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FIRST DEMAND GUARANTEES

THE RELEVANCE OF FRAUD AND ILLEGALITY IN THE ENGLISH AND ITALIAN JURISDICTIONS

A COMPARATIVE STUDY

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ISBN
979–12–5994–532–7

1ST EDITION
ROME NOVEMBER 2021

I will never forget those years…

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ABSTRACT

The legal principle characterising first demand guarantees arising from international trade practice is that of their independence from the underlying relationship, a principle that corresponds to the needs for security and fluidity of commercial transactions. Such principle of independence can nevertheless give rise to cases of abuse, that is, of undue advantage, and the aim and objectives of the research are to investigate what these cases of abuse can be and what the remedies offered in English and Italian law are, if any, and if they are adequate, weak or excessive, with particular regard to the relevance of fraud and illegality. In order to effectively investigate the relevance of fraud and illegality in the area of first demand guarantees and to propose an interpretation aimed at finding a clear balance point between the needs involved, the research has firstly used the case study method, aimed at tracing the *ratio decidendi* from the examination of the concrete facts, and the comparative method both with respect to the two jurisdictions

considered and from a historical perspective; moreover the economic analysis of law method has been used as an important test, also in combination with the criterion of minimum ethical standards for the sustainability of commercial development.

The investigation has shown a point of balance effectively achieved in the jurisdictions considered, namely that the relevance of the underlying relationship situations, as exceptions to the principle of autonomy, is subject to the existence of liquid evidence, mostly documentary and/or, in any case, self-evident of the fraud or illegality. In the English jurisdiction, however, notwithstanding a convincing identification of the concept of fraud, as the enforcement of the guarantee in the awareness of not having the right to do so, there are prohibitive requirements for the granting of payment restrictions against the guarantor bank, such as the bank's knowledge of the beneficiary's fraud, the existence of a cause of action between the applicant and the issuing bank and the passing of the balance of convenience test against the predominant need to protect the reliability of the banks' promises of payment considered as the central pillar of international trade. In the Italian legal system the *periculum in mora* requirement appears less severe but the principle of the *causa* of the contract re-emerges in those judgements that do not only consider relevant the fraud but also the anomalous or abusive use of the instrument even if not clearly fraudulent. As to illegality, in the Italian jurisdiction the prevailing orientation does not consider relevant all the cases of invalidity of the main contract, but only those aimed at preventing a result absolutely prohibited by the law, as in the English jurisdiction the seriousness of the illegality and the instrumental use of the

autonomous guarantee to achieve the illegal result assume decisive importance. The proposal put forward is to distinguish cases of manifest fraud, to the counterpart or to the law, as the only conclusion to be derived from liquid evidence, in which the principle *fraus omnia corrumpit* should prevail, deriving from the historically constant application of the principle of good faith in commercial relationships, from cases of abuse or anomalies that are not clearly fraudulent, in which the principle of autonomy must prevail. Suggested clauses are that which requires the beneficiary's submission of a declaration specifying the debtor's non-fulfilment and that which provides for an adequate payment term for the bank's verification of the evidence transmitted by the debtor.

LIST OF ABBREVIATIONS

ICC: International Chamber of Commerce;
ISP98: International Standby Practices, ICC Publication no. 590 (1998);
URDG: Uniform Rules for Demand Guarantees;
ISDGP: International Standard Demand Guarantee Practice, ICC Publication no. 814E (2021);
BGB: *Bürgerliches Gesetzbuch*.

INTRODUCTION

Context

This research aims to analyse the demand guarantee in international trade law and from a comparative perspective with reference to abuse (in particular fraud and illegality in the underlying relationship) and its related remedies.

The first demand guarantee was born in the context of international trade and meets a precise need for security for those operating in this context: the security of payment of a sum of money in case of non-execution or faulty execution of the performance promised by the counterpart.

In order for this security requirement to be satisfied, it is necessary that the obligation of the party guaranteeing the payment of such sum be independent of the underlying relationship, whose correct execution is intended to be guaranteed, or in other words be an autonomous obligation. In fact, international trade transactions are characterised by a higher risk than domestic ones, due primarily to the greater difficulty in verifying the reliability of the coun-

terpart but also to possible conflicts of laws and/or jurisdictions and finally to the possibility of political upheaval in the country of the counterpart.

The first demand guarantee has the purpose of providing cover against these risks and in fact it is usually issued by a bank in the country of the creditor, instructed and counter-guaranteed by a bank in the debtor's country, which is in turn instructed and counter-guaranteed by the debtor.(1) The autonomy of the first demand guarantee implies that the bank issuing the guarantee must pay the promised sum to the creditor on the simple written request of the latter without being able to oppose any exceptions or defences deriving from the underlying relationship between the debtor-applicant and the creditor-beneficiary, as well as from the relationships between the debtor-applicant and the instructing (or issuing) bank, or between the instructing bank and the issuing bank.

Aim and objectives

The autonomy of the first demand guarantee can nevertheless give rise to cases of abuse, that is, of undue advantage taken by the creditor. This research aims to investigate what these cases of abuse are and what they can be, and what the remedies offered in case law are and whether they are appropriate.

