bank will become insolvent. After the funds transfer is final, the transferee runs the risk that the transferee bank will become insolvent. It is not clear who bears the risk that either of these banks or that one of the intermediary banks will become insolvent during the funds transfer and before settlement.

109. A funds transfer may be made by a chain of banks as follows:

Transferor	Transferor Bank A	Intermediary Bank B	Intermediary Bank C	Transferee Bank D	Transferee

110. There are many possible situations if one of the banks becomes insolvent. Assume that Bank A debits the transferor's account and sends the instruction to Bank B. Settlement occurs by debit to the account Bank A holds with Bank B. Before Bank B sends the instruction to Bank C, it becomes insolvent. In this case the transferor has not paid the transferee but its account with Bank A has been debited. Similarly Bank A has settled with Bank B. Should Bank A be required to find another route to Bank D? Does the transferor or Bank A bear the risk of loss from Bank B's insolvency?

111. A different problem is posed when Bank D has credited the transferee's account before Bank B has settled with Bank C and before Bank C has settled with Bank D. If Bank C then becomes insolvent, should Bank B be required to settle with Bank C. Should Bank C be required to settle with Bank D in spite of Bank C's insolvency? Alternatively, should Bank B be required to settle directly with Bank D, thereby eliminating Bank C from the settlement chain?

112. Would the rule be different if Bank C's failure was that of settlement at the clearinghouse?

113. What should be the impact of such failure to settle on the funds transfer between the transferor and the transferee?

114. Whether or not it would be necessary for every country to have special rules on the allocation of the risk of loss arising out of the insolvency of a domestic bank, it may be thought that such rules would be of particular value for international funds transfers.

115. For general discussion, see *UNCITRAL Legal Guide*, issue 37.

V.5 *Should the Model Rules contain a provision on the time when an underlying obligation is discharged?*

116. In most countries the rules on discharge of an underlying obligation by funds transfer are not contained in the law governing the funds transfer. Instead, those rules are contained in the law governing the underlying obligation. Nevertheless, the two sets of rules should be in harmony. Therefore, without prejudice to any later decision should the Model Rules be transformed into a convention, model law or other form of binding legal norm, it may be thought appropriate to consider in the context of the Model Rules the appropriate time for discharge of an underlying obligation when payment is made by means of an electronic funds transfer.

117. For general discussion, see *UNCITRAL Legal Guide*, issue 36.

B. Stand-by letters of credit and guarantees: report of the Secretary-General (A/CN.9/301) [Original: English]

CONTENTS

INTRODUCTION

1. The Commission at its fifteenth session in 1982 decided to request the Secretary-General to submit to a future session of the Commission a study on letters of credit and their operation in order to identify legal problems arising from their use, especially in connection with contracts other than those for the sale of goods (A/37/17, para. 112).[1] The proposal for such a study was made on the occasion of the Commission's consideration of the work of the International Chamber of Commerce (ICC) then in progress to revise the 1974 version of the Uniform Customs and Practice for Documentary Credits (UCP).

2. In support of the proposal it was pointed out that letters of credit were originally intended to be used in connection with the documentary sale of goods. Currently they were being used for a number of other purposes, such as in connection with bid bonds and repurchase agreements. It was suggested that the legal rules developed for the one situation might not be appropriate for these other uses to which letters of credit were currently being put (A/37/17, para. 109).

[1]Report of the United Nations Commission on International Trade Law on the work of its fifteenth session, *Official Records of the General Assembly, Twenty-seventh Session, Supplement No. 17* (A/37/17). Reports of the annual session of the Commission are reprinted in the Yearbook of the United Nations Commission on International Trade Law for the year in question.

Scope and lay-out of report

3. As will be discussed in more detail below (Part I, A), these other uses of letters of credit are, except for acceptance credits or facility letters, essentially in the form of stand-by letters of credit. While the traditional documentary credit provides the seller (or similar performing party) with a secure mechanism for payment by the buyer, the stand-by letter of credit is a default instrument in that it covers the risk of non-performance or defective performance by a contractor, supplier or other obligor.

4. Stand-by letters of credit, which are issued primarily by banks in the United States of America and less frequently in some other countries, thus serve the same purpose as do bonds or guarantees used in most countries. These other indemnity devices, issued by banks or similar institutions, are therefore included in this report; their characteristics and uses are described below in Part I, B.

5. Stand-by letters of credit and guarantees (or bonds), while functionally equivalent or at least similar, differ as to their legal treatment for the formal reason that the stand-by letter of credit is a letter of credit. Thus, the laws and rules governing documentary letters of credit would generally be applicable to stand-by letters of credit. As discussed below (Part II, A), the question arises whether, or to what extent, such laws

or rules are appropriate for the stand-by letter of credit in view of its different purpose. For guarantees and bonds, the legal framework is different. As discussed below (Part II, B), it is characterized by a varied development of national laws, in particular case law, towards recognizing the independent (non-accessory) legal nature of the guarantee and by attempts to prepare uniform rules.

6. Despite the different legal setting of stand-by letters of credit and guarantees, many of the same legal issues and problems may arise in both contexts. The discussion of such issues (e.g. unfair calling of first demand instruments) will therefore deal jointly with stand-by letters of credit and guarantees (Part III).

7. In the last part of this report, some conclusions will be suggested as to the desirability and feasibility of undertaking efforts towards establishing uniform legal rules or clauses. Some recommendations will be presented as to possible future work of the Commission, including co-operation with the ICC.

Previous involvement of the Commission

8. The topic of this report as outlined above has been with the Commission since its inception, albeit with varying scope and emphasis, first on bank or contract guarantees and later on stand-by letters of credit. Pursuant to a request by the Commission at its first session in 1968 (A/7216, para. 29), the secretariat submitted to the second session a preliminary study of guarantees and securities as related to international payments (A/CN.9/20 and Add.1). Ten years later, the secretariat submitted a preliminary study on stand-by letters of credit (A/CN.9/163), following a decision by the Commission at its eleventh session in 1978 to include in its programme of work as a priority topic "Stand-by letters of credit, to be studied in conjunction with the International Chamber of Commerce" (A/33/17, paras. 67(c)(ii)a, 68 and 69). The wording of the topic indicates what has been a recurrent feature in the Commission's previous involvement, namely co-operation with ICC.

9. This co-operation has taken various forms. At the secretariat level, it has consisted of informal contacts and consultations, including participation at various meetings of relevant ICC Commissions and Working Parties. In support of ICC's efforts in obtaining comprehensive information on the practice and needs in this field, questionnaires, reports and draft rules prepared by ICC and sent to its National Committees have been transmitted to Governments and to banking and trade institutions not represented in ICC for their comments. The replies were then forwarded to ICC, in some cases with an analysis by the secretariat. This kind of assistance was rendered in connection with ICC's efforts to prepare uniform rules on contract guarantees and its work of preparing the 1974 and 1983 revisions of UCP.

10. For a number of years starting with the third session in 1970, the Commission considered progress reports of ICC on its preparatory work in the field of contract guarantees. In commenting on the work, suggestions were made, for example, on the scope of the work and on the interests and needs to be taken into account. The Commission would encourage continuation of the work and, on occasion, expressed the hope that ICC would submit to it any draft rules before their final adoption by the competent organs of ICC.

11. In 1978, ICC adopted and published its "Uniform Rules on Contract Guarantees" (ICC publication no. 325), which do not recognize first demand guarantees.[2] The following year, the Commission encouraged ICC to continue its work on stand-by letters of credit in co-operation with the secretariat and reiterated the hope that ICC would submit any results of its work before final adoption (A/34/17, para. 48).

12. What may be called the ultimate form of co-operation between organizations is the endorsement by one organization of a final text adopted by another organization, usually expressed as a recommendation that it be used in transactions of the type in question. In the area of guarantees and letters of credit, the Commission has done so only with regard to UCP (in respect of their 1962, 1974 and 1983 revisions).

13. As will be described in more detail below (paras. 68-70), ICC is currently engaged in preparing uniform rules applicable to guarantees, indemnities, bonds or similar undertakings. A first draft of "ICC Uniform Rules for Guarantees" is set forth in the annex to this report.

