



Judicial Intervention in Demand Guarantee Cases: Analysis of Ethiopian Federal Courts' Jurisprudence

By

Wondimagegn Tafesse Admassu

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**Advisor: Jetu Edosa (PhD.)
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Declaration

I hereby declare that the thesis entitled “**Judicial Intervention in Demand Guarantee Cases: Analysis of Ethiopian Federal Courts Jurisprudence**” has been carried out by me under the guidance and supervision of my advisor, **Dr. Jetu Edosa**.

This thesis is original and has not been submitted, either in part or in full, for the award of any degree or diploma to any other university or institution.

Researcher's Name	Signature	Date
Wondimagegn Tafesse		

Certification

This is to certify that Wondimamegn Tafesse has carried out research on the topic
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This research is the original work of the author and has not been submitted for a degree at any other university. All sources of material used in the study have been duly acknowledged. Therefore, it is sufficient for submission in partial fulfillment of the requirements for the award of the Master of Laws (LL.M) degree.

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Abbreviations

ICC/ International Center for Arbitration/

FIDIC / International Federation of consulting Engineers/

NBE/ National Bank Of Ethiopia/

PPA/ Procurement and property Administration/

URDG/ Uniform Rules on Demand Guarantees/

UNCITRAL/ United Nations Commission on International Trade Law/

UNC/ United Nations Convention/

Abstract

This paper examines the Ethiopian federal courts jurisprudence towards demand guarantee cases. It explores various issues pertaining to demand guarantee, including its distinctive nature that set them apart from ordinary guarantee as well as international and domestic legal frame work governing it. The crux of this paper lies in analyzing how Ethiopian federal courts entertain cases involving demand guarantee and assessing courts understanding towards basic features of demand guarantee. As such the paper conducted case analysis of selected decisions of the federal court in light of internationally recognized rules of demand guarantee and tries to show the gaps and inconsistencies in the judicial practice.

And finally based on the findings the paper forwards recommendations that may address the gaps in the judicial practice.

Chapter One

1.1. Background of the Problem

Contract significantly contributes in regulating business relationships, however it by no means guarantee performance, nor does it eliminate the risks that may arise during the enforcement process. To ensure contract enforcement and mitigate the risks associated with non performance, it has become common business practice to conclude additional contracts, such as contracts of guarantee.¹ The well-known Black's Law Dictionary defines a contract of guarantee as a collateral agreement, or promise collateral to the primary or principal obligation, which binds the guarantor to perform in the event of non-performance.² Contract of guarantee is intended to ensure the enforcement of the primary contract or mitigate the risks that will occur due to non performance by the other party.³

There are several types of guarantee contracts, each serving a unique purpose. Compared to other types of guarantee bank payment undertaking, as it is an obligation undertaken by the bank to pay a specified amount of money to the beneficiary, is highly preferred for reasons of reliability, security, and ease of enforcement.

Unlike other guarantees, bank guarantee offers a higher degree of assurance because it is backed by the credibility, financial stability, and legal authority of a reputable

¹ Frederick Niepmann, 'International Trade, Risk and the Role of Banks' (2017) *Journal of International Economics* 11 available at https://www.researchgate.net/publication/329506029_Bank_guarantees_in_international_trade visited on 2nd jan 2025

² Henry Campbell Black, *Black's Law Dictionary* (5th edn, West Publishing Co 1979) 634. available at <https://www.ljudska-pisarna.si/wp-content/uploads/2022/04/Blacks-Law-Dictionary-Fifth-Edition-1979.pdf> accessed on January 1st 2025

³ Elisabeth Peden, 'A Classification of Contract of Guarantee' (1991) 13 *Sydney Law Review* 221. available at <http://classic.austlii.edu.au/au/journals/SydLawRw/1991/17.pdf> accessed on 1st Jan.2025

financial institution.⁴ Due to this, overseas trade, as well as high scale domestic contract usually secured by bank guarantees. Based on its relationship with the underlying contract, bank guarantee may be classified into conditional and unconditional/ demand/ guarantee. The former is highly influenced by the original contract, the beneficiary before demanding payment, is required to prove nonperformance of contractual obligation and losses attributed to it. Whereas in demand guarantee the beneficiary is not required to prove nonperformance or any loss sustained due to it.⁵

Therefore, in demand guarantee the beneficiary is not required to exert any additional effort to receive the payment other than making demand accompanied by relevant documents.⁶ Likewise, there is virtually no basis for the guarantor or the principal to object the payment. Neither the guarantor nor the debtor raise dispute regarding the principal contract as a reason to hold the payment. By the same token, there is very little room for court intervention in cases involving such guarantees, with the general principle being ‘pay first, argue later’.⁷

The United Nations Convention on independent guarantees and stand by letter of credit has stipulated certain exceptions for demand guarantee. As per article 11 and 19 of the convention, the guarantor may refuse payment or the principal may file an opposition to the court in case where the guarantor is about to effect payment disregarding those exceptions. Exceptions are generally classified into acts of fraud, falsification of documents, and non-fulfillment of the documentary requirements and

⁴ Addis Gemechu, ‘Ethiopian Law of Demand Guarantees: The Exception to the Obligation to Pay on Demand’ (2020) 9 *Haramaya Law Review* 20.

⁵ Michelle Kelly, *The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance* (LLM thesis, University of South Africa 2009) 311. available at https://www.researchgate.net/publication/345681378_The_Documentary_Nature_of_Demand_Guarantees_and_the_Doctrine_of_Strict_Compliance_Part_1_and_Part_1/citation/download?tp=eyJjb250ZXh0Ijp7ImZpcnN0UGFnZSI6InB1YmV2F0aW9uIiwicGFnZSI6InB1YmV2F0aW9uIn19 accessed on 2nd jan 2025

⁶ Kamal Jamal Awad Alawamleh, *Documentary Credits and Independent Guarantees: A Critique of the ‘Fraud Exception’ Position in English and Jordanian Law* (PhD thesis, University of Central Lancashire 2013) 3. available at <https://clou.uclan.ac.uk/9627/> accessed on 7th jan.2025

⁷ Mesfin Kebede, *Court Involvement in Construction Demand Guarantee in Ethiopia: An Examination of Law and Practice* (Senior essay, Jimma University School of Law 2017) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3379663 accessed on 4/1/2025

conditions stipulated in the guarantee instrument. Apart from these exceptions, it is entirely inappropriate for the guarantor to refuse payment, for the principal to object to the payment, or for the court to intervene in any manner.

Despite the general principle of non-intervention, it has become a common trend for guarantors to refuse payment, principals to initiate court actions, and courts to issue injunctions even in the absence of valid grounds for intervention. In particular, it has been observed that the Federal Supreme Court and the Federal High Court Lideta Division of Ethiopia unnecessarily interfere in matters involving demand guarantees, treating them as if they were ordinary guarantees. For instance, the courts often accept applications from guarantors and principals without valid legal grounds, issue injunction orders, and direct all parties to join the proceedings

This practice by the courts directly undermines the autonomy of demand guarantee and compromises their primary purpose. Even though court involvement in the enforcement of contracts, including demand guarantee, may be inevitable, such intervention should be justifiable and consistent with the nature and objectives of the specific contract involved. Similarly the federal supreme court and high court of Ethiopia other than making unnecessary interventions, has to limit its intervention and balance between preserving the integrity of commercial instruments like bank guarantees and ensuring fairness and justice.

1.2. Statement of the Problem

Some situations in business transactions may require transfer of risks to a credible third party. Demand guarantee is among methods of transferring risks to an external third party, the bank.⁸ It is imperative to understand that, in demand guarantees, the obligation of the guarantor is to pay a specified amount of money to the beneficiary not to complete the project, deliver goods, or fulfill any other obligations stipulated in the primary contract.⁹ This is for a reason that the guarantor may have no knowledge

⁸ Nordea Trade Finance, *Bank Guarantees in International Trade* (2010) available at <https://www.nordea.no/Images/152-67647/bank-guarantees-in-international-trade.pdf> retrieved on 4th Jan 2025

⁹ Ibid

about the subject matter of the transaction and can not take upon itself to decide what will do well enough and what will not.¹⁰ Therefore, the limited expertise of guarantor regarding the details of the contract, coupled with the intended purpose of demand guarantee, underscores the autonomy of such guarantees.¹¹ principle of autonomy/independence and strict compliance rule are the underpinnings of demand guarantee and it demonstrate the distinction of the guarantee from the root contract and payment on demand supported by relevant documents¹² Hence it implies that a guarantor shall not hesitate to pay by referring to the underlying contract or stipulating non documentary requirements. Neither the principal nor the court intervene in alleviate for the justifiable grounds provided by the law.

Despite the established principles of autonomy and the strict compliance rule, courts in many jurisdictions have been observed unnecessarily interfering with the execution of demand guarantees. The Ethiopian Federal Supreme Court and the Federal High Court Lideta division similarly follow this trend. Both courts have been observed issuing injunction orders against demand guarantees and conducting full trials, even in the absence of justifiable grounds.

This has sparked considerable concerns about the potential erosion of fundamental principles of demand guarantee. Moreover, discrepancies have been observed in judicial practice, with court decisions exhibiting inconsistencies. The decisions of court reveals the shallow understanding they have towards demand guarantee, to the surprise demand guarantee is labeled as surety ship and regulated by surety ship provisions of the civil code. In some cases, courts are seen giving due recognition/ consideration for special nature of demand guarantee, while in other cases such features disregarded/ set aside. And this has created uncertainties in judicial

¹⁰ Chung-Hsin Hsu, 'The Independence of Demand Guarantees, Performance Bonds and Standby Letters of Credit' (2006) 2 *National Taiwan University Law Review*. available at https://www.academia.edu/36092770/The_Independence_of_Demand_Guarantees_Performance_Bonds_and_Standby_Letters_of_Credit accessed on 7th jan 2025

¹¹ Ibid

¹² Roberto Luis, 'The Autonomy Principle of Documentary Guarantees' (Year unknown) 3 *Mexican Law Review* 75. available at https://www.researchgate.net/publication/265311198_the_autonomy_principle_of_letter_of_credit accessed on 8th Jan 2025.

environment and impose negative impact on the general practice of demand guarantee.

1.3 Research Questions

- What are the distinctive features of demand guarantee?
- What are the major legal rules governing demand guarantees?
- What role do courts have in disputes pertaining to demand guarantee?
- what are the justifiable grounds for court intervention in disputes over demand guarantees?
- How do Ethiopian federal courts handle cases involving demand guarantee, and how do they strike a balance between preserving the fundamental principles of demand guarantee and the interests of other parties?

1.4. Objectives of the Study

The main objective of this study is to critically examine the jurisprudence of the Ethiopian Federal Supreme Court and the Federal High Court Lideta Division in cases related to demand guarantees, in light of the fundamental principles of demand guarantees, the governing legal rules, and global practice. The study will also examine the legal framework regulating demand guarantees from both international and Ethiopian perspectives, and assess which specific laws Ethiopian federal courts apply to resolve issues related to demand guarantees.

1.5. Research Method

The research employs qualitative method of study. Statutes, and court decisions served as a primary source of data. While books, journal articles, and other scholarly materials used as secondary sources. The statutes, including domestic laws and international legal instrument governing demand guarantee such as the Uniform Rules on demand guarantee used to assess the legal frame work of demand guarantee from domestic and international perspective.

The federal supreme court cassation bench decisions which are published and the cases entertained by the Federal high court Lideta bench selected on the basis of their importance to the study at hand are utilized to assess the judicial jurisprudence of Ethiopian Courts in handling cases involving demand guarantee. Furthermore secondary sources are used to explore the theoretical aspects of demand guarantee.

1.6. Literature Review

Before delving into the specific focus of this paper, I reviewed a broad range of literature dealing with bank undertakings. And considerable portion of these materials addressed various aspects of demand guarantee, with particular attention to limited intervention of the judiciary.

For instance, Roy Goode, a prominent scholar frequently cited by various authors and research works, has made substantial contributions to the field. His books, including *Transnational Commercial Law: Texts, Cases, and Materials*,¹³ *Abstract Payment Undertakings in International Transactions*,¹⁴ and *Guide to Uniform Rules for Demand Guarantee*,¹⁵ are highly regarded in the field.

Upon reviewing these works, it is evident that Goode emphasizes the crucial role of bank payment undertakings, particularly demand guarantees, as fundamental instruments in modern commercial transactions. Goode articulates the unique features of demand guarantees, such as their autonomy and documentary nature.

He also identifies exceptional situations in which the fundamental principles governing demand guarantees may be set aside. Furthermore, he explores the justifications for, and the extent of judicial or arbitral tribunal intervention arguing that such intervention should be limited to cases involving fraud, forgery, or non-complying demands.

¹³Roy Goode, *Transnational Commercial Law: Texts, Cases and Materials* (2nd edn, Oxford University Press 2015).

¹⁴ Roy Goode, 'Abstract Payment Undertakings in International Transactions' (1996) 22 *Brooklyn Journal of International Law* available at

<https://brooklynworks.brooklaw.edu/cgi/viewcontent.cgi?article=1696&context=bjil>

¹⁵ Roy Goode, *Guide for Uniform Rules on Demand Guarantees* (2nd edn, 2011).

