Summary record of the 550th meeting

Wednesday, 3 May 1995, at 2 p.m.

[A/CN.9/SR.550]

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

The meeting was called to order at 2.05 p.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT *(continued)* (A/CN.9/405, A/CN.9/408 and A/CN.9/411)

Article 2 (continued) (A/CN.9/408, annex)

1. Mr. GAUTHIER (Chairman of the Committee of the Whole) noted that there was support for the replacement of the phrase "usually referred to as an independent guarantee or as a stand-by letter of credit" in paragraph (1) by the phrase "known in international practice as an independent guarantee or stand-by letter of credit" and for the retention of paragraphs (2), (3) and (4) as drafted.

2. *It was so agreed.*

Article 3 (A/CN.9/408, annex)

3. Mr. GAUTHIER (Chairman of the Committee of the Whole) invited the Commission to consider article 3, which described the circumstances under which an undertaking could be considered as independent.

4. Mr. VASSEUR (Observer for Monaco) said he thought that there was an inconsistency between the provision in article 3 that "an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not subject to the existence or validity of an underlying transaction" and the provision in paragraph (2) of article 19, which mentioned "types of situations in which a demand has no conceivable basis" and quoted as an example in its subparagraph *(b)* a situation in which "the underlying obligation of the principal/applicant has been declared invalid by a court".

5. Mr. FAYERS (United Kingdom) shared that misgiving and suggested that the difficulty might be solved by adding the words "and subject to article 19" before the words "an undertaking is independent" in the first sentence of the article. That would indicate that articles 3 and 19 were related.

6. Mr. BYRNE (United States of America) said that he appreciated the issue raised by the observer for Monaco but thought that the purpose of article 3 was to define the notion of independence in order to determine the scope of the Convention. For that purpose, even though an independent undertaking within the Convention existed, it might conceivably be declared pursuant to article 19 to be an independent obligation entailing no obligation to pay because of the presence of fraud. The suggestion made by the United Kingdom would mean that an independent guarantee tainted by fraud would be outside the scope of the Convention, which would be inadvisable, since the purpose of article 19 was to provide a system of regulation where fraud was alleged.

7. Mr. SHISHIDO (Japan) supported the proposal made by the United Kingdom.

8. Mr. HERRMANN (Secretary of the Commission) said that the purpose of article 3 was to distinguish between those instruments in respect of which a payment obligation under a guarantee depended directly on the validity of an underlying obligation and those in which it did not. However, that should not be construed as implying that an underlying obligation was irrelevant. For instance, a positive statement of non-performance by the principal/applicant would clearly be relevant.

9. However, inclusion of the words "subject to" would not clarify the meaning, but might lead to confusion. The text as drafted introduced important progress by severing a direct link and making it indirect and documentary.

10. Mr. FAYERS (United Kingdom) withdrew his proposal to add the words "subject to" in the first line of the article. He thanked the Secretary for his explanations and suggested that the phrase "is not subject to" in the second line be replaced by the words "is not dependent upon" and that the words "is not subject" be added before the words "to any term or condition" in the fourth line of the article.

11. Mr. CHOUKRI SBAI (Observer for Morocco) said that the term "subject to" would lead to confusion in Arabic. He would therefore prefer the expression "linked to" or "dependent on". In both French and Arabic, the use of the term "dependent upon", as proposed by the United Kingdom, would be correct.

12. The CHAIRMAN, speaking in his capacity as the representative of Singapore, supported the United Kingdom proposal.

13. Mr. OGARRIO (Mexico) supported the United Kingdom proposal, the Spanish version of which expressed much more clearly the idea explained by the Secretary.

14. Mr. GAUTHIER (Chairman of the Committee of the Whole) asked the Commission whether it wished to accept the amendment proposed by the United Kingdom.

15. *It was so decided.*

Article 4 (A/CN.9/408, annex)

16. Mr. MARKUS (Observer for Switzerland) mentioned some concerns that he shared with the Observer for Sweden.

17. Firstly, there was no rule to cover the rare but possible case that the undertaking did not expressly indicate one or more of the places of business involved.