I. Functions and characteristics of stand-by letters of credit and guarantees

A. *Stand-by letter of credit distinguished from traditional documentary credit*

1. *Commercial or documentary credit*

14. The traditional and most common use of a letter of credit in international transactions is that of the commercial or documentary credit. It is the primary, and by far the main, type envisaged by UCP and defined in its article 2 as:

> "any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and on the instructions of a customer (the applicant for the credit),
>
> i. is to make a payment to or to the order of a third party (the beneficiary), or is to pay or accept bills of exchange (drafts) drawn by the beneficiary,
>
> or
>
> ii. authorizes another bank to effect such payment, or to pay, accept or negotiate such bills of exchange (drafts),

[2] On this point and on the limited success of these Uniform Rules see below, paras. 62-67.

against stipulated documents, provided that the terms and conditions of the credit are complied with." (1983 revision, ICC publication no. 400; reproduced in annex II to A/CN.9/251).

15. Commercial letters of credit are used to effect or facilitate payment of amounts due under international transactions, especially contracts of sale. Pursuant to a stipulation in the contract, the buyer instructs his bank to open a letter of credit in favour of the seller. The issuing bank notifies the seller usually through a correspondent bank in the seller's country. The correspondent bank may be instructed to act as a mere intermediary transmitting information ("advising bank") or to add its own undertaking, as "confirming bank", to that of the issuing bank.

16. The letter of credit is either revocable or, if it so states, irrevocable. In the first case, the issuing bank may, without notice to the beneficiary (seller), cancel or modify it before the acceptance of the documents. In the second case, the issuing bank is bound by contract with the seller and would need his consent for any modification or revocation.

17. The letter of credit sets forth the terms and conditions of payment, in particular the documents to be tendered, except for the rare case of a "clean" commercial credit. Documents specified usually include bills of lading or other transport documents issued by the carrier, a commercial invoice, an insurance policy, and often other documents such as inspection certificates or certificates of origin.

18. The bank may be committed to perform its promise against the tender of the documents in one of three ways. It may be obliged (1) to pay cash or credit the beneficiary's account, or (2) to accept a bill of exchange drawn on it by the seller in the amount of the purchase price, or (3) to negotiate a bill of exchange drawn by the seller on the buyer. Reportedly,[3] the first type prevails in Continental Europe and South America, the second type is the most common one in the United Kingdom, many Commonwealth countries and in the United States, and the third type is common in South East Asia.

19. The value of the documentary credit, appreciated especially in sales transactions involving carriage of goods by sea, lies in its twin objectives, namely to raise credit and to secure payment of the purchase price. The credit meets the common interest of both parties not to tie up funds during the transport of goods. Even more importantly, it safeguards the different interests of buyer and seller. The buyer is assured that payment is made only against documents that confer title of the goods to him or at least provide evidence of their shipment and of certain qualities (e.g. by certificates of inspection, examination or origin). The seller when parting possession of the goods is assured of payment, or honour of a bill of exchange he may wish to discount, by a financially strong and reliable third party, often a confirming bank in his own country. He is thus protected against the risk of the foreign buyer's inability or unwillingness to pay.

20. Realizing these objectives achieved by a documentary credit, one understands why its potential and use go beyond sales transactions. It may be used in the context of works contracts, provision of services or any other transaction where the fact of performance for which payment is due may be established by documents such as certificates of acceptance or completion or any other certification, preferably by an independent third party.

21. Just as it is true that the use of the traditional documentary credit or commercial letter of credit is not limited to sales transactions, it will be seen that other types of letters of credit such as acceptance credits and, in particular, stand-by credits are not limited to use in non-sale transactions.

2. *Other uses of letter of credit, especially stand-by letter of credit*

(a) *Acceptance credit or facility letter*

22. The idea of facilitating the raising of credit is the main objective of the "acceptance credit" or "facility letter". The issuing bank does not finance the customer's transactions from its own funds but helps him to secure credit from other sources, by authorizing him to draw on it bills of exchange up to a certain limit. With such backing these so-called "commercial bills" may be easily discounted while the customer needs to provide the necessary funds only shortly before maturity. Often the funds needed are taken from the proceeds of the discount of a fresh, second set of bills (so-called "rolling-over").

23. The acceptance credit may be given in respect of any business activity of the customer. For example, it may help to finance building projects or other works, the provision of services or the manufacture of goods for sale. While there may be an international link, for example where the goods are intended for export, the acceptance credit is essentially a domestic facility, sometimes used, instead of a loan, for reasons of special domestic legislation. Above all, there are only two parties to the credit with their places of business usually in the same country, namely the issuing bank and its customer who is at the same time applicant and beneficiary of the credit. Thus, there is no need here for further discussion of this type of letter of credit.[4]

(b) *Use of stand-by letter of credit in sale and non-sale transactions*

24. The stand-by letter of credit was developed in the United States of America where the pledging of credit

[3] *Ellinger*, Letters of Credit, in: The Transnational Law of International Commercial Transactions, vol. 2 of Studies in Transnational Economic Law (eds. Horn and Schmitthoff, Deventer 1982) 241, 244.

[4] For more details see, e.g., *Ellinger* (note 3) 246, and Securitibank's collapse and the commercial bills market of New Zealand, 20 Malaysia Law Review (1978) 84.

as surety and the issuance of guarantees is beyond the powers of banks as defined in statutes, charters and case law. During the past thirty years it has been commonly used there instead of guarantees or bonds that banks elsewhere may issue.

25. In other countries stand-by letters of credit are used, if at all, to a considerably lesser extent. Often the reason for doing so is that the commercial or banking relationship at hand involves a United States party. In other contexts, the reasons contributing to what appears to be an increasing use are probably to be found in the familiarity of business and banking circles with the traditional letter of credit and their perception of its legal certainty as compared with a possibly unsettled law on guarantees, in particular as regards the independence of the bank's undertaking from the underlying transaction (see below, paras. 57-61).

26. In contrast to the documentary credit, which secures payment due to the beneficiary for his regular performance of a commercial obligation, the stand-by letter of credit is designed to provide security or indemnity to the beneficiary for the unlikely contingency of the other party's default. Such contingency, and the need to protect against it, may arise in respect of a great variety of commercial or financial obligations. Stand-by letters of credit may thus be used to underwrite undertakings in various contexts, as are bank guarantees and bonds.

27. For example, the stand-by letter of credit may protect the employer or owner of a construction project or similar works contract against the non-performance, late performance or faulty performance of the contractor who, in turn, may benefit from stand-by letters of credit guarding against his sub-contractors' default. At different stages of such projects, various types of stand-by letters of credit may be used that are better known from bank guarantees and bonds (e.g. tender guarantees, repayment guarantees, performance and customs bonds, retention money guarantees, maintenance guarantees; see below, paras. 42-44). Of other commercial uses, only two more may be mentioned, namely protection against a charterer's failure to carry out maintenance obligations and indemnity for losses accruing from a land owner's failure to obtain a building licence.[5]

28. In the financial field, stand-by letters of credit may, for example, bolster corporate issues of commercial paper (e.g. to take advantage of the credit rating of the bank providing the stand-by credit) or to back corporate bond issues on the long-term market. Other common uses include underwriting municipal obligations and industrial revenue bonds, limited partnership syndications, reinsurance, mergers and acquisitions.[6]

29. The variety of recent uses confirms predictions made more than ten years ago, namely that "the letter-of-credit device would be used to accomplish results that previously had to be accomplished by performance bonds, or repurchase agreements,"[7] and that "the spread of the letter of credit into non-sales areas has just begun, and the only limit would seem to be in the extent of the creative abilities of businessmen, bankers and lawyers and the economic restraints affecting the extension of financial credit by banks."[8]

30. It must be added that stand-by letters of credit are used also in sales transactions and thus often in addition to the traditional letter of credit in one and the same transaction. It may be given for the benefit of the buyer so as to cover, in case of seller's breach, expenses or losses that might be incurred in arranging import or other measures taken in anticipation of the seller's performance. More frequently, the seller is the beneficiary and the stand-by letter of credit operates as a secondary payment in case the primary mode of payment fails (e.g. promissory notes are not paid).

31. In the latter situation the roles of buyer and seller and their respective banks with regard to the stand-by letter of credit are seemingly the same as with regard to the documentary credit. The buyer's bank, at the request and account of its customer, may issue the stand-by credit itself or instruct a bank in the seller's country to issue it, providing that bank with a counter-guarantee (whether or not in the form of a stand-by letter of credit) promising reimbursement if the stand-by credit is called in accordance with its terms. However, the similarity in pattern should not disguise the fact that even in such a situation the stand-by letter of credit differs essentially from the documentary credit as regards the nature and purpose of the undertaking and the ensuing risks.

