

## **SECURING OBLIGATIONS OF A TRADE ASSOCIATION**

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### **Abstract in original language**

Příspěvek pojednává o možnostech zajištění závazků sdružení zřízeného dle § 829 an. zákona č. 40/1964 Sb., občanský zákoník, ve znění pozdějších předpisů. Sdružení dle § 829 an. občanského zákoníku nemá vlastní právní subjektivitu. Přesto se jedná o hojně používanou formu spolupráce v případě realizace rozsáhlých a odborně vysoce specializovaných veřejných zakázek. Nabízí se proto otázka, jak zajistit splnění závazků sdružení vůči zadavateli veřejné zakázky navenek a jak upravit vztahy mezi členy navzájem uvnitř sdružení. Příspěvek se bude věnovat možnostem zajištění závazků sdružení bez právní subjektivity vůči třetímu subjektu (zadavateli veřejné zakázky). V tomto ohledu budou rozebrány jednotlivé bankovní záruky, zejména bankovní záruka sdílená nebo dílčí bankovní záruky jednotlivých členů sdružení, jejich výhody, nevýhody a rizika pro členy sdružení i zadavatele veřejné zakázky. Druhá část příspěvku bude věnována možnostem omezení odpovědnosti či zajištění jednotlivých členů sdružení pro případ, kdy by k uplatnění práva z bankovní záruky došlo převážně jednáním jednoho z členů sdružení. Jako vhodné zajišťovací instituty se jeví dílčí bankovní protizáruky zajišťující bankovní záruku sdílenou, ručení členů sdružení, případně vystavení směnky.

### **Key words in original language**

Sdružení; zajištění závazku; veřejná zakázka; bankovní záruka; záruka; právo rozhodné.

### **Abstract**

The conference paper surveys possible ways how to secure an obligation of a trade association established under Section 829 of Act No. 40/1964 Coll., Civil Code. Although, the trade association under Section 829 is not regarded as a legal entity, it is a widely used form of business cooperation, especially in complex and technologically sophisticated public procurements. It is therefore of an utmost importance to secure the fulfillment of obligations towards a public authority, as well as in-between the members of the association. First part of the paper will discuss the issue how to secure an obligation towards third entity (public authority). In this regard, the paper will focus on collaterals (bank guarantees), either shared or separate, discussing advantages and disadvantages for the members of the association and for the public authority itself. Second part of the paper will discuss the issue how to limit the liability of members, if the collateral was drawn by the public authority due to the prevailing fault of one member of

the association. In this case, partial reverse collateral, contractual guarantee or bill of exchange may be regarded as suitable instruments.

**Key words**

Trade association; securing obligation; public procurement; collateral; guarantee; applicable law.

**INTRODUCTION**

Tenders are considered to be an effective tool for obtaining best priced and best quality services or goods. Tender enables a principal to choose from the best bid; i.e. that best suits the needs and requirements of the principal. The needs and requirements are basically projected to tender conditions, which may be as complex as the subject of the tender itself. Generally, subject of the tender may vary both in an extent and complexity. The more complex and extensive work should be carried out, the more challenging conditions are placed on tender applicants. Therefore, it may be the case when entrepreneurs must join forces and cooperate by submitting a single tender bid.

There are numerous ways how such cooperation might be based upon. Basically, there are two poles. One stands for a general contractor who submits the bid as a single entity, but some part of goods are delivered or works and service are partially provided by a third party – a subcontractor. From the perspective of the principal, the overall liability is on general contractor who is responsible for actions of its subcontractors (*culpa in eligendo*). However, for various reasons, the principal may ban the use of subcontractors.

Second pole is for prospective bidders to create a separate legal entity which is subsequently provided with necessary assets, permits, licenses etc. to fulfill the conditions of a particular tender. Czech law offers various types of business companies, as well as a special association of artificial persons<sup>1</sup> (including business companies) which may be suitable for this purpose. However, creating such an artificial body requires certain amount of assets, administrative effort, and last but not least sufficient time.

As a third option, we may recognize a simple contract based association to be formed by the perspective bidders. Internationally, this solution resembles joint ventures, more specifically so called strategic alliance. However, strategic alliance is a more sophisticated form of cooperation with

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<sup>1</sup> See Section 20f et seq. of Act No. 40/1964 Coll., Civil Code (hereinafter “Civil Code”).

the foreign partner.<sup>2</sup> A strategic alliance is a formal relationship between two or more parties to pursue a set of agreed upon goals or to meet a critical business need while remaining independent organizations.<sup>3</sup> These are often called as “contractual joint ventures”. In contrast to the joint ventures, the partners do not create a separate and independent legal entity. This is also the case regarding association under Czech law, which will be surveyed in the second part of this contribution.

Plurality of subjects working jointly during the realization of the public tender, and missing legal personality of the association (and thus the absence of only one responsible contracting party) gives rise to the issue of securities for the duly and timely performance of the contractual duties, which will be surveyed in third and fourth part of the contribution.

Final part will briefly describe some issues of conflicting national laws in cases where the relationship includes foreign elements.

