THE REGIME OF THE LETTER OF GUARANTEE UNDER THE ROMANIAN LEGISLATION AND INTERNATIONAL LEGAL PROVISIONS

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Abstract

The letter of guarantee is widely utilized in the international trade relations and its regime was regulated through three publications issued by the International Chamber of Commerce from Paris (Publication no.325, Publication no.458 and Publication no. 758); at the same time, it is well known that some of the European countries (and not only) enacted internal laws with regard to the letter of guarantee. The putting into operation of the domestic and international provisions in the field of the letter of guarantee has generated miscorrelations and/or legal conflicts mostly settled by decisions issued by the Courts of Law or by uniform practices accepted by the players from market.

The present article aims at providing a legal analysis of the letter of guarantee taking into consideration mainly the legal traits, the types of the letters of guarantee, the modalities of issuance and utilization, the publicity, the assignment of the receivables deriving from the letter of guarantee.

Also one of the envisaged scope is to submit proposals to amend the current legislation for the large benefit of the business community, legal professionals or theoreticians.

Keywords: *Letter of Guarantee, Mortgage, Receivables, Assignment, Trade Finance, Joint-Stock Company, Limited Liability Company.*

1. Introduction

1.1. What matter does the paper cover?

The subject matter of the present study is to emphasize the role performed by the letter of guarantee and also its strategic importance in the banking industry from Romania, under the Publication no.325, Publication no. 458, Publication no. 758 issued by the International Chamber of Commerce from Paris and also under the internal legislation; it is important to be highlighted that the letter of guarantee was not expressly regulated by the national legislation until the entering into force of the new Civil Code (October 1st, 2011).

In accordance with the former legislation, the letter of guarantee was compared with the *surety (Rom. fideiusiune)* but maintaining its particular traits meaning the autonomy towards the underlying transaction.

To the same extent, the letter of guarantee was called "autonomous guarantee" or "demand guarantee".

Thus, the present paper will provide a legal analysis of the letter of guarantee taking into account the following: the definitions and the evolution of the concept over the time, the legal nature of the letter of guarantee, the main legal traits of the letter of guarantee, the principal types of the letter of guarantee used in Romania, the extent to which the receivables deriving from a letter of guarantee may form the subject of a movable mortgage as provided by the new Civil Code, the publicity related to the letter of guarantee and/or related to the movable mortgage set over the receivables coming from the letter of guarantee, the legal report between the international rules and the national legislation (inclusively the potential conflicts), proposals to amend the existing legislation.

Nowadays the letter of guarantee are issued by the institutions of credit like banks and non-financial institutions the main scope being to safeguard the commercial and financial interests of the beneficiary in case of a non-compliant event (regarding the performance of the underlying transaction) shall be generated by the applicant.

Taking into account the fact that the letter of guarantee is currently regulated by the new Civil code, the first covered domain is the civil law.

At the same time, it has to be underpinned that the letter of guarantee is applied to the trade relations (national or international) between the companies; so the second covered domain is the commercial law.

Although there are contradictions displayed by the local doctrine regarding the autonomy of the commercial law[1], we consider that the commercial law has full autonomy towards the civil law, even the commercial law derives from the civil law. The civil law and the commercial law may peacefully coexist for the benefit of the business environment and legal professionals.

1.2. Why is the studies matter important?

The importance of the present paper consists mainly in the following:

a) to gather the relevant arguments with the scope to deliver an overall legal analysis of the letter of guarantee applicable in the current business

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[1] Stanciu D. Carpenaru, *Treatise Of Romanian Commercial Law* (Bucharest: Universul Juridic Publishing House, 5th edition, updated, 2016), 21;

milieu;
b) to point-out the practicality and the real benefits issued by the use of the letter of guarantee in trade relations (domestic and international);
c) to submit amendments regarding the applicable legislation.

The pursued objectives of the study are:
a) to strengthen the importance of the letter of guarantee as an instrument prone to streamline the business relations;
b) to outline the aspects needed to be improved and/or shifted;
c) to present in greater details the modalities by which the international regulations in the field of the letter of guarantee may be harmonized with the national legislation in this regard.

1.3. How does the author intend to answer to this matter?

The means aimed to be utilized in order to complete the research are:
a) the critical and contrastive analysis of the foregoing and current applicable legislation;
b) the investigation of the relevant practice;
c) the study of the significant legal doctrine.

The main methods that will be used are: the logical method, the contrastive method and the historical-teleological method.

1.4. What is the relation between the paper and the already existent specialized literature?

The existent legal literature has not sufficiently debated the following aspects:
a) a) the difficulty of proper application of the Article 2321 (regarding the letter of guarantee) from the new Civil Code versus the issues arising from the legal practice;
b) b) the possibility to established a mortgage over the receivables arising from letter a guarantee;
c) c) the possibility to be taken into guarantee the beneficiary's right to claim the payment deriving from the letter of guarantee.