Another well versed scholar on this subject matter is Nelson Enonchong. In his book titled *Independence Principle of Letters of Credit and Demand Guarantees*¹⁶ he thoroughly examines various aspects of demand guarantee. Among other topics, Enonchong explores the concept of demand guarantees, the key differences between demand guarantee and ordinary guarantee, and the foundational principles such as autonomy and the rule of strict compliance.

He also highlights the exceptions to these core principles that may permit judicial intervention, asserting that such exceptions, particularly those involving fraud or abuse, should be applied strictly and narrowly.

There are also numerous scholarly works that focus on the subject of demand guarantees. One notable example is Michelle Kelly's thesis titled *Selective Legal Aspects of Demand Guarantee*, which addresses nearly every detail of the topic. Her study specifically explores the South African experience in the application of demand guarantees.

In addition, I have conducted a survey of domestic materials and academic works that are directly or indirectly related to the subject. This includes both published and unpublished sources, such as senior theses.

One relevant contribution is by Addis Gemechu, in his article titled *Ethiopian Law of Demand Guarantee, Exceptions to the Obligation to Pay on Demand*¹⁷. Addis examines the Ethiopian legal framework governing demand guarantees. According to his analysis, Ethiopia lacks well-established legal rules in this area, making it under regulated. He highlights ongoing controversies concerning the applicability of Civil Code provisions to demand guarantee cases.

To this effect, he presents two opposing arguments. The first position argues against the application of the Civil Code, asserting that demand guarantees do not fulfill the essential elements of a contract. The second position relies on the principle of

¹⁶Nelson Enonchong, *The Independence Principle of Letters of Credit and Demand Guarantee* (Oxford University Press 2011)

¹⁷Addis Gemechu, 'Ethiopian Law of Demand Guarantee: Exceptions to the Obligation to Pay on Demand' (2020) 9 *Haramaya Law Review*

freedom of contract, contending that demand guarantees should be treated as special contractual arrangements as intended by the parties. Therefore, the general rules of contract under the Civil Code should apply. The author raises the question of whether demand guarantees have a legal basis in Ethiopia, and attempts to demonstrate their legal foundation by referencing relevant provisions of the Civil Code and the country's banking laws.

The thesis written by Yared seyoum, titled '*The Law Governing Unconditional/ First Demand -Independent/ Guarantee in Ethiopia*'¹⁸ addresses various topics relevant to the present study most notably, the domestic legal frameworks regulating demand guarantees.

In addition, there is a senior thesis written by Mesfin Kebede, titled '*Court Involvement in Construction Demand Guarantee in Ethiopia an Examination of the Law and Practice*'¹⁹ At first glance, this work appears to closely relate to the subject matter of my paper, as the title suggests that it addresses court involvement in demand guarantees. However, upon a thorough examination, I have identified several differences between his study and mine.

The scope of his work is limited to construction demand guarantees, whereas my paper is not confined to the construction sector; it also covers demand guarantees issued in other commercial transactions. His study, conducted in 2007, is now nearly eight years old and does not reflect recent legal developments or emerging judicial trends related to demand guarantees in Ethiopia.

Furthermore, his research was primarily aimed at identifying the specific laws applied by courts when adjudicating cases involving demand guarantees. His focus was on determining which legal framework the judiciary relies upon and analyzing relevant cases in light of that objective.

In contrast, my paper goes further by analyzing judicial involvement in light of the fundamental principles of demand guarantees as established under international legal

¹⁸ Yared Seyoum, *The Law Governing Unconditional/First Demand – Independent/Guarantee in Ethiopia* (Senior thesis, Addis Ababa University School of Law 2017) available at <https://etd.aau.edu.et/server/api/core/bitstreams/81c4a40f-9b04-4ce2-8a6a-b662631f8394/content>

¹⁹ Mesfin Kebede (n 7)

instruments and the general global practice. This comparative approach allows for a more comprehensive and up to date examination of how Ethiopian courts engage with Furthermore, his study relies exclusively on Federal Supreme Court cassation decisions. In contrast, my research also explores decisions from lower courts, as briefly referenced in the cassation rulings. It does not only discuss Supreme Court judgments but includes an analysis of lower court decisions relevant to demand guarantees. Additionally, my study incorporates decisions from the Federal High Court Lideta Bench concerning demand guarantees.

Therefore, it is evident that my research differs significantly from previous works in terms of research methods and scope. Given these differences, it is likely that my study will yield distinct findings and conclusions.

1.7 Limitations of the Study

Time constraint is the major limitation to the study. Besides this the study faced problems related to accessing court cases involving demand guarantees.

1.8 Organization of the Study

The study have five parts, divided into chapters. Chapter one provides an introduction to the topic, including an overview of the research background, statement of the problem, key objectives, and the research questions. Chapter two is a literature review, where an exploration and discussion of key litterateurs related to the subject of the study will be presented

The third chapter focuses on discussing the legal framework governing demand guarantee. It provides an in-depth analysis of both international legal instruments and domestic laws governing subject matter of the study.

The forth chapter delve on the judicial intervention in demand guarantee cases, examine justifiable grounds of intervention and analyze the experiences of Ethiopian federal courts in light of the basic principles of demand guarantee. And The fifth chapter presents conclusion and recommendations.

Chapter Two

2.1. Introduction to Bank Payment Undertakings

Commercial transactions become more sophisticated, complex and characterized by different risks, one of such risks is nonperformance of contractual obligations.²⁰ The risks associated with commercial transactions have existed since the onset of trade activities. In ancient times contracting parties in order to reduce the risks of nonperformance, rely on real securities, personal guarantee and in some cases require cash deposit.²¹ However, this traditional types of securities often create difficulties for the parties when it comes to enforcement, and it is inconvenient for the party to furnish a cash deposit as they may not have extra funds available to use as security.²²

This underscored the need for an alternative security mechanism that addresses the limitations of traditional security methods. As a result, the traditional practice was in due course replaced by a safer and more convenient approach: the provision of a written undertaking by a bank in favor of the buyer or employer, payable on demand.²³

Nowadays, this payment undertakings by the bank are commonly referred to by different terms, such as independent undertakings, independent (bank) guarantees, demand guarantees, first demand guarantees, bank guarantees, stand by letter of credits, documentary undertakings and default undertakings.²⁴

²⁰ Boris Kozolchyk, 'Bank Guarantees and Letters of Credit: Time for a Return to the Fold' (1990) 11 *Journal of International Business Law* 3 available at <https://heinonline.org/HOL/CiteNav?collection=journals&cittitle=> accessed on 11th Jan 2025

²¹ Michelle Kelly, *Selective Legal Aspects of Bank Demand Guarantee* (PhD thesis, University of South Africa, 2008) 17 available at <https://uir.unisa.ac.za/bitstream/10500/1350/1/thesis.pdf> visited on 12th jan 2025

²² Oeland Bertrams, *Bank Guarantees in International Trade* (Kluwer Law International 2004)

²³ Goode (n 15)

²⁴ M Coleman, 'Performance Guarantees' (1990) *Lloyd's Maritime and Commercial Law Quarterly*

Those undertakings, despite their differing names, share common features and have become a standard part of commercial activities, particularly in international trade, construction and engineering projects, as well as large scale domestic contract of sale.²⁵ They are documentary in character, so that the obligation is triggered solely by presentation of documents within the time and on the terms specified in the undertaking without regard to external facts or events. They are distinct from ordinary contract; unlike general contract principles they do not require offer and acceptance, they are not based on consideration or reliance by the beneficiary, they are not subject to specific formalities.²⁶

Moreover, they are also different from ordinary types of guarantee contracts: in a typical guarantee contract, a breach of the original or principal contract is a prerequisite for the guarantee to be enforceable whereas it is not a requirement in the case of a bank undertaking. additionally, in an ordinary guarantee contract, the guarantor can raise various defenses available to the debtor against the creditor, including the benefit of discussion. However, it is not possible with bank undertakings.²⁷ And for the above mentioned reasons some scholars consider those

²⁵Michelle Kelly, 'The Documentary Nature of Demand Guarantees and the Doctrine of Strict Compliance' (2009) South African Mercantile Law Journal 306 available at https://www.researchgate.net/publication/345681378_The_Documentary_Nature_of_Demand_Guarantees_and_the_Doctrine_of_Strict_Compliance_Part_1_and_Part_1 visited on 13th Jan 2025

²⁶Roy Goode, 'Abstract Payment Undertakings in International Transactions' (1996) 22 Brooklyn Journal of International Law 4 available at <https://brooklynworks.brooklaw.edu/cgi/viewcontent.cgi?article=1696&context=bjil> visited on 16th Jan.2025

http://ethesisarchive.library.tu.ac.th/thesis/2015/TU_2015_5501040538_467_7_3259.pdf visited on 16th jan.2025

²⁷Jaideep Khanna, 'Special Equities as an Exception to Restrain Bank Guarantee Invocation' (2022) 8 The GNLU Law Review 361 available at https://gnlu.ac.in/Content/the-gnlu-law-review/pdf/volume-8-issue-2/07_jaideep_khanna.pdf accessed on 17th jan 2025

bank undertakings to be more akin to engagements than contractual promises in strict sense.²⁸

2.2. Demand Guarantee

There is no global consensus on the terminology of demand guarantee.²⁹ This inconsistency in terminology arises from the differences in language used by the various sectors that utilize demand guarantees. For instance, in the banking industry, they are typically referred to as bank guarantees or financial guarantees; in the construction sector, they are often called performance bonds, performance guarantees, or construction guarantees. In the insurance industry, they are usually termed surety bonds, while among legal professionals, they are commonly referred to as independent or unconditional guarantees.³⁰

A demand guarantee, one among various forms of payment undertakings, is defined in different ways by various scholars. Although their wording may differ, the definitions are similar in substance. There is an extensive body of international literature

²⁸John F Dolan, 'Law of Letters of Credit' (2014) 3 American University Business Law Review available at <http://www.aublr.org/wp-content/uploads/2017/03/Volume3Issue1.pdf> This author strictly argues that it is improper to name bank undertakings including demand guarantees as contractual arrangements, for a reason that there is no bilateral promise involved in the undertaking and neither there is a bargain agreement between the issuer and the beneficiary. In nut shell, bank undertakings do not satisfy the defining element of contract, which is an agreement between two or more parties to create, vary or extinguish an obligation as between themselves.

²⁹ Karl Marxen, *Demand Guarantee in the Construction Industry: Comparative Legal Study of Their Use and Abuse from South African, English and German Perspective* (PhD thesis, University of Johannesburg, 2017) 50 available at <https://ujcontent.uj.ac.za/esploro/outputs/doctoral/Demand-guarantees-in-the-construction-industry/999762107691> accessed on 28th Jan 2025

³⁰ Dinh Xuan and Dang Thi, 'Demand Guarantee is Actually a Documentary Guarantee' (2023) 11 International Journal of Economics, Commerce and Management 263 available at <https://ijecm.co.uk/wp-content/uploads/2023/02/11216.pdf> accessed on 28th Jan 2025

addressing demand guarantees. Below, we will explore definitions provided by a few widely cited scholars in the field.

Roy Goode defines a demand guarantee as an undertaking by a bank to pay the beneficiary a specified sum upon receiving a written demand and any other documents required under the guarantee, regardless of any non-performance under the underlying contract.³¹

According to Ross C., a demand guarantee is an undertaking by a bank to pay a beneficiary independently of the principal contract, either upon a written demand, the presentation of a certificate by an independent third party, or the submission of a court judgment or an arbitral award.³² According to Michelle Kelly-Louw³³, a demand guarantee is a form of personal security in which a bank promises to pay a beneficiary if the principal, often the bank's client, defaults on the performance of their obligations under the underlying contract. She further explains that the bank is obligated to pay if the documents presented with the demand for payment comply with the documents specified in the text of the demand guarantee.³⁴

In addition to scholarly definitions, there are also international legal instruments that define and regulate demand guarantees. For instance, the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) defines a demand guarantee as “*an undertaking in which a bank promises to pay a beneficiary if a principal (often the bank's client) defaults in the performance of their obligation under the underlying contract.*”³⁵ The Convention further provides that the bank is required to make payment if the documents presented with the demand comply with the terms specified in the guarantee.

Another important international legal instrument is the Uniform Rules for Demand Guarantees (URDG 758), issued by the International Chamber of Commerce (ICC) in

³¹ Roy Goode and Herbert, *Transnational Commercial Law: Texts, Cases and Materials* (2nd edn, Oxford University Press 2015) 327

³² Ross Cranston, *Principles of Banking Law* (2nd edn, Oxford University Press 2007) 390

³³ Goode (n 15) 18

³⁴ *Ibid*

³⁵ United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1996) art 2

2010. This document also provides a definition of demand guarantee.³⁶ Unlike the United Nations Convention on Independent Guarantees, the URDG offers a more concise definition, describing a demand guarantee as “*any signed undertaking, however named or described, providing for payment on presentation of a complying demand.*”³⁷ From the above definitions, several common defining elements of a demand guarantee can be identified:

- i. An undertaking by the guarantor to pay a specified amount of money to the beneficiary
- ii. Payment is effected on demand up on presentation of the relevant documents mentioned under the guarantee instrument.
- iii. No need to prove a breach of the underlying/ principal/ contract.

All definitions of demand guarantees envisage the involvement of at least **three parties**: the **applicant**, who instructs the issuance of the demand guarantee to secure their obligation; the **beneficiary**, in whose favour the guarantee is issued; and the **guarantor**, the party issuing the guarantee.

