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Analysis of Legal Nature of Bank Guarantees in the Light of the Principles of Autonomy and Strict Compliance

The Civil Code of Georgia contains rules regulating relationship originating from the means of security of a creditor's demand. These means are can be found in different chapters of the Code, according to their legal nature.

A bank guarantee is one of the means of demand security, where a guarantor undertakes to pay the amount and satisfy creditor's demand if the debtor breaches his liabilities. It is regarded as one of the quick and efficient means of satisfaction of creditor's demand. A bank guarantee, as a demand security appeared on the local market of the USA in mid-1960s, however it has been widely used in the international banking practice since 1970s.¹

The institute of bank guarantee is widely used both in international trade and economic relationships and at national level. It is associated with the fulfilment of both pecuniary and non-pecuniary liabilities. Guarantee is used to secure such contractual relationships, that are related to provision of goods or construction services.² The bank guarantees, together with documentary letters of credit, constitute the main elements of modern commercial relationships. Due to the intensity of its application in international trade relationships and the problems arising with regard to regulation, along domestic legal law it is regulated on the basis of the Uniform Rules of the International Chamber of Commerce and the Convention on Independent Guarantees and Stand-by Letters of Credit (hereinafter the Convention)³, adopted by the United National Commission on International Trade.

Despite diverse regulation, a bank guarantee has a very complex nature. Furthermore, it is both necessary and mandatory to correctly administer the demand, deriving from the bank guarantee as the existence of the rights and obligations to the parties to the relationship are directly related thereto. Such complexity of relationships gives rise to many problems in practice. The parties to an agreement are not able to fully exercise their rights, administer demands and protect their rights, what in most cases, results in a dispute.

The problems related to bank guarantee are quite abundant in Georgian reality as well. Their abundance was conditioned by the introduction of bank guarantees in public procurement relationships and their increased number.

The paper offers analysis of the legal nature of a bank guarantee and its basic principles, whose role in the administration of demands originating from bank guarantees is of paramount importance.

Keywords: *Guarantee, autonomous nature, public procurement, security mean, guarantor, principal, beneficiary, demand, demand presentation period, principle of "strict compliance", correct management of claim, advance security guarantee, contract fulfilment guarantee, terms of a bank guarantee, competition, Convention.*

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¹ *Bertrams R.*, Bank Guarantees in International trade, 3rd ed., Kluwer Law International, 2004, 1.

² *Kayembe G.L.*, The Fraud Exception in Bank Guarantee, 2008, 1.

³ Convention on Independent Guarantees and Stand-by Letters of Credit.

1. Bank Guarantee as a Demand Security Mean

Bank guarantee is the mean to secure the demand of the parties to a contract. It is mainly used in cases, when a creditor has particular interest in the fulfilment of contractual obligation. This may be investment, international sales, construction and other contracts.

A bank guarantee, as one of the means to secure the fulfilment of an obligation, was also envisaged by Georgian legislation of the Soviet period. Under Article 205 of the Civil Code of Georgia of 1964 guarantee, in fact, was a variety of suretyship, but with one difference - a guarantor could have been only a superior authority of an organisation, whilst any person could have acted as a surety⁴.

The new Civil Code provided for a different regulation of bank guarantees, however their usage in Georgia of 90-s has not significantly increased as compared with the Soviet period. The number of bank guarantees has particularly increased since 2005, what was conditioned by the mandatory application of guarantees in public procurement related relationships.

The essence of a bank guarantee is embodied in Article 879 of the civil Code. Specifically, "By virtue of a bank guarantee, a bank, other credit institution or insurance organization (guarantor), on request of another person (principal), undertakes a written obligation to pay money to principal's creditor (beneficiary)".⁵ The Code version of the guarantee conveys the content of the relationship and does not provide for the definition thereof. However, the content and parties to the relationship are clearly readable from the provision. The content of this provision is fully compatible with the internationally agreed and effective definition of the guarantee.

A similar, but longer definition is contained in the Uniform Rules for Demand Guarantees (URDG#458)⁶ developed by the International Chamber of Commerce.⁷ "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 (hereinafter called "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 (hereinafter 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 (hereinafter "the instructing Party") acting on the instructions of a Principal to another party (hereinafter "the Beneficiary")".⁸

The purpose of the guarantee is to secure creditor's demand, where the guarantor undertakes to pay the guarantee amount. In reality, the text of most bank guarantees contains the stipulation, that they are payable on "first demand" or "simple demand" without any additional documents.⁹ Simple demand may mean an oral

⁴ *Khotenashvili P.*, Legal Aspects of Bank Guarantees, Tbilisi, 2015, 7, (In Georgian).

⁵ Civil Code of Georgia, Law of Georgia, 26/06/1997.

⁶ Was adopted by the International Chamber of Commerce in 1992 and became effective since 1993. The Uniform Rules should be applied to undertakings, originating from independent guarantees. Under this undertaking a guarantor has to pay money against presentation of a written demand or documents specified in the guarantee.

⁷ International Chamber of Commerce (ICC) was founded in 1919 by several business-leaders. It is an international non-governmental organisation consisting of thousands of business entities and associations. It operates in various countries with its headquarters in Paris. The main purpose of this organisation is the promotion of open international trade and investment systems. One of its goals is the harmonization of international trade practice through establishing Uniform rules and their incorporation into contracts.

⁸ Uniform Rules for Demand Guarantees of the International Chamber of Commerce, Publication №458, Article 2.