18. Secondly, there was no clarity regarding the case where the undertaking specified an objectively wrong place of business. The question was whether the decisive place of business would be the real place of business or the place of business indicated in the

undertaking, i.e. objectively, the wrong one. If the latter were the case, the parties would be given the possibility of opting-in by indicating an objectively wrong place of business, which was not satisfactory. Opting-in should be allowed exclusively by means of the mechanism mentioned in article 1.

19. Thirdly, since the concept of habitual residence had not been mentioned elsewhere in the draft, it should not be introduced in the context of internationality.

20. He therefore proposed that paragraph (1) be amended to read:

"(1) An undertaking is international if the places of business of any two of the following persons are in different States and if these places are specified in the undertaking: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer."

21. Paragraph (2)*(b)* should be deleted and the entire paragraph (2) should read:

"(2) If the undertaking lists more than one place of business for a given person, the relevant place of business is that which has the closest relationship to the undertaking."

22. Mr. KOZOLCHYK (United States of America) asked if the term "beneficiary" in paragraph (1) included the transferee. If it did not, it would be necessary to include the transferee as one of the persons whose presence might be relevant to the internationality of an undertaking. He also suggested including the assignee of proceeds because as long as the presence of either one of the parties could lead to a dispute, there would be every reason to apply the Convention.

23. Mr. FAYERS (United Kingdom) asked why the word "confirmer" had been added at the end of paragraph (1). He pointed out that according to article (6)*(b)*, the term "guarantor/issuer" included "counter-guarantor" and "confirmer". Therefore either "counter-guarantor" should be inserted or "confirmer" should be deleted.

24. Mr. GAUTHIER (Chairman of the Committee of the Whole) pointed out that the Working Group on International Contract Practices had referred in paragraphs 92 and 93 of the report on the work of its twenty-second session (A/CN.9/405) to its decision not to mention the place of business of the counter-guarantor but to retain a reference to the confirmer, and referred to the reasons for that decision.

25. Ms. ASTOLA (Finland) said that the amendment proposed by the observer for Switzerland seemed to say more clearly the same as the existing text. It might be the intention of the amendment to state that parties could not invent places of business, which would be a good point, but the existing English text might allow that interpretation. In general, she supported the proposed amendment.

26. Ms. CZERWENKA (Germany) said she was not sure what change was introduced by the proposal. Paragraph (2) of the article provided that the criterion of internationality would be that the undertaking had listed different places of business, but there was no other objective criterion. She asked whether it was the concern of the drafters of the amendment to take into account what would happen if the place of business did not exist in reality, though the proposal did not explicitly address that question.

27. What was needed was a definition of internationality based on very simple criteria to make it possible to know when an instrument was international and would be covered by the Convention.

28. She thought that an amendment was not justified and preferred retention of the existing wording.

29. Mr. MARKUS (Observer for Switzerland) explained that the very slight change in the order of the wording of paragraph 1 was intended merely to clarify that the text referred to the objectively existing "places of business" of the persons concerned, which might not be obvious from the phrase "as specified in the undertaking".

30. To some extent, he agreed with the remarks made by the representative of Finland but was not sure that "as specified in the undertaking" could be construed in the way the Finnish delegation had suggested.

31. Mr. CHOUKRI SBAI (Observer for Morocco) asked whether it was obligatory to state the place of business or residence in the undertaking and whether there would be a penalty for failing to do so. If it was conceivable that neither place was specified, he suggested that the beginning of the paragraph be amended to read: "An undertaking is international if the places of business of two of the following persons are in different States . . .". It would then be necessary to ascertain the real place of business.

32. Mr. HERRMANN (Secretary of the Commission) said that the wording of paragraph (1) proposed by the representatives for Sweden and Switzerland somewhat resembled that used in the United Nations Sales Convention (1980), which referred to the real place of business. In contrast, a more formalistic approach had been taken in the United Nations Convention on International Bills of Exchange and International Promissory Notes (1988), which referred to the place as specified in the instrument. The proposed amendment lay somewhere between the two and was therefore, in his opinion, inoperable. The scope of application would be determined in two steps, first by inquiring about the real places of business and then by ascertaining whether they corresponded to the places specified in the undertaking. He therefore felt that it would be preferable to leave the paragraph as it stood.