32. While the documentary credit is employed in anticipation of the seller's performance, the stand-by letter of credit aims at meeting the contingency of default, which is considerably less likely to occur. However, if it is called, the stand-by letter of credit tends to entail greater risks.

33. The undertaking, which is for obvious reasons almost always irrevocable, is independent from the underlying transaction in that the beneficiary need not prove default, as he would have to do under an accessory guarantee or surety instrument. While the formal requirements for a claim as stipulated in the stand-by credit may include documents by an independent third party dealing with the issue of default (e.g. certificate of engineer or decision by court or arbitral tribunal), it is far more common to require only a written statement of the beneficiary himself to the effect that the other party defaulted on its obligation. Payment might thus be demanded and obtained even though the contingency had not in fact occurred.

[5] As to further examples, see, e.g., *Ellinger*, Standby Letters of Credit, 6 Int. Bus. Lawy. (1978) 612-614; Recent extensions in the use of commercial letters of credit (comment) 66 Yale L.J. (1957) 903-909, and *Murray*, Letters of Credit in Nonsale of Goods Transactions, 30 Bus. Lawy. (1975) 1103-1105.

[6] *Rowe*, Guarantees—Stand-by letters of credit and other securities (Euromoney, London 1987) 110.

[7] *Harfield*, Code, Customs and Conscience In Letter-of-Credit Law, 4 U.C.C.L.J. (1971) 14.

[8] Murray (note 5) 1123.

34. The ensuing risk rests ultimately on the bank's customer who, in addition to having performed his obligation in the underlying transaction, would have to reimburse the bank that had made the payment in accordance with the terms of the stand-by credit. In case of correct payment, whether or not the contingency had occurred, the risk might have to be borne by the bank if the customer was bankrupt or insolvent. However, banks normally protect themselves by requiring sufficient security or collateral before issuing the credit.

35. The stand-by letter of credit in its most common form is thus considerably more risky than the traditional documentary credit, which provides a high degree of security by requiring documents that confer title or at least evidence shipment of apparently conforming goods. While dressed in the form of a normal letter of credit, the stand-by credit resembles in functional terms, and constitutes in essence, a bank guarantee or similar indemnity.

B. *Bank guarantees, bonds and similar indemnities*

36. When entering the area of guarantees, bonds and similar securities issued by banks or other institutions, one is faced with confusing terminology, conceptual uncertainty and a bewildering array of classifications. For example, traditional labels (e.g. "guarantee", "bond", "*cautionnement*") are used also for more recent types of securities with different legal content. Suggested classifications juxtapose categories such as primary/secondary, autonomous/ancillary, independent/accessory, automatic/documentary, unconditional/conditional, or abstract/causal. Generally speaking, this state of affairs reflects the varying stages and directions of legal development (as discussed below, Part II).

1. *Independence from underlying transaction*

37. For the purpose of identifying those guarantees, bonds and other securities for which the stand-by letter of credit constitutes a functional equivalent, the most appropriate criterion is that of the independence of the guarantor's undertaking from the underlying relationship between principal and beneficiary. The most obvious example is the on-demand guarantee (also called first demand or simple demand guarantee), which may be payable either against a written statement of the beneficiary about the principal's default (in general or specific terms) or on simple demand whereby the principal's default would be impliedly stated.

38. As is the case with stand-by letters of credit, the promise to pay the guarantee may be subject to further conditions such as presentation of a certificate of default issued by a third party. Even such a requirement stated in the terms of the guarantee itself does not affect the legal independence of the guarantee, though it establishes a practical link with the underlying relationship in accordance with the commercial purpose of the guarantee. In the opposite case of an accessory guarantee (e.g. the traditional common law "letter of guarantee" or "contract of guarantee") the existence and scope of the guarantor's undertaking legally depends on the principal's actual default which, in turn, presumes the existence of a valid obligation on his part. The beneficiary's right to payment is subject to the restrictions or objections provided for in the general law of guarantee or suretyship, irrespective of whether they are set forth in the contract of guarantee.

39. The necessary task of distinguishing clearly between independent and accessory guarantees is made difficult by the fact that both types serve essentially the same commercial purpose and may bear the same label. This is also true, for example, with regard to the term "performance bond". It may refer either to an independent guarantee designed to protect the beneficiary's interest in the principal's performance or to an accessory undertaking, usually of a bonding or insurance company (e.g. in Canada and the United States), to step in for a defaulting principal, to arrange for the completion by others or to indemnify the beneficiary for his expenses or losses.[9] Payment to the beneficiary is thus but one of various options open to the guarantor which, in further contrast to the independent guarantee, covers only actual damages suffered by the beneficiary as a result of the principal's actual default. Determination of the principal's default tends to involve the guarantor (surety) in factual investigations and disputes between principal and beneficiary—all matters shunned by issuers of independent monetary guarantees. Banks, in particular, are equipped and willing to deal with documents, as they do in letter of credit operations, but not with goods or construction projects.

2. *Types and uses*

40. One encounters essentially the same wide variety in the commercial contexts in which independent guarantees or bonds are used, as in the case of stand-by letters of credit. After all, the function and purpose are identical, including the desire of not tying up capital as security for an unlikely contingency, as would be the case if a deposit were given to the beneficiary or funds were placed in escrow. Guarantees or bonds may be used to underwrite any kind of commercial obligation or liability. To mention only a few examples, they may ensure repayment of a bank loan, provide security for interim measures or deferred payments, or facilitate the smooth functioning of commercial activities, for example, by ensuring compliance with mutual obligations in joint undertakings or by overcoming temporary obstacles such as a missing document in a documentary credit operation.

41. Guarantees or bonds are particularly useful and commonly used in complex long-term relationships such as co-operation agreements, civil engineering contracts and, in particular, construction or works contracts. In accordance with the various stages of a

[9]For details see, e.g., *Graham and Matejck*, The law and practice relating to the use of letters of credit and performance bonds in securing contractual performance in Canada and the United States, in: *Les garanties bancaires dans les contrats internationaux, Colloque de Tours des 19 et 20 juin 1980* (feduci, Paris) 49-66.

project and the respective needs, different types of guarantees are used, as described in the *UNCITRAL Legal Guide* on Drawing Up International Contracts for the Construction of Industrial Works (Chapter XVIII, Security for performance, paras. 1-13, 17-24, 40).[10]

42. In the initial phase, tender guarantees (or bid bonds) are employed to add strength to the bidder's commitment by protecting the beneficiary against withdrawal of the bid or non-acceptance of the award of the contract. Where the purchaser has to make an advance payment to finance the first stage of the operations, any obligation to repay the amount in full or in part may be secured by a repayment guarantee (or advance payment bond). Advance payments to the contractor for the specific purpose of transporting capital goods or materials to the construction site may be covered by transportation guarantees. Where the purchaser himself provides equipment or machinery, instead of advance payment, equipment guarantees may be issued in his favour.

43. Performance guarantees are designed to ensure completion of the project by the contractor in accordance with his contractual obligations. Where the contract price is to be paid in stages depending on the progress of the work, a retention money guarantee may be issued as a substitute for an otherwise retained percentage of the progress payment. In order to ensure re-export of equipment imported for temporary use, customs bonds may be posted with the authorities. Finally, for any obligations relating to the warranty period after completion, security may be sought through maintenance guarantees. As with any other financial obligation, the purchaser's duty to pay the contract price may be backed by a payment guarantee.

44. In addition to these main types of guarantees, other types may be agreed upon between contractor and purchaser for more specific purposes. The contractor, in turn, may seek to shift his exposure in part on to his sub-contractors by proportionate guarantees tailored in the light of the main contract guarantees.

45. In the context of construction projects as in any other commercial context, it is a matter of negotiation whether for a given purpose a guarantee or some other device will be used. The economic strength of the parties and the special market situation and practices will influence the crucial terms of the guarantee, in particular whether it would be payable on simple demand or against a third party's determination of the principal's default.

II. The legal framework

A. *Laws and rules for stand-by credits*

1. *Few provisions of law*

46. Stand-by letters of credit are not regulated in any special laws on stand-by credits, except for certain government regulations laying down, for example, the powers and procedures of banks. Instead, they would be governed, in accordance with their form, by any general law of letters of credit. However, most States have no specific legislation on letters of credit; and where it exists it tends to consist of only a few provisions often of a general nature.