Bearing in mind the aforesaid, the present paper intends to supply arguments, ideas, solutions in order to streamline and also to facilitate the trade finance relations.

2. The letter of guarantee. Concept. Traits. Legal nature

2.1. As provided by the Article 2321 from the new Civil Code, the letter of guarantee is the irrevocable and unconditional commitment by which a person called "issuer" undertakes, upon the request of the other person, called "applicant", in consideration of a prior obligational report, to pay an amount of money to a third party, called "beneficiary", in compliance with the already assumed commitment.

2.2. In the architecture of the new Civil Code, the letter of guarantee is an autonomous guarantee, which is a sub-category of the personal guarantee. It means that the entire patrimony of the issuer will be dedicated to the payment of the letter of guarantee, in case of a demand in this regard (usually, a payment demand is made when an event of default-deriving from the trade relation between applicant and beneficiary- occurs).

2.3.Until the entering into force of the new Civil Code, there was no specific regulation with regard to the letter of guarantee.

The letter of guarantee was called "independent bank guarantee" and the general opinion was that such atypical guarantee is generated by the bank customs.

In fact, the aforesaid bank customs were originated by the uniform rules regarding the letter of guarantee, issued by the International Chamber of Commerce from Paris, France.

The first step in the direction to codify the applicable rules regarding the letter of guarantee was the year 1978 when the International Chamber of Commerce from Paris issued the Publication no.325 on demand guarantee aiming at assure the uniformity of the practices based on a fair balance between the contracting parties[2].

Following the same trend and taking into consideration the latest developments in the trade finance relations, the International Chamber of Commerce from Paris issued (in 1992) a new set of Uniform Rules on Demand Guarantee, applicable since January 1st, 1994 (Publication no. 458).

The latest version of the abovementioned uniform rules was provided in 2010 through the Publication no. 758 – Uniform Rules on Demand Guarantee, issued by the International Chamber of Commerce from Paris.

In order to avoid any doubt it has to be mentioned that the Publication no. 758 hasn't abrogated the Publication no. 458 but it has updated the Publication no. 458.

2.4. It has to be highlighted that, in accordance with the Article 2 from the Publication no. 458, a demand guarantee was defined as any guarantee, obligational title or payment commitment (however it would be called or depicted by a bank, insurance company or any other natural person or legal entity), provided in writing, for the payment of an amount of money at the presentation (in conformity with the assumed commitment) of a written payment requirement and any other documents that may be mentioned with the demand guarantee, based on the assumed commitment: (i) upon request or based on the instructions and on a party's liability (applicant); (ii) upon request or based on the instructions and on a liability of a bank, insurance company or any other natural person or legal entity, acting based on the

[2] Boroi, Gabriel, Ilie, Alexandru. The Commentaries of the Civil Code. The personal guaranties. The privileges and the real guaranties (Bucharest: Hamangiu Publishing House, 2012), 64;

applicant's instructions in the benefit of a third party ("beneficiary").

With regard to the abovementioned definition, it is worthy to mention that 3 principles[3] were generated by the Publication no. 458 meaning:

a) a demand guarantee is irrevocable (Article 5);
b) the documentary trait of a demand guarantee;
c) a demand guarantee is a formal title, respectively the guarantor will pay only if the payment requirement and/or the documents are conformable with the text of the demand guarantee.

2.5. Legal traits

A demand guarantee has the following traits:

a) it is an irrevocable title, as moment as the Article 2321, 1st paragraph from the new Civil Code stipulates that a letter of guarantee is an irrevocable title. It means that the demand guarantee may be not retracted before the expiry date;
b) it is an autonomous title in comparison with the underlying transaction. Thus, the issuer may not sustain before the beneficiary the legal exceptions arising from the obligational report prior to the assumed commitment; moreover, the issuer may be not held to pay in case of an abuse or obvious fraud.
c) it is an independent title, meaning the safeguard provided is not ancillary to the secured obligation in comparison with the surety (where the surety is an accessory of the secured obligation), as provided by the Articles 2288-2290 from the new Civil Code);
d) it is a formal title, as moment as the payment will be made in accordance with the terms of the assumed commitment, as provided by the Article 2321, 1 st paragraph from the new Civil Code. Moreover, this trait is also supported by the Article 14 from the Publication no.758 based on which the payment demand under the guarantee shall be supported by other documents as the guarantee specifies;
e) it is an unilateral document because the issuer obliges to pay an amount of money for the benefit of a third party. Although, the Article 2321 from the new Civil Code uses the wording "at the applicant's request", this fact will not negatively impact the unilateral trait because the applicant's offer is a simple proposal; furthermore, the issuer may be not obliged by the applicant to issue a demand guarantee. The issuance of such guarantee is the result of the issuer's will;
f) it is an unconditional title meaning the payment will be made at first and simple request of payment, following the terms and conditions as provided by the demand guarantee;
g) it is a documentary title, as moment as the payment shall be made in accordance with the terms and conditions as stipulated by the demand guarantee;
h) it is an *intuitu personae* title, meaning the guarantee may be not transmitted concomitantly with the transfer of the rights and obligations deriving from the prior obligational title, in lack of a contrary provision, as provided by the Article 2321, 5th paragraph from the new Civil Code;
i) it bears a connection with the prior obligational report which shall not impact the autonomy of the letter of guarantee;
j) it bears a financial trait, meaning the letter of guarantee is expressed in money;
k) it is considered issued when is out of the issuer's control (Article 5 from the Publication no. 758).

