist its client in applying for stop-payment injunction. On the other hands, bank tries to maintain good relationship even with beneficiary and it could use the court's decision as a shield and excuse for non-payment. This because, bank tries to take a neutral position to safeguard its interests and to avoid to ruin its relationships with entities and clients that are of vital importance for the bank's business.

4.6 APPLICABLE LAW TO STANDARD OF FRAUD

Banks are worried about the possibility to face fraud in their issued guarantees or standby letters of credit. Here because, any kind of standard or provision to manage fraud is well accepted. In this sense, one of the most considered set of rules is the UCP (particularly for standby letters of credit), which, however has been considered not exhaustive because of "*Jurisdiction and fraud are two matters which the UCP cannot deal with due to the legal nature of the UCP*"[166]. It means that, in the matter of fraud exception, government and public policy are involved with the aim to reach and maintain a public interest.

Parties must be careful in drafting their contract because they cannot permit to give rise to a fraudulent contract, first of all for their personal interest. The applicable law should include

[166] Stated by Dan Taylor, Vice President of the ICC Banking Commission. Statement at the 2000 Annual Survey of Letter of Credit Law and Practice, New York, 9 March 2000.

the revised UCC art. 5-109[167] or the art. 19 UN Convention. The art. 19(1) creates a sort of equilibrium between parties' interests. One of the purposes of the Convention is to be *sensitive to the content of guarantor/issuers over preserving the commercial reliability of undertakings as promises that are independent from underlying transactions*[168]. In fact, no rights arise under the Convention entitling account party to avoid reimbursement of payment but an exception exist under the article 19 giving to the applicant the possibility to block payment through a request of a provisional court measure. Moreover, art. 20 establishes the provisional court measures that must be ordered when there is an "high probability" of fraudulent or abusive circumstances outlined in art. 19[169].

Instead, the UCP 600 does not deal with fraud because in no way it mentions the fraud directly but it might be thought that the essence of the set of Rules is the protection of banks in case of fraud. This can be seen through some articles that try to enclose this protection:

- Art. 34: "*A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon ...*"
- Art. 12(b): "*By nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorizes that nominated bank to prepay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank*".

Apart the elements enclosed in these articles, the UCP don't deal in practically with fraud exception. As well as ISP 98 and URDG because never they define fraud standards whereby guarantor or account party is entitled to withhold payment. It could be explain considering the will of case law to leave the matter to the courts, for example the ISP 98 expressly provides that: "*it does not define or otherwise provide for defences based on fraud, abuse, or similar matters and that these matters are left to applicable law*"[170].

In conclusion, it can be drafted a scheme to summarise the main points that have been developed concerning fraud:

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[167] Art. 5-109 "Fraud and Forgery" Uniform Commercial Code (UCC). Available at: https://www.law.cornell.edu/ucc/5/5-109 [date of access: 01/06/2016]

[168] Official explanatory note of UN Convention, paragraph 48.

[169] Art. 20(1) "Provisional court measures" UNCITRAL Convention

[170] Rule 1.05 ISP 98

- Fraud is the unique exception to the principle of independence;
- its existence refers to the underlying contract;
- it is stated facing a suspicious beneficiary's demand for payment;
- the account party has the burden of proof of fraud;
- fraud must be established and proven beyond every reasonable doubt through clear and reliable evidence;
- the fraudulent events can be enclosed in three categories (UNCITRAL Principles): no genuine documentations; no right of payment by the beneficiary; demand without substantial basis.
- the fraud must be accepted and known to the bank before it has made its payments. If a bank pays without knowledge of the fraud, the bank is protected from action; otherwise, bank is liable;
- when fraud is ascertain, the bank's payment shall be blocked and a preliminary injunction may be granted;
- national approaches are not uniform but they agree on the basic elements that concern fraud.
- the applicable law in case of fraud is weak because it is left more autonomy to judges in case law resolutions.