⁹ *Kelly-Louw M.*, The Documentary Nature of Demand Guarantee and Doctrine of Strict Compliance, 2009, 309, < <http://uir.unisa.ac.za/bitstream/handle/10500/1350/thesis.pdf> >, [10.02.2018].

demand, however, as a general rule the demand should be presented in writing. Some countries also provide for the obligation to submit various documents together with the demand.¹⁰

The next version of the Uniform Rules provides for more laconic definition of a bank guarantee. Under URDG #758¹¹ a guarantee means any signed undertaking, however named or described, providing for payment on presentation of a complying demand.¹²

Convention on Independent Guarantees and Stand-by Letters of Credit (hereinafter the Convention), of the United Nations Commission on International Trade¹³ gives the description of the essence of guarantee relationship. Under Article 2 of the Convention: “An independent commitment is known in international practice as an independent guarantee or as a stand-by letter of credit, given by a bank or other institution or person (“guarantor/ issuer”) to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, [demand] indicating, that payment is due because of a default in the performance of an obligation, or because of another contingency.”

Common for all the definitions of a bank guarantee are the following circumstances: 1) a bank guarantee, as a general rule, is issued by persons with strong financial standing, amongst them, by banks and insurance companies, however, it is stated in both Uniform Rules and the Convention, that it can be issued by any person as well. In this case the Uniform Rules and the Convention empowers the legislation of different countries to define who can issue the guarantees; 2) a guarantee is issued on request of a Principal to secure the obligation undertaken before a beneficiary; 3) A guarantor undertakes to pay the money on presentation of a complying demand, if principal is in breach with the primary obligation¹⁴.

Based on the generalisation of the above definitions, a bank guarantee can be defined as follows: “An undertaking, which provides for the payment of money according to guarantee terms, in the case of presentation of a notice (as a general rule, such a notice should be made in writing) and other documents prescribed by guarantee (if any) within the guarantee period.¹⁵ In this case the definition of a bank guarantee is broader and three main parameters of guarantee relationships are stressed. Specifically: 1) guarantee terms; 2) Guarantee amount; 3) guarantee period. All these three parameters are of paramount importance upon settlement of a guarantee event.

2. Independent Nature of Bank Guarantee

For the determination of relationships originating from bank guarantees and correct management of the rights and obligations of the parties thereto of paramount importance is the definition of the nature of a guarantee.

When discussing the nature of a bank guarantee particular attention should be paid to its independence from fundamental law-of-obligations relationships.¹⁶ Similar to bank guarantees and standby letters of credit, docu-

¹⁰ Ibid, 310, Cited, Guide to the URDG op cit 2, 9.

¹¹ In 2007 the ICC Bank Commission launched the revision of the Uniform Rules for Demand Guarantees. When the process was accomplished, the new Rules were adopted, which were published in 1992 in Publication №758 and became effective on 1 July, 1993.

¹² URDG №758, Article 2.

¹³ In 1966, the United Nations created the UNCITRAL because it desired to play a more active role in reducing and removing legal obstacles to the flow of international trade. Its aim is to further the progressive harmonization and unification of the law of international trade and its mandate is to be the main legal body in the field of international trade law within the United Nations system Membership is structured so that a specified number of seats are allocated to each of the various geographic regions. Therefore, UNCITRAL is an intergovernmental body of the General Assembly that prepares international commercial law instruments designed to assist the international community in modernizing and harmonizing laws dealing with international trade. Various legal instruments have since been prepared by commission.

¹⁴ *De Ly.*, The UN Convention on Independent Guarantees and Stand-by Letters of Credit, Vol. 33, No. 3, Foreign Law Year in Review: 1998, fall 1999, 831-846, 1999, 831.

¹⁵ *Goode R.*, Guide to the ICC Uniform Rules for Demand Guarantees, 1992, 751.

¹⁶ Kelly-Louw M., Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit, University of South Africa, 2008, 197,

mentary guarantees are autonomous by their nature. The foregoing means that primary undertaking embodied in a letter of credit or a bank guarantee, specifically the existence of a demand, originating from the guarantee is not dependent on the rights and obligations of the parties to primary undertaking¹⁷.

The principle of autonomy of bank guarantees is reflected in the Convention on Demand Guarantees and Stand-by Letters of Credit New-York (New-York, 1996) of the United Nations Commission on International Trades and Uniform Rules, developed by the International Chamber of Commerce. Specifically in Uniform Rules for Demand Guarantees #458 and #758¹⁸. According to Article 3 of the Convention “For the purposes of this Convention, an undertaking is independent where the guarantor/issuer’s obligation to the beneficiary is not: a) Dependent upon the existence or validity of any underlying transaction, or upon any other undertaking (including stand-by letters of credit or independent guarantees to which confirmations or counter-guarantees relate); or b) Subject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents or another such act or event within a guarantor/issuer’s sphere of operations.” Uniform Rules #458¹⁹ and #758²⁰ speak about the same autonomous nature of a guarantee in the same manner.

The Convention and the Uniform Rules stress the autonomy of the primary undertaking of the guarantee. Furthermore, they state, that guarantor’s liability should not be subject to claims or defences of primary undertaking, although the guarantee contains reference to primary undertaking. The guarantor or issuer is not obliged to authenticate the documents submitted.²¹ He would limit himself to the verification of documents, submitted thereto. Due to this reason a bank guarantee is documentary in character, in the sense that the amount and duration of the duty to pay, the conditions of payment and the termination of the payment obligation depend exclusively on the terms of the guarantee itself²². After the submission of a demand beneficiary verifies the documents, submitted thereto and does not bear the responsibility for their authenticity. Guarantor examines external parts of the demand, like breach of the undertaking by principal or the amount of damages inflicted by principal upon beneficiary through the breach of undertaking.²³ Of paramount importance for guarantee is for the presented document, of in the case of unconditional demand guarantee - demand for compensation of guarantee amount to

<https://www.academia.edu/10292595/Limiting_exceptions_to_the_autonomy_principle_of_demand_guarantees_and_letters_of_credit>, [10.02.2018].

