II. GUARANTEES AND STAND-BY LETTERS OF CREDIT

A. Report of the Working Group on International Contract Practices on the work of its eighteenth session

(Vienna, 30 November-11 December 1992) (A/CN.9/372) [Original: English]

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INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,[1] the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce (ICC) and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit (A/CN.9/316). The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

2. The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and entrusted this task to the Working Group.[2]

3. At its thirteenth session (A/CN.9/330), the Working Group commenced its work by considering possible issues of a uniform law as discussed in a note by the Secretariat (A/CN.9/WG.II/WP.65). Those issues related to the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of the guarantee or stand-by letter of credit. The Working Group requested the Secretariat to submit to its fourteenth session a first draft set of articles, with possible variants, on the above issues as well as a note discussing other possible issues to be covered by the uniform law.

[1] *Official Records of the General Assembly, Forty-third Session, Supplement No. 17* (A/43/17), para. 22.

[2] Ibid., *Forty-fourth Session, Supplement No. 17* (A/44/17), para. 244.

4. At its fourteenth session (A/CN.9/342), the Working Group examined draft articles 1 to 7 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.67). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a revised draft of articles 1 to 7 of the uniform law. The Working Group also considered the issues discussed in a note by the Secretariat relating to amendment, transfer, expiry, and obligations of the guarantor (A/CN.9/WG.II/WP.68). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft of articles on the issues discussed. It was noted that the Secretariat would submit to the Working Group, at its fifteenth session, a note on further issues to be covered by the uniform law, including fraud and other objections to payment, injunctions and other court measures, conflict of laws and jurisdiction.

5. At its fifteenth session (A/CN.9/345), the Working Group considered certain issues concerning the obligations of the guarantor. Those issues had been discussed in the note by the Secretariat relating to amendment, transfer, expiry, and obligations of the guarantor (A/CN.9/WG.II/WP.68) that had been submitted to the Working Group at its fourteenth session but had not then been considered, for lack of time. The Working Group then considered the issues discussed in a note by the Secretariat relating to fraud and other objections to payment, injunctions and other court measures (A/CN.9/WG.II/WP.70). The Working Group also considered the issues discussed in a note by the Secretariat relating to conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft set of articles on the issues discussed.

6. At its sixteenth session (A/CN.9/358), the Working Group examined draft articles 1 to 13, and, at its seventeenth session (A/CN.9/361), draft articles 14 to 27 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.73 and Add.1). The Secretariat was requested to prepare on the basis of the deliberations and conclusions of the Working Group, a revised draft text.

7. The Working Group, which was composed of all States members of the Commission, held its eighteenth session at Vienna, from 30 November to 11 December 1992. The session was attended by representatives of the following States members of the Working Group: Argentina, Austria, Bulgaria, Canada, Chile, China, Czechoslovakia, Ecuador, Egypt, France, Germany, Hungary, Iran (Islamic Republic of), Japan, Kenya, Mexico, Morocco, Nigeria, Poland, Russian Federation, Saudi Arabia, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay.

8. The session was attended by observers from the following States: Australia, Bolivia, Brazil, Finland, Greece, Indonesia, Lebanon, Malaysia, Netherlands, Nicaragua, Peru, Philippines, Republic of Korea, Romania, Sweden, Switzerland and Ukraine.

9. The session was attended by observers from the following international organizations: International Monetary Fund (IMF), Hague Conference on Private International Law, Banking Federation of the European Community, International Bar Association, International Union for Marine Insurance (IUMI).

10. The Working Group elected the following officers:

Chairman: Mr. J. Gauthier (Canada)

Rapporteur: Mr. A. Faridi Araghi (Islamic Republic of Iran)

11. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.75), a note by the Secretariat containing the revision of a draft Convention on international guaranty letters (A/CN.9/WG.II/WP.76 and Add.1) and a note containing a proposal of the United States of America relating to draft rules on stand-by letters of credit (A/CN.9/WG.II/WP.77).

12. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a draft Convention on international guaranty letters.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

13. It was noted that the draft rules on stand-by letters of credit as proposed by the United States of America (A/CN.9/WG.II/WP.77) were based on the assumption that independent guarantees and stand-by letters of credit would be dealt with in separate parts of the future Convention. It was agreed that the need for such treatment in separate parts could appropriately be determined only when it was clear which, and how many, provisions should be applicable exclusively to bank guarantees or to stand-by letters of credit. The Working Group thus focused its discussion on the draft articles prepared by the Secretariat (A/CN.9/WG.II/WP.76), with special attention to the question whether a given rule was appropriate for both types of undertakings or for only one of them.

14. The deliberations and conclusions of the Working Group relating to draft articles 1 to 8 of the draft Convention are set forth below in chapter II. The Secretariat was requested to prepare, on the basis of those conclusions, a revised draft of articles 1 to 8.

II. CONSIDERATION OF ARTICLES OF A DRAFT CONVENTION ON INTERNATIONAL GUARANTY LETTERS

Chapter I. Sphere of application

Article 1. Substantive scope of application

15. The text of draft article 1 as considered by the Working Group was as follows:

"This Convention applies to international guaranty letters [issued in a Contracting State]."

16. The Working Group reaffirmed its decision taken at its seventeenth session to proceed on the working assumption that the final text would take the form of a convention without thereby precluding the possibility of reverting to the more flexible form of a model law at the final stage of the work (A/CN.9/361, para. 147).

17. Divergent views were expressed as regards the term "international guaranty letters" used in article 1 to delimit the substantive scope of application of the draft Convention. One view was in favour of retaining that term since it embraced in a suitably short way the two types of undertakings to be covered by the Convention, i.e. demand guarantees and stand-by letters of credit. Moreover, the term was in line with the current approach of having common provisions for both types of undertaking unless in particular cases there was a need for referring to only one of those types. However, consideration might be given to using the common name as a shorthand expression only in the provisions of the draft Convention but not in its title where the naming of both types of undertaking might better signal to the reader what the Convention was intended to cover.

18. Another view was that the term was inappropriate since it was not reflective of terminology used in practice. It should therefore be replaced by terms such as bank guarantees (or demand guarantees) and stand-by letters of credit. If, however, there was a need for using a short common name, a truly neutral term such as "undertaking" or "financial assurance" should be used which would not raise the concern of leaning towards one of the two types of undertakings.

19. A concern was that the use of the term "guaranty letter" in the title and article 1 of the Convention might suggest a preference for independent guarantees over accessory guarantees; therefore the qualifier "independent" should be added in the title and article 1. It was stated in reply that article 2 made it clear that only independent guarantees were covered by the Convention.

20. The Working Group was agreed that the need for a common expression depended, at least to some degree, on the future structure of the Convention. If the current approach of largely common provisions (as reflected in document A/CN.9/WG.II/WP.76 and Add.1) was retained, the use of one expression might be preferable from a drafting point of view; if, however, bank guarantees and stand-by letters of credit were to be dealt with in separate parts (as suggested in the United States proposal, A/CN.9/WG.II/WP.77), there would be little need for a common expression.

21. In the light of the divergence of views and the awareness of the linkage with the future structure of the Convention, the Working Group decided to reconsider the terminological issue at a later stage.

22. The Working Group discussed the wording between square brackets "issued in a Contracting State" as a possible criterion for the territorial scope of application of the Convention. It was noted that the suggested wording represented one of various approaches used in commercial law conventions in that it determined its territorial scope of application by a factor connecting the transaction to a Contracting State autonomously without reference to conflict-of-laws rules. Another approach would be not to provide such a connecting factor and to leave the determination of the applicability exclusively to the rules of conflict of laws (private international law). Yet another approach would be to establish one or possibly two connecting factors and, in addition, provide for the applicability of the Convention in cases where conflict-of-laws rules pointed to the law of a Contracting State. Finally, there was the possibility, tentatively suggested in the current draft, of including in the Convention rules on conflict of laws and jurisdiction.

23. Various questions were raised concerning the delimitation of the territorial scope of application in general and concerning the above approaches. One question was whether the Convention would satisfactorily deal with the situation where only the guarantor but not the beneficiary was in a Contracting State or where only the counter-guarantor but not the second bank issuing an indirect guarantee was in a Contracting State. In that connection, it was suggested that, as provided in article 1(1)*(a)* of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as the United Nations Sales Convention), the Convention should apply where the parties concerned had their places of business in different Contracting States. Another question was whether parties in non-contracting States could choose the Convention as governing law. Yet another question was to what extent parties could derogate from provisions of the Convention, only some of which were currently stated to be non-mandatory.