Compared to other definitions, the one provided by the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit is broader and more detailed. For example, under the Convention, it is possible for non-bank institutions or individuals to act as guarantors. In contrast, other definitions typically restrict the guarantor role to banks, and most scholars do not recognize demand guarantees issued by entities other than financial institutions.

Furthermore, the Convention grants greater autonomy to demand guarantees than other definitions. According to the Convention, the existence or validity of a principal contract is irrelevant the guarantee remains effective regardless. In contrast, scholarly definitions generally assume the existence of a principal (underlying) contract as a basis for issuing the guarantee.

2.3. Functions of Demand Guarantee

³⁶ International Chamber of Commerce, *Uniform Rules for Demand Guarantees (URDG 758)* (2010)

³⁷ *Ibid* art 2

Demand guarantee serves multiple purposes, one of which is providing security for the performance of the underlying contract. It can be used to secure a range of contractual obligations, including sales and construction contracts. Additionally, it may be used to guarantee a borrower's repayment obligations under a loan agreement. A demand guarantee offers the beneficiary a form of security that can be quickly and easily accessed once the specified event takes place.³⁸ This is because payment can be made by the issuer to the beneficiary on demand, without a need to prove fault or breach. This makes demand guarantees a quick and straightforward way for the beneficiary to secure compensation or payment when certain conditions are met.

It allows the beneficiary to receive immediate cash to cover any loss incurred due to the account party's breach, without affecting any future claims against the account party for additional damages.³⁹ This payment helps cover any losses the beneficiary has incurred due to the breach. However, it does not prevent the beneficiary from pursuing further claims against the account party for additional damages.⁴⁰ In other words, the beneficiary can still seek compensation beyond the amount covered by the demand guarantee if the breach causes further harm or losses.

Demand guarantee is essentially as valuable as a promissory note and is designed to influence the timing of the parties' obligations. When an allegation of breach of contract is made in good faith, the beneficiary can call on the bond and receive its value while the contractual dispute is being resolved.⁴¹

Finally, demand guarantee could be used to secure performance of an otherwise unenforceable obligation.⁴² Meaning Since a demand guarantee is independent of the underlying contract, it is not affected by the validity, potential void ability, or even the non-existence of the original contract.⁴³ Even if the obligation is not directly

³⁸ Nelson Enonchong, *The Independence Principle of Demand Guarantees and Letters of Credit* (Oxford University Press 2011) 35

³⁹ Ibid

⁴⁰ Gidey Belay, 'Unsettled Concept of Performance Bond in Ethiopia: Practical Problems in Determining the Scope of the Obligee's Right to Compensation' (2021) 5 *Hawasa University Journal of Law* 24

⁴¹ Nelson (n 19) 35

⁴² Ibid

⁴³ UNCIGSLC (n 35) art 3

enforceable through legal means, the demand guarantee remains enforceable and allows the beneficiary to claim compensation from the guarantor if the account party fails to perform the obligation. Hence, if the underlying contract is at risk of being revoked due to factors like breach of legal requirements, or other disputes, the demand guarantee provides a way to secure the beneficiary's interests regardless of the contract's status. Essentially, the guarantee ensures that the beneficiary will still be compensated if the contract is revoked or deemed invalid, helping to mitigate the risks associated with such revocation and this adds a layer of financial protection to the beneficiary, even if the underlying contract is in jeopardy.

2.4. Types of Demand Guarantee

Generally there are two main criteria for classifying demand guarantees. The first is based on the structure, specifically the number of parties involved in the guarantee. The second is based on the particular type of activity or phase the guarantee is intended to cover.

Based on structural classification demand guarantee can be categorized as either three-party (direct) guarantees or four-party (indirect) guarantees.⁴⁴

2.4.1. Direct/ Three Party/ Demand Guarantee

As clearly envisaged under the Uniform Rules for Demand Guarantee/URDG/ as well as the UN Convention on Demand Guarantee and Stand by Letter of Credit, a demand guarantee involves at least three parties, the principal, the guarantor and the beneficiary. In three party demand guarantee as the name implies there are three parties involved: the principal, the bank, beneficiary and three separate contractual relationships: such as, the underlying agreement between the principal and the beneficiary, the contract between the principal and the bank, and the guarantee instrument issued by the bank in favor of the beneficiary.

Under ordinary circumstance the guarantor in three party structure is typically the principal's bank and may operate in the same country as the principal, while the beneficiary is located in a different state.⁴⁵ This type of demand guarantee is also

⁴⁴ Roy Goode, *Guide to Uniform Rules for Demand Guarantees and Letters of Credit (URDG 758)* (2011) 159–161

⁴⁵ Kelly (n 18) 22.

referred to as a direct guarantee, because the guarantee is issued directly by the principal's bank rather than by a local bank in the beneficiary's country.⁴⁶

Alternatively, a direct (three-party) demand guarantee can be better explained with the following example: Suppose the principal, **P**, is a contractor domiciled in Ethiopia who agrees with a client, the beneficiary **B**, residing in either Ethiopia or Kenya, for consultation on a construction project in Ethiopia. According to the terms of the contract, it is a condition to furnish a demand guarantee. Therefore, **P** instructs his bank, **K**, operating either in Ethiopia or Kenya, to pay **B** the sum stipulated in the demand guarantee. In such cases, the bank pays the beneficiary directly upon demand. There is no intermediary or third party involved between the issuing bank and the beneficiary

Michelle Kelly⁴⁷ also attempted to explain this structure. According to her explanation, in a direct demand guarantee, the issuing bank and the principal must be located in the same country, while the beneficiary should be in a different country. Mesfin Kebede⁴⁸ also agrees to this effect. However, I believe that as long as the bank and the principal have an agreement and mutual trust, and the guarantee is accepted by the beneficiary, the requirement for the bank and principal to be in the same country is not essential. Furthermore, there is no reason the beneficiary must be in a different country. The arrangement shall work even if the beneficiary is in the same country with the principal and/or the bank. I see no logical basis for imposing these restrictions. In a direct demand guarantee, the geographical location of the parties is not important. What matters is that payment is made directly to the beneficiary by the issuing bank, without any intermediary.

2.4.2. Indirect/ Four party/ Demand Guarantee

⁴⁶ Ibid

⁴⁷ Ibid,

⁴⁸ Mesfin [n 7] p.16

Indirect demand guarantee, as the name implies, involves four parties, and unlike direct demand guarantee it encompasses four distinct types of contractual relations.⁴⁹ such as;

1. The primary contract,/ the underlying contract creating obligations between the principal and the beneficiary; which is secured by the demand guarantee/.
2. The contract between the principal and the guarantor, a contract setting the respective obligations of the guarantor and the principal regarding issuance of the guarantee.
3. Counter-guarantee agreement: this is a contract between principal's bank and the second bank (the issuing bank), in which they agree on conditions the second bank issue the demand guarantee on behalf of the principal. This agreement establishes obligations of the two guarantors.
4. The guarantee instrument, which is a document that represents the commitment of the bank (or issuing bank) to honor the demand guarantee under specified conditions.

In four party demand guarantee the principal directs his bank to arrange an agreement with another bank operating in the beneficiary's country and instructs that bank to issue a demand guarantee in favour of the beneficiary. In this case, the beneficiary does not receive the payment from the principal's bank. Instead, the second bank issues the guarantee and makes the payment on behalf of the principal's bank and will be reimbursed by the instructing bank.⁵⁰

Indirect demand guarantee comes in to play when the beneficiary requests the demand guarantee to be issued by a bank in his/her own country and it involves additional contract that is the contract between the principal's bank and the issuing bank which is the local bank in the country of the beneficiary.⁵¹ Hence indirect demand guarantee contract has two aspects, the first one is the agreement between the principal and his bank and the second agreement is the contract between the principal's bank and the issuing bank known as the counter guarantee agreement.⁵²

⁴⁹ Nelson Enonchong, *The Independence Principle of Demand Guarantees and Letters of Credit* (Oxford University Press 2011) 32

⁵⁰ Ibid

⁵¹ Kelly [n 18] 24

⁵² Ibid

In nut shell, in direct demand guarantee has a more intricate structure than a direct demand guarantee as it involves two banks and four parties, each with their own distinct roles and contractual relations.

Based on the stage it intends to secure demand guarantee could be classified in to various types. It is important to note that with an extension of freedom of contract, it is to the discretion of the parties to stipulate demand guarantee at any stages of the transaction.⁵³ While all guarantees serve the same fundamental purpose of protecting against nonperformance, it is considered more appropriate to guarantee each phase of performance separately, rather than having a single guarantee covering all stages.

This approach helps to restrict the principal's liability to the amount corresponding to each specific phase of performance thereby limit the liability of the principal to the amount corresponding to the specific phase of performance.⁵⁴ A demand guarantee is flexible and can be applied at different times through out the life of a contract. It can be issued before the contract is signed to secure future obligations, during the contract period to ensure continuous performance, and even after its completion to cover post-contractual responsibilities or warranties.

Unlike direct/ indirect types of demand guarantee, the URDG nor the UN Convention on Demand Guarantee has illustrated types of demand guarantee based on specific stages they cover. However, by referencing some international legal instruments, such as the FIDIC, established practices, and academic writings, we can identify several types of demand guarantees. The major ones include bid bonds, advance payment bonds, performance bonds, retention bonds and maintenance guarantee.

2.4.3 Bid Bond

Bid security is the most commonly used type of demand guarantee and is typically provided by a party bidding for a supply or construction contract. It ensures that if the bidder is awarded the contract, will sign the agreement and furnish performance

⁵³ Peden (n 3) 220

⁵⁴ Grace Longwa Kayembe, *The Fraud Exception in Bank Guarantee* (LL.M thesis, University of Cape Town, South Africa, 2008) 24 available at: <https://ssrn.com/abstract=3379663> accessed on 24th Feb 2025

guarantee or any other bond specified in the contract.⁵⁵ The critical purpose of Bid bond is not within the performance of the contract, rather the proper honoring of the procurement procedure and the signing of the contract.⁵⁶ It is a means to safeguard the tender-inviting party from breaches and helps to prevent non serious bidders from participating in the tender. If the bidder is awarded and then decides not to sign the contract or fails to honor their commitment, it will be at the pain of losing the bid guarantee.

Bid bond has a short lifespan, the period between the issuing date and the date when any performance security, typically required after the letter of acceptance, is due. And once the performance security is required, the bid guarantee's role is effectively complete. Bid bonds may indicate that it will be returned to the unsuccessful tenderer either once a tender has been accepted or a decision is made not to proceed with the project.⁵⁷

2.4.4. Advance payment Guarantee

Some contracts may stipulate the employer or the buyer pay advance payment, a portion of the contract price to be paid to the contractor or supplier to cover initial expenses related to the commencement of the work. This advance amount is deducted from future payments due, either at a later stage or according to a predefined repayment schedule, and is ultimately returned to the employer.

Hence, an advance payment/ refund guarantee/ is required to secure the contractor's or supplier's obligation to repay the advanced amount.⁵⁸ Advance guarantee assures the Employer the sum of money paid in advance will not be lost. It covers the value of work not yet performed, typically up to the amount of the advance payment.⁵⁹ The

⁵⁵ Nael Buni, *The FIDIC Forms of Contract* (3rd edn, 2005) 272

⁵⁶ Girma Getu, *Challenges in the Enforcement of Performance Security in the Ethiopian Construction Industry* (Master's thesis, Bahir Dar University Law School, unpublished, 2020) 24

⁵⁷ *Ibid*

⁵⁸ Nelson [n 49] 37

⁵⁹ Bailey (n 56) 28

advance payment guarantee often amounts to /ranges between 10 and 20 % of the contract value.⁶⁰

2.4.5 Performance Gurantee

performance guarantee secures the performance and completion of the work in accordance with the contractual terms and is often used to cover all stages of the contract.⁶¹ It guarantees the payment of a sum of money to the project owner/ employer if the contractor fails to perform. The amount of money paid to the beneficiary may be a sum required to complete the remaining works or the whole amount of the bond.⁶² The amount of the performance guarantee usually ranges between 5 to 10 % of the contract price.⁶³

2.4.6 Retention Guarantee

In construction contracts, as well as in long term and high volume supply contracts, payments are made on an installment basis. In construction contracts, payment is basically made upon completion of specific portion of the work. In supply contracts, payment is often tied to the delivery of goods in predefined stages or rounds. This structure helps address potential funding issues that either party may face and mitigates the risk of non-performance by breaking the project into phases and linking payments to the successful completion of each phase. It is common practice for the employer or buyer to withhold a certain amount from each payment made to the seller or contractor. This withheld amount is known as retention money.⁶⁴ In the event of a default under a contract, the retention money serves as a security for the other party and instead of going through a potentially lengthy and expensive legal process to claim against the contractor or seller the party holding the retention money has a quicker and more straightforward way to obtain redress.⁶⁵

However, there are times when the contractor or seller may feel uncomfortable with the reduction in payment due to retention, as it can decrease the amount they receive and impact their cash flow. In such cases, the parties may agree that the employer will

⁶⁰ Kelly [n18] 28

⁶¹ Ibid

⁶² Nael [55] 273

⁶³ Nelson [n 49] 37

⁶⁴ Id 39

⁶⁵ Kelly [n 18] 29

make full payment without withholding retention, provided that the contractor furnishes a retention guarantee. This guarantee serves to assure the employer that the contractor will fulfill their obligations, thereby eliminating the need to withhold retention money.