3. Legal nature. Form. Types

3.1. The letter of guarantee is a personal guarantee, being framed as an autonomous guarantee.

3.2. A letter of guarantee must be issued in a written form although it is not expressly mentioned by the law. The main argument in this regard is based on the customs specific to the banking activity meaning the formalism and the documentary requirement.

We have in mind the provisions of the Article 121 from the Emergency Govern Ordinance no.99/2006 on the credit institutions and the adequacy of the capital, based on which the credit institutions must keep an exemplar of the document contracts at its offices.

Moreover, the letter of guarantee is a writ of execution and during the foreclosure process the lender must prove/document the real existence of the letter of guarantee.

To the same extent, we emphasize that the letter of guarantee is subject to the communication, taking into consideration its trait of unilateral act, as provided by the Article 1326, 1st paragraph from the new Civil Code.

3.3. The Romanian banks mostly issue the bid bond, the performance bond, the advance payment guarantee, the payment guarantee etc.

4. The legal relation between applicant and issuer

4.1. It is undoubtedly that there is a relation of mandate between the applicant and the issuer, as moment as the letter of guarantee shall be issued by bank upon the applicant's request as provided by the Article 2321, 1st paragraph from the new Civil Code.

With regard to the mandate, we underline that there is a mandate without representation, as provided by the Article 2039, 1st paragraph from the Civil Code.

The relation of mandate does not impact the autonomy of the letter of guarantee towards the underlying transaction, because the applicant undertakes to pay independently towards the prior

[3] Negrus Mariana, Payments and international guarantees (Bucharest: C.H.Beck, 3rd edition, reviewed and updated, 2006), 336

obligational report, in accordance with the Article 2321, 1st paragraph from the new Civil Code.

4.2. Having in mind the above, the applicant has the following obligations:

a) to furnish instructions to the issuer

In this respect, the Article 8 from the Publication 758 provides that the instructions must be clear, precise and should avoid the excessive detail; the letter of guarantee must specify, amongst others, the following: the applicant, the beneficiary, the issuer, the guarantor, the amount or maximum amount payable and the currency, the expiry date, the party liable for the payment of any charges etc.;

b) to pay an issuance fee to the bank, in conformity with the Article 32 from the Publication no.758

Moreover, this fee is justified because the issuing bank grants a loan to the applicant fact that ensues some outlays for the bank; to the same extent, the bank is a joint-stock company that must pursue to gain profit;

c) to reimburse the issuer with the amount that represents the object of the letter of guarantee

The bank supplies a non-cash loan to the applicant and the repayment also includes the related interests and other bank fees;

d) to provide collaterals to the bank[4]

The usual guarantees requested by the Romanian banks are: (i) movable mortgage over the receivables arising from the underlying agreement, enrolled with the Electronic Archive; (ii) movable mortgage over the bank account open by the applicant to the issuing bank enrolled with the Electronic Archive; (iii) mortgage over a real estate, enrolled with the Land Book.

Regarding the beneficiary of a letter of guarantee, he may dispose by the proceeds deriving from the letter of guarantee. It means that a different bank than the issuing bank may set movable mortgage over such proceeds under the condition that the letter of guarantee is transferable and the conditions stipulated by the Article 33 from the Publication no.758 are followed.

Pursuant to a prudential approach a bank will require previously the documents attesting that the beneficiary of the transferred letter of guarantee had took over all the rights and obligations deriving from the letter of guarantee [Article 33, letter d), subpoint i) from the Publication no. 758].

The aforesaid movable guarantee will be enrolled with the Electronic Archive.

Also, it is worthy to be mentioned that the issuing bank may take into guarantee the beneficiary's right to claim the payment (deriving from the letter of guarantee) unless otherwise is provided; this operation may be set through a movable mortgage enrolled with the Electronic Archive. The new Civil Code took over the aforesaid principle mentioned by the Article 4 from Publication no. 458 based on which the beneficiary's right to request the payment of the guarantee is transferable unless otherwise is provided by the letter of guarantee.