CONCLUSIONS

From the beginning, there has been a general awareness that guarantees are an international phenomenon. Especially for the parties involved in trade and that act within an environment characterised by a high complexity and a wide range of risks. Fortunately, the needs of traders have been satisfied thanks to particular instruments as bank guarantees able to provide a major level of security and reliability. Bank guarantees are the natural evolution of previously instruments, there latter are not capable to meet the new needs of these economic subjects and they are unable to adapt to a more flexible and ever-changing market.

Consequently, the same law has changed to conform to these new tools of business and to provide a legal framework able to control and regulate bank guarantees with the aim to safeguard their users and permit their usage as a further instrument to enhance trade among different countries. For this reason, international organizations like ICC, UNCITRAL and UNIDROIT provided new sets of rules and practices to better satisfy the emerging requests. One of the organizations' purposes was the law unification as always wanted and carried out by the European Union, such as the achievement of a unique legal system avoiding in this way the potential conflicts of law that often arise when there are links between two or more different countries. It can be seen through the Italian law evolution that has started with an internal unification of rules and continued toward a complete substitution with European Regulations.

Another fundamental matter is the gap of knowledge shown by the parties involved; traders can use very often bank guarantees but they have to bear in mind that they are using contracts that then, to all effects, are subjected to law. The majority of traders present a lack of knowledge and awareness about the importance of a good drafting of contract, to a clear definition of clauses and often they ignore the potential consequences in case in which something goes wrong. The principal users of guarantees are businessmen and companies that usually have a limited knowledge about law and the legal framework. In fact, until a sale of goods or a building of an infrastructure is carried out and complete without problems, parties don't care how the contract was drafted, what clauses were put inside or if some items were written with little care. But, when something goes wrong, parties became conscious of these items and about the legal consequences that they bring with them. Unfortunately, traders do not deal only with goods, numbers and logistic problems but also with an intricate bulk of regulations and laws. Thus, it seems clear that parties should be more aware of the legal

system in which they operate and in which they are enclosed. This because, if known, it could be an important instrument for business to guarantee its safety and to simplify the settlement of disputes; unless a lack of knowledge and consciousness might be fatal for an organization or might bring to serious and negative consequences. As matter of fact, trading involves any kind of risks and even if disputes arose from bank guarantees are not so frequent, it doesn't mean that it might not seriously prejudice the business, even because often bank guarantees assure high amount of money and a negative event can result in a huge loss of money or a loss of credibility in front of future commercial partners.

The negative consequences usually are transformed in legal disputes that can arise from different events (failure of contractual obligations, mistakes within the contracts, force majeure, etc…) involving the underlying contract as well as the contract of guarantee. Even if, parties try to avoid these situations that mean a waste of time and money through a better attention during the steps of negotiation and drafting or defining a favourable and safe agreement. Although, it is sometimes not so easy to foresee and take into account all the potential threats and risks when a contract is drafted. About this, a substantial and wide regulatory system was created to solve disputes determining easily and through clearly principles the applicable law and jurisdiction. Today, case law and the past Court's rulings together with the work of legal scholars have led to the creation of a solid legal framework able to provide a clear assurance to the parties about the way in which the dispute will be solved or how potential matters will be treated by law. The same happen against fraud; it was necessary to determine the standard of proof of fraud that are fundamental for an account party's defence and they are important to identify the range of events in which fraud could manifest. Here, the role of bank cannot be underestimated because the bank's evaluation of the beneficiary's demand represents the first and most important line of defence for account party. Anyway, the role of bank is important in more than one aspect concerning bank guarantees; even though bank has a personal economic interest in provide these instruments of assurance, they are however involved in a wider mechanism able to reach the global interests of every country: economy development, improvement of citizens' life, an internal market able to offer a high variety of products and services. All these intents are achievable only through an open economy and a high level of commercial exchanges that are possible only if traders can obtain the necessary freedom, rules and the right instruments such as standard of contracts and guarantees on which to rely to increase their businesses, conclude commercial relationships and enhance their international reputation out of national borders with the purpose to open their businesses and trade worldwide.