2.4.7. Maintenance Guarantee (Warranty Guarantee)

Under normal circumstances, a guarantee is released once the contract has been performed. However, some contracts may specify that the guarantee remains in effect even after performance is complete. The main purpose of extending the guarantee beyond the performance period is to ensure that the work meets the required standards and to secure the correction of any defects that may be discovered during the defect liability period.⁶⁶

A maintenance guarantee comes into play when the parties agree that neither retention money deducted from payments to the contractor nor a retention guarantee will be furnished.⁶⁷ In such cases, the maintenance guarantee serves as an important alternative to ensure that the contractor's obligations are fulfilled after performance.⁶⁸

It provides financial protection for the beneficiary by ensuring that if the work performed or goods delivered do not conform to the required specifications or quality standards, the beneficiary will be compensated for any defects.⁶⁹ The duration of maintenance guarantee typically matches the defect liability period outlined in the contract.⁷⁰

2.5. Distinctive Features of Demand Guarantee

Elsewhere in this paper I have tangentially touched up on the peculiarities of bank payment undertakings. As an instrument falling under the umbrella of bank payment

⁶⁶ Nael [n 55] 291

⁶⁷ Miss Warrisa, *Problems of Bank Guarantee under Thai Law* (Thammasat University 2015) 25, citing Roeland Bertrams

⁶⁸ Ibid

⁶⁹ Seyoum (n 19) 19, citing Bertrams, *Bank Guarantees in International Trade: The Law and Practice*

⁷⁰ Nelson [n49] 39

undertaking, independent guarantee too poses several characteristics that set them apart from conventional types of contracts.

2.5.1 Independence of Demand Guarantee/ principle of Autonomy/

The integrity of documentary guarantees as a financial instrument is premised on the principle of independence.⁷¹ A key principle governing letters of credit and demand guarantees is that the bank's obligation to make payment under the instrument is independent of any claims or defenses related to the underlying contract for which the instrument was issued.⁷² The issuing bank undertakes an absolute obligation to pay the beneficiary and honor the guarantee with out the need to prove non permanence of the principal contract.⁷³ Some argue that even the issuing bank is not required to notify the principal about the call made by the beneficiary.⁷⁴

The independence of the demand guarantee may be seen from three perspectives,⁷⁵ first, from the point of view of the relation between the issuer and the principal, the issuer can not raise any dispute it may have with the principal, for instance non payment of the service charge or invoke the principal's failure to fulfill other preconditions related to the guarantee.⁷⁶

Second, from the point of view of the principal-beneficiary relation ships, demand guarantee is independent of the principal-beneficiary relation ships.⁷⁷ Neither the issuer nor the principal can object to the payment by alleging a dispute between the principal and the beneficiary arising from the underlying contract or any other relationship. The third perspective can be seen from the point of view of the beneficiary- issuer relationships. Here the bank may not refuse payment based on its relationship with beneficiary; for instance, it may not invoke a set-off for any debt or

⁷¹ Chung [n 11] 5

⁷² Nelson [n19] p. 67

⁷³ Ibid. 16

⁷⁴ Ibid. 24

⁷⁵ Roberto Luis, 'The Autonomy Principle of Letters of Credit' (v III, no 1, Mexican Law Review, [Year]) 73, citing Robert D

⁷⁶ Goode (n 20) 12.

⁷⁷ Roeland V F Bertrams, *Bank Guarantees in International Trade: The Law and Practice of Independent (First Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions* (3rd rev edn, 2004) 11

payment it owes the beneficiary due to any other relationship the beneficiary may have with the bank. Hence when said a demand guarantee is autonomous/independent it connotes that it remains unaffected by any of the above mentioned scenarios and even strictly speaking the existence/ non existence or validity/invalidity of the underlying contract has no impact on demand guarantee at all.⁷⁸

Even though independent guarantee and surety ship share a significant characteristic in that they both provide security to the beneficiary they differ greatly as far as autonomy is concerned.⁷⁹ The key difference lies on the nature of the contract and guarantor's liability. Unlike demand guarantee, ordinary guarantee is secondary to the principal contract, influenced by relations extraneous to the guarantee contract. Furthermore, nonperformance of the obligations specified in the primary contract by the debtor is a condition precedent for the enforcement of the guarantee contract.⁸⁰ If the surety disputes the principal's default, the creditor is required to provide proof of the default.⁸¹ In contrast, the liability of the issuer in a demand guarantee is primary, meaning the issuer is directly responsible for fulfilling the obligation upon demand, regardless of whether the principal has defaulted .⁸²

There are various rationals for conferring autonomy to demand guarantee, the major one being the facilitation of commercial transactions. It has been recalled that, it is the gaps/limitations exhibited in traditional guarantee that triggered the introduction independent guarantee. The autonomy of Demand guarantee creates safer commercial environment by avoiding many of concerns that parties to a commercial transaction had been experiencing before demand guarantee come in to practice, such as, various inconveniences related to the lengthy of the proceeding and difficulties in enforcement.⁸³ The autonomy principle provides contracting parties with significant

⁷⁸ United Nations Convention on Independent Guarantees (n 27) art 3

⁷⁹ Yared Siyum, Siyum (n 19) 23

⁸⁰ Peden (n 3) 221

⁸¹ Ibid

⁸² Michelle Kelly 'General Update to the Law of Demand Guarantee and Letter of Credit' (2016) *Annual Banking Update* 45, citing Hapgood available at https://www.researchgate.net/publication/345681966_General_update_on_the_law_of_demand_guarantees_and_letters_of_credit accessed on 26th feb. 2025

⁸³ L Sarna, *Letters of Credit: The Law and Current Practice* (2nd edn, Carswell Legal Publishers, 1986) 128–129

risk reduction by ensuring payment, regardless of any contractual disputes that may arise from the main contract.⁸⁴

The other justification for autonomy of demand guarantee is related to the bank's limited ability to understand the nature of the underlying contract, the bank may not have an expertise to intervene in the dispute between the applicant and the beneficiary, and verify whether there is breach of contract.⁸⁵

2.5.2 Documentary Nature of Demand Guarantee/ Strict Compliance Rule/

Documentary characteristic of demand guarantee is expressed by some scholars as strict compliance rule and it works hand in hand with principle of autonomy.⁸⁶ per this rule, what expected from the beneficiary is just to demand payment by presenting documents stipulated on the undertaking with out any proof of default by the principal.⁸⁷ The guarantor is bound to strictly comply with the terms of the undertaking and if it is shown that the demand complies with the undertaking, for instance, it is made with in the specified time and in a prescribed form accompanied by required documents the bank must automatically pay the beneficiary with out making any further investigation/ non documentary/, basically the non permanence of the underlying contract.⁸⁸

It is a general rule that the beneficiary is awarded with out proving breach of underlying contract. However, demand guarantees may stipulate a written submission should be made by the beneficiary showing facts constituting a breach to the underlying contract, how ever this does not extend to proving those facts.⁸⁹

2.6. Exceptions to Basic Principles of Demand Guarantee

Principles and exceptions often go hand in hand. Likewise these two bed rock principles of demand guarantee, principle of independence and strict compliance rule, does not deviate from this general understanding and are subjected to certain exceptions.

⁸⁴ Jaideep (n 21) 362

⁸⁵ Ibid

⁸⁶ Ibid 45

⁸⁷ Penn, 'On Demand Bonds: Primary or Secondary Obligation' (1986) 4 *Journal of International Banking Law* 224

⁸⁸ Kelly (n 40) 46

⁸⁹ Kelly (n 40) 46, citing Oberin, 'Letter of Intent and Demand Guarantees'

As can be inferred from our discussions so far, the primary objective of demand guarantee is to protect the interest of the beneficiary. However, demand guarantee does not let the beneficiary to take undue advantage over the interests of other parties. Hence in order to avoid in appropriate demand by the beneficiary and strike balance between all interested parties to the undertaking it has become necessary to impose certain exceptions/ limitations. These exceptions can be classified in to three categories: exceptions attributed;to the undertaking, those related to the underlying/principal contract and general exceptions, such as forgery/fraud and lack of good faith.⁹⁰

The first type of exception, which relates to deviations from the strict compliance rule, arises from the guarantee instrument itself. The strict compliance rule generally requires the bank to make payment automatically upon a conforming demand.

However, there are instances in which the bank may justifiably refuse payment based on exceptions grounded in the terms of the undertaking. For example, as provided under articles 11 and 19 of the UN Convention on Independent Guarantees and Stand-by Letters of Credit, the bank may reject a demand that is not made within the specified time frame or that fails to comply with the formal requirements set out in the guarantee document. Additionally, if the beneficiary releases the bank from its obligations or terminates the guarantee contract, the bank may refuse payment even if the demand otherwise strictly complies with the original terms of the guarantee.

The bank is generally not obligated to follow the strict compliance rule if the beneficiary fails to provide the required documents or if the documents do not meet the exact specifications, such as missing a required signature, incorrect dates, or incomplete information. In such cases, the principle of strict compliance may be set aside, and the issuer may refuse to make the payment.⁹¹

Furthermore, although international rules governing demand guarantees do not explicitly address it, some scholars suggest that illegality of the guarantee may be mentioned as an exception to the strict compliance rule. Kelly Louwe, for example,

⁹⁰ United Nations Convention on Independent Guarantees and Standby Letters of Credit (n 28) ch III, arts 7–19

⁹¹ Goode (n 15), citing E Hugo, *The Law Relating to Documentary Credit*

argues that illegality of the undertaking it self could be a valid ground for a bank to refuse payment by dis regarding strict compliance rule.⁹²

Issue of illegality arises only in rare circumstances, typically when a court deems a properly issued guarantee to be illegal for specific, policy reasons and once the court rules that the guarantee is illegal, it becomes unenforceable. Courts generally invalidate demand guarantees issued for the benefit of a foreign beneficiary, often to protect the interests of the principal who is a national or domiciled within that state or based on the policy considerations of the country where the beneficiary resides.⁹³

Therefore, for in such case, a demand guarantee that was validly issued may be ruled illegal by the court. As a result, the bank may refuse payment, and the strict compliance rule may be set aside. Good faith can also be an exception to the strict compliance rule, requiring the issuer to act honestly when reviewing the documents, and if the demand does not strictly conform to the terms of the undertaking, payment should not be made to the beneficiary.⁹⁴

The second type of exception arises from the principal contract, and it poses a challenge to the principle of autonomy. exceptions based on the underlying contract may be invoked in limited and exceptional circumstances. These include situations where: the underlying obligation is invalid, its fulfillment has been clearly obstructed by the willful misconduct of the beneficiary, or the underlying obligation has unquestionably been fulfilled. Such exceptions, though rare, allow courts or banks to pierce the autonomy of the guarantee and consider the substantive issues arising from the underlying contract.

Though not explicitly addressed in international rules governing demand guarantees, some scholars argue that illegality of the underlying obligation could be an exception to the autonomy principles. For instance, Nelson Enchong, states that if the underlying contract between the principal and the beneficiary is deemed illegal, the bank may have grounds to deny payment under the guarantee, provided that the

⁹² Michelle Kelly Lowu, 'Illegality as an Exception to the Autonomy Principle of Demand Guarantee' (2009) XL *Comparative and International Law Journal of South Africa* 352

⁹³ Ibid

⁹⁴ Goode (n 20) 11

illegality is proved by the principal.⁹⁵ For an illegality to be invoked, it must be adequately proven, sufficiently serious, the beneficiary must have been involved in the illegal activity and there must be a clear connection between the demand guarantee and the illegality in the underlying transaction.⁹⁶

General exceptions include issues such as document falsification, forgery, and fraud. The principle of strict compliance may be disregarded and payment may be refused if the demand is based on falsified documents whether through the alteration of existing documents, the creation of entirely forged documents, or fraudulent or deceptive acts committed by the beneficiary or a third party.

Exceptions pertaining to the undertaking such as failure to comply with time and form requirements, non-presentation of relevant documents, termination or waiver of the beneficiary's right to demand, and issues of fraud seem to align with and support the core principles of demand guarantees. However the exceptions related to the underlying contract significantly contradict with the very notion of demand guarantee, eroding its very purpose and objective. Because, if defenses based on the original contract, for instance the invalidity/ performance/ non performance of the original contract are allowed to be raised against the demand guarantee, it will lose its intended advantages discussed so far.⁹⁷ However, it is important to note that the applicant and the beneficiary can mutually agree to exclude these limitations from the guarantee, thereby ensuring that certain defenses related to the underlying contract do not apply.⁹⁸

⁹⁵ Enonchong (n 16) 411

⁹⁶ Kelly (n 92) 384

⁹⁷ R Perrignon, 'Performance Bonds and Standby Letters of Credit: The Australian Experience' (1991) 2 *Journal of Business and Finance Librarianship* 161

⁹⁸ Article 19(2)(b) of the United Nations Convention on Independent Guarantees and Standby Letters of Credit provides an "exception to an exception," allowing parties to waive certain defenses to a demand guarantee through agreement. Specifically, it permits the parties to enforce the demand regardless of the validity of the underlying contract, while the Convention does not address other potential exceptions. Under the

Chapter Three

Legal Frame Work Governing Demand Guarantee

Owing to its recent development, laws governing demand guarantee are very young as compared to laws governing other activities. Its progress in the international legal environment with the strong commitment of the UNCITRAL is very remarkable. However domestically many jurisdictions has not yet established a comprehensive legal frame work governing various aspects of demand guarantee.