¹⁷ *Oelofse A.*, The Law of Documentary Letters of Credit in Comparative Perspective, 1997, 354.

¹⁸ The principle of independence (autonomy) of a documentary letter of credit is contained in Uniform rules, applied with regard to them. Under Article 4 of the UCP 600, that: “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.” The documentary nature of a letter of credit is also mentioned in Article 5 of the same Rules, which certifies, that “Banks deal with documents and not with goods, services or performance to which the documents may relate.”

¹⁹ Subparagraph “b” of Article 2 provides for the following: “Guarantees by their nature are separate transactions from the contract(s) or tender conditions on which they may be based, and Guarantors are in no way concerned with or bound by such contract(s), or tender conditions, despite the inclusion of a reference to them in the Guarantee. The duty of a Guarantor under a Guarantee is to pay the sum or sums therein stated on the presentation of a written demand for payment and other documents specified in the Guarantee which appear on their face to be in accordance with the terms of the Guarantee”.

²⁰ According to Part 1 of Article 5: “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.”

²¹ *Kelly-Louw M.*, Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit, 2008, 199.

²² *Kelly-Louw M.*, The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance, University of South Africa, 2009, 311, <<http://heinonline.org/HOL/LandingPage?handle=hein.journals/safmerlj21&div=42&id=&page=>>>, [10.02.2018].

²³ *Eitelber E.*, Autonomy of Document Credit Undertakings in South African Law, 2002, 122.

be compatible with the terms of the bank guarantee.²⁴ Beneficiary regulates a guarantee event and makes a decision on the satisfaction or rejection of demand, commensurate with the bank guarantee terms, issued thereby.

2.1. Principle of Autonomy According to the Civil Code of Georgia

Autonomous nature of a bank guarantee is explicitly stipulated in Article 881 of the Civil Code of Georgia²⁵. Specifically, “The guarantor’s obligation before the beneficiary defined under the banker’s guarantee in their relations shall not depend for performance upon the primary obligation for which it is issued, even when the guarantee includes a reference to this obligation.”

The principle of autonomy should be considered as the main virtue of a bank guarantee. A guarantor regulates the event at its sole discretion and the rights and obligations of the parties to primary undertaking cannot affect the actions of the guarantor. Guarantor’s is equally independent both from the primary undertaking and the guarantee contract, entered between a guarantor and a principal.²⁶

Guarantor’s obligation is to pay the guarantee amount against lawful and legally valid claim of the beneficiary, however, this does not mean his passive role and absolute nature of the principle of autonomy. Fraudulent claim is an internationally accepted exemption from the principle of autonomy²⁷. In the case of a fraudulent claim the court of law is required to examine the circumstances, that became grounds for refusal to compensation. In real life it is rather difficult to prevent a fraud and sometimes non-compliant demand,²⁸ however a guarantor is required to thoroughly investigated all the circumstances to prevent the satisfaction of unlawful demands.

Autonomous nature of a bank guarantee was highlighted in a number of decisions of the Supreme Court of Georgia. Specifically, “The Civil Code regards a bank guarantee as one of the bank security means, which differs from other security means by its independence - non-accessory nature, meaning that the primary undertaking - a contract for the provision of which the bank guarantee was issued - does not affect the latter”²⁹... also “The guarantor’s obligation before the beneficiary in their relationship stemming from a bank guarantee, envisaged by Article 881 of the Civil Code of Georgia, is not dependent on primary undertaking, for the provision of fulfilment of which it was issued.”³⁰ Also, “One of the main characteristics of the bank guarantee that makes it different from other security means, is the autonomy of a bank guarantee from primary undertaking. A bank guarantee is based not on the agreement (contract) of the parties, but rather on a unilateral undertaking of its issuer (guarantor).”³¹

Through the accentuation of the autonomous nature of a bank guarantee the court differentiated between a secured obligation and guarantor’s obligation to pay the guarantee amount to the beneficiary. The guarantor is required to act only in compliance with the guarantee terms and submitted demand. Hence, a guarantor is devoid

²⁴ *Hsun Ch.H.*, The Independence of Demand Guarantees, Performance Bonds and Standby Letters of Credit, National Taiwan University Law Review, Vol. 1:2, 2006, 3.

²⁵ Civil Code of Georgia, Law of Georgia, 26/06/1997.

²⁶ *Barru D.J.*, How to Guarantee Contractor Performance on International Construction Projects: Comparing Surety Bonds with Bank Guarantees and Standby Letters of Credit, George Washington International Law Review, Vol. 37, Issue 1, 2005, 78-80.

²⁷ *Enonchong N.*, The Autonomy Principle of Letter of Credit: an Illegality Exception? Lloyd’s Maritime and Commercial Law Quarterly, 2006, 404.

²⁸ *Pugh-Thomas A.*, Letters of credit – Injunctions - the Purist and the Pragmatist: Can a Buyer Bypass the Guarantor and Stop the Seller from Demand Payment from the Guarantor? 1996, 210.

²⁹ Ruling of the Chamber of Civil, Industrial and Bankruptcy Cases of the Supreme Court of Georgia, dated October 20, 2009, Tbilisi, Case № AS-562-871-09, 10.

³⁰ Ruling of the Chamber of Civil, Industrial and Bankruptcy Cases of the Supreme Court of Georgia, dated January 20, 2001 Case №3 K-62-01 17, 3.