#### **ASSOCIATION ACCORDING TO THE SECTION 829 OF THE CIVIL CODE**

Association under 829 of the Civil Code may pursue various, even non-economic, activities. Informality and freedom of contract are considered to be its main advantages. On the other hand, by contracting for this type of cooperation, contracting partners cannot create an independent legal entity.<sup>4</sup>

Civil Code does require a simple condition to form a contract of association - parties must set a common goal which should be achieved. Civil Code offers few provisions that regulate both the internal and external relationships of contracting parties; however, it is presumed that more detailed provisions shall be negotiated by the entrepreneurs themselves. In this regard statutory provisions form the basic level of regulation that is set as mandatory. Moreover, as this is a purely contractual cooperation, general provisions on contract law shall also apply.

The form for creation of this type of association is not set; it may be concluded even orally. Time horizon for cooperation is not limited either; it may be a short term for a specific goal or as well an unlimited time period for a continuous cooperation. Number of contracting parties is not limited but of course a contract of association requires at least two subjects. Origins of parties are not regulated; it may be domestic, as well as foreign entity, either natural or artificial person.

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<sup>2</sup> Chlebcová, R.: The Movement Of Legal Entities: Joint Ventures. In: Dávid R., Neckář J., Sehnálek D., (Editors). COFOLA 2009: the Conference Proceedings.

<sup>3</sup> Wikipedia: Strategic Alliance, [cited 22. 5. 2008]. Available at: [http://en.wikipedia.org/wiki/Strategic\\_alliance](http://en.wikipedia.org/wiki/Strategic_alliance)

<sup>4</sup> For that cause, a similar association may be considered. Under Section 20f et seq. of the Civil Code, artificial persons can constitute an interest association.

However, restrictions arising out of various public law provisions must be considered when a foreign entity enters into this kind of contract.<sup>5</sup> Certain aspects regarding the regulations of trade activities must be mainly stressed. As was stated earlier, the association is not a separate legal entity; it is a mere cooperation of entrepreneurs on a contractual basis. This means that if statutes require specific trade licenses or certificates, they must be obtained by contracting parties themselves.

Contracting parties pledge to work in mutual cooperation to achieve a common goal set in the contract of association. They are obliged to make all efforts to achieve the goal – the internal responsibility is not therefore for outcome, but for the effort itself. Similarly, contracting parties are contractually prevented from taking any action that may interfere or contravene marked goals.

Moreover, contracting parties may be bound to provide specific tangible or intangible assets. If that is the case, than financial or generic assets become a joint property of all contracting parties; individually designated items become free for use by any contracting party.

Any assets that are gained by the activity of the association will also become a joint property of all contracting parties; the ratio depends on each of parties' proportional share.

Regarding decision making, the basic rule, which may be modified, requires a unilateral decision of all contracting parties. If contract of association modifies the default rule and sets majority vote principle, than no matter what the partner's shares are, each contracting party has one vote only.

The way the association deals with third parties should be regulated primarily in the contract of association, too. There are basically three main ways:

- Each contracting partner is acting by himself as an attorney acting on the behalf of all contracting parties;
- One of contracting parties (leading associate) is entitled to act as an attorney on the behalf of all contracting parties.
- Contracting parties are entitled to act only by their mutual consent.

However, if contracting party acts by itself, with no clear reference to the association, such acts are accountable to this party alone. On the other hand, if one contracting party uses a designation of, or a reference to its

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<sup>5</sup> An example may be made regarding the purchase of immovable properties, where several restrictions are imposed on foreigners.

association,<sup>6</sup> it is presumed it acted on the behalf of this association and all contracting parties must bear joint liability.

Finally, as was stated at the beginning of this part, any obligation forms a joint liability of all contracting parties. This means that an obligee is entitled to pursue the claim against any of liable parties in full amount. However, if the contract of association does not provide otherwise, each contracting party is, internally, liable for equal share. This implies if the obligee requires higher payment (even full payment) against one of such contracting parties, this party is required to inform other parties and allow them to carry their portion of liability. However, in case other parties are not willing to do so, and the obligor is made to pay, he than steps into obligee shoes and is entitled to the compensation against other associated parties (statutory subrogation of the rights). This liability scheme cannot be derived from by the agreement of the parties; however, it is advisable to provide more detailed procedures how the parties should proceed against raised claims and subsequently how the parties should deal with the subrogation.

To summarize, basic advantages and disadvantages of the association may:<sup>7</sup>

Business and capital power may be pooled relatively easily and swiftly, without the necessity to register a separate company.

Entrepreneurs may associate for a single cause, limited period of time or set goals.

No minimal membership contribution is required.

Each contracting partner is liable for the obligations of the association by its whole company assets; the liability last even if the association is terminated.

Each contracting partner is responsible for the obligations of other contracting partners.

As the association has no legal personality, one or more contracting partners must act on the behalf of others.

If at least one contracting partner is a VAT payer, other partners should register for VAT.

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<sup>6</sup> Section 835 of Civil Code and Section 10 of Commercial Code.

<sup>7</sup> Available at <http://business.center.cz/business/pravo/formypodn/sdruzeni-fo/shrnuti.asp>, accessed on 28. 5. 2010.