By the upcoming session we will explore the legal frame work governing demand guarantee from an international and Ethiopian perspective. Besides this the section will briefly touch the experience of some selected jurisdictions.

3.1. International Legal Instruments Governing Demand Guarantee

3.1.1 United Nations Convention on Demand Guarantee and Stand by Letter of Credit

This convention was drafted by the United nations commission on international trade law(UNCITRAL) and was adopted and opened for signature by the General Assembly through its resolution 50/48 on 11 December 1995.⁹⁹ It is regarded as a pioneering legal instrument, that acknowledge fundamental principles of demand guarantee and lay the ground for subsequent international legal frameworks and influence incorporation of demand guarantee provisions in to domestic legislation.

Article 1 of the convention states that rules in the convention are applicable when the guarantor bank is situated in a member state or where its application is determined through private international law, specifically choice of law rules.

principle of freedom of contract, parties are generally free to disregard those exceptions by agreement

⁹⁹ UNCITRAL, *Explanatory Note on the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (1996) para 12

The Convention commonly uses the term an ‘undertaking’ to refer to both demand guarantee and letter of credit. And it defines it as,

‘An independent commitment, 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, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person.’¹⁰⁰

The definition provided by the convention clearly outlines the basic features of demand guarantee discussed so far. When we closely examine the phrase in the definition.... *that payment is due because of a default in the performance of an obligation, or because of another contingency*, seems the convention is applicable for conditional guarantee too. This phrase merely indicates that the undertaking may require the beneficiary to make a statement regarding the principal’s default. It is simply a declaration of fact and does not transform the guarantee into a conditional one. Principle of independence is incorporated under article 3 of the Convention, and pursuant to this, the issuer’s obligation to the beneficiary is neither dependant on the existence or validity of the underlying transaction nor subject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents.

As per the Convention, an undertaking is formed where the bank as instructed by principal issues the guarantee for the account of the beneficiary.¹⁰¹ The guarantee gets effective at a time it leaves the sphere of control of the issuer, regardless of acceptance by the beneficiary. And once issued it can not be revoked for what so ever reason unless stipulated.¹⁰² The convention provides that an undertaking may be issued in *any form which preserves a complete record of the text of the undertaking*

¹⁰⁰ United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (n 27) art 2

¹⁰¹ Ibid

¹⁰² United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (n 27) art 7

*and provides authentication of its source by generally accepted means.*¹⁰³ This certainly suggests that a demand guarantee should be issued in a written form, as it is difficult to think of any other form which met such requirements.

The rights and obligations of parties to the undertaking are addressed by the convention. As demand guarantee is a unilateral undertaking the issuer bears mostly an obligation; such as, pay the beneficiary on demand, careful examination of the demand light of the terms of the undertaking and verify whether all documents are original and act in good faith not to jeopardize the rights the beneficiary and the principal. the beneficiary, as the name implies mostly conferred with entitlements than obligation. The only obligation imposed on the beneficiary is to support his/her demand with relevant documents and ensuring the demand is made in accordance with the terms of the undertaking.

3.1.2 Uniform Rules on Demand Guarantee/URDG 758/

As previously noted the UN Convention on Demand Guarantee serves as base line for laws governing demand guarantee. However, the convention only outlines general principles/ skeletons than addressing detailed aspects of it. To fill this gap Uniform rules on demand guarantee has been developed by the UNCITRAL, aiming to govern various issues pertaining to demand guarantee. Article 1 of the URDG provides that rules are voluntarily applicable, where its application is expressly provided on the guarantee instrument. Once the guarantee is issued in accordance with the URDG all parties to the undertaking are hither too bound by it.

The URDG precisely defined the term demand guarantee as any signed undertaking, however named or described, providing for payment on presentation of a complying demand.¹⁰⁴ It provides that demand guarantee is only concerned with documents, and not with goods, service or performance to which the documents may relate.¹⁰⁵

Fundamental principles of demand guarantee, such as principle of independence and strict compliance/ documentary nature/ are well established under URDG. Article 5 clearly affirms independence of demand guarantee from the underlying contract.

¹⁰³ Ibid

¹⁰⁴ URDG 758 (n 36) art 2

¹⁰⁵ URDG 758 (n 36) art 6

Accordingly demand guarantee is not subject to claims or defenses arising from any underlying relationship. Articles 6 and 7 of the URDG emphasize the documentary nature of the guarantee. Therefore, a guarantee must stipulate only documentary requirements, and any non-documentary conditions are not acceptable.

The URDG recommends that the demand guarantee instrument specify, among other things, the applicant, the beneficiary, the guarantor, the maximum amount payable, the expiry date of the guarantee, the terms for demanding payment, and whether the demand or any required documents must be presented in paper and/or electronic form.¹⁰⁶

The URDG provides possibilities of amendment or variation of demand guarantee with the consent of the beneficiary.¹⁰⁷ Unless the beneficiary consented to such acts they are not binding and do not relieve the guarantor from his/her former obligations. Potential causes for variation of demand guarantee are listed under article 25. Pursuantly, the guarantee could be reduced proportionally to the obligation already performed and to the extent sufficient to guarantee the remaining obligation. It may also be reduced where the beneficiary partially releases the liability under the guarantee for any reason.

The questions of ‘when, where and how’, are essential in the enforcement of any contract including demand guarantee. These issues are comprehensively addressed under Article 14 of the URDG. A demand must be presented to the guarantor either at the place of issuance or at another location specified in the guarantee, and it must be submitted on or before the expiry of the demand period stipulated in the guarantee instrument. If the guarantee specifies a particular form for the demand, that form must be strictly followed. Otherwise, the demand must be made in written form and accompanied by the required supporting documents.

The demand shall specify the guarantor’s reference number and show facts constituting breach of the underlying contract. According to Articles 17 and 18 of the URDG, a demand is considered non-complying if it is not made within the

¹⁰⁶ URDG 758 (n 36) art 8

¹⁰⁷ URDG 758 (n 36) arts 11 and 13

prescribed time or if the amount demanded exceeds the maximum amount specified in the guarantee. Non complying demand is not counted and does not preclude the beneficiary from making fresh demand./ art.18/. Upon receiving a complying demand, the guarantor is expected to notify the applicant of the demand. This serves to alert the applicant in case they wish to raise any valid objections. However, the guarantor is not permitted to withhold payment while waiting for the applicant's response, as its obligation is limited to notification only.

The URDG incorporates various obligations of the issuer and rights of the beneficiary. The obligations of the guarantor can be viewed from the perspectives of protecting both the principal's and the beneficiary's interests. This includes thoroughly examining the demand in accordance with the terms and conditions stipulated in the guarantee instrument and verifying the authenticity of the documents accompanying the demand. Additionally, the guarantor is required to notify the principal, provide a copy of the complying demand, and forward all related documents (see Article 22). The guarantor is also expected to act in good faith when handling the demand and the documents presented (see Article 30).

It has to be noted that the guarantor is not liable for any sufficiency, accuracy, genuineness, falsification, or legal effect of any signature or document, presented to it / article 27/. With respect to the beneficiary, the guarantor has a duty to make payment promptly, within a maximum of five days from the date the demand is made (see Article 20(a)). The guarantor is required to accept the beneficiary's calculations as presented and is not obligated to recalculate the amount demanded (see Article 19(e)). Article 23 of the Uniform Rules stipulates that the demand period may be extended before it expires. The extension is granted upon the beneficiary's request and with the guarantor's approval. This time extension is usually presented as an alternative to payment, with the demand titled "pay or extend." Once the extension is approved, the demand remains in effect for the extended period. If the guarantor does not accept the extension request, they are expected to release payment without requiring the beneficiary to make a second demand. The grounds for termination of a demand guarantee are provided under Article 25 of the URDG. Accordingly, a

demand guarantee terminates upon the expiry of the demand period, when no amount remains payable, or when the beneficiary releases the guarantor from liability.

3.2. Domestic Legal Frame Work Regulating Demand Guarantee

The legal frame work regulating demand guarantee in Ethiopia has been discussed by some research works and articles. Those materials in one way or another state absence of comprehensive law governing demand guarantee in the country.

For instance, Addis Gemechu¹⁰⁸ argues that, despite its widespread use, the demand guarantee remains one of the least regulated areas of law in Ethiopia, with no explicit reference to it in the country's legislation.

He emphasizes that the rules relevant for governing demand guarantee are dispersedly located in piecemeal legislation. Likewise, Mesfin Kebede¹⁰⁹, and Gezu Ayele¹¹⁰ also points out that the term demand guarantee is not explicitly addressed in Ethiopian laws, instead, specific types such as bid security, advance bond, and performance bond are mentioned without using the general term demand guarantee.

With this overview in mind, let us now examine the place of demand guarantee under Ethiopian domestic legislation.

3.2.1 The 1960 Civil Code

The Civil Code of Ethiopia contains various provisions governing contracts, including guarantee contracts. However the definition provided under article 1675 and requirements under subsequent provisions as well as surety ship provisions of article 1920 and following provisions of the civil code are not compatible with the characteristic of demand guarantee.

Let's highlight on the major differences between the two, the first difference lies on the the number of parties involved in the contract; the definition under article 1768, suggest at least two parties involved in the contract how ever demand guarantee only involves one party, the issuing bank. The second is, type of obligation, in case of

¹⁰⁸ Addis Gemechu, (n 4) 26

¹⁰⁹ Mesfin Kebede (n 7) 30

¹¹⁰ Gezu Ayele, *Ethiopian Banking and Commercial Instruments Law* (Amharic version, 2017) 100–107

ordinary contract under article 1675 and 1920, the obligation could be any kind that can be expressed in pecuniary terms. For instance, the guarantors obligation could be to pay certain amount of money to the creditor or to perform certain work, to deliver certain good/service or to abstain from doing certain activities. However, in case of demand guarantee the obligation is strictly to pay the agreed sum of money and not to perform the obligation in the underlying contract.

In case of guarantee under the civil code non performance of the obligation by the debtor is a precondition to put the guarantor under liability. This could easily be inferred from the definition of surety ship under article 1920 of the code. The phrase ... *'to discharge the obligation should the debtor fail to discharge it'* clearly implies surety ship comes in to effect where the debtor for what so ever reason fails to perform his/her obligation. However, this condition do not apply for demand guarantee due to the principle of independence. As enunciated under article 1923 and 1926 of the civil code surety ship contract is totally dependant on the validity/ existence of the principal contract. Given the principal contract invalid or extinguished for what so ever reason , the surety ship automatically cease to exist. However demand guarantee is not affected by the validity/ termination/cancellation of the principal contract. any variation/ modification to the original contract automatically release the guarantor from his obligation, how ever demand guarantee is not affected by variation/ modification of the original contract.¹¹¹

Moreover, with regards to defenses, the guarantor under the civil code/ art.1942/ can exhaustively raise defenses available for the debtor. However, in demand guarantee the guarantor is totally precluded from raising defenses based on the underlying contract or relation ship.

Benefit of discussion ; as provided under article 1935 of the civil code, proof to contractual breach is not sufficient to claim payment from the guarantor, rather the creditor has to first proceed against the debtor/ and has to show efforts has been made to get payment from the debtor. Other wise the guarantor may raise the benefit of discussion as a defence and force the creditor to first resort to settle his payment with

¹¹¹ Civil Code of the Ethiopian Empire (1960) art 1928

the debtor, unless the guarantor is joint and severally liable/ general guarantor/ in accordance with article 1934 of the civil code. However, there is no such concept of benefit of discussion under demand guarantee, the beneficiary directly demand from the guarantor.

Despite the above distinctions some suggest that the general principles of contract and surety ship provisions under the civil code to some extent may apply for demand guarantee. For instance, Addis Gemechu suggests that general principles of contract law shall be used in demand guarantee as a gap filling role, though he is silent regarding applicability surety ship provisions under the civil code.¹¹² Mesfin Kebede also agrees to the effect that principles of general contract particularly, rules of interpretation, good faith, illegality of an object of contract, falsification of document and fraud shall apply to demand guarantee too.¹¹³

The judiciary in Ethiopian as precisely presented by Gidey Belay, treats demand guarantee as surety ship contract. The issuer is regarded as a joint guarantor and holds all the obligations under the civil code imposed on the joint guarantor.¹¹⁴ the details of the judicial practice, including which specific law they employ to adjudicate demand guarantee case would broadly be discussed under chapter four.

3.2.2. Banking and Insurance Business Laws

As established in our previous discussion financial institutions are the main actors in demand guarantee. Given their central role it would be imperative to scrutinize whether demand guarantee is addressed by the Ethiopian banking and insurance laws.

Neither the the banking business proclamation number 1360/2025 nor insurance business proclamation number 746/2012 and its amendment proclamation number 1163/2019 has expressly incorporated demand guarantee. The term is missing in all these primary legislation. Let alone, demand guarantee the specific types are not indicated in those proclamations. Hence at this juncture it will be important to pose a

¹¹² Addis Gemechu (n 108) 26

¹¹³ Mesfin Kebede (n 7)

¹¹⁴ Gidey Belay (n 40) 17–19

question where does the banks or other financial institution obtain an authority to deal with demand guarantee? The only justification and which is in fact referred by some scholars like Addis Gemechu,¹¹⁵ is article 2 sub article 6/j/ of the banking business proclamation No.1163/2025. and we find no inferences made to demand guarantee under the insurance business proclamation at all.