24. As regards the above approaches to determining the territorial scope of application, it was noted that the criterion suggested in article 1 was the same as that suggested in article 27 for determining the law applicable to guaranty letters, failing a choice of law by the parties. While this fact was stated in favour of not providing for a connecting factor in article 1, it was also noted that a territorial factor such as the one suggested would clearly apply to the substantive law provisions of the Convention but not necessarily to the provisions on conflict of laws and certainly not to the provisions of procedural law since those provisions were addressed to the courts of the Contracting States.

25. After deliberation, the Working Group decided to continue its discussion on the territorial scope of application in connection with its discussion on the draft articles on jurisdiction and conflict of laws, in view of the link between those matters.

Article 2. Guaranty letter

26. The text of draft article 2 as considered by the Working Group was as follows:

"(1) A guaranty letter is an independent undertaking [, in the form of a demand guarantee or bond or in the form of a stand-by letter of credit,] given by a bank or

other institution or person (["issuer"] ["guarantor"]) to pay to another person ("beneficiary") [or, if so stipulated in the undertaking, to itself acting as a fiduciary or through another branch] a certain or determinable amount of a specified currency or unit of account [or other item of value] [or to accept a bill of exchange for a specified amount] in conformity with the terms and [any documentary] conditions of the undertaking when so demanded in the manner prescribed in the undertaking.

(2) The undertaking may be given

(a) at the request or on the instruction of the customer ('principal') of the issuer ('direct guaranty letter'),

(b) on the instruction of another bank, institution or person ('instructing party') that acts at the request of the customer ('principal') of that instructing party ('indirect guaranty letter'), or

(c) on behalf of the issuer itself ('guaranty letter on issuer's own behalf')."

Paragraph (1)

27. The Working Group engaged in an extensive discussion of the various elements contained in the definition of "guaranty letter". It was noted that the definition, and especially the introductory wording, was crucial for defining the substantive scope of application of the Convention.

"independent undertaking [,in the form of a demand guarantee or bond or in the form of a stand-by letter of credit,]"

28. Various suggestions were made that represented two divergent approaches. One approach was to introduce in the definition as an essential characteristic of the undertakings to be covered the purpose for which the undertaking was given. That purpose could be expressed by such words as currently used in an indirect and non-exclusive manner in article 3, namely as "securing the beneficiary against the non-fulfilment of certain obligations by the principal or against another contingency" or as "guaranteeing fulfilment of an underlying obligation".

29. In support of that approach, it was stated that the introductory words of article 2(1) defined "guaranty letter" by reference to expressions that were not defined in the Convention and thus did not clearly delimit those types of independent undertakings that were to be covered by the Convention. Without the additional element of the guaranteeing purpose the definition would be too wide and, for example, embrace commercial letters of credit and other independent undertakings for payment against documents. While the guaranteeing purpose did not necessarily have to be stated in the text of each individual undertaking, it was necessary as a common element descriptive of all independent undertakings to be covered by the Convention. The guaranteeing purpose was said to be a practical and understandable point of reference on which the definition could be based. It was also stated that in some countries it was assumed that stand-by letters of credit were issued for the purpose of guaranteeing or backing an underlying obligation and that universal coverage of stand-by letters of credit that were not issued for such purpose would not be well understood.

30. Another approach, opposed to the inclusion of the guaranteeing purpose as an essential requirement, was to refer to the undertakings covered by the Convention by words used in practice to designate those undertakings. This might be done by referring to undertakings designated as bank guarantees or stand-by letters of credit or similarly designated undertakings or, without requiring designation, by merely referring to demand guarantees and stand-by letters of credit as understood and used in the market.

31. In support of that approach, it was stated that the purpose of an undertaking was more a psychological or economic motive than an objective legal element, and that requiring a guaranteeing purpose would introduce an unacceptable degree of uncertainty as to whether the Convention was applicable. Moreover, undertakings were found in stand-by as well as guarantee practice that were not given for a guaranteeing purpose in a strict sense but for purposes of enhancing creditworthiness or for providing an assured mechanism of payment owed by another person (so-called "direct-pay" stand-bys or guarantees). It was further stated that to require a guaranteeing purpose might be construed as establishing a duty of the guarantor or a court to ascertain that purpose, which might erode the independent nature of the undertaking. Even if the purpose was not required to be stated in the individual undertaking, there remained uncertainty as to the consequences of any inaccurate statement of the purpose of a given guaranty letter.

32. While it was recognized that demand guarantees and stand-by letters of credit were typically issued in order to backup an obligation, support was expressed for the approach according to which the Convention would apply to those undertakings without making a particular purpose a definitional requirement for the applicability of the Convention. Nevertheless, it was not considered appropriate to make the applicability dependent solely on the use in the undertaking of the designation "demand guarantee" or "stand-by letter of credit". It was said that the Convention should recognize the use of undertakings that served the same purpose as demand guarantees or stand-by letters of credit, but did not use those designations. In line with this thinking, support was expressed for stating in article 2 that the undertakings covered were independent undertakings designated as demand guarantee (or bank guarantee), stand-by letter of credit or an equivalent instrument typically given to secure the beneficiary against the non-fulfilment of certain obligations by the principal or against another contingency. In connection with this modification of article 2, it was considered appropriate to provide in article 1 that the Convention applied to demand guarantees and stand-by letters of credit.

33. An alternative suggestion was not to reference any typical purpose but to list those independent undertakings that should not be covered. Examples of such undertakings included insurance contracts and, especially, commercial letters of credit, which the Working Group again decided not to cover in the draft Convention, without thereby precluding consideration at a later stage as to the appropriateness of the finally agreed provisions for commercial letters of credit.

34. After deliberation, the Working Group requested the Secretariat to suggest wording, with possible variants, for articles 2 and 1 that would, with possible reference to the guaranteeing purpose but not as an exclusive requirement, draw the line between, on the one side, commercial letters of credit and other undertakings not covered and, on the other side, demand guarantees and stand-by letters of credit as well as similar undertakings that might emerge in the market.

"given by a bank or other institution or person ([issuer] [guarantor])"

35. A concern was expressed that the reference to "person" might be misinterpreted as establishing the right for individual consumers to issue independent guarantees or stand-by letters of credit. At the same time, it was realized that the test of internationality set forth in draft article 4 was likely to limit the practical consequences of such possible misinterpretation. Moreover, it was understood that the Convention as a text of private law was neither designed nor able to deal with regulatory matters of authorization or prohibition of certain activities. However, if it were later felt that any clarification was needed, consideration might be given to including an indication, for example, along the lines of the footnote appended to article 1 of the UNCITRAL Model Law on International Credit Transfers.

36. A view was expressed that it might be appropriate for the draft Convention to contain different rules for those cases where guaranty letters were issued by banks and financial institutions as an ordinary part of their business and for those cases where a guaranty letter was occasionally issued by a non-professional. The prevailing view was that the legal regime applicable to the guaranty letter should not depend upon the professional or non-professional character of the issuer and that the draft Convention should leave it to other applicable rules of law to determine the legal capacity of entities or persons to issue guaranty letters.

37. As regards the reference to the "issuer" or "guarantor" between square brackets, the view was expressed that the term "issuer" was preferable. Apart from being typical of stand-by letter of credit practice, it was described as sufficiently neutral to be applicable to bank guarantee practice as well, while the term "guarantor" might be misunderstood as embracing the issuer of an accessory guarantee. Another view was that the term "guarantor" should be used since it reflected better the characteristic purpose of the undertakings covered.

38. It was felt that, if a single neutral term to designate the issuing entity were to be used, the same should be done in respect of the designation of the customer who requested the issuance of the guaranty letter. Since no agreement could be reached on common terminology, the Working Group decided to maintain in the draft Convention references to both stand-by letter of credit and bank guarantee terminology and to use the double expressions "guarantor or issuer" and "principal or applicant", subject to review by the drafting group that would be set up at the next session.

"to pay to another person ("beneficiary") [or, if so stipulated in the undertaking, to itself acting as a fiduciary or through another branch]"

39. As regards the words "to pay to another person ('beneficiary')", a suggestion was made to replace the word "person" by the words "bank or other institution or person", as used in the preceding wording describing the issuer or guarantor. In the interest of simplicity and brevity of the definition, the Working Group decided not to accept the suggestion.

40. Divergent views were expressed as regards the wording between square brackets ("or, if so stipulated in the undertaking, to itself acting as a fiduciary or through another branch"). One view was that the wording should be deleted. In support of the deletion it was said that the meaning of the wording was unclear and that the practice intended to be covered gave rise to serious concerns. Both the reference to the issuer acting as a "fiduciary" (or trustee) and the reference to "another branch" were said to lack clarity. As regards the latter reference, it was noted that no provision was necessary for the case where the other branch was a separate legal entity.