APPENDICES

This part wants to collect the main set of rules already shown in the thesis. Specifically, every mentioned set of Uniform rules includes the principal laws utilised in the text to explain the complex environment and structure that involves bank guarantee.

A) Convention for the International Sales of Goods (CISG)

Article 1

1. This Convention applies to contracts of sale of goods between parties whose places of business are in different States: (a) When the States are Contracting States; or (b) When the rules of private international law lead to the application of the law of a Contracting State.
2. The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.
3. Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

Article 2

This Convention does not apply to sales: (a) Of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use; (b) By auction; (c) On execution or otherwise by authority of law; (d) Of stocks, shares, investment securities, negotiable instruments or money; (e) Of ships, vessels, hovercraft or aircraft; (f) Of electricity.

Article 3

1. Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production.
2. This Convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services.

Article 6

The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.

Article 7

1. In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.
2. Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

Article 8

1. For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was.
2. If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.
3. In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

Article 11

A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses.

Article 12

Any provision of article 11, article 29 or Part II of this Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing does not apply where any party has his place of business in a Contracting State which has made a declaration under article 96 of this Convention. The parties may not derogate from or vary the effect of this article.

Article 23

A contract is concluded at the moment when an acceptance of an offer becomes effective in accordance with the provisions of this Convention.

Article 39

(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.
(2) In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were

actually handed over to the buyer, unless this time limit is inconsistent with a contractual period of guarantee.

B) UNIDROIT Principles

Article 1.1 *Freedom of contract*

The parties are free to enter into a contract and to determine its content.

Article 1.2 *No form required*

Nothing in there Principles requires a contract, statement or any other act to be made in or evidenced by a particular form. It may be proved by any means, includying witnesses.

Article 4.1 *Intention of the parties*

(1) A contract shall be interpreted according to the common intention of the parties.

(2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

Article 4.2 *Interpretation of statements and other conduct*

(1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention.

(2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

Article 4.4 *Reference to contract or statement as a whole*

Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear.

C) The Rome Convention of 1980

Article 1 *Scope of the Convention*

1 . The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries.

2 . They shall not apply to : (a) questions involving the status or legal capacity of natural persons, without prejudice to Article 11 ; (b) contractual obligations relating to : — wills and succession, — rights in property arising out of a matrimonial relationship, — rights and duties arising out of a family relationship,

parentage, marriage or affinity, including maintenance obligations in respect of children who are not legitimate.

Article 3 *Freedom of choice*

1 . A contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract.

2 . The parties may at any time agree to subject the contract to a law other than that which previously governed it, ... Any variation by the parties of the law to be applied made after the conclusion of the contract shall not prejudice its formal validity under Article 9 or adversely affect the rights of third parties.

(3. and 4. are omitted)

Article 4 *Applicable law in the absence of choice*

1 . To the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country.

2 . Subject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration. However, if the contract is entered into in the course of that party's trade or profession, that country shall be the country in which the principal place of business is situated or, where under the terms of the contract the performance is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated.

(3., 4. and 5. are omitted)

Article 10 *Scope of the applicable law*

1 . The law applicable to a contract by virtue of Articles 3 to 6 and 12 of this Convention shall govern in particular: (a) interpretation ; (b) performance; (c) within the limits of the powers conferred on the court by its procedural law, the consquences of breach, including the assessment of damages in so far as it is governed by rules of law; (d) the various ways of extinguishing obligations, and prescription and limitation of actions; (e) the consequences of nullity of the contract.

2. In relation to the manner of performance and the steps to be taken in the event of defective performance regard shall be had to the law of the country in which performance takes place.

Article 18 *Uniform interpretation*

In the interpretation and application of the preceding uniform rules, regard shall be had to their international character and to the desirability of achieving uniformity in their interpretation and application.