Article 2 sub article 6 of the banking business proclamation provides illustrative list of banking business activities. Sub article 6, j further authorizes banks to engage in activities which are not explicitly listed and customarily recognized as banking business. One of such activities which is missing in the list but is widely practiced by banks at international level is issuance of demand guarantee. Therefore this specific article 2/6 j/ of the proclamation serves as an authoritative source for Ethiopian banks to issue and deal with demand guarantee.

Other than this, the NBE prohibition of certain types of bonds by insurance companies directive number SIB/24/2004 and its amendment directive No.SIB 51/2020 can be cited as a key legal instrument addressing demand guarantee. Notably, it is the only instrument that refer to demand guarantee in its generic terms other than specific types and it at least implicitly indicates that the practice of demand guarantee in Ethiopia has a legal foundation. The mere observation of the preamble part of the directive reveals that the demand guarantee is widely issued by insurance companies and it is validity recognized as lawful activities of insurance until the issuance of the prohibiting directive.

It is noted that the directive prohibiting insurance business from issuing unconditional bond SIB 24/2004 is issued under the licensing and supervision of insurance business proclamation number 86/1994 and this proclamation is repealed by a new proclamation an insurance business proclamation number 747/2012. However, it appears that Directive No. 24/2004 remains in force and has not been repealed along with its source proclamation. This is evident from the title of the amendment Directive No. 51/2020, named a directive to amend Directive No. 24/2004. This clearly indicates that, aside from the amended portions, the old directive is still in

¹¹⁵ Addis Gemechu (n 108) 26-28

force. However, according to general principles of law, the repeal of a source law typically renders all subsidiary legislation issued under it invalid, unless the new law includes transitional provisions that explicitly preserve such subsidiary legislation. In light of this general legal principle, the validity of the above directive can easily be challenged, given that the new proclamation does not contain any transitional provisions extending its applicability. Nevertheless, this issue appears to have gone unnoticed, and the directive continues to be applied and cited as a legal basis for demand guarantee in Ethiopia despite questions surrounding its legal validity.

The taking away demand guarantee from the activities of insurance is lawful and logically sound. Because insurance and guarantee are very different concepts, insurance as defined under article 654 sub article 1 of the commercial code of 1960 and article 2/16/ of the insurance business proclamation number 746/2012 refers to an undertaking by the insurer to pay an agreed amount to the beneficiary against payment of premium and up on occurrence of a certain risk. The validity requirements of insurance such as existence of insurable interest, payment of premium, occurrence of risk, principle of indemnity are absent in demand. Gidey Belay also agrees to this effect.¹¹⁶ Hence in the absence of this concepts in demand guarantee it would be illogical to treat demand guarantee as insurance business.

3.2.3. Federal Public Procurement Laws

Another area of law relevant for our discussion is the Federal Public Procurement Proclamation, along with its accompanying directives and standard bidding documents. The Federal Public Procurement Proclamation No. 133/2024 that regulates the procurement of goods and services by government entities, has contained provisions dealing with demand guarantee; article 52 about bid security and 65, advance payment guarantee, both in unconditional bank guarantee form or other equivalent types of guarantee. The proclamation leaves the details to the subsidiary legislation, public procurement directive number 1073/2025. this directive contains several provisions addressing demand guarantee. among various types of demand guarantees, the directive particularly incorporates bid security, advance payment

¹¹⁶ Ibid 18-20

guarantee, and performance guarantee. Bid security is enshrined under article 2 sub article 7 and article 116 of the directive. Accordingly every bidder is required to furnish bid security, unconditional guarantee submitted by the bidder from time of participation until contract formation. The amount of the bid security ranges between 0.5% up to 2 % of the total estimated price of the contract.

Advance payment guarantee is addressed under Article 139, Sub-article 2 of the directive. According to this provision, it is mandatory to provide an advance payment guarantee in the form of an unconditional bank guarantee. Similarly, performance guarantees are covered under Article 136 of the directive. This article requires the furnishing of a performance guarantee amounting at least 10% of the contract value. The guarantee must be in the form of an unconditional bank guarantee or any other form recognized under Article 162 of the contract.

Based on the above discussion, it can be concluded with confidence that demand guarantee have a solid legal basis in Ethiopia and are consistently applied throughout the public procurement process.

3.2.4 public procurmenet Standard Documents

Due to the reason that Public Procurement Proclamation and its subsidiary legislation do not address every detailed aspect of the procurement process, the development of a Standard public procurement document has become necessary. These document explicitly and comprehensively covers various technical and specific issues, thereby ensuring consistency and uniformity in procurement activities conducted by government entities. Hence with this objective in mind the federal government procurement agency in accordance with the authority granted by article 2/19/, 12/6/ of the procurement proclamation has issued standard documents for various procurement activities, including standard document for procurement of goods and related service, as well as standard condition for construction contract/PPA/ 2011.

Such standard conditions as provided under article 5/5/, 7/1/ article 31, 50 and 62 of the proclamation are binding on the government procurement process. It is important to note that there are multitude of standard documents issued by the respective government bodies. However, it would be very cumbersome to go through every one

of these documents in detail. Therefore, for the economy of time the analysis will focus on the place of demand guarantee in standard bid document for procurement of goods and related service and the PPA 2011.

Standard bidding document for procurement of goods, explicitly incorporates various types of demand guarantee, specifically bid security, advance payment security and performance security. For instance, Article 22.1 stipulates that bidders must furnish a bid security in the form of an unconditional bank guarantee or other acceptable forms. In addition, Article 32.10 requires an advance payment guarantee, while Article 47 mandates the submission of a performance guarantee in the form of an unconditional bank guarantee.

The PPA 2011, serves as a key standard for construction contracts concluded between public bodies either among themselves or with domestic contractors. Unlike the standard for procurement of goods, PPA 2011 incorporated two types of demand guarantee, advance payment guarantee/ under clause 60/ and performance guarantee/ under clause 58/. Per this standard, the contractor is required to furnish an advance payment security in the form of unconditional bank guarantee. However, for performance guarantee, the PPA suggests for conditional bank guarantee unless the parties agree otherwise under the special conditions of contract.

The PPA 2011 is the only instrument in Ethiopia that makes reference to the URDG and it provides that a guarantee document may stipulate it is governed by UDRG.

3.3. Demand Guarantees in Selected Jurisdictions

Thus far, it has been attempted to explore the legal framework governing demand guarantee from both international and Ethiopian perspectives. However, I believe the subject matter will not be fully addressed without a comprehensive analysis of the trend in and regulatory approaches of some selected jurisdictions.

The literature indicates that demand guarantee is a new concept in various jurisdictions, including economically advanced ones. For instance, Roland F. points out that the concept, independent bank guarantees and their American equivalent,

standby letters of credit, are a relatively new legal phenomenon.¹¹⁷ It appears that the United States did not have specific legislation governing demand guarantees and, instead, such instruments were traditionally regulated by custom and practice until the enactment of the Uniform Commercial Code in the 1950.¹¹⁸ The American Uniform Commercial Code has incorporated a single provision/ article 5/ addressing bank undertakings. Even though, the code does not use standby letter of credit, the provisions are applicable for demand guarantee due to identical nature of the two.

The definition provided under article 5 is almost similar with the one provided by international legal instruments discussed earlier. The law gives due recognition to the basic principles of bank undertakings such as principle of autonomy and strict compliance rule. The former is encompassed under article 5 /103,1b and the latter under article 5/109 1 of the code. Apart from this, the code has incorporated various provisions defining the rights and obligations of the parties involved in the undertaking. And it is almost similar with what is provided under international legal instruments. Likewise the Uniform Commercial Code provides that a demand guarantee shall be issued in written format. This is also similar with what is endowed in international instruments. The Uniform Commercial Code under its article 5-109 has incorporated exceptional grounds of demand guarantee, and those grounds include fraud and falsification. Article 5 of the Commercial Code has been amended to incorporate more detailed provisions, including the principle of independence of the demand from the underlying contract.

The French civil code contained a single provisions dealing with demand guarantee. Article 2321 of the code has defined demand guarantee as an ‘undertaking by which the guarantor binds himself, in consideration of a debt subscribed by a third party to pay a sum either on first demand or subject to terms agreed upon’. The law incorporated basic principles of demand guarantee, autonomy and strict compliance. It has also incorporated exceptions where a demand guarantee may not be enforced.

¹¹⁷ Roeland F. Bertrams, *Bank Guarantee in International Trade: The Law and Practice of Independent/First Demand Guarantees and Letters of Credit in Civil and Common Law Jurisdictions* (4th rev. edn, 2013) 1

¹¹⁸ William C. Anderson III, ‘Uniform Commercial Code - Article Five -A Bank May Be a Confirming Bank on the Credit of a Non-Bank Issuer’ (1974) 19 *Villanova Law Review* 688 Available at <https://digitalcommons.law.villanova.edu/vlr/vol19/iss4/8/>

Even though, the code contained a single provision it has almost addressed basic issues related to demand guarantee. It is said that Ethiopian civil code is transplanted from the French civil code, how ever I wonder why the legislators have failed to incorporate demand guarantee provision.

While exploring the place of demand guarantee in various legal jurisdiction, I have encountered that common law countries mostly have case laws regulating demand guarantee whereas most civil law countries except for French, lacks specific law directly addressing demand guarantee. The absence of specific provisions on demand guarantees in the codified laws of many civil law countries may be attributed to the relatively recent emergence of this concept. Unlike common law systems, which allow courts to develop legal principles through case-by-case adjudication, civil law systems rely heavily on codification. This gives common law jurisdictions a greater ability to establish legal rules governing demand guarantees through judicial decisions, while civil law countries may lag behind in formally addressing such instruments within their legal codes. In civil law systems, demand guarantees are often regulated not by specific statutory provisions, but rather through general principles of contract law, banking law, and judicial interpretation.

Chapte Four

Judicial Intervention in Demand Guarantee and the Jurisprudence of Ethiopian Federal Courts

4.1. General Overview on Judicial Intervention in Demand Guarantee Cases

Unlike other ordinary contracts, courts take a very minimum role in demand guarantee cases, due to its distinctive nature. As discussed earlier demand guarantee is paid on demand, and there are very limited grounds to object the payment. The principle is that courts do not intervene in demand guarantee cases. However, this does not mean demand guarantee cases never appear before court and the court has no role at all . It just mean the involvement of courts is only limited to certain scenarios. The applicant may bring court action against the demand for justifiable grounds, the beneficiary too may bring action to the court where his demand is rejected by the issuer for no good cause. Hence in such cases, the parties may present their case to the

court and seek court intervention.

The UN Convention on Demand Guarantee and Letter of Credit as well as the URDG regulates the engagement of courts in demand guarantee cases.

The UN Convention under article 20 stipulate that courts may intervene in demand guarantee through provisional remedies when requested by the principal. The party applying for injunction must show either of the grounds under article 19/1/ such as falsification of document, non fulfillment of documentary requirements, judging by the type and purpose of the undertaking, the demand has no conceivable basis.

If the court after examining the validity of the application on the above grounds may reject the application or accept it and require the applicant to produce a security in a form it deems appropriate before it renders injunction order. The court in no ground other than stipulated under the above article may interfere with demand guarantee and nor render injunction order.

The explanatory notes on the UN convention on demand guarantee states that the objective of the convention is to strike balance between the interest of the parties to the demand guarantee, and it furthers that granting a limited power for courts to restrain payment based on justified grounds is very essential as it avoids allegations of fraud or abusive demand.¹¹⁹ Even though, the URDG contained no explicit provisions regarding judicial involvement in demand guarantee cases, from the whole text of the document we can certainly say that the instruments just like the UN Convention gives only limited authority for courts to interfere with demand guarantee, such justifiable grounds for court intervention are exceptions to demand guarantee provided under article 24/ non complying demand/ which is the obviously issue of forgery, falsification, non fulfillment of requirements under the guarantee instrument.

This two instruments laying the foundations for demand guarantee envisages that the court, in principle abstain from engaging itself in demand guarantee, demand guarantee stand far from the reach of court. However, under exceptional cases provided above the court may enroll in such disputes, and the court should only stick it self with the face examination of the non compliance of the demand. And it is evident that it is the position of the two instruments that the court while adjudicating

¹¹⁹ UNCITRAL Explanatory notes (n 99)

such issues shall give due consideration to the nature and the peculiar features, such as autonomy and documentary nature of the undertaking.

Having said this about the place of court in demand guarantee, let us by the forthcoming session explore the judicial practice of Ethiopian Federal courts.

The cases are analyzed from the point of view of the specific law the courts apply to settle demand guarantee cases, the perception of the court towards the peculiar nature of demand guarantee, the principle of independence/ autonomy/ and strict compliance rule. And finally assess the over all prevailing practice of demand guarantee.

4.2. Case Analysis

Federal Supreme Court/FSC/ Cassation Descissions

Case 1. FSC Cassation File Number 21355¹²⁰

The case was between the applicant, Anbassa City Transport Enterprise, and the respondent, Anbassa Insurance. The dispute concerned an advance payment guarantee. In the lower court, the applicant brought an action against the respondent, alleging that the latter had failed to honor the demand guarantee.

The respondent defended against the allegations by arguing that the advance payment guarantee was void. According to the respondent, the party who instructed the issuance of the guarantee, the principal, lacked the legal capacity to enter into the underlying contract with the applicant. The respondent further contended that, since the principal contract was invalid due to the principal's lack of capacity, the guarantee issued to secure that contract must also be considered invalid. Therefore, the invalidation of the original contract automatically nullifies the demand guarantee.