47. A more comprehensive set of provisions on letters of credit is to be found in the United States of America, where the stand-by letter of credit originated. The range of issues covered by article 5 of the Uniform Commercial Code (UCC), enacted with minor variations in all 50 states, may be gathered from its section headings: Formal Requirements; Signing (5-104), Consideration (5-105), Time and Effect of Establishment of Credit (5-106), Advice of Credit; Confirmation; Error in Statement of Terms (5-107), "Notation Credit"; Exhaustion of Credit (5-108), Issuer's Obligation to Its Customer (5-109), Availability of Credit in Portions; Presenter's Reservation of Lien or Claim (5-110), Warranties on Transfer and Presentment (5-111), Time Allowed for Honor or Rejection; Withholding Honor or Rejection by Consent; "Presenter" (5-112), Indemnities (5-113), Issuer's Duty and Privilege to Honor; Right to Reimbursement (5-114), Remedy for Improper Dishonour or Anticipatory Repudiation (5-115), Transfer and Assignment (5-116), Insolvency of Bank Holding Funds for Documentary Credit (5-117).

48. Article 5 UCC, as expressed in section 5-102(3), "deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop", and according to the Official Comment on that section "the rules embodied in the Article can be viewed as those expressing the fundamental theories underlying letters of credit". There remain thus, even here, ample room and need for development and refinement of legal solutions based on commercial usages. Moreover, there is a clear deference to commercial practices in three states (Alabama, Missouri and New York) where article 5 does not apply to documentary credits incorporating the UCP.

49. In view of the lack of a statutory framework in most countries and its fragmentary nature in others, courts may generally give effect to the letter-of-credit practices developed by the business community and, as regards stand-by letters of credit, take into account their different purpose and characteristics. In some legal systems restrictions may follow from mandatory provisions of law, even if those provisions do not expressly refer to stand-by letters of credit. Such provisions dealing, for example, with questions of validity or expiry of bank guarantees are likely to be applied also to the functionally equivalent stand-by credit, especially where the provisions are regarded as forming part of public policy.

2. *Uniform international rules*

50. Stand-by letters of credit might, in conformity with their purpose and despite their name, be made subject to the Uniform Rules for Contract Guarantees

[10] A/CN.9/SER.B/2; New York 1988, United Nations publication, sales no. E.87.V.10.

(ICC Publication no. 325) which "apply to any guarantee, bond, indemnity, surety or similar undertaking, however named or described" (article 1(1)). However, these Rules for Tender, Performance and Repayment Guarantees are of limited practical use since they fail to recognize the most common type of stand-by credit, i.e. a credit that is payable upon the beneficiary's declaration of the principal's default (see below, paras. 64-67).

51. The international rules most commonly referred to in stand-by letters of credit are the Uniform Customs and Practice for Documentary Credits. While this practice developed under previous versions of UCP, the 1983 revision (ICC Publication no. 400, reproduced in annex II to A/CN.9/251) now specifically covers stand-by letters of credit.

52. Its article 2 cited earlier (para. 14) defines not only the documentary credit or traditional letter of credit but also, and in the same terms, the stand-by letter of credit. Even more explicit, and apparently sensitive to the difference in nature and purpose of the two types of letter of credit, is article 1 according to which "these articles apply to all documentary credits, including, to the extent to which they may be applicable, stand-by letters of credit".

53. No rules or guidelines are offered for determining which of the articles of UCP are in fact applicable to a stand-by letter of credit and, if they are applicable, to what extent. The answer has to be sought by examining the purpose and scope of each provision and then judging its suitability for this functionally different type of credit. While questions of applicability may be easily answered at a general level, there remains a considerable amount of uncertainty when it comes to concrete issues.

54. Generally applicable are, for example, the general provisions and definitions set forth in articles 1 to 6, the rules on the form and notification of credits (articles 7 to 14) and the imposition or exclusion of liabilities and responsibilities of banks (articles 15 to 21). Of these provisions, articles 3 and 6 are of particular relevance to stand-by credits in that they establish and underline the independence or autonomy of the letter of credit. As an important complement, article 4 provides that "all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents may relate"; the reference to services and performances as well as goods reflects the wide coverage of UCP, including its extension to stand-by credits.

55. In general, the provisions that would not be applicable include those on transport documents, insurance documents and commercial invoices (articles 22 to 42), which are geared to the traditional documentary credit in a sales transaction. However, those provisions may be relevant to a stand-by letter of credit operating as a secondary payment (see above, para. 30).

56. The miscellaneous provisions of UCP (articles 43 to 53) combine applicable and non-applicable rules. This may happen even within one and the same article; for example, article 44 deals with partial drawings that may occur in stand-by operations and with partial shipments that are unlikely to occur. In respect of a number of these articles, no certainty exists as to whether they are applicable to stand-by letters of credit. To mention only one example, the question has arisen (and is currently before the ICC Commission on Banking Technique and Practice) whether subparagraph *a)* of article 47 governing the period of time for presentation of documents and their refusal after the expiry date is applicable to a stand-by letter of credit.

B. *Laws and rules for bank guarantees and similar indemnities*

1. *Evolution of law recognizing independent guarantees*

57. As is the case with stand-by letters of credit, bank guarantees and similar indemnities have in most States not been the subject of special legislation, except for specific laws, for example, on procurement, public works or banking, which may prescribe or prevent certain types of guarantee or contain certain requirements. General provisions of law on bank guarantees are rare (e.g. sect. 665-674 of the 1964 International Trade Code of Czechoslovakia and sect. 252-255 of the 1976 International Commercial Contracts Act of the German Democratic Republic). Even rarer is the inclusion of a statutory provision expressly referring to the guarantee payable on demand and without objections, as found in section 1087 of the 1978 Law of Obligations of Yugoslavia.

58. In most legal systems, it fell to the courts to respond to the emergence of the independent guarantee, which was essentially a creation of banking and commercial practice.[11] The evolution of the law, while differing from country to country, often faced the same kind of difficulty. On the one hand, it started from the traditional statutory or non-statutory law governing the accessory guarantee (surety); on the other hand, the realization that the new guarantee was of an independent nature made it necessary to disregard the basis of the traditional law, i.e. the linkage between guarantee and underlying transaction, and to develop a truly separate type of guarantee. The process of differentiation and severance has been easier and faster in some jurisdictions than in others. In a number of countries the process was facilitated by the application by analogy of letter-of-credit law with its well-established principle of independence or by general resort to the principle of contractual freedom.

59. Compared with the legal situation eight years ago, as described in an account covering various regions of the world,[12] there has been further progress towards

[11] *Lesguillons, Histoire, signification et pratique des garanties, in: Les garanties bancaires . . .* (above, note 9) 1-10.

[12] See contributions in *Les garanties bancaires . . .* (above, note 9), especially: *Vasseur, Rapport de synthèse: le droit des garanties bancaires dans les contrats internationaux en France et dans les pays de l'Europe de l'Ouest* (319-364); *Florescu, Pays socialistes Européens* (367-381); *El Hakim, Les pays du Proche-Orient* (383-406); *Cremades/Valluis/Zivy, Droit et pratique des garanties en Amérique Latine* (81-99).

wide recognition in national law of the independent guarantee. Nevertheless, the principle is not yet firmly established in all legal systems; and there is no uniformity as regards the extent to which the principle is recognized. Uncertainty or divergence of views exists, for example, with regard to the legal effects on the guarantee of any initial invalidity, modification or agreed termination of the underlying transaction or with regard to the relevance of the beneficiary's default having caused the principal's non-performance.

60. Even with regard to such a generally accepted rule as the fraud exception (discussed later, paras. 85-88), the positions in different jurisdictions differ considerably when it comes to determining the precise scope of the rule and the procedural measures available to implement it. Conceptually speaking, the fraud rule neither contradicts nor limits the independence of the guarantee. As in any other context where principles such as abuse of right (*abus de droit*) or *exceptio doli* operate, it presupposes the existence of a formal right to call the guarantee. The fraud rule constitutes an exception to the general rule that the obligation to pay the guarantee depends only on the conditions contained in the guarantee, and it shows that even an unconditional guarantee that is labelled as "payable on demand and without objections" remains subject to some objections.

61. Since the nature of the guarantee and the rights and obligations under it are based on the will of the parties, they are determined according to the terms and conditions laid down in the guarantee agreement. The texts of guarantee agreements tend to be elaborate, in part due to the fact that they have been drafted by banking and commercial parties against the background of a fragmentary statutory framework and often unsettled case law. Contract practice in this field is not widely standardized and experience shows that the texts of guarantee agreements are not always free from uncertainties, ambiguities or inconsistencies. Above all, even the most elaborate and consistent text could not provide answers to all the issues that may arise during the lifetime of the guarantee. There would thus seem to be a need for a set of standard rules that could be conveniently referred to in guarantee agreements.

