



News – May 14, 2020

ADVANCE PAYMENT BOND AND RISK OF ILLEGITIMATE DEMAND FOR PAYMENT BY THE BENEFICIARY: WHAT ACTIONS TO TAKE?



1) DESCRIPTION OF THE CASE

An Italian corporate client of our Law Firm, which we will call “ALFA”, entered into a contract with its foreign customer “BETA” for the supply and installation of an industrial plant at the premises of BETA.

The contract stipulated that the installation should be completed by April 30th.

ALFA received a substantial sum from BETA as a down payment, against the issue, by the Italian bank of ALFA and in favor of BETA, of an Advance Payment Bond, i.e. an autonomous bank guarantee for the refund of the amount paid in advance by BETA. Should ALFA fail to deliver and install the plant, for which it had received the down payment, BETA could demand the refund of the down payment under the aforementioned guarantee, by a simple written request to the guarantor bank.

Due to the Coronavirus outbreak and the related emergency measures, ALFA was unable to send its personnel to the premises of BETA to carry out the installation of the system, which in the meantime had arrived there. As a result, ALFA was unable to meet the April 30th deadline.

The Coronavirus pandemic is undoubtedly a force majeure event which exempts ALFA from any liability for the delay in the installation.

However, ALFA could not be sure that BETA would not demand payment from the bank under the Advance Payment Bond.

2) OUR CLIENT'S QUESTION

ALFA asked us if BETA had the possibility to demand payment under the Advance Payment Bond and, if so, if ALFA had the possibility to avoid the payment by the bank, despite the awareness that the Advance Payment Bond constitutes an independent guarantee completely autonomous from the events of the underlying supply and installation contract.



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3) OUR LEGAL OPINION

Having verified the contractual documentation, the text and the nature of the guarantee as well as the applicable legislation, we confirmed to our client ALFA that there was a risk that BETA would demand payment under the Advance Payment Bond and get back the amount paid in advance; therefore we indicated to our client ALFA the actions it could take to reduce the risk of (undue) payment under the Advance Payment Bond.

We also pointed out to ALFA that the risk was increased by the margin of discretion of the bank in interpreting the factual situation at the time of the possible request of payment, as well as that the risk could be difficult to reduce due to the current impossibility to file a request for a precautionary measure with the judicial authority.

4) THE LEGAL REASONS IN SUPPORT OF OUR LEGAL OPINION AND OUR CONCLUSIONS

The conclusions reached by our Law Firm were the result of a specific analysis of the contractual documentation, as well as of the text and nature of the guarantee, which was governed by the Uniform Rules on Demand Guarantees of the International Chamber of Commerce (URDG 758).

With reference to the contract, failure to comply with the installation date was certainly not attributable to ALFA, as it was caused by an event of force majeure, represented by the provisions enacted by the authorities to tackle the pandemic.

With reference to the guarantee, it was likewise certain that, being it an independent guarantee, neither the applicant of the guarantee (ALFA) nor the guarantor (bank) could raise exceptions to the beneficiary (BETA) to block the payment. Consequently, the guarantor bank would have to effect the payment following the simple request sent by the beneficiary.

Nonetheless, according to the case law, the demand of payment under an autonomous bank guarantee is to be considered abusive when the breach of underlying contract by the applicant (generally the supplier or the contractor) is caused by force majeure or by reasons directly attributable to the beneficiary.

In these cases the beneficiary knows that he has no right to demand the amount of the guarantee but, although knowing it, he nevertheless requests payment from the guarantor. In other words, the demand of payment is abusive when the beneficiary acts in bad faith, knowing that he is not entitled to it.

In consideration of the above, we first advised ALFA to notify BETA in writing that the failure to fulfill its contractual obligation was due to force majeure and to provide suitable documentary evidence.

Once such a communication was received, BETA could no longer be considered in good faith, having become aware that, given the circumstances notified and documented by ALFA, the factual and legal conditions supporting the payment request did not exist, and therefore the request would be abusive.

We also advised ALFA to formally notify the guarantor bank not to make any payment on the basis of the guarantee, explaining, also in this case, the legal and factual reasons why a possible demand for payment by BETA would be illegitimate and attaching appropriate documentary evidence.

It should be noted in this regard that, based on the contractual relationship between the bank and ALFA, the bank also has the obligation to behave in good faith and not to make the payment in those cases where the request for payment appear blatantly unjustified and abusive.

Under normal circumstances, ALFA could have filed an urgent request with the competent court to obtain an order to the bank not to make the payment. Unfortunately, this remedy was impossible following the Legislative Decree of 8 March 2020 n. 11 and subsequent amendments, which suspended the activity of the Italian judicial system almost entirely.

Without prejudice to the above, we have however suggested ALFA to start a negotiation with BETA, in order to reach an agreement whereby BETA undertook not to demand payment under the guarantee and ALFA undertook to obtain from the bank an extension of the term of the guarantee itself, in light of the foreseeable duration of the force majeure event.