41. The concerns expressed in respect of the practice intended to be accommodated by the wording included the following. The role of the issuer as a fiduciary was stated to be potentially in conflict with its responsibilities towards the principal or applicant and that such potential conflict of interest had to be guarded against by high standards of fiduciary conduct, as had been imposed by regulatory authorities in some countries. However, the draft Convention should not condone such practice without itself imposing such high standards, and without providing appropriate operational rules for such special situations. Therefore, the preferable approach was to retain only the words "to pay to another person", in line with the approach used in the UCP and the URDG. A less far-reaching suggestion was to use the expression "to pay to the beneficiary" which would enable States to provide for an interpretation of the term beneficiary as encompassing the above fiduciary practice.

42. The prevailing view, however, was that the draft Convention should accommodate that practice which was not only found in the context of stand-by letters of credit but occasionally also with bank guarantees. Unlike the UCP and the URDG which constituted operational rules of practice, the draft Convention had to provide clear legal rules about the rights and obligations of the parties and should therefore contain express wording accommodating that practice. The wording might be clarified by using such expression as "acting for and on behalf of another person" or "acting in favour of another person", instead of using the uncertain concept of fiduciary and the unclear reference to another branch. In order to keep the provision of article 2(1) short and easily readable, it might be sufficient to refer therein simply to payment, or to payment to the beneficiary, and then to include the wording accommodating that practice either in a separate paragraph of article 2 or in article 6.

43. After deliberation, the Working Group requested the Secretariat to prepare revised wording along the lines of the prevailing view.

"a certain or determinable amount of a specified currency or unit of account [or other item of value] [or to accept a bill of exchange for a specified amount]"

44. At the outset, the Working Group was agreed that, in whichever way the object of the payment obligation was finally described in the draft Convention, the reference to "a certain or determinable amount" was necessary in order to provide certainty. It was also agreed that a reference to the possibility of stipulating a specified unit of account might be welcome in view of the increased number of guaranty letters that were stipulated to be payable in units of account.

45. Differing views were expressed as to the desirability of retaining the words "or other item of value", which would place within the scope of the draft Convention guaranty letters in which payment was in a form other than money. A proposal was made to delete those words on the ground that they were too vague and might, for example, embrace services and that any reference to a non-monetary mode of payment might jeopardize the essentially monetary function of the undertaking. It was stated that, while payment in a form other than money might be acceptable if the guaranty letter were conceived primarily as a credit instrument, such mode of payment was not acceptable in the case of an undertaking given for a guaranteeing purpose. The possible need, at the time of payment, to convert an amount of a non-monetary item of value into an amount expressed in a given currency might defeat the purpose of the guaranty letter, which was to ensure prompt payment (a feature described as "moneyness"). While it was felt that payments in precious metals constituted a practice that might increase and should be addressed by the draft Convention, a concern was expressed that payment through commodities might necessitate investigations to ascertain quality, thus detracting from the independence of the guarantor's undertaking. Payment through commodities might implicate various national regulatory laws which might, for example, prohibit certain transfers of commodities.

46. In response, it was stated that inclusion of such instruments within the scope of the draft Convention would not affect the continued applicability of regulatory laws in question. In support of retention of the words "or other item of value", it was also stated that stand-by letters of credit in which payment was made in a form other than money were used and that their use was likely to increase. The draft Convention should therefore include such instruments within its scope so as to avoid restricting the options of the parties, as well as to stay abreast of new forms of payment that might develop in the coming years. It was also suggested that a broad reading of the term "units of account" would not be sufficient to secure coverage of such instruments. The prevailing view was that the question of the modes of payment should be left open to determination by the parties.

47. As regards the reference to the acceptance of a bill of exchange, it was stated that such a mode of payment was rarely used where the main purpose of the undertaking was a guaranteeing purpose. It was stated that it would be contrary to the guaranteeing function to allow the guarantor (or issuer) to accept a bill of exchange instead of paying once the demand was made. Moreover, where a bill of exchange was discounted before it reached its date of maturity, events might occur (e.g., the issuance of a restraining order) that would prevent payment at the date of maturity; in such a case, uncertainties might arise as to whether the obligation under the guaranty letter had been properly discharged. However, the prevailing view was that, since payments by way of acceptance of bills of exchange were used in practice, the draft Convention should validate such practice.

48. The Working Group discussed the question whether paragraph (1) should contain a provision addressing the case where the issuer was to pay the claim under the guaranty letter after the expiry of a stipulated period of time after the demand for payment. The words "or to incur a deferred payment obligation", mentioned in remark 5 to draft article 2 and suggested in article 2(1) of the United States proposal, were mentioned as possible formulation covering such a case. While some support was expressed for including those words since they reflected a practice to which some banks resorted when so requested by their clients, the concern was expressed that the use of those words might be interpreted as requiring the issuer to assume *vis-à-vis* the beneficiary a payment obligation whose nature was unclear, in particular whether there was a separate and additional obligation to be incurred by the issuer after presentation of the demand. Such a duality of obligations would be a source of concern, in particular when there arose an obstacle to the fulfilment of the obligation incorporated in the guaranty letter.

49. After deliberation, the Working Group was agreed that a provision on deferred payment should not envisage the assumption by the issuer of a payment obligation that was separate from the obligation incorporated in the guaranty letter. However, that would not hinder the stipulation in the guaranty letter of a modality of payment such as "X days after receipt of a conforming demand".

50. While the general view was that any acceptable banking practice should be validated by the draft Convention, it was also stated that, as a matter of drafting, it might be preferable not to include such practical considerations as to the object of the payment obligation in a definition of the guaranty letter, which should be limited to listing the essential elements of the guaranty letter.

51. Divergent views were expressed as to whether the possible objects of the payment obligation should be set forth elsewhere in the draft Convention. One view was that the draft Convention should simply refer to an obligation to pay to the beneficiary in conformity with the terms of the undertaking. Such a general statement would allow commercial practice to develop any appropriate means of payment, while an attempt to list acceptable means of payment might be considered as overly exclusionary. Another view was that the draft Convention should accommodate practice in an express and liberal manner. Silence of the draft Convention as to the means through which an obligation of payment under a guaranty letter might be discharged was likely to be interpreted as overly restrictive and could result in a situation where the draft Convention, for failure to expressly recognize a given means of payment, would be

construed as disqualifying means of payment the parties might have agreed upon. It was suggested that wording along the following lines might be included in article 2(2) or article 6:

"Payment may be made in any form specified in the undertaking, including:

(a) a deferred payment;

(b) a specified currency or unit of account;

(c) the acceptance of a bill of exchange for a specified amount; or

(d) any other item of value."

52. After deliberation, the Working Group requested the Secretariat to prepare, in the light of the above suggestions, a revised draft of a provision on acceptable means of payment for later consideration by the Working Group.

"in conformity with the terms and [any documentary] conditions of the undertaking when so demanded in the manner prescribed in the undertaking"

53. The Working Group approved the phrase, subject to the possibility of later reconsidering the expression "any documentary" (particularly the modifier "any"), which was linked to the treatment of non-documentary conditions in draft article 3.

Paragraph (2)

54. The Working Group accepted subparagraphs *(a)* and *(b)*.

55. As to subparagraph *(c)*, a view was expressed that the traditional understanding of a guarantee was that the guarantor answered for the debt of another and that therefore an undertaking issued by the guarantor in support of its own primary obligation could not properly be regarded as a guaranty letter. Particular reservation was expressed with respect to the possibility that a trading enterprise, as opposed to a bank, would issue a guaranty letter on its own behalf. The Working Group, however, recalling its consideration of the matter at its sixteenth session (A/CN.9/358, paras. 24-25), approved the substance of subparagraph *(c)*. A view was expressed that it might be more appropriate to include the possibility of issuing a guaranty letter on one's own behalf in the definition of the guaranty letter; by using that approach, the draft Convention would not appear as portraying the issuance of such undertakings as a practice that was at the same level as the issuance of the undertakings mentioned in subparagraphs *(a)* and *(b)*.

Article 3. Independence of undertaking

56. The text of draft article 3 as considered by the Working Group was as follows:

"(1) [For the purposes of this Convention,] an undertaking is [deemed to be] independent if:

(a) it provides for payment upon demand and presentation of any specified documents [, without any verification of facts that are outside the operational purview of the issuer];

or

(b) it contains [as its heading and] within its text the words 'Stand-by letter of credit' or 'Demand guarantee' [or 'Independent documentary promise' or 'International guaranty letter'].