2. *Uniform international rules*

(a) *ICC Uniform Rules for Contract Guarantees (1978)*

62. In an effort to respond to this need, ICC prepared over a 12-year period of time the earlier mentioned 1978 ICC Uniform Rules for Contract Guarantees (ICC Publication no. 325). These Rules cover tender, performance and repayment guarantees, whether issued by banks or other institutions (hence the term "contract guarantees" instead of "bank guarantees").

63. The issues dealt with in the Rules include the guarantor's undertaking, last date of claim, expiry and return of guarantee, amendments to contracts and guarantees, submission of claim and documentation to support it, applicable law and settlement of disputes. Neither the relationship between the guarantor and the principal nor the relationships between banks are comprehensively dealt with in the Rules.

64. More importantly, the independent nature of the guarantee is not unequivocally stated. One may even get the impression that secondary or accessory guarantees are covered when seeing, for example, the term "surety" included in article 1: "These rules apply to any guarantee, bond, indemnity, surety or similar undertaking, however named or described . . ." Above all, the Rules recognize only conditional guarantees, without expressly so stating.

65. As explained in the Introduction to the Rules, it was "not found advisable to make provision for so-called simple or first demand guarantees, under which claims are payable without independent evidence of their validity". The reason given therefor was "to invest guarantee practice with a moral content". The requirement of independent evidence is set forth in article 9 which, leaving aside its subparagraph *a)* on tender guarantees, reads as follows:

> "If a guarantee does not specify the documentation to be produced in support of a claim or merely specifies only a statement of claim by the beneficiary, the beneficiary must submit:
>
> *a)* . . .
>
> *b)* in the case of a performance guarantee or of a repayment guarantee, either a court decision or an arbitral award justifying the claim, or the approval of the principal in writing to the claim and the amount to be paid."

66. It is obvious that article 9 does not give effect to a simple demand guarantee. Less obvious is a weakness that may constitute a trap to an unwary party. Taken literally, the chapeau would embrace a simple demand guarantee, since it is one which "merely specifies only a statement of claim by the beneficiary", and such guarantee would then, if subjected to the Rules, undergo a mutation to a guarantee payable only with the principal's consent or after a decision of a court or arbitral tribunal.

67. The failure to give effect to demand guarantees and the limited range of issues covered by the Rules are probably the main reasons for the fact that the Rules have not become widely accepted and used.

(b) *ICC Draft Uniform Rules for Guarantees (1988)*

68. Aware of the limited success of its 1978 Uniform Rules, ICC has undertaken a new effort towards preparing uniform rules for guarantees, indemnities, bonds and similar undertakings. Entrusted with this task is the Joint Working Party "Contractual Guarantees", composed of five members each of the ICC Commission on Banking Technique and Practice and the ICC Commission on International Commercial Practices.

69. The Joint Working Party decided, after extensive discussions, to take as the basis of its work a Code of

Practice for Demand Guarantees and Bonds drawn up by the Committee of London and Scottish Bankers and to incorporate certain provisions of the 1978 ICC Uniform Rules on Contract Guarantees. At its meeting on 7 and 8 January 1988, the Joint Working Party agreed upon a first draft of ICC Uniform Rules for Guarantees. It should be noted that this draft must be reviewed by the two ICC Commissions and it may be referred back to the Joint Working Party for further consideration.

70. This first draft has been reproduced in the annex to this report so as to provide information on the range of issues covered and on the current thinking within ICC as regards the general approach and individual solutions. This information may assist the Commission in considering any future activities in this field and, in particular, any means of co-operation with ICC (as suggested later, paras. 94-99).

III. Some legal issues and practical problems

71. The ICC Draft Uniform Rules for Guarantees provide a good indication of the range and kind of issues that may arise in guarantee operations. There are further issues that may be mentioned here, without taking a stand on whether they should be included in a future version of the Rules. First, a number of issues may come up in the relationship between the principal (account party, applicant) and his bank, pertaining, for example, to uncertain, inconsistent or incomplete instructions or to the matter of cover or reimbursement. Then, there are additional issues relating to activities of the bank such as the issuance of guarantees by teletransmission, including questions of authentication, or the involvement of a bank as a mere advising bank or as an agent claiming or collecting on behalf of the beneficiary. Other questions may relate to amendments of the guarantee, any instructions in this respect by the principal, or the possible refusal by the beneficiary to accept the guarantee.

72. Of all the issues, whether or not covered by the current ICC draft, only a few can be discussed here by way of illustration. The following issues have been selected for reasons of their practical relevance and the need for clear and uniform solutions. They would in part be covered by the guarantee agreement and otherwise remain to be answered by the applicable law.

A. *Stipulated terms and conditions of payment*

73. Since the undertaking of the guarantor is based on the contractual principle of party autonomy and in recognition of the independent nature of the guarantee, the guarantor's obligations are determined by the terms of the guarantee agreement, subject to any limitation imposed by mandatory provisions of law. Problems encountered in this context tend to be due to uncertain or inconsistent formulations in the agreement.

1. *Amount and possible reduction*

74. The amount payable under a guarantee is often calculated in proportion to the value of an underlying obligation such as a certain percentage of the contract price. However, the use of percentage figures may create doubts as to the precise reference point, in particular in case of changes in the underlying transaction, and might even cast doubt on the independent character of the guarantee. Therefore, the amount of the guarantee is often expressed in absolute terms, at least as a maximum amount.

75. Especially performance guarantees relating to long-term projects tend to provide for a gradual reduction of the amount payable in accordance with the progress of the works. The mechanism for reduction would specify the extent of the reduction and link it to particular phases of the works. However, the mere indication of these phases would not be appropriate for an independent guarantee; certificates of partial completion or acceptance might be required so that guarantors are in a position to determine the amount due on the basis of documents.

2. *Statement of claim and any supporting documents*

76. A variety of requirements for calling the guarantee has been developed and used, based on varying commercial factors such as bargaining power, confidence and assessment of risk. The claim may be unconditional as in the case of a true simple demand guarantee where a demand suffices, or it may have to be accompanied by the beneficiary's statement about the principal's default. A general declaration to that effect may be sufficient, or the beneficiary may be required to state more details; for example, the nature of the principal's breach of his obligations, the fact that as a result the beneficiary is entitled to payment of the claimed amount and that the amount has not yet been paid to him. Yet another requirement as to the content of the statement may be a submission to arbitration (or court jurisdiction) to enable the principal to recover the amount in case of an unjustified call. It may be questioned whether any of these statements or declarations, even if in writing, constitutes a document—a question that may arise in applying provisions of the UCC or UCP to stand-by letters of credit, since such letters of credit often require only a pro-forma declaration by the beneficiary and, perhaps, presentment of a sight draft.

77. However, there can be no doubt of the documentary nature of other writings required to call a credit, even though only few of them resemble the commercial documents used in documentary credit operations (see earlier case of secondary payment, para. 30). In particular, in order to implement the purpose of the guarantee to guard against the risk of default, the required writings may relate to evidencing any kind of default, whether it be non-performance, non-conformity or late performance of construction, supply or payment obligations. Evidentiary documents of this type may be established by the engineer on site or another technical expert agreed upon for that

purpose. Yet other requirements are those envisaged in subparagraph *b)* of article 9 of the 1978 ICC Uniform Rules on Contract Guarantees (cited above, para. 65); namely, consent of the principal or decision of a court or arbitral tribunal.

78. There exists, thus, a wide range of possible requirements reflecting the variety of commercial needs. The fewer the conditions, the more the guarantee functions like a security deposit, shifting the burden of litigation, but not tying up capital. The more demanding the requirement as to establishing proof of default, the more the guarantee resembles an accessory type of guarantee (e.g. surety). While this impression is understandable from a practical point of view, legal analysis allows and requires a distinction to be made between documentary requirements, even if those documents relate to occurrences in the underlying transaction, and a direct link of dependence between the guarantee undertaking and any terms or events in that transaction.