³¹ Ruling of the Chamber of Civil, Industrial and Bankruptcy Cases of the Supreme Court of Georgia, dated March 17, 2009, Case №AS-781-996-08, 14-15.

of the possibility to refer to some grounds, which enable the principal to refuse the payment of money within the framework of secured obligation.

In competition of contract and guarantee terms, when administrating a guarantee demand the guarantor should be guided by the terms of the document issued thereby, which binds and obliged him to pay the amount when a demand is presented.

There are many disputes, falling under the jurisdiction of general courts of Georgia, where the guarantors refuse the satisfaction of claim, submitted thereto, due to incompliance of claims with guarantee terms. The grounds for the foregoing is submission of a claim which is not compatible with guarantee terms, what excludes the obligation of pay the guarantee amount.

Specifically, one of the disputes was about the demand of the beneficiary, which was not satisfied by the guarantor. The case concerned the bank guarantee of advance payment bank guarantee, under which guarantee the principal received the contract amount in advance for the fulfilment of the obligations under public procurement contract. To secure this amount the beneficiary was presented with advance payment bank guarantee. The nature of this guarantee was the reduction of guarantee amount. Namely, owing to its general nature, the reduction of the amount of the advance payment bank guarantee is linked with the scope of fulfilled contractual obligation. Quite often a public procurement contract provides for a different procedure of reduction of advance payment bank guarantee. The guarantee amount may be reduced only by full or partial amount of fulfilled obligation. In this case the amount is reduced by different percentage amount. This very term becomes ground of a dispute between a beneficiary and a guarantor. Upon settlement of a dispute the problem of competition between the terms of the bank guarantee and those of the contract, which provide for the reduction of advance payment guarantee. Namely, according to terms of the bank guarantee the volume of the advance payment bank guarantee was to have been reduced by the amount of work, accomplished by the principal. By its Ruling the Supreme Court of Georgia³² upheld the decision of the Tbilisi Appeals Court on dismissal of the beneficiary's claim. The agreement entered between the beneficiary and the principal provided for the reduction (offset) of the amount of advance payment guarantee by 20% of the amount, stated in the invoice confirming the accomplishment of work and Form #2, whereas under guarantee terms the amount prescribed by bank guarantee is reduced by the amount of work accomplished by the principal for the beneficiary. It was established with regard to the case, that the principal had accomplished only a part of work.³³ The guarantor refused the payment of the remaining after the setoff part of the advance payment bank guarantee and stated, that the amount of bank guarantee is reduced by the amount of work, accomplished by the principal for the beneficiary. Hence, insofar as the bank guarantee was issued for GEL 861 388.07, and the fulfilment for October amounted to 994 108.71 GEL, the defendant was not entitled to satisfy the beneficiary's demand. The claimant based the claim on contract terms, under which terms the claimant was to pay 20% of the net value of the contract as an advance payment in the case of presentation of the bank guarantee for the amount of the respective advance payment. Furthermore, during the settlement the claimant would have deducted 20% of the amount, specified in the invoice and Form #2 from the amount payable to the contractor until the full amount of the advance payment was set off, meaning the accomplishment of the work to full extent. In this case the subject matter of the dispute was the clarification of the question of priority of contract and guarantee terms. The beneficiary would maintain that the advance payment was set off according to the provisions of the contract and the amount was to have been reduced by full amount of accomplished work, according to the directions of the guarantor. And here it comes to the question of independence of the guarantee from primary undertaking. A demand arising out of the guarantee is determined by the terms

³² Decision of the Supreme Court of Georgia, dated July 07, 2012, Case №AS-80, 77, 2014.

³³ The facts of the case evidence the following: a contract was entered between the beneficiary and the principal on the construction of 20-50 km. section of the main pipeline. The principal received 3 020 000 GEL as an advance payment and accomplished works within the framework of the contract worth 12 935 449.80 GEL and of which the claimant paid 12 573 871.44 GEL including the amount of the advance payment. The beneficiary requested the difference in amount of 433 710.10 GEL.

of the bank guarantee and the guarantor cannot be bound by the content of secured obligation or the rights and obligations of the parties. Although the origin of secured obligation preceded the issuance of the guarantee, the guarantor's liability arises only under the terms of the guarantee and the undertaking, envisaged by the contract (primary undertaking) could not have been imposed thereto in any case. In the case of competition of terms, the guarantor should be guided by the terms of the guarantee issued thereby and denounce the satisfaction of the claim.³⁴

It should be mentioned that the precedent, created by this decision was repeatedly sustained by courts of different instances³⁵, however, such decisions are not made with regard to all the cases of similar categories and initiated on identical grounds.³⁶ Specifically, Gurjaani District Court satisfied the guarantee demand with regard to imposition of the payment of the advance payment bank guarantee. The court explained, that "the agreement of the parties that "the guarantor has undertaken to refund the amount paid as an advance payment to the principal in the case of principal's default with advance payment obligations related to public procurement contract envisaged by the project," was to be considered together with the provision of public procurement contract, under which provision it is possible for procuring entity to make transfer for 30% of net contract value on the basis of advance bank or/and insurance guarantee for the amount identical to one, that is to be transferred, specified by the supplier. As per the contract, in the case of advance payment, the settlement will be made as follows: 30% of the value of actually supplied works, confirmed by a takeover act, will be disbursed for the coverage of the advance payment made, and the remaining 70% will be paid by the procuring entity." The court established, that the work was not accomplished, and thus imposed the payment of the full amount of the guarantee to the guarantor. In this case the court has not paid attention to the term of the bank guarantee, according to which the amount of the advance payment should have been set off not in amount of 30%, but rather in full amount of accomplished work. The court based its decision on contract provisions and ignored the guarantee terms. We do believe, that after appealing this decision, the superior instance court will adequately assess this situation and revoke it in accordance with already established practice.³⁷