33. Mr. BYRNE (United States of America) said that the Working Group had decided, in the interest of commercial certainty, that it ought to be possible to rely on the face of the instrument. The original wording of the paragraph reflected that requirement.

34. Mr. GAUTHIER (Chairman of the Committee of the Whole) took it that the prevailing view was that the existing structure of the paragraph be maintained.

35. Mr. BYRNE (United States of America) said that the word "confirmer" had been inserted in the list referring to "any two of the following persons" because some delegations thought that otherwise, if the guarantor/issuer was also the confirmer and the two were in different countries, the Convention would not apply. Since there must be more than one category, it would be necessary to insert a reference to such persons as the transferee/second beneficiary, the confirmer and also, in his view, the counter-guarantor.

36. Mr. HERRMANN (Secretary of the Commission) said that two separate issues had been raised. One concerned the time of determination of internationality and the other, raised earlier by the representative of the United Kingdom, concerned the interplay between articles 4 and 6. The former raised a difficult policy issue, namely, whether account should be taken of changes in individual categories, for example, where one person moved outside a given jurisdiction. Should a legal regime apply for some

time prior to a change in the beneficiary or before assignment of proceeds? The important question of the new beneficiary or transferee should be discussed separately.

37. On the second issue, an undertaking was considered to be international if the confirmer alone were in a different State from the other parties, but that did not apply in the case of a counter-guarantor. There was possibly a slight problem in that connection in the interplay between the definitions in articles 4 and 6. The statement in article 6 that "guarantor/issuer" included "counter-guarantor" and "confirmer", could not be interpreted as meaning, for the purposes of article 4, that each term subsumed the other two. It was therefore necessary to insert the term "confirmer" in article 4.

38. Mr. FAYERS (United Kingdom) suggested that article 6*(b)* should be reworded to read: "guarantor/issuer, otherwise than in paragraph (1) of article 4, includes 'counter-guarantor' and 'confirmer'".

39. Mr. GAUTHIER (Chairman of the Committee of the Whole) took it that there was insufficient support for the inclusion of "transferee" in the list of persons in paragraph 1 of article 4. He asked whether there was any support for including the "assignee of proceeds".

40. Ms. FENG Aimin (China) said that rule 49 of the Uniform Customs and Practice for Documentary Credits (UCP) clearly stated that the assignee's role related to the transfer of proceeds and not to the transfer of rights. The assignee of proceeds should therefore not be included in the list.

41. Mr. KOZOLCHYK (United States of America) said that, although the assignee was not entitled to draw, the UCP rules stated that the rights of the assignee of proceeds were a matter for the law of individual countries. As the purpose of the Convention was to provide a measure of international uniformity and as the assignee of proceeds was mentioned in article 10, it was felt that it should also be included in article 4.

42. The Convention was likely to be particularly useful in dealing with both the transferee and assignee categories in order to ensure greater uniformity where there was a conflict between the laws of different countries. It would not make sense to omit categories because of a misunderstanding of the application of the rules and assignments.

43. Ms. FENG Aimin (China) said that if the transferee, as second beneficiary, were to be omitted, the assignee should also be omitted.

44. Mr. EDWARDS (Australia) said that it would be entirely unacceptable if the contractual basis of a transaction that was not initially international were changed *ex post facto*, merely because the assignee provided an international character.

45. Mr. FAYERS (United Kingdom) said that he shared the doubts of the representatives of China and Australia. He had great difficulty in understanding the practical implications of a provision that allowed an instrument to start life in one category and suddenly change to another.

46. He agreed that the assignee of proceeds should be omitted from the list.

47. Ms. CZERWENKA (Germany) did not seriously object to the inclusion of the transferee in the list of persons in paragraph (1) of article 4. Where an undertaking was transferable, it would probably be necessary to state in the undertaking itself that an international element might arise, as a result of, say, the nomination of a transferee in a different State.