More precisely the questions to be asked by the research are as follows:

(1) Roeland F. Bertrams, *Bank Guarantees in International Trade* (4th edn Wolters Kluwer 2013) 19.

1. Is there any relevance for fraud and illegality in the underlying relationship as exceptions to the autonomy of first demand guarantees?
2. If there is any relevance, what are the conditions for such relevance?
3. What are the remedies, if any, offered in international trade law and in particular in the English and the Italian jurisdictions?
4. Are these remedies, if any, adequate, or do they have any weaknesses, or are they excessive?

Rationale for the research

The rationale for this research lies in the need to find the most appropriate balance between the need to provide international operators with adequate coverage against the risks that are typical of international trade and the need to avoid abusive advantage being taken of the autonomy of the first demand guarantee. On closer inspection, it is a question of finding the most appropriate balance between needs that cannot be considered opposed because both respond to a need for security. In fact, a high possibility of abuse of the autonomous guarantee would negatively affect international trade as much as inadequate coverage provided by the guarantee against the risks that are typical of international transactions would.

Methodology and limiting factors

From the methodological perspective, this research has used the case study method aimed at examining the alleged cases of fraud and illegality in the underlying rela-

tionship brought before the courts, and the *ratio decidendi* of the related judgments. This research has also made use of the comparative method(2) by investigating and comparing case law and doctrine in the English jurisdiction and in the Italian jurisdiction even if, the subject being of international trade, references to other jurisdictions have been made where useful or necessary.

The issues covered by the research certainly belong to the area of international trade, since the autonomous first demand guarantee was born precisely from international trade practice in order to respond to the particular needs for security typical of international trade operators. In this pattern it is possible to recognize the particular force of international trade practice capable of imposing its typical patterns even in those systems traditionally characterized, such as the Italian one, by the principle of the ancillary nature of guarantees.

From this standpoint the issues covered by the research have also allowed us to compare, with regard to the autonomous first demand guarantee, a common law jurisdiction such as the English one and a civil law jurisdiction such as the Italian one, the latter of which has, in turn, been influenced by both French and German (civil law) legal tradition. It has emerged that the regulation and practice of international trade tends to favour the circulation of legal models and the competition of legal systems, producing significant results of regulatory uniformity also applicable to domestic commercial relationships, even if significant

(2) Geoffrey Samuel, 'Comparative Law and its methodology' in Dawn Watkins and Mandy Burton (eds), *Research Methods in Law* (2nd edn Routledge 2018) 122-145.

and important differences remain, with regard to the autonomous first demand guarantee, between the legal systems considered. It can therefore be considered that the issues covered by the research concern not only the area of international trade but also the area of legal comparison.

This research has also taken into account the method of economic analysis of law,(3) which tries to measure the effectiveness in economic terms of legal remedies.

The limits of the research are somehow inherent in the adopted methodology and in particular in the choice to compare only two jurisdictions albeit with references to others. Limitations could also lie in the relativity of the results achievable through the method of economic analysis of law, as it is not certain that the most efficient remedy from the economic point of view is also the fairest or most appropriate one according to a different scale of values, and for this reason the relationships between ethics and business(4) and, from the methodological perspective, between ethics and economic analysis of law have been specifically considered.

The results of the research have been critically evaluated and discussed by reasoning upon the adequacy of the remedies provided in the jurisdictions considered, while being aware that an evaluation of the adequacy of a remedy pre-

(3) Albert Sanchez-Graells, 'Economic analysis of law, or economically informed legal research' in Dawn Watkins and Mandy Burton (eds), *Research Methods in Law* (2nd edn Routledge 2018) 170-193.

(4) Roger Brownsword, 'Maps, Methodologies, and Critiques: Confessions of a Contract Lawyer. IV The Underlying Ethic of Contract Law' in Mark Van Hoecke (ed), *Methodologies of Legal Research. Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 139-143.

supposes the precise identification of the value to be protected and this identification can certainly vary from jurisdiction to jurisdiction, being inevitably conditioned by the social and juridical context of each legal system.

Structure

The research has analysed the alleged cases of abuse brought before the courts in the jurisdictions considered and the judgments rendered in such cases. The research has also examined the doctrinal comments on these cases and, more generally, the doctrinal positions relating to the issues covered by the research. The uniform rules issued by international bodies have been examined in order to verify whether these uniform rules provide solutions and remedies to the questions covered by the research.

In particular, the first chapter of the research has been devoted to a general examination of doctrine and case law in the two jurisdictions considered with regard to the questions under investigation, preceded by a brief, but necessary, general outline of the relationship between the special model of the autonomous guarantee and the general scheme of the guarantee obligation. Finally, the position of international instruments with regard to the issues under investigation has been referred to.

The second chapter has been devoted to examining the specific relevance of the methodological criteria adopted: case study method, comparative method, economic analysis of law, ethics and economic development.

In the third chapter, the main cases brought before the courts in the two jurisdictions considered have been analytically discussed in light of the methodological crite-