3. Principle of Strict Compliance of a Bank Guarantee

Along with the major principle of autonomy the bank guarantees and documentary letter of credit is subject to Strict Compliance Principle.³⁸ Under this principle, the beneficiary's demand must be strictly compliant with the terms of the bank guarantee and be supplemented with documents mentioned in the guarantee.³⁹ Observance of the Principle of Strict Compliance is the main obligation of the beneficiary. This principle defends the interests of both parties of the relationship. In the case of accurate enforcement of a documentary demand, a creditor⁴⁰ will receive the amount without the proving the breach of undertaking and making references. A debtor⁴¹ is assured, that the

³⁴ In this case the guarantor refused the satisfaction under Part 1 of Article 887 of the Code of Civil Procedure of Georgia due to incompletion of the claim with the terms of the guarantee. The position of the guarantor was upheld by the court of all three instances.

³⁵ Decision of Khashuri District Court of September 29, 2015 №2-302-2015, №130210015001063580, which was upheld by Civil Chamber of the Tbilisi Appeals Court by its decision of February 16, 2017 №2ð/5563-15, №130210015001063580; Decision of the Tbilisi City Court of July 17, 2015, Case №2/856-15; Decision of the Tbilisi Appeals Court of November 09, 2016 №2ð/4559-15, №330210015703697, which was upheld by the Supreme Court of Georgia.

³⁶ By decision №340110015001160711 of Gurjaani district Court of December 27, 2016, the beneficiary's claim on the imposition of the payment of the bank guarantee of advance payment security was satisfied. The court explained, that the bank guarantee of advance payment security was to have been set off in amount, prescribed by the terms of the contract.

³⁷ The Decision is appealed with the Tbilisi Appeals Court, Case №2ð/2835-17.

³⁸ Principle of „Strict Compliance“.

³⁹ *Moffeh A.I.*, Abstract Payment Undertaking: To What Extent are They Truly Abstract? 2009, 10.< file:///C:/Users/Nino%20Lipartia/Downloads/U205241%20(4).pdf> [10.02.2018].

⁴⁰ A seller in the case of a documentary letter of credit and a beneficiary in the case of a guarantee.

⁴¹ An applicant in the case of a documentary letter of credit and a principal in the case of a guarantee.

payment will not be made without submission of strictly complying documents.⁴² The problem between the parties arises when there is a conflict between their differing interests. According to abstraction principle, principal/applicant bears the burden of proof with regard to fulfilment of primary undertaking. When it deems impossible to prove, the principle is entitled to rely on strict compliance doctrine and refer to refusal to satisfaction.⁴³ In the course of fulfilment of demand the beneficiary is required to be guided by adherence to the principle. Otherwise improperly presented demand may become ground to refusal to the payment of the amount.

3.1. Principle of “Strict Compliance” in Uniform Rules

In bank guarantee related relationship the main obligation of a beneficiary is to correctly present a demand. The guarantor decides to make the payment after the authentication of the demand. Based on the general principles of contract law, a beneficiary is required to present an correct and accurate demand, whereas the guarantor is required to examine the demand presented thereto with reasonable care.⁴⁴ A decision made by a beneficiary should be the result of reasonable judgement and examination. A guarantor is required to examine documents with reasonable care to ascertain whether they appear on their face to conform with the guarantee⁴⁵.

Uniform Rules of Demand Guarantees #758 clarifies and defines the terms “complying demand” and “complying presentation”⁴⁶. According to URDG #758 a guarantee should be presented in accordance with guarantee terms, or Uniform Rules or the established rules of international banking practice. According to these Uniform Rules: “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 (principal) 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.”⁴⁷

The existence of Strict Compliance Doctrine serves mainly the protection of Principal’s interests⁴⁸ and empowers a guarantor with the right to waiver if the demand is incompliant with the documents. The requirements of this principle concern only the content of the demand. No minor errors or clerical mistakes may become grounds for denial the satisfaction of the demand.⁴⁹

⁴² *Mofleh A.I.*, Abstract Payment Undertaking: To What Extent are They Truly Abstract, 2009, 11. <file:///C:/Users/Nino%20Lipartia/Downloads/U205241%20(4).pdf> [10.02.2018].

⁴³ *Ibid*, 12.

⁴⁴ Article 9 of Uniform Rules of Demand Guarantees №458: “All documents specified and presented under a Guarantee, including the demand, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such documents do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused”. The principle, envisaged by this Article also applies to a documentary letter of credit. Article 14 (a) of the Uniform Customs and Practice - UCP 600 explains, that “The [letter of credit] issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.”

⁴⁵ *Kelly-Louw M.*, The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance, (part 2) 2009, 478, <https://www.academia.edu/27460056/The_Doctrine_of_Strict_Compliance_in_the_Context_of_Demand_Guarantees>, [10.02.2018].

⁴⁶ Under Paragraph 1 of Article 15 of the Uniform Rules of Demand Guarantees - URDG №758: “Complying demand means a demand that meets the requirements of a complying presentation, and “Complying presentation under a guarantee means a presentation that is in accordance with, first, the terms of that guarantee, these rules so far as consistent with those terms and, third, in the absence of a relevant provision in the guarantee or these rules, international standard demand guarantee practice.”

⁴⁷ *Kelly-Louw M.*, Selective Legal Aspects of Bank Guarantees, 2008, 126.