(2) Where an undertaking referred to in paragraph (1)*(b)* of this article provides for payment upon the occurrence of a future uncertain event without specifying the documentary means for establishing that occurrence, payment is due only upon certification of that occurrence by the beneficiary [or the principal], unless its verification falls within the operational purview of the issuer. The same rule applies to any non-documentary condition for the effectiveness of a guaranty letter or for the [reduction or increase] [adjustment] of its amount.

(3) While the purpose of an undertaking covered by this Convention [would ordinarily be] [may be] to secure the beneficiary against the non-fulfilment of certain obligations by the principal or against another contingency, the undertaking is not subject to, or qualified by, any underlying transaction or other relationship, even if referred to in the undertaking, and the payment obligation does not depend on the [ultimate] determination of the occurrence of that contingency but solely on the presentation of any documents required in the undertaking or by paragraph (2) of this article. [The same rule applies to a counter-guaranty letter in respect of the contingency of the beneficiary of the counter-guaranty letter being demanded to pay under its guaranty letter.]"

Independence of undertaking (paragraph (1)(a))

57. The Working Group decided to retain the words "For the purposes of this Convention" and to remove the words "deemed to be".

58. Divergent views were expressed as regards the way in which subparagraph *(a)* defined an independent undertaking. One view was that it was inappropriate and unnecessary to equate the independent character with the documentary character since the documentary character provided a clear-cut criterion while the concept of independence was vague in that there might exist varying degrees of independence. It was stated in response that, depending on the type and number of documents required, it might in some cases be more burdensome than in others for the beneficiary to obtain the required documents but that the undertaking was independent in that payment depended solely on the presentation of facially conforming documents.

59. Another view was that the notion of independence should be retained in subparagraph *(a)* and that the description of that notion in paragraph (3) provided useful guidance. A similar, and finally prevailing, view was that the notion of independence should not only be retained in subparagraph *(a)* but also elaborated in that definitional provision. It was suggested that the provision should be modelled on draft article 3(2) of the United States proposal (A/CN.9/WG.II/WP.77), which read as follows:

"An undertaking is independent in that the issuer's performance to the beneficiary is not subject to or qualified

by the existence or validity of an underlying transaction or of any terms other than those appearing in the undertaking or any condition, act or event other than presentation of stipulated documents."

60. Various suggestions were made with a view to improving the formulation. One such suggestion was to provide guidance as to the distinction between terms and conditions, for example, by defining "condition" as a future, uncertain event. As regards the reference to "any condition, act or event other than presentation of stipulated documents", a concern was expressed that this wording might be read as allowing the issuer to act imprudently by disregarding relevant facts known to it.

61. The same concern, based on public policy considerations, was raised as regards the wording between square brackets in subparagraph *(a)*. Another concern in respect of that wording was that the expression "operational purview" was uncertain and inappropriate since the scope of that purview could be influenced by the individual issuer. Another view was that the reference to the operational purview was not needed since the documentary character was sufficiently clearly described by the words "without any verification of facts".

62. After deliberation, the Working Group requested the Secretariat to prepare a revised version of subparagraph *(a)* along the lines of draft article 3(2) of the United States proposal.

"Safe-haven" rule (paragraph (1)(b)*) and treatment of "non-documentary conditions" (paragraph (2))*

63. The Working Group discussed subparagraph *(b)*, according to which parties could ensure that the Convention would apply by designating the undertaking in a certain way ("safe-haven" rule), and the related question of how the Convention should treat a non-documentary condition found in a guaranty letter thus designated. It was felt that, if it were found to be acceptable to disregard non-documentary conditions or to treat such conditions as documentary ones, the safe-haven rule could provide a certain and easily applicable criterion for the applicability of the Convention. If, however, it were found that non-documentary conditions should neither be disregarded nor converted into documentary ones, the safe-haven rule served no practical purpose.

64. One view was that a safe-haven rule was useful since it provided certainty as to the applicability of the Convention. Without such a rule, it would be necessary to screen each guaranty letter as to the presence of any non-documentary condition in order to ascertain whether the Convention applied. Furthermore, it would be inappropriate to deny the applicability of the Convention if by oversight or poor drafting the undertaking contained a non-documentary condition. Some proponents of this view favoured the solution that a non-documentary condition should be disregarded (draft article 3(3) of the United States proposal, A/CN.9/WG.II/WP.77) since the implementation of a required conversion posed serious practical problems. Others favoured the solution that a non-documentary condition should be treated as a documentary one (draft article 3(2) prepared by the Secretariat, A/CN.9/WG.II/WP.76) since that was less draconian than to ignore the agreed condition.

65. The prevailing view was that the safe-haven rule should not be adopted since it gave priority to a label over the substance or content of an undertaking. Above all, it was not justified to frustrate the intention of the parties by disregarding a non-documentary condition or by requiring that the fulfilment of the condition be certified by the beneficiary. It was pointed out that in practice non-documentary conditions might be within or without the operational purview of the issuer. Some proponents of that view considered that certain less important non-documentary conditions might be disregarded or treated as documentary ones, but that a general safe-haven rule was not acceptable. Accordingly, the Working Group decided to delete paragraphs (1)*(b)* and (2).

Paragraph (3)

66. In view of the decision to include in paragraph (1) the reference to the independence from the underlying transaction, the Working Group decided not to retain paragraph (3).

Article 4. Internationality of guaranty letter

67. The text of draft article 4 as considered by the Working Group was as follows:

"(1) A guaranty letter is international if:

(a) the places of business specified in the guaranty letter of any two of the following persons are in different States: issuer, beneficiary, principal, instructing party [,adviser] or confirmer; or

(b) it expressly states that it is international or that it is subject to [generally recognized] international rules or usages of guarantee or letter of credit practice.

(2) For the purposes of the preceding paragraph:

(a) if the guaranty letter lists more than one place of business of a given party, the place of business is that which has the closest relationship to the guaranty letter;

[*(b)* if the guaranty letter does not specify a place of business for a given party but specifies its habitual residence, that residence is relevant for determining the international character of the guaranty letter.]".

Paragraph (1)

68. It was generally felt that the scope of application of the draft Convention should be broad. In connection with the discussion of a possible need to broaden the scope of the definition of internationality, it was recalled that the Working Group had previously discussed, and left open the final decision on, whether the draft Convention should extend to domestic transactions. A concern was expressed that, even in the context of purely domestic transactions, the development of modern telecommunication techniques involving the use of computer facilities that might be operated from foreign countries might increase the difficulty in distinguishing international from domestic transactions. It was also stated that, should the scope of the draft Con-

vention be limited to international transactions, possible differences between rules contained in the draft Convention and the general rules of domestic law might be less acceptable.

69. While support was expressed in favour of encompassing domestic transactions, a note of caution was struck about going too far in the direction of regulating domestic transactions since that might affect the acceptability of the draft Convention. States would anyway remain free to use the final text also for domestic transactions. After discussion, the Working Group decided to continue focusing its work on international transactions and to postpone a final decision as to the application of the draft Convention to domestic transactions until it had completed its review of the substantive provisions of the draft Convention.

Subparagraph (a)

70. The Working Group found the objective criteria provided in the subparagraph for determining the internationality of an undertaking to be generally acceptable. However, concerns were expressed as to the reference to the "adviser" of a guaranty letter since the role of an adviser was of a subordinate character. It was stated in reply that advisers might have important functions as paying agents or as negotiating banks and that the reference to the adviser would to some extent broaden the scope of application. The Working Group decided to leave the term "adviser" between square brackets for reconsideration at a later session.

Subparagraph (b)

71. The Working Group next considered the merits of retaining the subjective criteria set forth in subparagraph *(b)* for determining the internationality of an undertaking. With respect to the possibility that the parties could meet the internationality requirement merely by calling the instrument international, the appropriateness of retaining the provision was questioned, as had previously been the case at the sixteenth session of the Working Group (see A/CN.9/358, para. 70), in particular because it was felt to be inappropriate to describe a purely domestic instrument as international. Such a device might be regarded as an intrusion into the sphere of domestic legislation. Various suggestions were made to limit such possible consequences with respect to domestic legislation. It was suggested that an additional connecting factor be introduced in the paragraph that would require the existence of a link between the object of a given guaranty letter and an international trade transaction. The suggestion was objected to on the ground that it would not be apparent on the face of an instrument whether such a requirement had been met, thus injecting an unacceptable degree of uncertainty. Another suggestion was that subjective criteria might be used to establish the internationality of an undertaking only if the Contracting States were given the possibility of ensuring, by means of a reservation, that parties that opted for the application of the Convention would not be allowed to disregard mandatory rules of public policy (e.g., rules on jurisdiction) in the case where the transaction involved only nationals of that State.