## **SECURITIES OVERVIEW – POSSIBILITIES OF ENSURING THE PERFORMANCE OBLIGATIONS**

Taking regard to the specific nature of the association, especially to the fact that it is an alliance without legal personality, it might be difficult to ensure efficiently the duly performance of the obligations. Because of the missing legal personality, association itself cannot be a party of any suretyship guarantee agreement, parent company guarantee or bank guarantees. The members of the association could certainly agree to provide separate securities for the respective parts of work they are obliged to perform, but this solution appears to be extremely disadvantageous for the public tender authority. In such case, the public tender authority would be obliged to prove who broke its duties which might be abnormal difficult if not impossible.

The next section of the paper deals firstly with kinds of securities which might be suitable to ensure the obligation of Association and then examines the ways how the security can be established – using the example of bank guarantee.

### *Suretyship guarantee:*

The suretyship guarantee is accessory to the underlying contract<sup>8</sup>. This means on one hand that the beneficiary must establish default by the principal before he can demand, from the guarantor payment or performance<sup>9</sup> of the obligation which had not been performed by the principal. On the other hand, the accessory character of the suretyship guarantee enables the guarantor to invoke all defenses which the principal debtor can raise against the beneficiary in accordance with the underlying contract<sup>10</sup>. Therefore, if default is established, the guarantor becomes liable for the amount of the loss suffered as a result of the principal's default, within a maximum amount stated in the guarantee, but subject to any defenses available to the principal.

### *Parent company guarantees:*

The parent company guarantees is special kind of suretyship guarantee which is provided by the parent company on behalf of the daughter company. Guarantor (parent company) guaranties in this case a contractor (daughter Company) shall duly perform all its obligations contained in the

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<sup>8</sup> Hökl, G.S.: Zur Absicherung der Verpflichtungen aus einem FIDIC-Bauvertrag durch Bankgarantien und Bürgschaften in der internationalen Praxis. In: ZfBR 2003, p. 527 et seq.

<sup>9</sup> Option of performing the obligation can be exercised by the guarantor only if it is specifically permitted in the form of a bond.

<sup>10</sup> Bunn, N. G.: The FIDIC Forms of Contract, Great Britain: Blackwell Publishing, 2005, third edition, p. 269 et seq., ISBN: 13: 978-14051-2031-9.

contract. In case of any failure of any of its obligations under the contract, the parent undertakes, on written notice by beneficiary, to perform or to take whatever steps may be necessary to achieve performance of said obligations under the Contract. The guarantor shall be also responsible for any loss, damages, claims, costs and expenses which are incurred by beneficiary by reason of any such failure or breach on the part of the daughter company but only to the extent that such losses, damages, claims, cost and expenses are recoverable under the contract.<sup>11</sup>

This kind of guarantees is used quite often to ensure the obligation of SPV<sup>12</sup> (single purpose vehicles - companies established for the ultimate purpose of executing one single project and being liquidated afterwards).

*Bank guarantees:*

A contracting party who wishes to have security that the other contracting party will perform its contractual obligations can ask to provide a bank guarantee<sup>13</sup>. Bank guarantee is a written undertaking by a guarantor, usually a bank, to pay the beneficiary up to the maximum sum quoted on the guarantee upon presentation of written demand<sup>14</sup>, presumed the principal failed to perform its obligations under the contract. In such way the beneficiary may recover some or all of his loss and/or may make and pay for alternative arrangements to complete the work in question.<sup>15</sup>

Despite the fact that these guarantees are intended to apply only if the principal fails to perform the obligations in the underlying contract<sup>16</sup>, in which case the beneficiary can call on the guarantee, the Bank guarantees are independent from the underlying contract<sup>17</sup>. This means that the

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<sup>11</sup> General Principles for the Use of Parent Company Guarantees and Performance Bonds, Available at: [http://www.logic-oil.com/PCGs\\_and\\_PBs\\_Aug07.pdf](http://www.logic-oil.com/PCGs_and_PBs_Aug07.pdf) , accessed on 25. 8. 2009.

<sup>12</sup> Chlebcová, R.: The Movement Of Legal Entities: Joint Ventures. In: Dávid R., Neckář J., Sehnálek D., (Editors). COFOLA 2009: the Conference Proceedings, 1. edition. Brno : Masaryk University, 2009, ISBN 978-80-210-4821-8.

<sup>13</sup> Note the ICC Uniform Rules fo Demand Guarantees (ICC No. 458) which are widely accepted and used all around the world. Another ICC Uniform Rules regarding the Ban guarantees: ICC Uniform Rules for Contract Guarantess (ICC No. 325) and ICC Uniform Rules for Contract Bonds (ICC No.524). Compare Hökl, G.S.: Zur Absicherung der Verpflichtungen aus einem FIDIC-Bauvertrag durch Bankgarantien und Bürgschaften in der internationalen Praxis. In: ZfBR 2003, p. 527 et seq.

<sup>14</sup> SITPRO Simplifying International Trade, Trading Advice, Demand Guarantees, available at: <http://www.sitpro.org.uk/trade/demandguar.html> , accessed on 25. 5. 2010.