⁴⁸ *Khatiashvili A.*, Bank Guarantee as an Independent Security for the Fulfilment of Obligation and Liability of the Parties to the Contract, 36, 2011, (in Georgian).

⁴⁹ *Barru D.J.*, How to Guarantee Contractor Performance on International Construction Projects: Comparing Surety Bonds with Bank Guarantees and Standby Letters of Credit, *George Washington International Law Review*, 2005, 74-75.

3.2. Principle of “Strict Compliance” Under the Convention

The Convention refers to the obligation of the parties to act in good faith when exercising their powers when settling a guarantee event. It obliges a guarantor to act in good faith and exercise reasonable care. Specifically, a guarantor is required to discharge its obligations in good faith and without a gross negligence. Abidance by this principle in the course of fulfilment of an obligation is prescribed by several articles of the Convention. Under Article 13, in settling relationship, the regard shall be taken of generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice, and under Article 14, the guarantor/issuer shall act in good faith and exercise reasonable care having due regard to generally accepted standards of international practice of independent guarantees or stand-by letters of credit.⁵⁰ The convention refers to the obligation to abide by the principle of strict abidance and imposes the duty of complying presentation.⁵¹ The guarantor verifies the soundness and makes satisfaction according to established international standard of banking practice (ISBP).⁵² Respectively, the Convention admitted the principle of strict compliance through reference to these standards. Consequently, the Convention stressed the submission of complying demand by beneficiary and satisfaction of the demand complying with guarantee terms by the guarantor.⁵³ The Court strictly controls the fulfilment of beneficiary’s obligation to present complying and sound demand.

Integral part of the principle of strict compliance is not only the obligation to observe the content requirement, but also to present complying documents. Non-presentation of relevant and exhaustive documents may become grounds for refusal the payment of the amount by the guarantor. Furthermore, complying demand and accompanying documents should be presented before the expiry of the guarantee.⁵⁴ Respectively, overdue demand, non-complying or incomplete documents or/and deficient demand constitute grounds for rejection of demand.⁵⁵

Requirement, based on the principle of strict compliance applies both to the content of the demand and the accompanying documents. No grammatical, spelling or other clerical errors constitute grounds for refusal the satisfaction of the demand. In the Decision in case *Seaconsar Far East Limited v. Bank Markazi Jomhouri Islami Iran*,⁵⁶ the letter of credit provided for the indication of the name of the buyer on every page, what was not observed in the demand. This requirement was not observed upon presentation of the demand, what became grounds for refusal the payment by guarantor. The Court explained, that a technical error like that could not have become grounds for refusal the payment of the amount⁵⁷

⁵⁰ *Kelly-Louw M.*, The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance, (part 2), 2009, 481.

⁵¹ *Dolan J.F.*, The UN Convention on International Independent Undertakings: Do States with Mature Letter-of- Credit Regimes Need it, *Banking and Finance Law Review*, 1998, 13.

⁵² As per Article 16 of the Convention the guarantor is required to examine the demand and any accompanying documents in accordance with the standard of conduct referred to in Article 14 of the Convention. And in the demand is compatible with the terms of a bank guarantee, the guarantor is required to satisfy the demand in accordance with the applicable international standards of independent guarantee or stand-by letter of credit practice.

⁵³ *Kelly-Louw M.*, The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance (Part 2), 2009, 481.

⁵⁴ According to Article 19 of the Uniform Rules: A demand shall be made in accordance with the terms of the Guarantee before its expiry, that is, on or before its Expiry Date and before any Expiry Event as defined in Article 22. In particular, all documents specified in the Guarantee for the purpose of the demand, and any statement required by Article 20, shall be presented to the Guarantor before its expiry at its place of issue; otherwise the demand shall be refused by the Guarantor.” The same principle is prescribe by Article 6 of the UCP 600 with regard to documentary letter of credit.

⁵⁵ *Kelly-Louw M.*, The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance (Part 2), 2009, 482.

⁵⁶ *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran*: HL 15 Oct 1993.

⁵⁷ *Kelly- Louw M.*, Selective Legal Aspects of Bank Demand Guarantees, University of South Africa, 2008, 65.

3.3. Interpretation of the Principle of “Strict Compliance” by Courts

The principle of “strict compliance” was interpreted more than once by the countries of various countries. It is explained in decision in case *Howe Richardson Scale Co. Ltd. V. Poli-Mex-Cekop*⁵⁸, that “A demand should be strictly complying with the terms of the bank guarantee and the documents. Also the demand arising out of e letter of credit should be strictly complying with its terms.” In the case *Frans Maas (UK) Ltd v. Habib Bank AG Zurich* the British court interpreted Strict Compliance Principle in a manner, that under the terms of the guarantee the guarantor has undertaken to pay the amount to the beneficiary against the presentation of a written demand in the case of breach of the obligation by the principal. It was stated in the demand, presented by the beneficiary, that “Principal failed to fulfil the contractual obligation and demanded the payment of 500,00£.” The court stated that the demand failed to prove the grounds of payment of the amount - breach of the primary undertaking by the principal.⁵⁹ Respectively, the court ruled that the demand was not compliant with the terms of the guarantee.