72. After discussion, the Working Group was agreed that a provision should be included in the draft Convention to the effect of permitting parties to opt for the application of the draft Convention. It was agreed that this should be done in a straightforward manner, rather than through a somewhat artificial extension of the test of internationality. The Working Group decided that a straightforward opting-in provision should be added to article 1 along the following lines: "and to any guaranty letter that states that it is subject to this Convention". Accordingly, it was decided that subparagraph *(b)* should be deleted. However, consideration might later be given to allowing Contracting States, by way of a reservation, to limit for their nationals the facility of subjecting their relationship to the provisions of the Convention. Another question to be considered at a later stage, in conjunction with the territorial scope of application, was whether parties should be given the facility of opting out of the draft Convention.

Paragraph (2)(a)

73. Various suggestions were made as to the way in which the draft Convention should address the possibility that a guaranty letter specified two places of business for a party, for example, when a guarantor with multiple places of business issued a guaranty letter with its letterhead listing more than one place of business. A first suggestion was that a guaranty letter should fall under the scope of the draft Convention if at least one of the various places of business of a party mentioned on the guaranty letter met the objective criteria set forth in paragraph (1)*(a)*. Such an approach would be consistent with the preference expressed by the Working Group for a broad scope of application of the Convention and would provide a clear and simple solution. The suggestion was objected to on the ground that the place of business of a party should be relevant for determining whether an undertaking was international only if that place of business was somehow linked to that undertaking.

74. A second suggestion was that a preferable solution, as currently expressed in subparagraph *(a)*, was to require some functional link between the relevant place of business and the guaranty letter. The possible difficulties in determining the closest relationship were regarded as acceptable in view of the fact that banks were unlikely to issue undertakings with a plurality of places. It was also stated in support of retention of the subparagraph that it was based on similar provisions that had been incorporated in a number of international conventions and that were therefore widely accepted and understood. A third suggestion was that, in case of a doubt as to the relevant place of business of a party, the principal place of business of that party should be decisive. That suggestion was objected to on the ground that there might be uncertainty as to what constituted the principal place of business of a party.

75. After discussion, the Working Group decided to retain the substance of the subparagraph.

Paragraph (2)(b)

76. The question was raised whether a rule relating to habitual residence was necessary. It was stated in reply that the draft Convention should address the case, however rare, where a given party (e.g., a non-professional party) had no place of business. It was also observed that the indication

of a place or address of a given party did not always reveal whether it was a place of business or the habitual residence. It was suggested that a solution to that difficulty might be not to use the words "place(s) of business" in article 4 but simply to refer to the "place" of a given party. After discussion, the Working Group adopted that proposal and, as a consequence, decided to delete subparagraph *(b)*.

Chapter II. Interpretation

Article 5. Principles of interpretation

77. The text of draft article 5 as considered by the Working Group was as follows:

"In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international guarantee and stand-by letter of credit practice."

78. The appropriateness of including a provision on interpretation in the draft Convention was questioned in view of the fact that generally applicable principles of interpretation were already contained in the 1969 Vienna Convention on the Law of Treaties. It was generally felt, however, that, as was already the case in other international instruments such as the United Nations Sales Convention, it was preferable to include in the draft Convention a specific provision on interpretation.

79. As to the wording of the provision, a concern was expressed that the reference to "good faith" might be more appropriate as a standard of conduct to be observed by parties to a guarantee transaction than as a standard for the interpretation of a legal text. Another concern was that the reference to the concept of "good faith" might raise difficult questions of interpretation in some jurisdictions. However, it was generally agreed that a provision along the lines of article 5, as embodied in many comparable international conventions, was useful. As to the drafting of the provision, a view was expressed that there was no need to limit the promotion of good faith to international guarantee and stand-by letter of credit practice. Instead, a general reference should be made to "the observance of good faith in international trade", along the lines of article 7(1) of the United Nations Sales Convention. Another suggestion was to simplify the text and to refer only to the need to promote uniformity and good faith in international guarantee and stand-by letter of credit practice.

80. After discussion, the Working Group decided to retain article 5 in its current wording.

Article 6. Rules of interpretation and definitions

81. The text of draft article 6 as considered by the Working Group was as follows:

"For the purposes of this Convention and unless otherwise indicated in a provision of this Convention or required by the context:

(a) 'guaranty letter' includes 'counter-guaranty letter' and 'confirmation of guaranty letter', and 'guarantor' includes 'counter-guarantor' and 'confirmer';

(b) any reference to the guaranty letter or the undertaking of the issuer, or to its terms and conditions, is to the text as originally established in accordance with article 7 or, if later amended in accordance with article 8, to the text in its last amended version;

(c) where a provision of this Convention refers to a possible agreement or stipulation of the parties, the parties meant are the issuer and the beneficiary of the guaranty letter in question;

(d) 'counter-guaranty letter' means a guaranty letter given to the issuer of another guaranty letter by its instructing party [or to the issuer of another guarantee or letter of credit] and providing for payment upon demand and presentation of any specified document stating that payment [under that other guaranty letter or undertaking] has been demanded from, or made by, the beneficiary of the 'counter-guaranty letter';

(e) 'counter-guarantor' means the issuer of a counter-guaranty letter;

(f) 'confirmation' of a guaranty letter means an independent undertaking added to that of the issuer providing the beneficiary with the option of demanding payment and, unless expressly stipulated otherwise, presenting any required documents to the confirmer [instead of to the issuer];

(g) 'confirmer' means the person confirming a guaranty letter;

(h) 'document' means a communication made in a form that provides a complete record thereof [and is authenticated as to its source by generally accepted means or by a procedure agreed with the recipient]."

Subparagraph (a)

82. A concern was expressed that the text of subparagraph *(a)* might be misinterpreted as equating the legal nature of the confirmation of a guaranty letter with the nature of a counter-guaranty letter. It was explained that, while the confirmation of a guaranty letter would give the beneficiary an option to claim payment either from the issuer of the original guaranty letter or from the confirmer, payment under a counter-guaranty letter could be sought exclusively from the counter-guarantor. In response, it was stated that that difference between a counter-guaranty letter and a confirmation was clearly reflected in the definitions in subparagraphs *(d)* and *(f)*. Moreover, subparagraph *(a)* merely established as a rule of interpretation that provisions referring to a "guaranty letter" were also applicable to a counter-guaranty letter and to the confirmation of a guaranty letter unless otherwise indicated in the draft Convention or required by the context. It was generally agreed that subparagraph *(a)* had no bearing on the legal nature of the counter-guaranty letter.

83. After discussion, the Working Group found the text of the subparagraph to be generally acceptable.

Subparagraph (b)

84. While the view was expressed that the rule contained in subparagraph *(b)* might be considered as self-evident, it was felt that such a rule should be maintained in the text of the draft Convention. Another view, however, was that the provision contained in subparagraph *(b)* might create difficulties, particularly in the situation where a payment under a guaranty letter was effected by means of a negotiable instrument that was negotiated prior to the later amendment of the guaranty letter. It was stated that the draft Convention should expressly address that situation to ensure that a bona fide holder of the instrument could base a claim for payment on the amount stipulated in the text of the guaranty letter as it stood at the time when the instrument was negotiated. A similar concern was expressed with respect to the situation where rights under the guaranty letter were transferred prior to an amendment.

85. While support was expressed for the deletion of subparagraph *(b)*, it was generally agreed that the concerns expressed should not be discussed in the context of article 6, which merely established an interpretation rule and expressly allowed for possible exceptions, but that they should be addressed during the discussion of the substantive rules set forth in articles 8 and 9 on amendment and transfer of rights. In addition, it was stated that matters such as the date relevant for establishing the rights and obligations of the parties would normally be addressed in the text of the amendment itself.

86. After discussion, the Working Group decided to place the text of subparagraph *(b)* between square brackets, subject to later reconsideration after review of the substantive provisions of the draft Convention.

Subparagraph (c)

87. The view was expressed that subparagraph *(c)* should be deleted since it might be overly restrictive and create uncertainty in the case where parties other than the issuer and the beneficiary of a guaranty letter might be envisaged under a provision of the draft Convention. For example, it was stated that, while the issuer and the beneficiary were the normal parties to the undertaking, such issues as amendment, assignment of proceeds, transfer of rights and notification that a demand for payment had been presented under the guaranty letter would typically involve "parties" other than the issuer and the beneficiary of the guaranty letter.