48. Mr. KOZOLCHYK (United States of America) said that if the internationality of a beneficiary in a transferable stand-by letter of credit were accepted, there was every reason to accept the internationality of the transferee or second beneficiary.

49. The potential of the type of stand-by letter of credit known as "direct pay" for generating an enormous number of assignments had been one of the reasons for including provisions on the assignment of proceeds in the Convention. It was a type of financial obligation payable directly by the principal obligor on presentation of documents and was likely to be used extensively in the international money market. The resultant stream of payment might become effective anywhere in the world within seconds. People therefore needed to be assured that payment of the assignee was guaranteed by a legal regime. It was furthermore implicit in any stand-by letter of credit that the instrument was assignable from the moment of issue.

50. Ms. ASTOLA (Finland) asked whether the place of business of the assignees in question would in that case be mentioned in the undertaking

51. Mr. BYRNE (United States of America) said that in the course of the transfer of a letter of credit, it was typical banking practice that a new letter of credit was issued to a second beneficiary, constituting in effect a virtually new undertaking. His delegation was not proposing that the first undertaking should retroactively be made international. But, if the second letter of credit, which might either supersede the original or become part of it, were on its face international, it would fall within the scope of the Convention. Similarly, if the document consummating an assignment were on its face international, the assignment and associated rights would also be international and come within the scope of the Convention.

52. Mr. GAUTHIER (Chairman of the Committee of the Whole) noted that there was insufficient support for the inclusion of "assignee" in the list of persons in paragraph (1) of article 4 and for the inclusion of "counter-guarantor" in the list. Lastly, he noted that there was insufficient support for the deletion of "confirmer" from the list.

The meeting was suspended at 3.35 p.m.
and resumed at 4 p.m.

Article 5 (A/CN.9/408, annex)

53. Mr. GAUTHIER (Chairman of the Committee of the Whole) noted that there were no comments on article 5.

Article 6 (A/CN.9/408, annex)

54. Ms. CZERWENKA (Germany) said that the phrase "upon simple demand or upon presentation of other documents" in subparagraph *(c)* might have to be revised in the light of whatever decision was taken on the same phrase in article 2(1).

55. In subparagraph *(f)*, she suggested that the definition should read "'confirmer' means the person issuing a confirmation", in order to link it more clearly to the definition of "confirmation" in subparagraph *(e)*.

56. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that those two points would be referred to the drafting group.

Article 7 (A/CN.9/408, annex)

57. Mr. GAUTHIER (Chairman of the Committee of the Whole), introducing the article, said that paragraph (1) was concerned with when and where an undertaking was issued, paragraph (2) with the form in which it should be issued, paragraph (3) with the point of time at which a demand for payment could be made and paragraph (4) with the question of revocability.

58. Mr. AL-NASSER (Saudi Arabia) proposed that the closing phrase of paragraph (1) should be amended to read "leaves the sphere of control of the guarantor/issuer to be transferred to the beneficiary". Without such clarification, the undertaking might be regarded as having been issued even if it had left the sphere of control of the guarantor through theft.

59. Mr. SHISHIDO (Japan) asked whether paragraphs (1) and (2) were mandatory provisions, with the result that the parties could not agree on a different time of issuance and could not issue purely oral undertakings.

60. Mr. HERRMANN (Secretary of the Commission) said that, although both paragraphs (1) and (2) were strictly speaking mandatory, that was not really the point. Paragraph (1) was a definition of the term "issuance"; it was not concerned with the time of effectiveness, which was dealt with in paragraph (3). Paragraph (2) was intended to exclude purely oral undertakings, as had been agreed. It was left to the parties to stipulate a stricter form of undertaking if they wished.

61. Mr. KOZOLCHYK (United States of America) said that, when read in conjunction with paragraph (4), paragraph (1) amounted to more than just a definition. It established a rule as to the time when the undertaking became effective. It was not enough for two of the parties to reach agreement on the matter; all parties involved in the international network of correspondent banking relationships needed to know exactly when liability was incurred, particularly in view of the growing use of electronic communications.