The lower courts accepted the argument presented by the respondent and rejected the applicant's claims, stating that the guarantee contract is ancillary to the principal

¹²⁰ Anbessa City Transport Enterprise v Anbessa Insurance [2006] 5 Federal Supreme court Cassation 21355

contract and is extinguished along with the underlying contract. In support of this conclusion, the court cited the suretyship provisions of the Civil Code.

However, this decision clearly demonstrates that the court failed to recognize the distinctive features of a demand guarantee. The principle of independence (or autonomy), which establishes a legal separation between the guarantee and the underlying contract, was disregarded. The court erroneously treated the demand guarantee as accessory to the principal contract, concluding that if the underlying contract is extinguished for any reason, the guarantee must also be extinguished.

This conclusion is inconsistent with the fundamental characteristics of a demand guarantee. Most notably, the court's reasoning contradicts the principle of independence, which dictates that a demand guarantee operates separately from the underlying contract and is not affected by disputes or defects in that contract. Despite these issues, the appellate court affirmed the decision of the lower court

Hence, it is evident that the appellate court fully adopted the analysis and conclusion of the lower court. For the same reasons stated above, the appellate court also failed to uphold the fundamental principles governing demand guarantees.

Eventually, the case was brought before the Cassation Bench. The Bench framed the following issues: whether the guarantor had knowledge of the principal's incapacity at the time of issuing the guarantee, and whether the principal had the legal capacity to enter into the underlying contract at the time the performance guarantee was issued.

However, after framing these issues, the Cassation Bench proceeded directly to its own factual analysis, without addressing the validity of the lower courts' approach in treating the demand guarantee as accessory to the underlying contract. The Bench's silence on this key legal question may suggest that it, too, subscribes to the reasoning of the lower courts.

The Cassation Bench, rather than addressing the legal relationship between the demand guarantee and the underlying contract, focused primarily on the issue of where the burden of proof lies in establishing a defect in the formation of the underlying contract—specifically, the absence of legal capacity.

The court held that the burden of proving incapacity or any defect in the formation of the underlying contract rests with the respondent. The Cassation Bench appeared to operate under the assumption that the validity of the demand guarantee is contingent upon the validity of the underlying contract and expressed certainty on this point. However, the central issue for the court was the allocation of the burden of proof. It ultimately concluded that the guarantor had failed to sufficiently demonstrate that it was unaware of the principal's incapacity at the time the guarantee was issued.

The court also stated that a demand guarantee is a contract concluded between the guarantor and the applicant, which is incorrect. A demand guarantee is a unilateral undertaking by the guarantor, not a bilateral agreement between the guarantor and the applicant. The applicant's role is limited to requesting the issuance of the guarantee; no contractual relationship is formed between the guarantor and the applicant in the traditional sense.

Furthermore, the court failed to address the fact that the relationship between the principal and the guarantor is immaterial to the enforcement of a demand guarantee. The fundamental principle of independence dictates that the guarantor's obligation exists separately from the underlying relationship between the applicant and the principal.

Case 2. FSC Cassation File Number 36935¹²¹

The case was between the applicant, Africa Insurance, and the respondent, the Commercial Bank of Ethiopia. The applicant filed an application challenging the decisions of the lower courts on three grounds. One of these grounds relevant to our discussion is that the bank guarantee issued by the applicant did not meet the formal requirements of suretyship as provided under Articles 1725(a) and 1727(b) of the Civil Code. Specifically, the requirements of written form and signature were not satisfied, and therefore, the guarantee instrument should be considered void.

The Cassation bench, in its interpretation, held that a demand guarantee is governed by surety ship provisions under the Civil Code, rather than by the insurance

¹²¹ Africa insurance v Commercial bank of Ethiopia [2011] 13 Federal supreme court cassation 36935

provisions of the Commercial Code. It provided reasoning as to why a demand guarantee should not be classified as an insurance contract, even when issued by insurance companies. According to the Cassation bench, demand guarantees are to be regulated under the surety ship provisions of the Civil Code, but these provisions must be applied in a way that aligns with the unique characteristics of demand guarantees.

For example, the court ruled that a demand guarantee must be in written form, expressly stated, and must specify the maximum amount. It further stated that the formal requirements of attestation by witnesses and signature are not applicable to demand guarantees. This decision highlights the distinctive nature of demand guarantees and suggests that while surety ship provisions apply, they should be interpreted in a manner that does not undermine the special features of the demand guarantee. This interpretation by the court is still used as the sole guiding authority for cases involving demand guarantees in Ethiopia, and at the very least, it clarifies the previously confused question of which law governs demand guarantees in the country. However, it does not address all aspects of demand guarantees, particularly the unique features that conflict with those of ordinary surety ship contracts. For example, the relationship between the guarantee and the original contract differs: in ordinary surety ship, the guarantee is entirely dependent on the original contract, including the defenses available under the surety ship provisions of the Civil Code.

Case 3. FSC Cassation File Number 47004¹²²

The case was between the applicant, Ethiopian Insurance Corporation, and the respondent, Bale Rural Development. The issue raised in the case concerned the specific law governing performance guarantees. The applicant filed a cassation application against the decisions of the Federal Supreme Court, alleging that performance guarantees should be regulated by the insurance provisions of the Commercial Code, and that the surety ship provisions of the Civil Code are inapplicable for resolving such matters.

¹²² Ethiopian Insurance Corporation v Bale Rural Development [2011] 13 Federal Supreme Court Cassation 47004

The Cassation Bench stated that neither the Commercial Code nor the Civil Code directly addresses bank guarantees; however, it suggested that the surety ship provisions of the Civil Code are applicable to demand guarantees. While considering the case, the Cassation Bench noted that there is no specific law in Ethiopia governing demand guarantees. It went further by consulting various references to gain a clearer understanding of the concept of performance guarantees and to identify the most appropriate governing law. Its findings indicate that a performance guarantee is a type of guarantee issued by a financial institution to secure the performance of a contractual obligation on behalf of the beneficiary. Moreover, it possesses more characteristics of surety ship than insurance and should therefore be governed by the law applicable to surety ship.

The court further stated that a performance guarantee is not an unconditional/demand guarantee, and therefore, proof of non-performance is essential to demand payment. However, this conclusion is fundamentally incorrect. As discussed in Chapter Two of this paper, a performance guarantee is one of several types of demand guarantees, and thus, it does not require proof of non-performance, which is a non-documentary requirement. The Cassation Bench treated the performance guarantee similarly to a joint guarantor under Article 1933 of the Civil Code. However, this conclusion is unsound, as we have established, demand guarantees including performance guarantees are fundamentally different from ordinary surety ship.

The court further stated that a performance guarantee is not an unconditional/demand guarantee, and therefore, proof of non-performance is essential to demand payment. However, this conclusion is fundamentally incorrect. As discussed in Chapter Two of this paper, a performance guarantee is one of several types of demand guarantees, and thus, it does not require proof of non-performance, which is a non-documentary requirement. The Cassation Bench treated the performance guarantee similarly to a joint guarantor under Article 1933 of the Civil Code. However, this conclusion is unsound, as we have established, demand guarantees—including performance guarantees—are fundamentally different from ordinary surety ship.

Case 4. FSC Cassation File Number 211616¹²³

The case was between the applicant, Buna Bank, and the respondent, Addis Ababa City Administration. The dispute concerned an advance payment guarantee and began at the Federal First Instance Court, where the respondent brought an action against the applicant, alleging that the latter should pay the amount under the advance payment guarantee bond. The facts of the case show that the court of first instance examined evidence to determine the value of the work performed under the contract and ruled that the remaining amount, which had not been spent, should be paid to the beneficiary.

However, this ruling contradicts the very nature of a demand guarantee. As we have repeatedly emphasized, no proof of performance or nonperformance is required to claim under a demand guarantee. Non documentary requirements, such as proof of nonperformance, are not necessary for a demand guarantee. In this regard, the court disregarded the fundamental principle of the documentary nature of demand guarantees. The lower court ultimately held that the issuer and the principal were jointly and severally liable to pay the advance payment amount. This decision clearly shows that the court treated the demand guarantee as if it were a general surety ship, despite the significant differences between the two. A demand guarantee is a unilateral undertaking by the bank; the principal is neither a party to the guarantee nor bears any obligation regarding the payment. The appellate court affirmed the lower court's decision.

Finally, the case was presented to the Federal Supreme Court Cassation Bench. While deciding the case, the bench stated that a demand guarantee, like ordinary surety ship, is accessory to the principal obligation and ceases to exist with the original obligation. However, this premise of the court is incorrect and directly contradicts the principle of independence of the demand guarantee, which presupposes the autonomy of the demand guarantee from the underlying contract.

¹²³ Buna Bank v Addis Ababa City Administration [2021] Fedreal Supreme Court Cassation 211616

Case 5. FSC Cassation File Number 98348¹²⁴

The case was between the applicant, Zeryihun Yenene (along with four others), and the respondent, Hawassa University. The dispute concerned a performance bond. The applicant had furnished a performance guarantee issued by Dashen Bank to secure a supply contract concluded with the respondent. However, due to poor performance, the respondent canceled the contract and demanded payment under the performance guarantee. The bank paid the guaranteed amount to the beneficiary despite the applicant's objections. Following this, the applicants filed a court action challenging the bank's payment and sought reimbursement. The High Court ruled that, pursuant to Article 1885 of the Civil Code, once the principal contract is canceled, the parties should be reinstated to their original positions, and any acts performed under the contract, including the performance guarantee, should cease to have effect.

The court treated the performance guarantee as if it were an ordinary guarantee. However, this approach is highly inappropriate, as it completely disregards the autonomy of a demand guarantee and its independence from the underlying contract. The invalidation or cancellation of the principal contract does not affect the enforceability of the guarantee. Furthermore, the Court of First Instance stated in its decision that a performance guarantee should be paid only after non-performance, its cause, and the resulting damage are proven, and that payment should be limited to the amount of damage incurred by the beneficiary due to the principal's failure. However, this reasoning does not hold water when examined in light of the fundamental principles of demand guarantees. Since a performance guarantee is a type of demand guarantee, it must be honored upon demand without the need to prove nonperformance, establish causation, or quantify the damage.

The case was finally presented before the Federal Supreme Court Cassation Bench. The Bench framed an issue: whether a performance guarantee should be paid in full or only to the extent of the damage incurred by the beneficiary. The Bench implicitly

¹²⁴Zeryihun Yenene (along with four others) V Hawassa University [2015] 19 Federal Supreme Court Cassation 98348

stated that proof of nonperformance by the obligor, along with evidence of the damage suffered by the beneficiary, constitutes a basic requirement for demanding payment under the performance guarantee.

By doing so, the court introduced a non documentary condition for enforcing a demand guarantee, which contradicts Article 7 of the URDG. This approach is inconsistent with the fundamental principle of demand guarantees namely, that payment must be made upon demand, regardless of whether nonperformance or actual damage to the beneficiary is proven.

Case 6. FSC Cassation File Number 156960¹²⁵

The case was between the applicant, Addis Ababa City Administration Housing Project and the respondents Kaleb Hiluf General Contractor and Abay Insurance.

The dispute concerned an advance payment guarantee. The applicant filed a cassation application challenging the decisions of the lower courts, alleging that the lower courts erred in holding that, in order to request payment, the beneficiary must prove fault on the part of the principal. In this particular case, the applicant, after terminating the principal contract with the contractor, promptly demanded payment under the advance payment guarantee.

However, the issuer refused to pay the guarantee, stating that the beneficiary had not shown good cause for the termination of the contract. The issuer further argued that the termination was not due to the contractor's fault, and therefore, the beneficiary had no valid claim under the guarantee.

As a result, the applicant initiated court proceedings. Surprisingly, the lower courts ruled against the applicant. In their decisions, the courts held that, in order to claim the advance payment guarantee, the beneficiary must demonstrate that the underlying contract was lawfully terminated. The courts also stated that the beneficiary must prove they fulfilled their contractual obligations and that the nonperformance was attributable to the principal. The Cassation Court affirmed the decisions of the lower courts for the same reasons.

¹²⁵ Addis Ababa City Administration Housing Project v Kaleb Hiluf General Contractor [2018] Federal Supreme Court Cassation 156960

This clearly reflects a violation of one of the fundamental principles of demand guarantees, the strict compliance rule or the documentary nature of such guarantees. According to this principle, it is sufficient for the beneficiary to demand payment by presenting the required documents stipulated in the guarantee. Non documentary requirements, such as proving a contractual breach, are not necessary and should not be imposed.

Federal High Court/FHC/ Lideta Division Cases

Case 7. File Number 276444¹²⁶

The case was between the plaintiff, Ethiopian Roads Administration, the defendant, Abay Bank, and the third-party intervener, Tekle Birhan Ambaye Construction. In this case, the plaintiff filed a claim against the defendant for payment under an advance payment guarantee issued as security for a contract concluded between the plaintiff and the third party intervener, Tekle Birhan.

The defendant requested the intervention of the contractor, Tekle Birhan, as an indispensable party to the suit. The basis for this application was that the intervening party might present reasons why the guarantee should not be paid to the beneficiary.