88. A view was also expressed that the reference to a possible "stipulation of the parties" should be dealt with separately from the "agreement of the parties". While the word "agreement" rightly referred to both the issuer and the beneficiary of a guaranty letter, the word "stipulation" was to be understood as encompassing the provisions contained in the text of the guaranty letter and thus referred to the guarantor only. It was stated that the current text should therefore be redrafted to avoid the possible misinterpretation that the consent of the beneficiary be required with respect to the stipulations of the undertaking.

89. In favour of retention of subparagraph *(c)*, it was stated that, by addressing the "agreement or stipulation of the parties", subparagraph *(c)* only dealt with the relationship between the guarantor and the beneficiary, which was distinct from all other legal relationships envisaged in the draft Convention, and which the Working Group had previously agreed should be the focus of the draft Convention. It was also noted that subparagraph *(c)* merely set forth a general rule of interpretation to which exceptions could be made. Furthermore, as a matter of drafting, the only alternative to a general provision, such as currently embodied in subparagraph *(c)*, was to designate expressly the parties concerned in each specific provision of the draft Convention containing a rule applicable to "parties". While it was noted that such a drafting technique might be excessively cumbersome, the Working Group was generally agreed that subparagraph *(c)* should be deleted and the parties expressly designated in each relevant provision of the draft Convention, subject to reconsideration of the issue by the Working Group at a future session.

Subparagraph (d)

90. The view was expressed that the definition should be limited to establishing that a counter-guaranty letter meant a guaranty letter given to the issuer of another guaranty letter by its instructing party. As to the rule that payment under the counter-guaranty letter would be conditioned by the production of a statement that payment under the other guaranty letter had been demanded from, or made by, the beneficiary of the counter-guaranty letter, it was suggested that that rule might undermine the independence of the counter-guaranty letter from the other guaranty letter.

91. While support was expressed for the deletion of the latter portion of subparagraph *(d)*, the prevailing view was that the current text sufficiently established that, in all cases, the obligation of the counter-guarantor under the counter-guaranty letter was to be regarded as legally independent not only from the underlying commercial relationship between the principal and the beneficiary but also from the other guaranty letter issued to the ultimate beneficiary. It was also felt by the Working Group that the reimbursement function performed by the counter-guaranty letter in the context of inter-bank relationships should be reflected in the text of the draft Convention, as was done in the latter portion of the current text of subparagraph *(d)*.

92. After discussion, the Working Group found the text of subparagraph *(d)* to be generally acceptable.

Subparagraph (e)

93. The Working Group accepted subparagraph *(e)*.

Subparagraph (f)

94. It was proposed to add to subparagraph *(f)*, which defined "confirmation", the requirement that a confirmation had to be authorized by the issuer. Clarifications were given that some banks had a policy not to have their guarantees or stand-by letters of credit confirmed by other banks, but that nevertheless beneficiaries sought, and sometimes obtained from their banks, an undertaking that purported to be a confirmation without the issuer being informed about or having authorized the undertaking given by the beneficiary's bank. Such unauthorized confirmations

were sometimes in practice referred to as "silent confirmations". It was further said that issuing banks were, as a matter of principle, dissatisfied with the practice of silent confirmations, one reason being that it involved them in relations with banks with which the issuing banks would not otherwise deal.

95. One view was to leave subparagraph *(f)* unchanged and to deal in the operative provisions of the draft Convention with consequences of a silent confirmation. One such consequence would be that a confirmer acting without authorization would have no right to reimbursement from the issuer.

96. However, the widely prevailing view was supportive of including the element of authorization in the definition; thus, a silent confirmation would not be a confirmation under the draft Convention, and it would depend on the terms of the silent undertaking whether or not it was to be regarded as an independent and documentary undertaking governed by the draft Convention. It was agreed to consider at a later stage whether silent confirmations should be mentioned in the draft Convention.

97. A suggestion was made to address in the draft Convention other issues concerning the relationship between the issuer and the confirmer (in particular the issue of reimbursement). The Working Group reserved its decision as to whether it was appropriate for the Convention to deal with those issues.

Subparagraph (g)

98. The Working Group accepted subparagraph *(g)*.

Subparagraph (h)

99. A view was expressed that the concept of "a communication made in a form that provides a complete record" was unclear and could be confounded with archiving of documents. The question was raised whether oral communications recorded on certain types of media, such as laser discs, which were an inalterable medium, were covered by the concept. If the purpose of the definition was to validate the use of electronic data interchange (EDI), it would be more appropriate to refer to EDI directly, for example, in a manner done in article 2*(d)* of URDG. It was stated in reply that the notion of EDI was in itself highly unclear. The Working Group, in approving the drafting approach taken in regard of the form of documents, noted that the purpose of referring to "a communication made in a form that provides a complete record" was to exclude from the draft Convention purely oral communications. It was observed that the provision on the form of documents should be understood as requiring records to be in tangible form, while being broad enough to embrace equivalent forms that might be developed in practice.

100. A suggestion was made to include within the definition of "document" bills of exchange, promissory notes and demands for payment so as to avoid any uncertainty as to the applicability of the Convention to clean stand-by letters of credit and simple demand guarantees. The Working Group did not discuss the suggestion.

101. It was suggested that the wording between square brackets be deleted. It was said that authentication and in particular its form were matters that depended on the terms and conditions of the undertaking as well as on the applicable law; thus, an unqualified requirement of authentication was not a necessary element of the definition of document. A counter-suggestion was to retain the wording unchanged in view of the generally accepted requirement that documents to be presented under a guaranty letter had to be authentic. A further suggestion was for the subparagraph to clarify the nature of the requirement of authentication. Some supporters of that suggestion considered that the subparagraph should limit itself to requiring authentication "where appropriate" or "where required by the terms and conditions of the undertaking" without a reference to the applicable law; it was said that observance of the applicable law was to be assumed and that it was not necessary for the draft Convention on that point to touch upon the question of the applicable law. Others were of the view that the subparagraph should clarify that documents had to be authenticated if so, and in the form, required by the applicable law or by the terms and conditions of the undertaking. After deliberation, the Working Group adopted that latter view.

102. A concern was expressed that the reference to "generally accepted means" of authentication was unclear in that it did not give sufficient guidance as to what standard of authentication was required, and a suggestion was made to either delete the words "as to its source by generally accepted means or by a procedure agreed with the recipient" or to clarify the standard of authentication. As a possible way to clarify the matter, it was suggested to use the concept of commercially reasonable method of authentication, used in article 5(2) of the UNCITRAL Model Law on International Credit Transfers.

Suggested addition of definition of "condition"

103. It was recalled that, in connection with the decision by the Working Group to adopt a definition of an independent undertaking that relied on a distinction between the terms and the conditions of the undertaking, a suggestion had been made that guidance should be provided in the draft Convention as to the distinction between terms and conditions (see above, paragraphs 59-60). A proposal was made to define in article 6 the word "condition" as referring to a future, uncertain event. While such a definition was commonplace in the legislation of many countries, it might serve a useful purpose in the draft Convention for other countries, and it would be of special value in all those countries where the expression "condition" was also used to refer to any clause or stipulation in an undertaking. It was generally felt that, should the draft Convention define "condition", the word "term" should also be defined.

104. While support was expressed in favour of the proposed definitions, there were also doubts expressed as to the need for such general definitions. It was noted that, except for article 3(1)*(a)* where a distinction between the notions of "term" and "condition" would be crucial, the wording "terms and conditions" was used indistinctively throughout the draft Convention as an equivalent for the word "stipulations". After discussion, the Working Group

was agreed that, since the words "terms" and "conditions" were used with a specific meaning in article 3(1)*(a)*, an attempt should be made to incorporate the notion of a "condition" as a future, uncertain event into that article, where it served an essential purpose in the definition of the independence of an undertaking by placing those undertakings that were subject to non-documentary conditions outside the scope of the draft Convention. If that attempt were to prove unsuccessful, the question of providing general definitions for the words "term" and "condition" could be reconsidered.

Suggested addition of a definition of "stand-by letter of credit"

105. It was recalled that, at a previous session, the Working Group had accepted a suggestion that a definition of the term "stand-by letter of credit" should be added to the draft Convention (A/CN.9/358, para. 74). It was stated that the purpose of such a definition might be to distinguish a stand-by letter of credit not only from a bank guarantee but also from a commercial letter of credit. It was noted that the definition of a stand-by letter of credit contained in article 2 of the United States proposal differed little in substance from the definition of a guaranty letter in the draft Convention. In addition, article 6(2) of the United States proposal contained a description of a number of possible types of stand-by letters of credit characterized by their purpose in a given commercial or financial context as reflected in the contents of the required documents.