<sup>15</sup> General Principles for the Use of Parent Company Guarantees and Performance Bonds, Available at: [http://www.logic-oil.com/PCGs\\_and\\_PBs\\_Aug07.pdf](http://www.logic-oil.com/PCGs_and_PBs_Aug07.pdf) , accessed on 25. 8. 2009.

<sup>16</sup> The bank guarantee is in this respect dependent on the underlying contract.

<sup>17</sup> Bunni, N. G.: The FIDIC Forms of Contract, Great Britain: Blackwell Publishing, 2005, third edition, 269 et seq., ISBN: 13: 978-14051-2031-9.

obligations and liability of the guarantor are solely defined by the terms and conditions mentioned in the guarantee without the necessity of proving default or the defenses which the principal could raise<sup>18</sup>.

*Types of bank guarantees:*

There are a number of varieties of this form of guarantee. The main distinctive feature is whether or not the beneficiary is required to present any documentation with his demand, and which kinds of documents or proves may be required<sup>19</sup> by the bank.

Based upon the necessity to provide any documentation or to prove the failure of the contract we may distinguish between “conditional” and “on demand”<sup>20</sup> guarantee.<sup>21</sup> Whereas in case of the “on demand” guarantee, the beneficiary has only to announce to the bank the breach of contract and the failure to fulfill the contractual obligation in order to request the payment, in case of conditional guarantee the beneficiary must fulfill additional requirements contained in the guarantee. This might be e.g. requirement to provide the bank with documents proving the actual breach of contract, written notice to the principal containing a call appeal to fulfill the contractual duties, judicial or arbitration award etc.

Despite the fact the conditional guarantees are able to minimize the risk of intentional abuse of guarantee when the guarantee is called without the principal being in default, they are not as common as on demand guarantees. The banks are usually not willing to take over the responsibility for examining the reasonableness of claiming bank guarantee by the beneficiary and to assume the risk of paying the requested amount without good reason. In case of the conditional guarantee it is upon the bank to decide whether the documents provided as prove of the failure are correct, sound and sufficient. As this is quite difficult and dangerous judgment, the banks are logically resistant to accept such a responsibility.

Another possible distinction is between direct and indirect guarantees. This distinction is based upon the number of banks involved in the bank

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<sup>18</sup> As opposed to the suretyship guarantees, bank guarantees are direct charges on the balance sheets of contractors and suppliers, thus affecting their liquidity and banking covenants. General Principles for the Use of Parent Company Guarantees and Performance Bonds, Available at: [http://www.logic-oil.com/PCGs\\_and\\_PBs\\_Aug07.pdf](http://www.logic-oil.com/PCGs_and_PBs_Aug07.pdf), accessed on 25. 8. 2009.

<sup>19</sup> For example, the guarantee may simply be payable on first written demand, or it may be that the demand be accompanied by a statement that a default has occurred, or it may further require that the default be identified.

<sup>20</sup> SITPRO Simplifying International Trade, Trading Advice, Demand Guarantees, available at: <http://www.sitpro.org.uk/trade/demandguar.html>, accessed on 25. 5. 2010.

<sup>21</sup> Bunn, N. G.: *The FIDIC Forms of Contract*, Great Britain: Blackwell Publishing, 2005, third edition, p. 269 et seq., ISBN: 13: 978-14051-2031-9.



guarantee. A direct guarantee is provided by the principal's bank directly to the beneficiary. The principal must provide the bank either with sufficient funds, or an indemnity, or other form of security, against the cost of meeting the beneficiary's claim. In this scenario, there are three distinct contracts: The underlying contract between the principal and the beneficiary (e.g. purchase contract), the counter-indemnity (reimbursement contract) between the principal and the bank and the guarantee between the principal's bank and the beneficiary.<sup>22</sup>

An indirect guarantee is provided by the beneficiary's bank or the bank in the beneficiary's country. In this case, the principal's bank will provide a counter-guarantee to the local bank. The principal has must provide the bank either with sufficient funds, or an indemnity, or other form of security, against the cost of meeting the beneficiary's claim. Hence, there are four distinct contracts: The underlying contract between the principal and the beneficiary (e.g. purchase contract), the counter-indemnity (reimbursement contract) between the principal, the counter-guarantee between the principal's bank and the bank in the beneficiary's country and the bank and the guarantee between the principal's bank and the beneficiary.<sup>23</sup>

Bank guarantees are commonly used in Public tenders for works or construction to ensure obligations to pay customs or taxes, not to withdraw from a tender after the tender closing date, to perform properly contractual obligations, to ensure the performance in case of advance payment or to ensure the performance of the warranty. Therefore, we may differentiate between following kinds of bank guarantees<sup>24</sup>:

Customs, tax and/or similar guarantee: These securities are issued to guarantee the payment of import duties, excise and related taxes in accordance with the legal requirements governing the entry of goods into a country.

*Contract<sup>25</sup> or Performance guarantee:*

These bonds secure due performance of a contract. The main categories of such bonds are bid, performance, payment and advance payment bonds.

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<sup>22</sup> SITPRO Simplifying International Trade, Trading Advice, Demand Guarantees, available at: <http://www.sitpro.org.uk/trade/demandguar.html> , accessed on 25. 5. 2010.