However, the court rejected the application, stating that since the guarantee in question was an unconditional bank guarantee, there was no need for the intervention of the contractor. As the undertaking was a unilateral obligation on the part of the bank (the defendant), it had to be honored upon demand, without requiring the beneficiary to show any cause.

Both the defendant and the contractor, aggrieved by the court's decision, appealed to the Federal Supreme Court. After reviewing the case under file number 222051¹²⁷, the Federal Supreme Court affirmed the decision of the lower court.

This case demonstrates that the judges had a proper understanding of the nature of an unconditional bank guarantee, particularly the principle of payment on demand. The

¹²⁶ Ethiopian Roads Administration v Abay Bank [2021] Federal High Court Lideta Division 276444

¹²⁷ Abay Bank v Ethiopian Roads Authority [2022] Federal Supreme Court 222051

court emphasized that no reason or objection shall be accepted as grounds to refuse payment under an unconditional bank guarantee. This aligns with the fundamental rules governing demand guarantees.

Case 8. File Number 300998¹²⁸

The case was between the plaintiff, BEAEKA General Business PLC, and the defendant, Ethiopian Construction Works Corporation. The facts of the case indicate that the plaintiff, acting as a contractor, and the defendant, acting as the employer, entered into a construction contract. Nib International Bank issued an advance payment guarantee in favor of the employer /the defendant/. Meanwhile, due to poor performance, the contract was terminated, and the contractor (the plaintiff) filed a lawsuit against the employer based on the principal contract. On the other hand, the defendant, as the beneficiary, made a demand for payment under the advance payment guarantee.

However, the contractor (plaintiff) filed an objection against the demand made by the beneficiary and requested that an injunction be issued to prevent the payment. The court, after accepting the application, ordered the guarantor to withhold payment. It reasoned that paying the advance bond to the beneficiary before the dispute regarding the principal contract is finally resolved would detrimentally affect the interests of the plaintiff.

In justifying its decision, the court raised arguments that are irrelevant to the case. For instance, it stated that if the guarantor pays the bond to the beneficiary, it would seek recourse against the principal for reimbursement based on their contractual relationship. However, the relationship between the guarantor and the principal is not at issue here.

Furthermore, the mere existence of a pending dispute regarding the principal contract cannot be a valid ground to restrain payment under a demand guarantee. By doing so,

¹²⁸BEAEKA General Business PLC v Ethiopian Construction Works Corporation [2024] Federal High Court Lideta Division 30089

the court violated the independence principle of demand guarantees—namely, that a demand guarantee operates independently of disputes arising from the principal contract and is not affected by the relationship between the guarantor and the principal. Therefore, this decision clearly contradicts the fundamental purpose of a demand guarantee.

The defendant appealed to the Federal Supreme Court; however, under file number 255221¹²⁹, the court affirmed the decision of the Federal High Court. Subsequently, an application was brought before the Federal Supreme Court Cassation bench. Nevertheless, under file number 266490¹³⁰, the bench rejected the application, stating that no fundamental error of law had been committed.

This case clearly demonstrates inconsistencies in the courts' decisions regarding demand guarantees. The issue in this case was almost identical to that presented in case number 7. However, the courts rendered different decisions. In case number 7, the court explicitly emphasized the independent nature of the demand guarantee and ruled that payment under a demand guarantee is to be made on demand regardless of any disputes concerning the principal contract. Conversely, in the current case, the court issued a contradictory decision, disregarding the principle of autonomy of the demand guarantee.

Case 9. File Number 285053¹³¹

The case was between the plaintiff, Ethiopian Road Authority (ERA), the defendant, Enat Bank S.C. and the third-party intervener, ORCHID Business Group PLC. The dispute concerned an advance payment guarantee.

¹²⁹ Ethiopian Construction Works Corporation v BEAEKA General Business PLC.[2024] Federal Supreme Court 255221

¹³⁰ Ethiopian Construction Works Corporation v BEAEKA General Business PLC.[2024] Federal Supreme Court Cassation 266490

¹³¹ Ethiopian Road Authority (ERA) v Enat Bank S.C [2025] Federal High Court Lideta Division 285053

The facts of the case show that the plaintiff and the third-party intervener, ORCHID PLC, entered into a contract for road construction. According to the contract, the plaintiff was to make an advance payment once the contractor furnished an unconditional advance payment bank guarantee. Accordingly, the contractor instructed the defendant, Enat Bank, to issue the guarantee, and the bank complied by issuing the advance payment guarantee.

Subsequently, the plaintiff (employer) terminated the principal contract due to poor progress in the work and immediately demanded payment under the advance payment guarantee. The bank (defendant) refused to pay the beneficiary (plaintiff), prompting the plaintiff to bring the case to court. During the proceedings, the defendant requested the joinder of the contractor, since the advance payment guarantee was issued in connection with the contract between the contractor and the plaintiff. The court accepted this request and ordered the contractor to join the proceedings.

The court then conducted a full trial, examining documentary evidence and hearing witnesses to determine the grounds for the cancellation of the original contract. It also ordered a physical measurement of the work completed and an assessment of the amount of money that had not been spent. The court took nearly three years to reach a decision on the demand guarantee.

This case reveals a serious violation of the fundamental principles of demand guarantees, undermining the very purpose that demand guarantees are intended to serve. As discussed in Chapter Two, a demand guarantee functions as liquid cash, allowing the beneficiary to finance a project without being entangled in lengthy court proceedings and mitigating the risks associated with nonperformance.

Moreover, the court is supposed to examine the demand solely on its face and render a prompt decision. However, in this case, the court undertook proceedings that are inconsistent with the nature of demand guarantees. For example, the examination of documents and witnesses concerning issues related to the principal contract directly contradicts the principle of independence inherent in demand guarantees. Similarly, scrutinizing evidence to determine the actual work completed on the ground and to assess the extent of nonperformance goes against the documentary nature of demand guarantees.

Case 10. File Number 315071¹³²

The case was between the plaintiff, Akal Construction PLC, and the defendant, Ethiopian Construction Works Corporation. The dispute arose from a subcontract agreement concluded between the defendant and the plaintiff. The plaintiff, as subcontractor, brought a court action claiming compensation from the defendant, alleging that it had sustained damages due to the defendant's fault.

While the dispute regarding the main contract was still pending, the defendant called for payment under the advance payment guarantee issued by Oromiya Bank on behalf of the defendant. However, the plaintiff applied to the court for an injunction order to restrain payment under the guarantee. The court accepted the plaintiff's application and issued an injunction against the advance payment guarantee, reasoning that it would be inappropriate to pay the beneficiary before the dispute concerning the main contract was finally resolved. However, this decision violates the principle of independence of demand guarantees, which holds that the demand is not affected by disputes arising from the underlying contract.

Chapter Five

Conclusion And Recommendation

5.1. Conclusion

Demand guarantee, widely used type of bank payment undertaking can be described as a unilateral undertaking by the bank to pay a beneficiary an amount of money specified in the guarantee instrument on demand, regardless of facts extraneous to the undertaking.

Even though demand guarantee is one form of security mechanism, it is significantly differs from ordinary types of guarantee. Independence/ autonomy and documentary nature of demand guarantee marks the basis for the difference.

¹³² Akal Construction PLC v Ethiopian Construction Works Corporation [2024]
Federa High Court Lideta Division 315071

Independence/autonomy principle implies the separation of demand guarantee from the underlying contract. As such, the guarantee is not affected by the principal-beneficiary and beneficiary- issuer relationships. The bank is obligated to pay the beneficiary irrespective of disputes regarding the underlying contract and the principal is not entitled to object to payment based on his relationship with the issuer.

The documentary nature of demand guarantee excludes non documentary requirements; the beneficiary is not expected to establish nonperformance or occurrence of damage. Mere indication of facts constituting contractual breach is sufficient and the bank pay as soon as a demand supported by documents stipulated in the guarantee instrument is presented by the beneficiary. Since demand guarantee is primarily designed to protect the interest of the beneficiary, it is highly likely that the beneficiary may take undue advantage and demand payment to the detriment of the principal. Hence to avoid such circumstances and strike balance between the interest of the beneficiary and principal and to ensure proper functioning of demand guarantee at large certain limitations are imposed on demand guarantee. This limitations restricts the beneficiary's right to get paid on demand, and set asides principles of autonomy and documentary nature of demand guarantee. Widely accepted limitations include, non complying demand, illegality, fraud and lack of good faith. Hence the bank based on such grounds may refuse payment, the principal may object the payment and seek court intervention and apart from these exceptions it is completely inappropriate for the bank, principal or the court to interfere with demand guarantee.

Despite its recent introduction, there are well established international legal instruments governing demand guarantee. The UN Convention on Demand Guarantee and Stand by Letter of Credit, a pioneering instrument lays the foundations for basic principles of demand guarantee. This Convention does not deal with every aspects of demand guarantee, due to this an additional international legal instrument was developed by the UNCITRAL, Uniform Rules on Demand guarantee/URDG/. This instrument almost dealt with detailed matters, including peculiar features, formation requirements and exceptions to demand guarantee. Looking from the domestic perspective, there is no explicit legislation or case law governing every aspects of demand guarantee in Ethiopia. As a result courts in Ethiopia refer to the civil code

provisions of surety ship to adjudicate cases involving demand guarantee, even though the provisions hardly address distinctive features demand guarantee. The case law, decisions of the federal supreme court cassation bench do not address issues of demand guarantee in a sufficient manner.

Examining the cases of Federal Supreme Court Cassation decisions, the lower Courts decision briefed in the cassation decision and the Federal High Court Lideta bench reveals existence of various gaps in the judicial practice towards demand guarantee. The basic gaps identified from the case analysis include wrong classification of demand guarantee as surety ship. Misunderstanding the peculiar features and purposes of demand guarantee, in many of the cases it is clearly examined that courts fail to give emphasis for autonomy and documentary nature of demand guarantee. In most of the cases Courts state demand guarantee is secondary to the underlying contract and its fate is highly affected by the original contract. Courts frequently render an injunction order against demand guarantee for the only reason dispute between principal and beneficiary/ based on the underlying contract/ is pending. The court usually invites the principal to take part in disputes arising between the bank/ issuer and the beneficiary regarding enforcement of payment, even though the principal was not supposed to be a party, as demand guarantee is only the concern of the bank and the issuer. Moreover courts are observed imposing non documentary requirements for demand guarantee. Cases show courts require presentation of evidences, including expert witness, to establish nonperformance, the causes for nonperformance and extent of damage occurred due to the nonperformance. Demand guarantee is intended to help the beneficiary immediately get the money and save him against inconveniences attributed to lengthy court proceedings. However the cases reveal that the very purpose of demand guarantee is dis regarded by the judiciary, courts conduct full trial and render decision after a long proceeding. By the time of decision, the beneficiary may sustain damage that can even exceed an amount covered by the demand guarantee, that could have been averted if the demand guarantee is paid at earliest possible time.

Case analysis shows the inconsistencies of the decisions rendered by various courts on cases involving similar issues. In some cases the court seems recognizing the distinctive features of demand guarantee, it rejected applications for injunction of

demand guarantee, which are not based on valid grounds. Despite this, court in other cases accept injunction application even though they are not based on valid grounds.

5.2. Recommendations

The case analysis gives as a clear understanding about misconceptions of the court towards demand guarantee particularly the autonomy and documentary nature of demand guarantee. It also reveals the uncertainties and inconsistencies in the judicial practice. The findings further show the judiciary unnecessarily intervenes in demand guarantee cases, regardless of existence of exceptions justifying intervention.

Hence, based on such findings this research recommends the following;-

- The researcher believes most of problems observed in the judicial practice with respect to demand guarantee case are amenable to lack of well framed domestic legal frame work governing demand guarantee. The inconsistencies, uncertainties and confusions are largely due to absence of a clear law that guide the judiciary in adjudicating such matters. Hence it is primarily recommended that comprehensive legal frame work, governing every aspects of demand guarantee; including its distinctive features, exceptions, rules for judicial intervention shall be enacted.
- It is a judicial notice that interpretations of Federal Supreme Court Cassation bench are binding on lower Courts. How ever the decisions of the Cassation bench towards demand guarantee are very vague and added to the confusion, the decisions hardly encompass special features of demand guarantee, exceptions and the limited role of courts in demand guarantee cases. The fact that cases involving demand guarantee are missing in the recently published volumes of the cassation decision implies the court assumes its previous interpretations sufficiently addressed every aspects of demand guarantee and so that no further interpretation is needed. However this is not the case, and I recommend the Federal Supreme Court Cassation bench shall give comprehensive legal interpretation which fully address fundamental issues pertaining to demand guarantee and publicize it.
- The gaps in the judicial practice may also be attributed to lack of awareness by the judiciary. Demand guarantee cases are relatively unfamiliar for the judiciary, specially judges not assigned on trade, banking, insurance and construction benches may not have exposure to such cases. Hence it is recommended that an

awareness has to be created to the judiciary through training or other mechanisms so that they understand basic features and legal principles of demand guarantee.

- I recommend including a reference in the undertaking/ guarantee instrument/ towards application of the the rules under international legal instruments such as the URDG. This would support proper functioning of demand guarantee as the rules referred under the undertaking may provide clear guidance for the judiciary and avoid confusions and unnecessary judicial interventions.
- Finally, it is recommended that Ethiopia accede to the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit. Accession would provide a coherent and internationally recognized legal framework for the regulation and enforcement of demand guarantees, thereby address the practical problems created by the absence of comprehensive domestic legal framework.

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