106. The view was expressed that a definition of the stand-by letter of credit would be particularly useful if the different features of the stand-by letter of credit and of the bank guarantee were found to be of such a nature that the draft Convention should deal with the two instruments in two separate sets of rules, in which case a definition of the bank guarantee would also be needed. Should most provisions of the draft Convention eventually be found to be equally applicable to both instruments, the need for such definitions might be less obvious.

107. With respect to a possible distinction between a stand-by letter of credit and a commercial letter of credit, it was noted that in those countries where stand-by and commercial letters of credit were used extensively, the same legal regime applied to both instruments and there existed no abstract definition of a stand-by letter of credit. The only known distinction, based on an assessment of the different credit risks that were inherent in the two types of instruments, was that established by banking regulatory authorities for reasons of capital adequacy. It was suggested that a definition relying on the purpose of the undertaking might be desirable and that such a definition might describe a stand-by letter of credit as a letter of credit issued for a guaranteeing purpose (or as a guarantee undertaking given in the form of a letter of credit). However, it was stated that a definition along those lines would not be workable in practice since undertakings were found in stand-by (as well as guarantee) practice that were not given for a guaranteeing purpose in a strict sense but for purposes of enhancing creditworthiness or for providing an assured mechanism of payment owed by another person (so-called "direct-pay" stand-bys or guarantees). Another suggestion was that the only workable criterion to distinguish a stand-by from a commercial letter of credit might be a formal one, stand-by letters of credit being letters of credit that called themselves stand-by letters of credit.

108. As regards the distinction between stand-by letters of credit and bank guarantees, a suggestion, based on article 6 of the United States proposal, was that, instead of attempting to establish an abstract definition of a stand-by letter of credit, the Working Group might consider as an appropriate focus for its work a list of conceivable forms of stand-by letters of credit. It was noted, however, that the proposed list was not exhaustive and that various other practices involving stand-by letters of credit might also need to be included. Moreover, a definition of a "direct-pay" stand-by letter of credit might be necessary, despite the attempt to cover it in a broad definition of a financial stand-by. As a possible definition of a direct-pay stand-by letter of credit, the following tentative wording was suggested:

> "A direct-pay stand-by, which provides for honour upon presentation of documents stating that payment is due in direct payment of a financial obligation."

109. Objections were raised against attempting to define a stand-by letter of credit by way of a list of examples. It was stated that a description of various types of guaranty letters would not serve the definitional purpose of determining the applicability of the draft Convention or of certain provisions of the draft Convention; such a mere description, however informative it might be, would not be appropriate in a text of a legislative nature such as the draft Convention. Moreover, it was pointed out that a definition by way of examples for the purpose of differentiating the two instruments was only valuable to the extent that the practices described were typical of one instrument as opposed to the other one. However, most of the functions performed by stand-by letters of credit were identical to the purposes for which bank guarantees were given.

110. After discussion, it was concluded that a stand-by letter of credit was distinguishable from independent guarantee undertakings by its form only. The Working Group decided that, for the time being, a stand-by letter of credit should be described in the draft Convention as a guaranty letter that adopted the form of a letter of credit. However, a concern was expressed that in those countries where there existed no statutory or other legal definition of the notion of "letter of credit", a reference to "the form of a letter of credit" would not provide the necessary certainty.

Chapter III. Effectiveness of guaranty letter

Proposal for a new provision on required contents of a guaranty letter

111. A suggestion was made to include in chapter III a provision enumerating certain elements that a guaranty letter had to contain. Examples of such elements were the places of the issuer and the beneficiary, the currency and amount of the guaranty letter, the place of payment, the place where documents were to be presented and the date of expiration of the guaranty letter. The proposal was not

accepted since it was felt that the imposition of necessary requisites would be too strict in that it would lead to the invalidity of many undertakings with missing elements, while it might be useful to provide guidance in rules of practice (as done in article 3 URDG). Moreover, it seemed preferable to leave to practice the level of detail at which guaranty letters would be issued. Furthermore, the amount of information included in various elements of a guaranty letter might develop, for example, as a result of developments in the area of communication and recording techniques, and the suggested requirements might stand in the way of such developments.

Article 7. Establishment of guaranty letter

112. The text of draft article 7 as considered by the Working Group was as follows:

"(1) A guaranty letter may be established in any form which preserves a complete record of the text of the guaranty letter and provides authentication of its source by generally accepted means or by a procedure agreed upon by the parties.

(2) *Variant A:* Unless otherwise stated therein, a guaranty letter becomes effective and irrevocable when it leaves the issuer's sphere of control ('issuance').

Variant B: A guaranty letter becomes effective and [, unless it expressly states that it is revocable,] irrevocable when it is issued, provided that it does not state a different time of effectiveness."

Paragraph (1)

113. The Working Group accepted paragraph (1).

Paragraph (2)

114. The use of the expression "effective", used in both variants, was criticized for being unclear as to whether it referred to the act of putting in place the guaranty letter as a binding and irrevocable undertaking or to the time as of which the guaranty letter was in force entitling the beneficiary to make a conforming demand for payment. While retaining the term "effective", the Working Group was agreed that the meaning of that term might need to be clarified.

115. The Working Group, having reaffirmed its decision that the guaranty letter should become effective at the time of its issuance, as opposed to the time of its receipt by the beneficiary, noted that the concept of issuance used in article 7(2) was the same as the concept of issuance used in article 8(2), which dealt with amendment of the guaranty letter. A view was expressed that the terms "issuance" in variant A and "issued" in variant B appeared to imply that the guaranty letter was a unilateral act as opposed to a contract. The Working Group, recalling its understanding that the draft Convention would not address that question of the legal nature of the guaranty letter, was of the view that the notion of issuance was appropriate and that the use of the notion should not be understood as giving an answer to that question.

116. Doubts were expressed as to the utility of the test of "the issuer's sphere of control" incorporated in variant A for defining the issuance of the guaranty letter. It was said that the test was unclear and gave rise to more questions than it solved. The prevailing view, however, was that the test was useful in that it provided guidance for the interpretation of the concept of issuance.

117. The Working Group preferred the drafting approach taken in variant B. While a suggestion was made for deleting in that variant the reference in square brackets to revocability, the widely prevailing view was that the reference should be retained. In accordance with the prevailing view on the utility of defining "issuance", it was decided to include in article 6 a provision defining the moment of issuance of the guaranty letter as the moment when the guaranty letter left the issuer's sphere of control.

Article 8. Amendment

118. The text of draft article 8 as considered by the Working Group was as follows:

"(1) A guaranty letter may be amended in the form agreed upon by the parties or, failing such agreement, in any form referred to in paragraph (1) of article 7.

(2) The amendment becomes effective, unless a different time of effectiveness is stated in the amendment or has been agreed upon by the parties,

Variant A: when it is issued [by the issuer], provided that it consists solely of an extension of the validity period of the guaranty letter; any other amendment becomes effective when the issuer receives a notice of acceptance by the beneficiary, unless a different time of effectiveness is stipulated.

Variant B: when it is issued, unless the issuer receives a notice of rejection by the beneficiary within [ten] [business] days.

[(2 *bis*) An amendment affects the confirmation of a guaranty letter only if the confirmer consents to the amendment.]

[(3) *Variant Y:* The provisions of paragraphs (1) and (2) of this article do not entitle the issuer to invoke the amendment in support of any claim for reimbursement against the principal if the issuer failed to obtain the consent of the principal required by agreement or law.

Variant Z: When issuing an amendment, the issuer shall promptly dispatch a copy thereof to the principal.]"

Paragraph (1)

119. The Working Group found the text of the paragraph to be generally acceptable.

Paragraph (2)

120. With respect to the proposed variants, the Working Group noted that while variant B embodied the concept of implied or silent acceptance, variant A required express agreement by the beneficiary. While views were expressed in favour of each variant, it was generally felt that, as a general rule, implied agreement by the beneficiary should not be presumed, since an amendment inherently affected the legal position of the beneficiary. A general rule equat-

ing silence and implied agreement by the beneficiary would be unfair since silence might be caused by difficulties in communication or by other events beyond the control of the beneficiary. It was also not in line with banking practice as reflected in draft article 9*(d)*(iii) of the proposed revision of the UCP.

121. At the same time, a concern was expressed that a general rule requiring that notice of acceptance be given by the beneficiary along the lines of variant A might be excessively burdensome. It was observed that in practice the vast majority of amendments were made at the request of the beneficiary. Where an amendment was based on a request by the beneficiary presented to the guarantor either directly or indirectly through the principal, the consent of the beneficiary should be presumed. It was stated in response that the time of effectiveness should not be made dependent on such uncertain and not easily verifiable criteria as whether the amendment originated from a request by the beneficiary. It was noted, however, that amendments made pursuant to a request by the beneficiary addressed to the issuer would be covered by the general rule if acceptance were to be understood as covering previous consent.