<sup>23</sup> SITPRO Simplifying International Trade, Trading Advice, Demand Guarantees, available at: <http://www.sitpro.org.uk/trade/demandguar.html> , accessed on 25. 5. 2010.

<sup>24</sup> Bunni, N. G.: *The FIDIC Forms of Contract*, Great Britain: Blackwell Publishing, 2005, third edition, 269 et seq., ISBN: 13: 978-14051-2031-9 and SITPRO Simplifying International Trade, Trading Advice, Demand Guarantees, available at: <http://www.sitpro.org.uk/trade/demandguar.html> , accessed on 25. 5. 2010.

<sup>25</sup> Hökl, G.S.: *Zur Absicherung der Verpflichtungen aus einem FIDIC-Bauvertrag durch Bankgarantien und Bürgschaften in der internationalen Praxis*. In: *ZfBR* 2003, s. 527 et seq.

Performance guarantee protects beneficiary against non-performance, or failure to properly execute and complete the contract involving the proper performance in respect of each and every obligation in accordance with the terms of that contract.<sup>26</sup>

**Tender or Bid guarantee:** This guarantee safeguards the party inviting to the tenders against the withdrawal from these after the tender closing date or the non-signing of the contract by the successful tenderer. It is also provided to safeguard against the successful tenderer signing the contract but not providing the agreed performance guarantee.

*Advance Payment Guarantee:*

Safeguards the beneficiary against an advance payment and the principal subsequently failing to perform the contract. An advance payment would have to be returned by deductions from monies that would become due at a later stage or in accordance with a schedule of repayments. Any default in the agreed program for repayments would have to be safeguarded by the issue of such payment guarantees.

**Warranty Guarantee** safeguards the beneficiary against the non-performance of the warranty by the principal and protects against defective materials and workmanship arising during the defect liability period of the contract.

Assurance of public tender's obligations by Performance guarantee in case the contracting party is Association according to the § 829 of the Civil Code

After providing a brief overview of the most common securities used in public tenders to ensure the obligation of the contractor, let us scrutinize closer the bank guarantee (performance guarantee) and the ways how the performance guarantee might be established to fulfill the requirements and needs of both contracting parties – public tender authority and the members of the association.

Public tender authority is usually either state authority or international company with much stronger market position than the members of association. Performance guarantee (especially on demand guarantee) provides an excellent means of securing the obligations of the contracting party under the contract. The public authority bears in such case no burden of proving the real breach of contract - it must only announce the bank of their claim. The public authority is not interested in losing this advantage only because there are more subjects (members of an association) performing the works. Therefore, the question might arise how the

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<sup>26</sup> This may be interpreted to mean that the beneficiary is covered for latent defects in the works during the period of validity of the bond and, hence, careful consideration should be given to the date of release of the bond and whether it should extend beyond the date of the defects liability period.

performance guarantee should be hand-tailored in order to meet the requirements and expectations of the public authority on one hand and to respect the internal relationships between the members of an association on the other.

Considering this issue we should bear in mind that:

The association has no legal personality, and therefore it might be difficult to organize one joint performance guarantee for the obligations of the association as whole,

The members are jointly and undistinguishable liable for the obligations of association towards third parties<sup>27</sup> (one for all, all for one). The public tender authority may also claim the performance or damage from every member of the association disregarding their task distribution in the performance of the work,

The members of an association regulate the responsibility against each other in the association agreement (regress claim against each other which may be based upon the culpability).

We can distinguish three models how the performance guarantee might be tailored:

Each of the association members bears liability for and ensures the performance of the respective part of work he is responsible for, in conformity with the scope of work.

In this situation, each of the association members shall negotiate performance guarantee regarding its own part of work. Such partial guarantee shall safeguard the duly performance of the part of performance in question up to the amount of this part of work. The public tender authority will be provided with partial separate guarantees which in total sum equal to the required amount of guarantee.

Disadvantage for the public tender authority: As the association members are jointly and undistinguishable liable towards third parties, the public tender authority should in no case be forced to investigate which member is actually in breach of the contractual obligations. The mere fact that any contractual obligation was broken should constitute the right to claim the performance guarantee. However, as the performance guarantees are separate from each other and each of them secures only the breach of the specific member of association, the public authority might be forced to investigate which member broke its duties. Otherwise, the bank could refuse the payment under the guarantee. Therefore, despite the fact that the

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<sup>27</sup> Compare Section 835, paragraph 2 Civil Code.

members of the association agreement are jointly and undistinguishable liable for the obligations of association, the public tender authority might get into the troubles claiming the rights from performance guarantee.

Advantage for the association members reflects the disadvantage for the public tender authority. As far as the performance guarantee is concerned, the joint liability of association members might turn out to be unenforceable and the member of the association might be liable only if he failed to perform any of its own contractual obligations.

Disadvantage for the association members: The member of association cannot be sure that the bank will consider the performance guarantee inapplicable in case another member of the association broke his contractual duties. Therefore, the respective member might be “fined” for mistake of another member.

All in all, the separate performance guarantee constitutes legal unpredictability and uncertainty in issues of liability for both, the public tender authority and the members of association.

One member of the association will ensure the performance guarantee for the obligations of the whole association in total sum equal to the amount of guarantee required by the public tender authority.