The courts have interpreted the presentation of a demand in compliance with the terms of a bank guarantee in case *I.E. Contractors Ltd v. Lloyds Bank PLC and Rafidain Bank*⁶⁰. The judge explained that the obligation to observe the compliance of demand under guarantee depends on the terms of a bank guarantee.⁶¹ According to the terms of the guarantor has undertake “to pay, unconditionally, the said amount on demand, being the claim for damages brought about by the [account party]”. The primary obligation concerned the construction of poultry slaughterhouses by principals in Iraq. On December 4, 1984 the beneficiary stated, that the principal failed to perform the works and demanded the payment of the guarantee amount. The demand mentioned no damage that followed the breach of obligation. The Guarantor (Rafidian Bank) forwarded the demand to the counteragent (Lloyd’s Bank). The first and second instance courts made different decisions on this case. Specifically, the first instance court has not satisfied the demand of the beneficiary (I.E. Contractors) on the imposition of the payment of guarantee amount on the Guarantor on the basis of Strict Compliance Doctrine and explained, that: 1) the Guarantor has not received the demand compliant with terms of the contract guarantee, 2) the counter-guarantor has not received the demand compliant with the terms of the guarantee⁶².

The Appeals Court interpreted the guarantee demand more broadly, what became grounds for changing the decision. The Appeals Court stated, that in the case of a demand guarantee it is less necessary to apply the principle of strict compliance. “In the case of a guarantee, of major importance is the demand, being the material grounds of payment of the amount and not its exact compliance with the terms.⁶³ Respectively, the court ruled that the demand was compliant with the guarantee terms and that the guarantor was to pay the amount.”

The opinion, offered by the above decision was criticised by various legal writers.⁶⁴ Specifically, it is presumed, that after the presentation of a demand by the beneficiary, the guarantor is not required to conduct thorough and complex “investigation” with a view to establishing the compliance of the demand with guarantee terms, however, he is liable to examine the material grounds of the demand. As the author of the comments to Uniform Rules, R. Goode puts it, “[t]he standard must be applied with a measure of common sense.”⁶⁵

⁵⁸ Decision of the Appeals Court of South Africa.

⁵⁹ *Elliot F.*, Project Security: Bonds and Guarantees, 10, <https://www.fenwickelliott.com/sites/default/files/nick_gould_-_project_security_bonds_and_guarantees_paper_for_university_of_vienna.indd_.pdf>, [15/07/2017].

⁶⁰ *I.E. Contractors Ltd v. Lloyds Bank Plc and Rafidian Bank*, Lloyd’s Bank 1990 2 Lloyd’s Rep.496, <<https://www.i-law.com/ilaw/doc/view.htm?id=150222>>, [15/07/2017].

⁶¹ In the opinion of Lord Justice Staughton more or less strictness of exact compliance towards a documentary letter of credit depends on the construction of the undertaking. Cited from: *Kelly-Louw M.*, Selective Legal Aspects of Bank Demand Guarantees, University of South Africa, 2008, 2

⁶² Hein online, Citation: 9 Const. L. Int’l 13 2014. The usage of on-demand bonds has become more prevalent and calls more frequent, 2014,17., Citation: 9 Const. L. Int’l 13 2014, last visited on: 10/12/2016.

⁶³ *Moffeh A.I.*, Abstract Payment Undertaking: To What Extent are They Truly Abstract?, University of Leicester, 2005, 35.

⁶⁴ Compare Goode R., Commercial Law, 1026, and Jack r. Documentary Credits, 2001, 366.

⁶⁵ *Goode R.*, Abstract Payment Undertakings and the Rules of the International Chamber of Commerce, Saint Louis university Law Journal, 1995, 740.

Consequently, there are two contradictory opinions concerning the nature of a bank guarantee and principle of strict compliance of a demand. According to the first opinion, a bank is required to examine only formal compliance of the demand and satisfy the beneficiary.⁶⁶ In this case the “The guarantor bears lesser risk to be misled and the risk of principal is vested with the principal. According to second opinion the guarantor is required to thoroughly and exhaustively examine the compatibility of a guarantee demand with guarantee terms and make payment after the establishment of compliance. Otherwise the guarantor will not be able to claim reimbursement from principal.”⁶⁷

Introduction of the Principle of Strict Compliance” by Uniform Rules and Convention aims at the protection of Principal’s interests. Based on the guarantee, there is only one obligation to be borne by the beneficiary - specifically, to present accurate, compliant and timely demand to the guarantor. Losing the right to claim reimbursement from the guarantor in the case of breach of this obligation is absolutely lawful.

3.4. Principle of “Strict Compliance” under the Civil Code of Georgia

The obligation to adhere to the Principle of Strict Compliance is provided for by the Civil Code of Georgia as well. Specifically, under Part 1 of Article 885 “The beneficiary’s claim [demand] for payment of the monetary amount due under the banker’s guarantee shall be presented to the guarantor in a written form, with the documents indicated in the guarantee enclosed. In the demand or in the enclosure the beneficiary shall indicate the incident of breach by the principal of the primary obligation for the securing of which the guarantee was issued.”

Furthermore, the compliant demand of the beneficiary should be presented within timelines, prescribed by the bank guarantee. Observance of these two requirements is beneficiary’s duty and its breach empowers the guarantor to refuse the compensation.

Judicial practice, related to the assessment of the duty to adhere to the Principle of Strict Compliance, has developed for the past few years. However, attention is not paid to formal compliance of the demand upon determination of compliance. The court explained the compliance of material grounds of the demand with guarantee terms.⁶⁸ The Tbilisi City Court has reviewed the dispute on imposition of payment of the amount under the advance payment bank guarantee.⁶⁹ The guarantor referred to several grounds for refusal the satisfaction of the demand: a) presentation of the guarantee demand after the expiry of the deadline; b) reduction of advance payment guarantee in amount of accomplished works, c) accuracy of the demand content, what includes the absence of any reference to a breach. Despite the imperative stipulation of Article 885, the beneficiary failed to provide the description of the essence of the breach of obligation by principal and the documents specified in the guarantee (certifying the breach). The beneficiary has not provided full information to the guarantor. The court ignored the question of formal compliance of the demand and discussed the other grounds of refusal of the demand. The beneficiary’s demand was not satisfied by the courts of either instance. The court was required to pay attention to the content of the demand and explain, whether such demand constituted one of the grounds for refusal to satisfaction.