79. However, the distinction between payment conditions that require the beneficiary to state that there has been default by the principal or to submit documentary evidence of such default and making payment accessory to the valid existence and breach of an obligation easily becomes doubtful where an otherwise clearly independent guarantee contains formulations such as "if the contractor does not perform his obligations" or "in case of the principal's breach of contract". Specific wordings of this nature place the guarantee in danger of being classified as accessory and subject to suretyship law, in particular by those courts that still hesitate to recognize in full independent guarantees.

3. *Validity period and expiry*

80. Certainty is especially desirable as regards the validity period of the guarantee and thus the liability of the guarantor and its right to charge commission or fees. The starting point, i.e. the date when the guarantee enters into effect, should be clearly defined; where it depends on events, e.g. awarding of contract or receipt of advance payment, difficulties may be avoided by tying the start of the guarantee period to the receipt of documentary evidence or notice thereof by the guarantor.

81. The more crucial point is the expiry of the validity period. Again, a definite date is preferable to any link with an occurrence or element of the underlying transaction (e.g. awarding of contract to other bidder, completion of project or expiry of warranty period). Problems may be reduced by requiring evidence or notice or by stipulating in addition an ultimate final date.

82. Whatever the agreed expiry date, it may turn out not to be valid or in practical terms not effective. No serious difficulties are encountered with termination prior to the expiry date by virtue, for example, of agreed cancellation, release by the beneficiary or return of the guarantee instrument. Considerable problems arise, however, from possible continuation or extension of the validity beyond the agreed expiry date. Such prolongation may be imposed by provisions of law found in some States which, for example, deny the expiry effect as long as the beneficiary retains the guarantee instrument or may even prescribe a statutory limitation period of up to 30 years.

83. More common is, at a practical level, the serious problem that has been labelled as the "pay or extend" demand. Especially in respect of an unconditional guarantee, the beneficiary may reinforce a demand for extension by threatening to call the guarantee. While the demand may be legitimate and justified on the ground that the secured contingency may still occur and thus the commercial purpose of the guarantee is not yet obsolete, there exists a potential for abuse. In either case, the principal has little choice but to agree to the extension. Since the guarantor often has little time for obtaining the principal's instructions, some bank-customer agreements confer a discretion on the guarantor to extend the validity period, which places considerable responsibility on the guarantor and may not be in the best interest of the principal.

B. *Fraud exception, other objections and supportive court measures*

84. In addition to limits following from the terms of the guarantee, especially conditions of payment, some other exceptions or objections may come into play based on statutory or case law. For example, a finding that the underlying transaction violates public policy or involves an unlawful activity may be a ground for objecting to payment. As mentioned above (para. 59), other instances of invalidity, termination or mere modification of the underlying contract, or the fact that the principal's default was due to an act or omission by the beneficiary may as such constitute the basis of an objection in those jurisdictions that do not adhere strictly to the principle of independence. Depending on the particular circumstances, they may also fall under the fraud exception, which, as noted above (para. 60), is not in conflict with that principle.

1. *Fraudulent or unfair calling*

85. As in the context of traditional documentary credits, fraud may relate to commercial documents presented by the beneficiary. Since such documents are normally issued by another person, the fraudulent act may consist of forging that person's signature or of inducing that person to make an untrue statement. The potential for fraud or abusive calls of guarantees or stand-by letters of credit is considerably enlarged by reason of the fact that often only a statement by the beneficiary himself is required or even a simple demand suffices. While the frequency of fraudulent, unfair or improper calls cannot be assessed with any degree of accuracy, court decisions in various countries bear evidence of the occurrence of such instances in a variety of fact settings. In addition, there is potential for threatening to call the guarantee as a means of securing an advantage in the underlying relationship.

86. In those jurisdictions where courts have had to deal with actions or with requests for interim measures based on alleged fraud the fraud exception has generally been recognized. However, its precise scope and application differ from country to country in various respects, and within certain jurisdictions the attitude of courts has been changing during recent years.

87. As regards the substantive scope, a difference of considerable practical importance stems from the fact that in some jurisdictions the fraud exception has been extended beyond fraud to cover instances of blatant abuse, manifest arbitrariness or bad faith. Even concerning the question whether a particular act amounts to fraud there exists a divergency of views that is wider than seems natural or necessary in the use of such a general concept as fraud. Different positions are taken, for example, as regards the relevance of fraudulent conduct by a person other than the beneficiary, or of apparently extraneous, possibly political, motives of the beneficiary, or of difficulties the principal may later face in trying to recover from the beneficiary an improperly obtained amount. Another example of divergency and uncertainty arising in the more complex situation of an indirect guarantee is whether a back-to-back or counter-guarantee may be called by a guarantor who paid upon a fraudulent or abusive call, perhaps without attempting to resist the call, although there was no collusion with the beneficiary.

88. Moreover, no uniformity exists as regards the required degree of certainty of the guarantor's knowledge of the fraud and, at the procedural level, the required evidence and the standard of proof. Thus, for the same type of court measure (e.g. injunction blocking payment) diverse requirements have been used such as absolute proof, strong evidence, *prima facie* evidence, high degree of probability, sometimes admitting only documentary evidence, excluding affidavits, or allowing any ready means of evidence.

2. *Court measures blocking payment*

89. Considerable divergency exists also in respect of the types and conditions of court measures that may be available in cases of alleged fraud or other objections. The most common interim measures are injunctions or similar orders that enjoin the beneficiary from calling the guarantee or the guarantor from paying it (*défense de payer*). Their availability depends on the particular requirements of the procedural law and on the varying judicial attitudes towards guarantee cases. In addition to the above questions of evidence, matters of divergency are, for example, which persons are entitled to obtain such measures, the extent of probable harm to the person applying, the period of time during which the measure would remain in effect, and the possible extra-territorial effect of the measure.

90. A variety of other court measures essentially aiming at freezing or conserving funds have been considered and tried in various jurisdictions and granted by some courts. Such measures are, for example, sequestration of funds held by the guarantor, seizure of such funds, attachment of the beneficiary's right of claiming the guarantee, arrest of the proceeds obtained, or injunction enjoining the movement of the assets out of the jurisdiction. The particular requirements and availability of any such measures in guarantee or stand-by letter of credit cases varies from country to country.

CONCLUSIONS

91. On the basis of the above account, a number of conclusions may be drawn that may assist the Commission in considering the desirability and feasibility of any future activity in this field. What was referred to at the fifteenth session as the letter of credit used in non-sale transactions is essentially the stand-by letter of credit used at times also in sales transactions. By its function and purpose, the stand-by letter of credit differs considerably from the traditional commercial letter of credit or documentary credit and is equivalent to independent bank guarantees and similar indemnities.

92. Stand-by letters of credit and guarantees play an important role in commercial practice and raise essentially the same kind of issues. Both types of instruments are used in a legal framework shaped by varying case law and rarely by statutory provisions. A general source of difficulties has been identified for each type of instrument. As regards stand-by letters of credit, it is often doubtful whether a given provision of the law on letters of credit is applicable, i.e. appropriate in view of the special nature and purpose of the stand-by letter of credit. As regards guarantees, uncertainty arises from the fact that the autonomy or independent nature of the undertaking is not yet recognized in full and firmly established in all jurisdictions.

93. When it comes to specific legal issues in the context of stand-by letters of credit or guarantees, difficulties are often due to the unsettled, unrefined state of the applicable law and the divergency of positions taken in different jurisdictions. Uncertainty and disparity may hinder the smooth functioning of guarantee operations in international cases where at least the principal and the beneficiary have their places of business (and their banks) in different States and where the laws of more States may become relevant by reason of the fact that, for example, banks in third countries are involved or that the guarantee forms part of a complex international network of contracts and connected guarantees. Moreover, individual stand-by letters of credit or guarantee agreements are unable to provide all necessary answers, their terms are not always consistent and they may be interpreted differently depending on the varying concepts and perceptions of the courts.

94. The Commission may thus wish to conclude that a greater degree of certainty and uniformity would be desirable. The foremost means of achieving this would be a comprehensive and consistent set of rules that parties may refer to in guarantees and stand-by letters of credit. In this respect, the recent efforts of ICC in

preparing uniform rules should be welcomed. The draft Uniform Rules for Guarantees, annexed to this report, deserve careful consideration and examination as regards the range of issues covered and, in particular, the individual solutions currently suggested. This would allow the Commission, with its balanced representation of all regions and the various economic and legal systems, to assess the world-wide acceptability of the draft Rules.

95. While the Commission may wish to hold a preliminary exchange of views at this session, it would seem appropriate to provide an opportunity for more extensive discussions and possible recommendations to ICC after representatives have had a chance to consult interested circles in their countries. If the Commission would agree with this suggestion, it may wish to authorize its Working Group on International Contract Practices to hold a session for that purpose, possibly in November of this year.