Choosing this possibility, one of the members of the association will negotiate with its bank the performance guarantee on behalf of the whole association. The members of the association should regulate this option in the association agreement, inclusive the sharing of direct costs related with the issuance of this guarantee, reward for the one member and regress payments process in case the public tender authority claimed its rights under the guarantee. The performance guarantee must, of course, state that it safeguards the performance of all respective members of association connected with the contract.

Advantage for the public tender authority: Should the performance guarantee be tailored in this manner, the public authority might be sure to get the expected payment. The only requirement for claiming its rights under the performance guarantee (demand guarantee) is to announce the bank the breach of contract by the association or to be more precise by the one member.

Disadvantages for the one member: Unfortunately, there are number of disadvantages for the providing member. Despite the fact that the members of an association shall share the cost of issuance of the performance guarantee, it is only this member whose liquidity and banking covenants are affected. Therefore, because of negotiating an extensive performance guarantee, the providing member might be hindered from getting any other bank guarantee or credit in the future (till the end of validity of this

performance guarantee). Moreover, should the public tender authority make a use of the performance guarantee, it is this member who has to bear the financial burden resulting from this claim, because the claimed amount of the performance guarantee will be deducted from its own account. Subsequently, he has to require proportional regress of the paid amount from the others.

The best way how to ensure the financial regress of providing member is to require the other members to issue partial counter-performance guarantees. In such a case the partial performance guarantee should state expressly that the principal issuing member is entitled to claim the respective amount only if the public tender authority claimed payment from the main performance guarantee and up to the proportional amount of the claim.

Whereas this possibility appears to be extremely advantageous for the public tender authority and for some of the association member, the disadvantage for the issuing member who is responsible for negotiating the main performance guarantee and bearing the risk connected seems to be hardly acceptable. Therefore, neither the first nor this second solution can be recommended as the ideal ones.

*Shared (joint) performance guarantee:*

Shared performance guarantee presumes that the member of association who is pursuant to the association agreement entitled to deal on behalf of the others will start to negotiate the performance guarantee with the designated bank. Nevertheless, the performance guarantee will not be negotiated in the name of this member (as in the previous case) but on behalf of all the members.

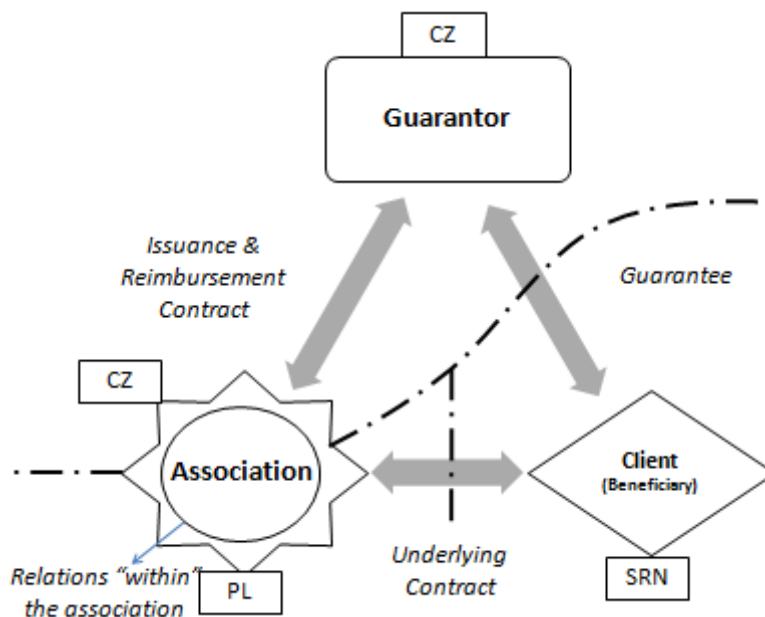
In this situation, the performance guarantee must state expressly the names of all the members and thus it ensures the joint performance of all of the members of the association. Moreover, it must state the covenant of a bank to pay the public tender authority up to the agreed amount if any of the members fails to perform any of its obligations under the contract. As the public authority may claim the performance guarantee in case any of the members breaks its duties or obligations under the contract without proving which of the members failed, this joint performance guarantee reflects precisely the joint and undistinguishable liability of the association members. Therefore, it provides high degree of security and expect-ability to the public tender authority.

The members of the association bear the costs connected with the issuance of the guarantee proportionally. In case the public tender authority makes a use of the performance guarantee, a proportional part of the payment is deducted from the bank accounts of all of the members. The right to claim regress payment is not excluded – it depends upon the wording of the

association agreement and upon the possibility to prove the sole liability of one of the members for the breach of contract.

Based upon the risk distribution between the members of association and the advantages of this solution for the public tender authority, the shared performance guarantee seems to be the best way how to ensure the obligations of the association.