4.3. The issuer has the following obligations:

a) to examine the payment demand

The issuer has to make a formal check of the payment demand because the letter of guarantee is independent towards the underlying transaction;

b) to pay or to reject the payment demand

The issuer may be not hold to make the payment in case of an abuse or obvious fraud, as provided by the Article 2321, 3rd paragraph from the new Civil Code;

The abuse of law may occur when the a right is exerted with the scope to harm or to prejudice a third party or in an excessive way contrary to the good faith, based on the Article 15 from the new Civil Code. From a practical perspective, it means that a payment demand must be exerted with an explicit aim (as mentioned above) and the issuing bank should have a clear representation of this thing based inclusively on the held information, documents regarding the beneficiary, its status etc.

The new Civil Code documents the fraud at law; in accordance to the Article 1237 from the new Civil Code, the cause is illicit when the agreement is the mean by which the putting into operation of a legal imperative norm is breached. From a practical perspective, it means that a payment demand is made in flagrant contradiction with the law, being the modality by which the law is breached.

Regarding the both cases as mentioned above, the assessment of the bank must be performed very carefully taking into consideration the potential indemnities that the bank shall pay to the beneficiary if a Court of Law will decide otherwise.

We deem that the assessment should be as much objective as possible based on effective evidences that may be submitted before a Court of Law; therefore it is advisable that the bank should display good faith and needed prudence in accordance with the law and with the professional customs applicable in the business milieu.

4.4. The issuer who made the payment may claim the paid amount from the applicant

Obviously the issuer is entitled to receive the paid amount, the issuance fee and the related interest.

5. The legal relation between issuer and beneficiary

5.1. The letter of guarantee is the legal foundation of the relation between issuer and beneficiary.

5.2. The first obligation of the issuer is to pay the guarantee at first and simple demand coming from beneficiary.

The issuer has to decide if a guarantee is payable or not in 5 days (Article 20 from the Publication 758); if the issuer's representation is that the payment demand is not conformable it may contact the beneficiary aiming to remediate the irregularities, if possible. On the contrary, the beneficiary will be acknowledged in writing with regard to the rejection

[4] Nedelea Zina, The banking demand guarantee (Bucharest: C.H.Beck Publishing House, 2010), 83-85

and the reasons on which the rejection was grounded (Article 24, letter d from the Publication 758).

6. The legal relation between beneficiary and applicant

6.1. The underlying transaction is the fundamental relation between beneficiary and applicant.

6.2.Besides the applicant's main undertaking to provide a letter of guarantee, the applicant must find a bank able to issue a letter of guarantee taking into consideration the underlying transaction.

6.3. The applicant may claim the restitution of the paid amount from the beneficiary who displayed a fraudulent conduct (if the case).

7. The governing law. The cessation of the letter of guarantee

The governing law is the law applicable to the registered office of the issuer if it is not otherwise provided by the letter of guarantee. As a rule, the national laws are mostly preferred as governing law; as a consequence, the international provisions (comprised in publications) complement (and detail) the national legislation.

The letter of guarantee is ceased at the expiry date mentioned with the letter of guarantee independently by the remittance of the original unless it is otherwise provided (Article 2321, 6th paragraph from the new Civil Code).

8. Conclusions

8.1. Main outcomes of the study

The main outcomes of the present paper are:

a) an overall presentation of the legal regime of the letter of guarantee with focus on the relevant aspects;
b) the highlight of some new securities that may be set by the issuing bank in connection with the letter of guarantee meaning the movable mortgage over the proceeds deriving from the letter of guarantee (if the letter of guarantee is transferable) and also over the beneficiary's right to transfer the right to claim the payment of the letter of guarantee.
c) a screening of the relevant former and current legislation;
d) the applicability of the national legislation of the issuer, the international provision being secondary;
e) the proposal to amend the new Civil Code as follows: (i) to be expressly mentioned the possibility to be settle the securities as provided by the letter b) above and their registration with the Electronic Archive; (ii) to be detailed the concepts of abuse and obvious fraud as provided by the Article 2321, 6th paragraph from the new Civil Code and the criteria based on which the issuing bank may or must consider when it decides to reject a payment demand.

8.2. Expected impact of the outcomes

The impact of the outcomes consists mainly in the following:

I. to strengthen the importance of the letter of guarantee in the current business relations due to its direct, streamlined and agile way of doing business;
II. to create the context by which the recommendations contained by the Article VIII.1, letter a) above shall be transposed into legal norms;

8.3. Suggestions for further research

The main suggestion is to amend the new Civil Code as follows:

I. to be expressly mentioned the possibility to be settle the securities as provided by the Article VIII.1, letter b) above and their registration with the Electronic Archive;
II. to be detailed the concepts of abuse and obvious fraud as provided by the Article 2321, 6th paragraph from the new Civil Code and the criteria based on which the issuing bank may or must consider when it decides to reject a payment demand.

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