96. The Working Group might also be requested to consider more closely, in the light of its examination of the ICC draft Rules, the following two ideas relating to needs that no set of contractual rules may meet. First, while uniform rules cover guarantees of all types with various degrees of payment conditions, it may be desirable to facilitate and standardize the drafting of individual guarantees of specific types. This might be done by means of model forms or, borrowing the technique employed in the Incoterms, by "Guaranterms" setting forth a variety of terms and specifying the rights and obligations of the parties under the selected term.

97. Secondly, since there are some important matters that remain subject to mandatory law and may not be regulated by the agreement of the parties, including by uniform rules incorporated into the agreement, it may be desirable to strive for greater uniformity at the statutory level. For example, uniform rules may contain provisions consistent with the independent nature of a guarantee, but the final and full recognition of such independence depends on its acceptance by the law. It would thus be an appropriate topic for a uniform law to specify clearly whether, and if so which, objections relating to the underlying transaction may be raised as a matter of law to the payment of the guarantee and to state expressly that otherwise only those objections are permitted that follow from the terms of the guarantee agreement or stand-by letter of credit. Other suitable issues may be those mentioned above where mandatory provisions of law currently frustrate agreements of the parties (e.g continuation of validity period beyond agreed expiry date).

98. Probably the most important topic for a uniform law would be the vexing problem of fraudulent or abusive calls and of appropriate court measures. The problem, which was at the heart of a previous note of the secretariat on stand-by letters of credit (A/CN.9/163), cannot effectively be dealt with by contractual rules. Without underestimating the difficulties of agreeing on the scope of the fraud exception and of supportive court measures, it is submitted that at least an attempt in this direction might be made. Based on suggestions by practitioners, it is further submitted that it would be useful to consider whether a uniform law might cover not only guarantees and stand-by letters of credit, but also traditional letters of credit. While the extent and the circumstances of fraud in documentary credits may be different, the legal problem is essentially the same and it cannot be solved by contractual rules (i.e. UCP).

99. Other topics that could be addressed in any future uniform law are, for example, court jurisdiction, arbitration and the applicable law. A uniform law could help to overcome the present disparity in matters that are governed by mandatory provisions of law. It could also come to the aid of parties who did not settle other questions in their guarantee agreement or letter of credit. Finally, a uniform law could and should guarantee the parties' freedom and give full effect to their agreement, including a reference to UCP or any uniform rules on guarantees that might be adopted. If the Commission were to pursue the idea of a uniform law, it may wish to request the secretariat to prepare a study, in consultation with ICC, on the possible features and the issues that might appropriately be covered. The study might also suggest whether a model law or convention would be preferable to a uniform law, or that issue might be deferred to a later time.

ANNEX

(Reproduced here is a first draft of ICC Uniform Rules for Guarantees agreed upon by a Joint Working Party on 8 January 1988)

ICC DRAFT UNIFORM RULES FOR GUARANTEES

INTRODUCTION

These Uniform Rules have been drawn up by an ICC Joint Working Party of members representing the Commission on International Commercial Practices and the Commission on Banking Technique and Practice to apply to the use of guarantees world-wide. Their purpose is to provide a basis for consistency of treatment by the parties to these engagements and the resolution of problems notably in relation to claims and expiry.

The Rules have been drafted to take account of and to encourage the issue of guarantees which provide for the documentary support of claims and for reduction of the guarantee amount against delivery documents or against

dates. They aim also at reducing the common expiry problems encountered with guarantees. One purpose, therefore, is to provide a framework within which equitable guarantee arrangements between principals and beneficiaries can continue to develop. The Rules intend to encourage a better understanding and standard practice in the use of guarantees.

The ICC hopes these Rules will make a major contribution to regulating guarantees by providing the basis on which parties can operate consistently. The Rules aim, by encouraging good guarantee practice, to achieve a fairer balance between the interests of the parties concerned and to deal with problems that arise.

As with the Uniform Customs and Practice for Documentary Credits (ICC Publication No. 400), this is a voluntary set of rules which does not confront the difficulties and conflicts arising from different national systems of law, and it recognises for example that specific requirements in some countries will have to be met. As a general guide, therefore, principals will be required to indemnify Guarantors against the consequences of foreign laws and usages. These Rules will largely depend for their eventual success, as did the Uniform Customs and Practice, upon their adoption and employment by the international business community. It is acknowledged that there may remain situations for a period of time in which some guarantees will not by their terms or because of the specific requirements of certain countries fall within all the articles hereafter, but the frequency of such cases would be expected to diminish.

A. Scope and application of the rules

Article 1

These Rules apply to any guarantee, indemnity, bond or similar engagement however named or described (hereinafter "Guarantee") unless otherwise provided in the Guarantee or any amendment thereto which a Guarantor (as hereinafter described) is instructed to issue and which states that it is subject to the Uniform Rules for Guarantees of the International Chamber of Commerce (Publication No. XXX).

B. Definitions

Article 2

(a) For the purposes of these Rules a Guarantee means an undertaking given by a bank, insurance company or any other party (hereinafter "the Guarantor") at the request of a Principal or given on the instructions of a bank, insurance company or any other party so requested by the Principal (hereinafter the "Instructing Party") to another party (hereinafter the "Beneficiary") to secure him in respect of a specified obligation.

(b) A Guarantee may be confirmed at the request of a Guarantor by another party (hereinafter "Confirming Guarantor"). Such an engagement is in addition to that of the Guarantor and may be described as confirming, joining-in, endorsement of, or counter-signing a Guarantee.

C. General provisions

Article 3

All instructions for and amendments to the Guarantee should be clear, precise and avoid excessive detail. Accordingly all Guarantees should stipulate:

(a) the name of the Principal;

(b) the name of the Beneficiary;

(c) the underlying transaction requiring the issue of the Guarantee;

(d) a total amount payable and the currency in which it is payable;

(e) the date and/or event of expiry of the Guarantee;

(f) the terms and procedures for claiming payment.

Article 4

Unless otherwise provided in the Guarantee, Guarantors and Confirming Guarantors shall not accept any assignment or other form of disposition which the Beneficiary may make, or may purport to make, of the Guarantee and, despite any knowledge of any such disposition, the Guarantor and Confirming Guarantor shall be deemed to remain solely liable to the first Beneficiary for the benefit of the Guarantee and its proceeds.

Article 5

All Guarantees are irrevocable.

Article 6

A Guarantee enters into effect as from the date of its issue to the Beneficiary, unless its terms expressly provide that its effectiveness is subject to conditions (e.g., written notification of an award of contract, the receipt of specified advance payment monies or any other event).

Article 7

Each Guarantee is by its nature separate from any underlying transaction and from any obligation for which the Guarantee may be security. Guarantors and Confirming Guarantors shall in no way be concerned with or bound by any such transaction even if any reference whatsoever thereto is included in the Guarantee. A Guarantor's or Confirming Guarantor's obligation of performance of any Guarantee is solely to pay the sum or sums specified therein.

Article 8

Except where the relevant Guarantee expressly provides otherwise, in guarantee operations the words "to", "until", "till", "from" and words of similar import applying to any date or term will be understood to include the date mentioned.

Article 9

Unless otherwise expressly provided in the Guarantee all interest, commission, charges and expenses arising in the course of guarantee operations will be for the account of the Principal.

D. Liabilities and responsibilities of guarantors

Article 10

All documents presented to a Guarantor or Confirming Guarantor shall be examined by that Guarantor or Confirming Guarantor with reasonable care to ascertain on their basis alone whether or not they appear on their face to be in compliance and conformity with the terms and conditions of the relevant Guarantee. Where such documents do not appear so to conform or appear on their face to be inconsistent with one another, they shall be rejected.

Article 11

(a) A Guarantor or Confirming Guarantor shall have reasonable time in which to examine a claim in respect of the Guarantee and to determine whether to pay or to reject the claim.

(b) If such Guarantor or Confirming Guarantor determines to reject a claim, it will give notice without delay by telecommunication or (if that is not possible) by other expeditious means to that effect to the Beneficiary.

Article 12

Subject to Article 16 hereunder Guarantors and Confirming Guarantors, in the course of guarantee operations, assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification, or legal effect of any guarantee document or for the general and/or particular statements made therein, or for the good faith or acts and/or omissions of any person whomsoever.