## CONFLICT OF LAW ISSUES IN THE GLOBALIZED WORLD



The all above mentioned issues may gain a new dimension within EU. With European information system on public procurement, it is relatively easy for a Czech company to submit a bid to a procurement announced by a German entity. As the work should be carried out in Germany, but near Polish borders, the Czech bidder may seek out a Polish entity to provide ancillary services. German client requires a bank guarantee that is eventually issued by a Czech bank. Although not too common so far, such situation may occur and bring important issues concerning the law governing individual issues that need to be considered. As the scheme above shows us, there are several relations involved.<sup>28</sup>

Firstly, there are relations “within” the association itself. Even though the association may externally resemble a business company, we must not forget that it is still nothing more than a contractual relationship. As such,

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<sup>28</sup> Conflict of law issues may be treated differently in various jurisdictions; therefore, we would like to analyze them only from the perspective of Czech courts.

we may consider the application of regulation No. 593/2008 on the law applicable to contractual obligations (Rome I. Regulation).

However, we may soon encounter an obstacle if we consider Article 1, subsection 2, letter f) of the Rome I. Regulation. Quoted article excludes from the scope of the regulation those relations arising out of company law and/or, more importantly, other bodies, corporate or unincorporated. As may be derived from other language versions,<sup>29</sup> regulation seems to exclude question of societies and associations even if based on the pure contractual nature. Initial legislative text of the regulation<sup>30</sup> seems to put it clearly when stating: “Also excluded are questions governed by company law and the law relating to other bodies corporate or unincorporated.” The legislative text and English text of the regulation uses the word “body”, which may in the context suggest that exclusion of only subjects possessing legal personality. The Guliano-Lagarde report<sup>31</sup> on Convention on the law applicable to contractual obligation (Rome Convention)<sup>32</sup> provides that: “certain relationships will be regarded as within the scope of company law or might be treated as being governed by that law (for example, société de droit civil, nicht-rechtsfähiger Verein, partnership, Vennootschap onder firma, etc.) in some countries but not in others.” Therefore, it will be for each jurisdiction to primarily characterize the relationship either as falling into company law or connected areas, or not.

From the perspective of the Czech law, we may conclude that association under Section 829 should fall within the scope of Rome I Regulation, because from our point of view, Czech law recognizes even associations with legal personality, but provides also a “version” lacking it – association under Section 829, which is moreover methodically put into part of the Civil Code that is regulating obligation arising out of contractual relationships.

Once we establish the applicability of regulation, we may seek for governing law. It is most proper for the parties to utilize their right under Article 3 and choose the law that would govern their relationship. If the parties fail to choose the applicable law, or cannot agree on one, they soon

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<sup>29</sup> In German language version: “Fragen betreffend das Gesellschaftsrecht, das Vereinsrecht und das Recht der juristischen Personen, ... Vereinen und juristischen Personen ...”; in French language version: “les questions relevant du droit des sociétés, associations et personnes morales ...”; in Czech language version: “otázky upravené právem obchodních společností, sdružení a jiných právnických osob...”

<sup>30</sup> Accessible from: <http://www.europarl.europa.eu/oeil/resume.jsp?id=5301232&eventId=922934&backToCaller=NO&language=en>; accessed on 31. 5. 2010.

<sup>31</sup> Accessible from: [http://www.uninova.sk/pf\\_bvsp/pdf/Text\\_GiulianoLagardeReport.pdf](http://www.uninova.sk/pf_bvsp/pdf/Text_GiulianoLagardeReport.pdf); accessed on 31. 5. 2010.

<sup>32</sup> Rome Convention is a predecessor of Rome I Regulation, and both instruments are nearly similar in their content, as the regulation is the result of convention being converted into EU instrument.

encounter several problems. Even though, the regulation provides conflict rules for several types of contracts, association is not included. We cannot apply various sets of conflict-of-law provisions for various relations that may exist between contracting parties, as that would contradict the principle of predictability and conflict justice.

Therefore, the answer must be derived firstly from the Article 4, subsection 2 which calls for the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence. This conflict solution may be helpful in situations where there is one leading party in the association which may render relatively substantial part of association's performance. This might be the case in our made-up scenario. As the Polish party renders only ancillary services and the main task is to be carried out by Czech party, law governing the association should be the Czech law.<sup>33</sup>

However, in situation when no leading party is recognized, we must move on to subsection 4 of the same article and thus govern the contract of association by the law of the country with which it is most closely connected. The closest connection may be derived from various factors<sup>34</sup> e.g. state where the common activity of the parties are focused on, or a state where the prevailing portion of assets is invested, or even a state where the seat from which the association is factually governed is located.

Secondly, there is a main contractual relation between the German client and the association. In this regard, we may freely apply Rome I. Regulation,<sup>35</sup> and apply the law that is either chosen by the parties (again recommended) or determined according to regulation's conflict-of-law rules. However, there are two crucial questions.

First, whether such relation must be, basically, regulated only by one applicable law, as we should not forget that association has no legal personality and only the associated parties are parties to the underlying contract. But, as the predictability of conflict result and inner harmony of relationship must be preserved, such reasoning has to be refused. Moreover, reaching dissimilar results how different substantial laws would treat the

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<sup>33</sup> However, argument can be made, that without such ancillary services the leading party would not be able to carry out his obligations to the principal. Therefore, it may be truly relativistic result.

<sup>34</sup> Kučera, Z. *Mezinárodní právo soukromé*. 6. edition. Brno : Doplněk, 2004, p. 317.