62. Mr. LAMBERTZ (Observer for Sweden), noting that there had been some uncertainty about the precise meaning of "leaves the sphere of control of the guarantor/issuer", gave a hypothetical example. Belgium and Germany were assumed to be Contracting States. A Belgian bank having its only office in Brussels issued a demand guarantee through a German bank in Frankfurt, which was not a branch of the Belgian bank. The Belgian bank sent the documents to the German bank on 1 February, telling it to issue the guarantee on 1 March unless the mandate was withdrawn before that date. The mandate was not withdrawn, and the guarantee was issued in Frankfurt on 1 March, leaving the Belgian bank's sphere of control at that time. As he understood it, that case would not be covered by the Convention, because under article 1 the Convention applied if the place of business of the bank at which the undertaking was issued was in a Contracting State. In his hypothetical example, the Belgian bank had no place of business at which the undertaking was issued.

63. Mr. FAYERS (United Kingdom) said that he did not understand where, in the Swedish representative's hypothetical example, there was a gap in the coverage of the Convention. It seemed to him that the guarantee would have been issued by the German bank on 1 March. What was the relationship between the Belgian bank and the German bank?

64. Mr. LAMBERTZ (Observer for Sweden) said that the German bank was only the advising bank or agent, not the issuing bank.

65. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that if the German bank was merely an agent, and hence merely an extension of the Belgian bank, the answer to the question regarding the time of issuance might be that the undertaking was not issued until such time as the agent released it. The place of issuance might, however, be Brussels, not Frankfurt.

66. Referring to the problem of theft, he noted that the Saudi Arabian representative's concern was that the undertaking should leave the sphere of control of the issuer as a result of a voluntary act on the issuer's part. That concern was not, however, to be met by saying that it left the issuer's sphere of control for transfer to the beneficiary, because it might, before it reached the beneficiary, pass through the hands of an advising bank, a confirming bank, an agent etc. The choice that had been made was that it would then for the purposes of the Convention be regarded as having been issued.

67. Mr. AL-NASSER (Saudi Arabia) suggested that the point might be covered if the text read "issuance of an undertaking occurs when and where the guarantor/issuer sends the undertaking".

68. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that the word "send" was not clear, either. In the Swedish representative's example, was the instrument sent when it went from Brussels to Frankfurt, or only when it left Frankfurt? The term "sphere of control" had been preferred by the Working Group to "sphere of operation" on the understanding that an undertaking would leave the issuer's sphere of control only as the result of a voluntary act. If it were removed through an illicit act, it would not be regarded as having left its sphere of control.

69. Mr. ILLESCAS (Spain) said that a problem would arise only if the undertaking were presented for payment. According to article 2, the undertaking was a commitment to pay to the beneficiary. Hence the situation raised by the Saudi Arabian representative could come about only if the instrument were stolen by or on behalf of the beneficiary. If the issuer had not authorized the circulation of the instrument, the beneficiary would be acting fraudulently in presenting it for payment, and the situation would be covered by article 19, no payment being due in the circumstances. The wording used in article 7 thus seemed to him to offer adequate safeguards.

70. Ms. FENG Aimin (China) agreed with the Spanish representative. Under article 4, moreover, the issuer and the beneficiary would probably not be in the same place, so that the likelihood of theft would be small. In any case, under article 7, the bank could simply revoke a stolen guarantee and issue a new one.

71. On the question of the hypothetical example given by the Swedish representative, she agreed with the United Kingdom representative that it was necessary to establish the relationship between the banks. It seemed to her that, after the issuer issued the guarantee, the other party was simply in an advising position, so that no problem could arise.

72. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that it was not being suggested that issuance could occur involuntarily. Rather, there was concern about the wording and its possible interpretation. However, he took it that the Commission agreed as to what was meant by "issuance" and that the current draft of article 7 was acceptable.

Article 8 (A/CN.9/408, annex)

73. Mr. GAUTHIER (Chairman of the Committee of the Whole) pointed out that in the current and subsequent articles,

references to paragraph (1) of article 7 should be read as references to paragraph (2) of article 7. He invited the Commission to comment on article 8.