Article 13

In the course of guarantee operations, Guarantors and Confirming Guarantors, insofar as they have exercised reasonable care assume no liability or responsibility for consequences arising out of delay and/or loss in transit of any messages, letters, claims or documents, or for delay, mutilation or other errors arising in the transmission of any telecommunication, or for errors in translation or interpretation of technical terms. Guarantors and Confirming Guarantors reserve the right to transmit Guarantee texts or any parts thereof without translating them.

Article 14

In the course of guarantee operations, Guarantors and Confirming Guarantors assume no liability or responsibility for consequences arising out of interruptions of their business by acts of God, riots, civil commotions, insurrections, wars or other causes beyond their control or by strikes, lock-outs or industrial action of whatever nature.

Article 15

If in the course of guarantee operations an Instructing Party and/or Guarantor utilises at the Principal's request the services of another party as Guarantor or Confirming Guarantor it does so for the account and at the risk of the Principal, and an Instructing Party and/or Guarantor assumes no liability or responsibility should the issuing or confirming instructions (or amendments thereto) not be carried out in whole or in part, even if it has itself taken the initiative in the choice of such other party as Guarantor or Confirming Guarantor.

Article 16

Guarantors and Confirming Guarantors shall not be excluded from liability or responsibility under the terms of Articles 12, 13 and 15 above for their own or their servants' grossly negligent or wilful acts or omissions.

E. Claims

Article 17

A Guarantor or Confirming Guarantor is liable to the Beneficiary only in accordance with the terms and conditions specified in the Guarantee (and any amendment thereof), and in these Rules and up to an amount not exceeding that stated in the Guarantee and any amendment thereof.

Article 18

In the event of a claim, each Guarantor involved in the guarantee operations shall inform its Instructing Party without delay.

Article 19

A Guarantee may contain express provision for reduction by a specified or determinable amount or amounts on a specified date or dates or upon presentation to the Guarantor or the Confirming Guarantor of document(s) specified for this purpose.

Article 20

The amount payable under a Guarantee shall be reduced by the amount of any payment made in satisfaction of a claim in respect thereof and, where the total amount payable under a Guarantee has been satisfied by payment and/or reduction, the Guarantee shall thereupon terminate.

F. Submission of claims

Article 21

A claim must be made in accordance with the terms and conditions of the Guarantee and, in particular, all specified documents must be presented to the Guarantor or the Confirming Guarantor on or before the expiry date of the Guarantee, otherwise the claim will be rejected.

Article 22

Any claim presented to the Guarantor or Confirming Guarantor must be in any one of the following agreed forms of written demand:

(a) the Beneficiary's written demand incorporating his statement that the Principal is in breach of his obligation(s) and indicating the nature of such breach; or

(b) the Beneficiary's written demand incorporating his statement that the Principal is in breach of his obligation(s) indicating the nature of such breach and supported by the documents to be specified in the Guarantee; or

(c) the Beneficiary's written demand incorporating his statement (i) indicating that the Principal is in breach of his obligation(s) and, (ii) indicating the nature of such breach and, (iii) declaring that as a result thereof the Beneficiary has become entitled to payment of the amount claimed by him and that the amount claimed has not been paid whether directly or indirectly, by or on behalf of the Principal or by any form of set off; and, (iv) supported by such other documents as may be specified in the Guarantee.

Where a Guarantee is issued and is expressed to be subject to these Uniform Rules and provides for claims by or on behalf of the Beneficiary on the Beneficiary's simple demand without any statement or document in support, it shall be deemed to have been issued in accordance with this Article and claims must comply with paragraph *(a)* of this Article.

G. Payment of the claim

Article 23

After paying a claim the Guarantor or Confirming Guarantor shall submit without delay the Beneficiary's claim documents to the Principal or to the Instructing Party or Guarantor for transmittal to the Principal.

H. Guarantee expiry provisions

Article 24

Expiry of a Guarantee must be indisputable; that is, upon a specified final date for the presentation of claims ("Expiry Date") or upon presentation to the Guarantor or the Confirming Guarantor of document(s) specified for the purpose of expiry ("Expiry Event"). If both an Expiry Date and an Expiry Event are specified in a Guarantee, the Guarantee will expire on whichever of the Expiry Date or Expiry Event occurs first. A Guarantor or a Confirming Guarantor shall have no obligation in respect of claims received after the Expiry Date or the Expiry Event specified in the Guarantee.

Article 25

Where a Guarantor has been given instructions for the issue of a Guarantee but the instructions are such that, if they were executed, the Guarantor would by reason of law be unable to observe any expiry provision of the relevant Guarantee, the instructions shall not be executed and the Guarantor must immediately inform the Instructing Party of the reasons for such inability and request appropriate instructions from that Instructing Party.

Article 26

Irrespective of any expiry provision contained therein, a Guarantee will be deemed to be cancelled on presentation to the Guarantor or the Confirming Guarantor of the Beneficiary's written statement of cancellation of the Guarantee, whether or not the Guarantee or any amendments thereto are returned with such statement.

Article 27

Where a Guarantee has terminated (by payment, expiry, cancellation or otherwise) retention of the Guarantee or of any amendments thereto shall not preserve any rights under the Guarantee.

Article 28

Where a Guarantee has terminated (by payment, expiry, cancellation or otherwise) or there has been a reduction of the total amount payable thereunder a Guarantor or Confirming Guarantor shall, in turn, so notify the party which gave that Guarantor or Confirming Guarantor its instructions in relation to the Guarantee.

Article 29

(a) The Guarantor or Confirming Guarantor shall not extend the validity period of a Guarantee without the approval of the Principal even if a request for extension is presented as an alternative to payment under the Guarantee.

(b) If the Beneficiary requests such an extension as an alternative to his demand for payment in accordance with the terms and conditions of the Guarantee, the Guarantor or Confirming Guarantor shall so inform the party which gave that Guarantor or Confirming Guarantor its instructions in relation to the Guarantee and shall defer payment of the claim for such time as the Guarantor or the Confirming Guarantor shall consider reasonable to permit the Principal and the Beneficiary concerned to reach agreement on the granting of such extension. That Guarantor or Confirming Guarantor shall incur no liability (for interest or otherwise) should any payment to the Beneficiary be delayed as a result of the above-mentioned procedure.

Article 30

(a) For the purposes of this Article, a "business day" of any Guarantor or Confirming Guarantor is a day on which that Guarantor or Confirming Guarantor is, or apart from any cause specified in Article 14 would be open for guarantee operations.

(b) If, apart from the provisions of this paragraph *(b)*, a Guarantee would expire on any other day than a business day of the Guarantor or the Confirming Guarantor, expiry of the Guarantee shall be deferred until the next following business day of that Guarantor or Confirming Guarantor respectively and expiry of any undertaking between a Guarantor or a Confirming Guarantor and an Instructing Party shall be deferred by the same number of days.

(c) In addition, in any case where there is a Confirming Guarantor and/or an Instructing Party and any undertaking between a Guarantor and a Confirming Guarantor and/or between a Guarantor or Confirming Guarantor and an Instructing Party would, apart from the provisions of this paragraph *(c)*, expire on any other day than a business day of the Guarantor or Confirming Guarantor on whom claims may be presented under that undertaking, expiry of such undertaking shall be deferred until the next following business day of that Guarantor or Confirming Guarantor respectively. Where expiry of an undertaking is so deferred expiry of any earlier undertaking between a Guarantor and a Confirming Guarantor and/or between a Guarantor or Confirming Guarantor and an Instructing Party shall be deferred by the same number of days.

(d) In any case where a Guarantor or Confirming Guarantor invokes the provisions of this Article in relation to an undertaking as referred to above, that Guarantor or Confirming Guarantor shall be required to present a statement that a claim under a Guarantee has been made upon him on a specified day which was not a business day for him under Article 30 *(b)* of the Uniform Rules for Guarantees of the International Chamber of Commerce (Publication No. XXX).

I. Applicable law and jurisdiction

Article 31

Unless otherwise provided in the Guarantee the applicable law is that of the Guarantor's place of business. If the Guarantor has more than one place of business, the applicable law is that of the branch which issued the Guarantee.

Article 32

If the parties have not agreed to the jurisdiction of any specific court, then any dispute between them relating to the Guarantee shall be settled exclusively by the competent court of the country of the Guarantor's place of business or, if the Guarantor has more than one place of business, by the competent court of the country of the branch which issued the Guarantee.