<sup>35</sup> Of course, it must always be considered if the regulation is applicable for the particular relationship, by submitting such relation under scrutiny by test of applicability (time and scope).



parties, which are joined in the same association subjected to the same law, cannot be sustained.<sup>36</sup>

Second, if we decided that just one governing law shall apply, the question would then sound - which one it should be. Similar considerations as in first issue may be applied even here. Final judgment may be dependent upon the fact if there is a leading associate, or not, where the services are rendered etc. However, we should not consider law governing the contract of association to be applicable, ipso facto, for the underlying contract as well because it is the law of parties rendering characteristic performance. In that limited sense, *lex causae* for association shall be primarily restricted for “internal” use.

Thirdly, association must contract with a Czech bank that shall issue the guarantee. Such contract will regularly deal with the conditions upon which the bank issues the guarantee (e.g. payment by bank’s client), what the content of the guarantee itself is (type and kind of guarantee), and last but not least provisions concerning the reimbursement of any sum paid to a beneficiary (client). Once again Rome I Regulation will be applicable; the bank will regularly make the client agree to choice of law provision subordinating the relation under the law of bank’s seat. This solution is in line even with the basic presumption under Article 4 subsection 2, as it is the bank which renders characteristic performance.

Lastly, what is the governing law in relation between the bank and the client, in case the client decides to exercise the rights from the guarantee? Basically, securities should share the fate of the main obligation they secure. If that is the case, bank guarantee shall follow the fate of underlying contract between association and beneficiary (client). However, there are two important remarks to be made.

First, if the bank issues a guarantee for a foreign beneficiary (client), it will regularly insert a choice of law provision, too; such provision shall be deemed as accepted by beneficiary, at the latest, when he starts exercising right from the guarantee. Second, absent choice of law provisions, bank guarantee is a specialty regarding securities, as was demonstrated in previous text. It is not, contrary to a simple guarantee, an accessory obligation governed independently. Most appropriate will once again be the law of issuing bank’s seat.

In a result, it is ordinary cause of business, that the bank guarantee shall be governed by a different law than the underlying obligation itself. Such law shall be primarily determinative for any objections bank may make against the client (beneficiary).

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<sup>36</sup> However, should it be the case if parties provide similar and strictly delimited parts of overall works?

To summarize, by this brief survey, it was presented *prima facie* that described situation is of a most complexity. There are several issues which may be treated independently and courts may reach different results. Therefore, it is highly advisable that parties utilize the rights Rome I Regulation offers and favors – autonomous will of parties to choose their “fate” by picking law (preferably one) governing various parts of this complex case.

Before ending the conflict section, we shall briefly point out reader’s attention to jurisdictional issues.<sup>37</sup> In this regard, regulation No. 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I. Regulation), which provide uniform rules to determine the jurisdiction in wide scope of commercial and civil matters within the EU. As the basic rule reads, the courts of defendants’ domicile shall have the jurisdiction for a dispute. Moreover, parties may employ alternatives under Article 5 (e.g. place of performance), or chose a specific jurisdiction under Article 23.

Article 6 provides special rules which may be found useful in above described situation.

Subsection 1 provides for cases with more than one defendant, i.e. if the client would sue the associated parties. As the claims may be so closely connected that it is expedient to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings. If that is the case, all defendants may be sued before one court in order to reach cohesive and just decision.

Subsection 2 contains the rule when third parties are concerned; which might be the case of bank providing the guarantee. The rules enables, for similar reasons as in subsection 1, the claimant to sue the third party – bank in the court seized of the original proceedings, unless these were instituted solely with the object of removing him from the jurisdiction of the court which would be competent in his case.

Similarity, even though Brussels I. Regulation provides wide scope of jurisdiction may be chosen from, it is also advisable to tailor prorogation agreements in individual relationship to ensure that the claims are considered at same forum.

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<sup>37</sup> Other aspects may be surveyed if some of the contracts include an arbitration agreement. With that regard interesting issue of multi-party arbitration and extension of arbitration agreement may arise. See e.g. Hanotiau, B.: *Complex Arbitrations: Multiparty, Multicontract, Multi-Issue and Class Actions*. Kluwer. 2006. or *Permanent Court of Arbitration: Multiple Party Actions in International Arbitration*. Oxford University Press. 2009.

## **FINAL REMARKS**

The aim of this article was to show the reader the complexity of various problems when an association is considered. Although, the trade association under Section 829 of Civil Code is not regarded as a legal entity, it is a widely used form of business cooperation, especially in complex and technologically sophisticated public procurements.

It is therefore of an utmost importance to secure the fulfillment of obligations towards a client, as well as in-between the members of the association. The paper introduced the security measures which are widely used to secure the fulfillment of obligations in public tenders and concentrated in detail on the bank guarantee. In this regard, the paper focused especially on different types of collaterals (bank guarantees), discussing advantages and disadvantages for the members of the association and for the client itself.

In the last part of the paper, a new dimension of issues emerged once foreign elements entered into our consideration. To this regard, the results may be articulated as such that promotion of a unified solution should be preferred, either in conflicts-of-law as well as jurisdictional issues. To that extent the best practice is to use a choice of law and choice of forum provisions that help create single legal frame even in these complex relationships.

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