Worth mentioning with regard to presentation of a guarantee demand is another important decision.⁷⁰ The guarantor stated that principal had not duly inform him about the breach of obligation. Specifically, the benefi-

⁶⁶ This opinion was upheld by Staughton L.J. and is contained in the decision, made in 1981.

⁶⁷ *Mofleh A.I.*, Abstract Payment Undertaking: To What Extent are They Truly Abstract?, University of Leicester, 2005, 36.

⁶⁸ Decision of the Tbilisi City Court of July 17, 2015, Case №2/856-15; Decision of the Tbilisi Appeals Court of November 09, 2016, №2B/4559-15, №330210015703697, which was upheld by the Supreme Court of Georgia.

⁶⁹ Decision of the Tbilisi City Court of June 21, 2016 №2/7526-15; Decision of the Tbilisi Appeals Court of April 10, 2017 №2B/4510-16, Ruling of the Supreme Court of Georgia of July 11, 2017.

⁷⁰ Ruling of Civil Chamber of the Tbilisi Appeals Court №2B7114/14, №330210014403740, dated May 20, 2015.

ciary was required to specify in the demand, whether what was meant under the breach of primary undertaking and what was the amount of damages inflicted to the beneficiary by the principal, following what the guarantor would have paid the guarantee amount to the plaintiff within the framework of the guarantee amount. One of the grounds of guarantor's refusal to pay compensation was failure to present complying demand. The court explained, that guarantor is entitled to refuse the fulfilment of the obligation undertaken before the beneficiary only when the demand or accompanying documents are not compliant with the guarantee terms, or if they were presented to the guarantor after the expiry of the guarantee period,⁷¹ what was not the case in the case concerned.

Specifically, it was established in this case that the guarantor refused to pay compensation under none of the these grounds: 1) incompliance with the terms of the guarantee and/or 2) presentation of the demand after the expiry of the guarantee. The court explained, that the only mandatory precondition, set by the parties for the payment of compensation was the presentation of the demand within established timelines. The parties have not agreed upon any special condition for the presentation of a demand. Insofar as the guarantee has not provided for some special provision and neither the refusal to the payment of the compensation was duly substantiated in this regard, there was no need to research and establish the reasons of breach of the obligation by principal. Respectively, the court imposed the payment of the compensation on the guarantor. The court has not interpreted the imperative obligation, prescribed by Article 885 of the Civil Code of Georgia, which imposes the duty to duly inform the guarantor upon the beneficiary. In the case of presentation of a demand, Part 1 of this Article obliges the beneficiary a) to present a demand in writing, b) supplement it with the documents, mentioned in the guarantee, 3) explain the essence of breach of primary undertaking. Non-compliance with any of these three requirements means the presentation of a demand in breach of the Principle of Strict Compliance, what, according to internationally accepted practice, exempts a guarantor from the obligation to pay money. Despite this stipulation of law, the court has linked the absence of special rules on presentation of a demand with party agreement, thus neglecting the very important Principle of Strict Compliance.

It is difficult to say how Georgian judicial practice will develop in the future, however it should be mentioned, that the position of the Civil Code of Georgia is similar to that of the Convention and Uniform Rules and this position fully upholds the approach dominating in the international practice. The beneficiary is required to abide by the principle of Strict Compliance upon presentation of a demand. The main purpose of this principle is the protection of the interests of the principal against the of "fraudulent" and unlawful demand of the beneficiary.

4. Conclusion

A bank guarantee as a demand security mean is widely applied both in international and domestic trade and economic relationships. It can be said boldly, that in modern business transactions there is almost no major economic project where a guarantee is not used as a security mean. The existence of various legal problems upon regulation of these large-scale relationships can never be excluded. Since the second half of the twentieth century the international organisations and states have been intensively involved in the regulation of the scope of guarantees. As a result of the foregoing various Uniform rules were developed, which are of recommendatory nature and the parties to contractual relationships are free to apply them for the settlement of their relationships.

Of paramount importance for the determination of the nature of bank guarantees are the basic principles developed according to Uniform Rules and the Convention of the UN Commission on International Trade. The principles of autonomy and Strict Compliance make guarantees different from the other security means and constitute their main virtue. However the foregoing should not be interpreted so as if it is a binding factor for the parties to relationship.

⁷¹ Civil Code of Georgia, Article 887, Part 1, 26/06/1997.

The principles of autonomy and strict compliance stress that a guarantor does not have only a ministerial function. His main duty is to examine presented documents, establish their compatibility with the terms of the guarantee.⁷² There is a certain correlation between these two principles, as the principle of autonomy makes principal to face the risk of abuse of power by the beneficiary. Its sole protector is just the principle of strict compliance. Hence these two principles are applied for the balancing of the interests of the parties to the main contract.⁷³

The principle of autonomy of a bank guarantee has been frequently interpreted by courts and according to the established practice, the guarantor is required to act in accordance with the terms of the guarantee, however, upon settlement of a demand, he is supposed to settle the situation in accordance with the principles of reasonable care and good faith. Unlike the autonomous nature of guarantee Georgian judicial practice does not pay attention to the content of the demand and importance of the principle of strict compliance.

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⁷² *Khatiashvili A.*, *Bank Guarantee as an Independent Security for the Fulfilment of Obligation and Liability of the Parties to the Contract*, 2011, 35 (in Georgian).

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