122. Based on a similar concern, a suggestion was made that the rule expressed in variant A should apply only to the very few cases where the amendment was detrimental to the beneficiary. In response, it was recalled that the Working Group at previous sessions had examined proposals to prepare a dual set of rules depending on whether a given amendment was beneficial or detrimental to the beneficiary. As had been felt then, rules that involved subjective judgements were not easy to administer and did not provide the certainty required in practice. As an example, it was stated that it might be difficult to decide whether a change in the place or currency of payment would be favourable to the beneficiary (see A/CN.9/358, para. 98). Even the extension of the validity period of the undertaking might not, in certain circumstances, be considered as favourable to the beneficiary.

123. Yet another concern was that the rule contained in variant A might be overly burdensome to the issuer of the amendment if no time limit was imposed on the beneficiary for notifying its agreement to the amendment. The draft Convention should provide a fixed period of time (e.g. 15 or 30 days) after which an issuer who had not received a required notice of acceptance could assume rejection of the amendment. The suggestion was opposed on the grounds that no fixed period of time would be appropriate in all cases and that any issuer who wanted certainty about the beneficiary's reaction was free to set a time limit for the beneficiary's acceptance.

124. A suggestion was made to specify in paragraph (2) that agreement by the beneficiary, whether implied or express, validated the amendment as of the date of issuance of the amendment, irrespective of whether the agreement had emanated from the beneficiary prior to the issuance of an amendment or whether the agreement validated the amendment retroactively.

125. A suggestion was made to consider at a later stage the treatment of partial acceptance.

126. After deliberation, the Working Group was agreed on the principle that the effectiveness of an amendment depended on the consent of the beneficiary. Such consent might be given before or after the issuance of the amendment, and it might be given expressly in any form or it might be implied in a certain act. As regards possible exceptions to the general rule, the Working Group was agreed that further information on banking practice was needed for determining the appropriateness of making an exception for certain types of amendments such as those solely extending the validity period or increasing the amount. It was further agreed that the parties should be permitted to derogate from the provisions of the draft Convention and that, thus, standby letters of credit incorporating the UCP would not be subject to the amendment rules contained in the Convention.

127. The Working Group requested the Secretariat to prepare a new draft of paragraph (2) reflecting the above discussion and conclusions for further consideration at a later session.

Paragraph (2 bis)

128. While the principle contained in paragraph (2 *bis*) met with the general agreement of the Working Group, divergent views were expressed on the appropriateness of retaining the paragraph. One view was that, since the principle contained in the paragraph obtained even if the paragraph were not included in the draft Convention, the paragraph should be deleted. Another view, which received considerable support, was that paragraph (2 *bis*) was useful; it was important to emphasize that the confirmer's undertaking was independent since the confirmation, according to article 6*(f)*, constituted an additional undertaking on the very same guaranty letter that was now being amended by the issuer and since, at the moment of the confirmation, the content of the confirmer's undertaking tracked the content of the issuer's undertaking.

129. Those that supported the retention of the substance of the paragraph were of different opinions as to how that substance should be expressed. One opinion was that the current wording of paragraph (2 *bis*) should be retained. Another opinion was that the paragraph should be limited to stating only the principle that an amendment of the guaranty letter did not affect the rights and obligations of the confirmer of that guaranty letter. According to yet another opinion, it would be useful to add to that principle the wording "unless consented to by the confirmer". An observation was made that consent to an amendment could be given either upon receipt of information on the amendment or in advance of any future amendment of a certain kind.

130. The Working Group discussed the appropriateness of adding to the paragraph a reference to the form in which consent could be given. A suggestion was made to establish a rule to the effect that the form of consent should be the same as the form in which the original confirmation had been given. Others considered that, if a rule on form was needed at all, the preferable rule would be to allow consent to be expressed in any form mentioned in article 7(1), even if it was different from the form in which the original confirmation had been given. Strong reservations

were expressed regarding the proposal to include in the draft Convention a rule on the form of consent. It was stated that no problems were reported in respect of the form in which consents to amendments were given; thus, it was preferable to leave the matter to practice to establish suitable rules.

131. It was recalled that a confirmation had to be authorized by the issuer and that "silent confirmations" were not to be considered confirmations in the sense of the draft Convention (see above, paragraph 96). While it was suggested that the principle of paragraph (2 *bis*) should also apply to an amendment of a "silent confirmation", it was noted that the Working Group had not yet decided on whether "silent confirmations" should be mentioned at all in the draft Convention.

Proposal for extension of rule to include counter-guarantor

132. Some support was expressed for the suggestion that a new provision be added to the effect that, when a counter-guaranty letter was issued to the issuer of another guaranty letter, a modification in one of those two guaranty letters did not affect the other guaranty letter. It was stated in support that the counter-guaranty letter was an independent undertaking, as was a confirmation, and that, after the decision of the Working Group to delete article 3(3), the draft Convention nowhere expressly stated that the counter-guaranty letter was independent from the other guaranty letter. Reservations were stated regarding the suggestion. It was said that it followed clearly from the draft Convention that a counter-guaranty letter, as a guaranty letter, was an independent undertaking and that stating that principle in the limited context of article 8 would not be in harmony with the structure of the draft Convention. Furthermore, a counter-guaranty letter might contain terms and conditions that ratified in advance some types of amendments that might be made to the guaranty letter for which the counter-guaranty letter was issued, and it required detailed drafting to express the difference between such possible indirect effects and the principle embodied in paragraph (2 *bis*), namely that the amendment was not effective towards third parties. (See further discussion below, paragraphs 135-138)

Paragraph (3)

133. Differing views were expressed regarding paragraph (3). One view was that paragraph (3) should be retained. In that connection, it was suggested that both variants Y and Z should be retained and combined into one paragraph in reverse order.

134. Another view was that paragraph (3) should be deleted. Proponents of that view criticized in particular variant Z as giving rise to more problems than it attempted to solve. It was said that variant Z was unclear as to whether the consequence of a failure to dispatch a copy of the amendment was invalidity of the amendment or loss or restriction of the right to reimbursement.

Proposal for merged provision

135. A proposal was made to include in article 8 a rule providing that an amendment of the guaranty letter had no effect on the rights and obligations of the confirmer, counter-guarantor and principal. The proposed rule was to replace current paragraphs (2 *bis*) and (3). Various observations and suggestions were made in respect of the proposal, based on positions taken previously in respect of the proposed extension of paragraph (2 *bis*) to counter-guarantors and of paragraph (3).

136. One observation was that the rights and obligations mentioned in the proposal were diverse in nature and origin: the rights and obligations of the confirmer tracked those of the issuer of the confirmed guaranty letter; the rights and obligations of the counter-guarantor arose from a separate undertaking that was independent from the other guaranty letter; and the rights and obligations of the principal pertained to the underlying transaction that was distinct from the guaranty letter. Thus, the terms of the proposed rule would have a different meaning depending on the relationship at issue. In that context, it was noted that UCP, the set of rules relevant to stand-by letters of credit, was limited to addressing only the effect of an amendment on the confirmer. The suggested conclusion was that the article should not address the rights and obligations of the counter-guarantor and principal.

137. According to another suggestion, the proposed provision should refer to the confirmer and the principal, but not to the counter-guarantor.

138. After deliberation, the Working Group decided to reconsider the question of a rule encompassing the principal (or instructing party) on the basis of a redrafted version of paragraph (2 *bis*) that would cover the confirmer and the principal (or instructing party).

III. FUTURE WORK

139. The Working Group noted that the dates of its next session had had to be changed and that the session would be held from 24 May to 4 June 1993 in New York.

140. It was agreed that the Working Group, at that session, would not have before it and consider a revised text of articles 1 to 8 but would continue its discussion of the current draft text, commencing with article 9.

141. Concerned about the pace of its work during the current session, the Working Group accepted a suggestion to consider its working methods at the beginning of its next session. Various proposals were made for consideration by the Working Group. One proposal was that representatives and observers might, between sessions of the Working Group, wish to consider, and hold consultations within their countries on, especially those substantive issues that were known from previous reports to be open and controversial. Another proposal was to find ways of enhancing the process of consensus building and the spirit of compromise. Procedural proposals included the utilization of ad hoc working parties that would, outside meeting hours, prepare drafts to be considered by the Working Group later in the same session, the adoption of a time schedule allotting limited time to the discussion of individual articles, and to limit the time for individual interventions.