74. Ms. CZERWENKA (Germany) said that, for the sake of consistency, the authorization of an amendment by the beneficiary referred to in paragraph (2)*(a)* should be in the form stipulated in article 7(2) in the same way as the notice of acceptance of an amendment by the beneficiary.

75. The question had been raised by the banking community in her country whether paragraph (2) related to both revocable and irrevocable undertakings. However, it seemed clear that the provisions covered only irrevocable undertakings.

76. Ms. FENG Aimin (China) said that oral amendments should not be permitted, though the article made no provision on that point. On the other hand, the Chinese version made it clear that issuance must be made in tangible form. She asked for clarification of the English version with regard to oral amendments.

77. Mr. KOZOLCHYK (United States of America) said that, under paragraph (2)*(b)* of article 8, the beneficiary's consent was not required if an amendment consisted "solely of an extension of the validity period of the undertaking", on the assumption that such an extension would invariably be in the interest of the beneficiary. However, that might not always be the case.

78. In stand-by letter of credit practice, a confirming bank might not have agreed to an extension, but the provision as worded did not make it clear whether or not a confirming bank would be bound by the extension. Also, a beneficiary might not want to have an extended credit or an extended bank guarantee.

79. Mr. EDWARDS (Australia) said that the passage at the end of paragraph (2), beginning with the words, "if any amendment does not fall . . .", should perhaps be made into a separate paragraph.

80. Although issuance had been appropriately defined in paragraph (1) of article 7 with regard to an undertaking, it did not seem to have been defined in the context of amendments.

81. He agreed with the representative of the United States on the question of the beneficiary's agreement under paragraph (2)*(b)*.

82. Mr. ILLESCAS (Spain) said that subparagraph *(a)* as drafted raised many questions. The condition that an amendment should be effective if previously authorized by the beneficiary should be changed to stipulate a previous proposal, suggestion or request by the beneficiary. The mechanism for authorization by the interested parties should also cover conditions for extension of validity.

The meeting rose at 5.05 p.m.

Summary record of the 551st meeting

Thursday, 4 May 1995, at 9.30 a.m.

[A/CN.9/SR.551]

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

The meeting was called to order at 9.30 a.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT *(continued)* (A/CN.9/405, A/CN.9/408, A/CN.9/411)

Article 8 (continued) (A/CN.9/408, annex)

1. Mr. EDWARDS (Australia) wondered whether the "validity period" (article 8), mentioned in paragraph (2)*(b)*, ought not to be defined, in view of the wording of article 7 and the fact that the term also appeared in articles 11 and 12.

2. Mr. CHOUKRI SBAI (Observer for Morocco), supporting the opinion expressed by the representative of Australia, suggested the addition, in article 8, of wording along the lines of "issuance of an amendment shall be in conformity with the terms of paragraph (1) of article 7".

3. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that, if it was feared that there might be confusion between the ideas of revocation and amendment, a phrase such as "unless stipulated to be revocable" could be inserted in paragraph (2).

4. Mr. HERRMANN (Secretary of the Commission) thought that there was a wider issue and referred to the paper submitted by the International Chamber of Commerce, which mentioned the rule set out in article 8 of the Uniform Customs and Practice for Documentary Credits (UCP). The position was clear if a stand-by letter of credit incorporated reference to UCP. He wondered whether the Commission wished to include a similar rule, in the interest of consistency.

5. Ms. FENG Aimin (China) pointed out that, pursuant to UCP and the Uniform Rules for Demand Guarantees (URDG), revocability was determined at the time of issuance.

6. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that, since instruments were basically irrevocable, revocability had to be stipulated. He asked whether the Commission really wished to insert specific reference to revocability in an article on amendment, in respect of instruments not subject to UCP or URDG. In the absence of any comment, he would assume that the current text was acceptable.

7. With regard to paragraph (2)*(a)*, he asked whether the Commission wished to establish a required form for previous authorization by the beneficiary.

8. Mr. CHOUKRI SBAI (Observer for Morocco) supported the current wording and stressed the advisability of avoiding too many formal requirements.