D) The Uniform Rules for Demand Guarantees (URDG)

Article 1 – Application of URDG

A. The Uniform Rules for Demand Guarantees (*"URDG"*) apply to any demand guarantee or counter-guarantee that expressly indicates it is subject to them. They are binding on all parties to the demand guarantee or counter-guarantee except so far as the demand guarantee or counter-guarantee modifies or excludes them.

B. Where, at the request of a counter-guarantor, a demand guarantee is issued subject to the URDG, the counter-guarantee shall also be subject to the URDG, unless the counter-guarantee excludes the URDG. However, a demand guarantee does not become subject to the URDG merely because the counter-guarantee is subject to the URDG.

C. Where, at the request or with the agreement of the instructing party, a demand guarantee or counter-guarantee is issued subject to the URDG, the instructing party is deemed to have accepted the rights and obligations expressly ascribed to it in these rules.

D. Where a demand guarantee or counter-guarantee issued on or after 1 July 2010 states that it is subject to the URDG without stating whether the 1992 version or the 2010 revision is to apply or indicating the publication number, the demand guarantee or counter-guarantee shall be subject to the URDG 2010 revision.

Article 4 – Issue and effectiveness

A. A guarantee is issued when it leaves the control of the guarantor.

B. A guarantee is irrevocable on issue even if it does not state this.

C. The beneficiary may present a demand from the time of issue of the guarantee or such later time or event as the guarantee provides.

Article 5 – Independence of guarantee and counter-guarantee

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

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

Article 6 – Documents v. goods, services or performance

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

Article 8 – Content of instructions and guarantees

All instructions for the issue of guarantees and guarantees themselves should be clear and precise and should avoid excessive detail. It is recommended that all guarantees specify:

A. the applicant;

B. the beneficiary;

C. the guarantor;

D. a reference number or other information identifying the underlying relationship;

E. a reference number or other information identifying the issued guarantee or, in the case of a counter-guarantee, the issued counter-guarantee;

F. the amount or maximum amount payable and the currency in which it is payable;

G. the expiry of the guarantee;

H. any terms for demanding payment;

I. whether a demand or other document shall be presented in paper and/or electronic form;

J. the language of any document specified in the guarantee; and

K. the party liable for the payment of any charges.

Article 15 – Requirements for demand

A. A demand under the guarantee shall be supported by such other documents as the guarantee specifies, and in any event by a statement, by the beneficiary, indicating in what respect the applicant is in breach of its obligations under the underlying relationship. This statement may be in the demand or in a separate signed document accompanying or identifying the demand.

B. A demand under the counter-guarantee shall in any event be supported by a statement, by the party to whom the counter-guarantee was issued, indicating that such party has received a complying demand under the guarantee or counter-guarantee issued by that party. This statement may be in the demand or in a separate signed document accompanying or identifying the demand.

C. The requirement for a supporting statement in paragraph (A) or (B) of this article applies except to the extent the guarantee or counter-guarantee expressly excludes this requirement. Exclusion terms such as *"The supporting statement under article 15[(A)] [(B)] is excluded"* satisfy the requirement of this paragraph.

D. Neither the demand nor the supporting statement may be dated before the date when the beneficiary is entitled to present a demand. Any other document may be dated before that date. Neither the demand, nor the supporting statement, nor any other document may be dated later than the date of its presentation.

Article 20 – Time for examination of demand; payment

A. If a presentation of a demand does not indicate that it is to be completed later, the guarantor shall, within five business days following the day of presentation, examine that demand and determine if it is a complying demand. This period is not shortened or otherwise affected by the expiry of the guarantee on or after the date of presentation. However, if the presentation indicates that it is to be completed later, it need not be examined until it is completed.

B. When the guarantor determines that a demand is complying, it shall pay.

C. Payment is to be made at the branch or office of the guarantor or counter-guarantor that issued the guarantee or counter-guarantee or such other place as may be indicated in that guarantee or counter-guarantee (*"place for payment"*).

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