79. Ms. EKEMEZIE (Nigeria) was in favour of option I and thought it might be useful to include paragraph (3) of option III in that option.

80. Mr. AL-NASSER (Saudi Arabia) said that his delegation would be in favour of option III with the Australian amendment, but suggested that the drafting group should study the text and take into account the points raised by the observer for Sweden.

81. Mr. FAYERS (United Kingdom) said his delegation preferred option III as amended by Australia, but could accept option I.

82. He wondered if some of the problems had arisen because delegations did not appreciate the fact that article 19 was concerned with a particular moment in time, namely, when the bank was called upon to pay. Trying to deal with questions that might arise years later when rights and wrongs came to light merely confused the issue.

83. On the link between articles 19 and 20 and the argument that if there was no obligation not to pay, it somehow impeded the right to have provisional measures under article 20, he believed that that matter could be accommodated in the text by providing that the courts had jurisdiction in that instance. In English law the courts had, as a matter of public policy, jurisdiction to intervene in any relationship where there was an instance of fraud.

84. Mr. HERRMANN (Secretary of the Commission) said that perhaps some of the considerations voiced in favour of or against the various options had not been fully understood. Those in favour of option I were primarily representatives of European States with a civil-law tradition. It might be wise to see what was behind their preference and whether there was a way of accommodating it. The main argument in favour of option I and against option III was the link with article 20 and the possibility of having provisional measures. For the States in question, a mere right not to pay could not be a sufficient basis for a provisional order to stop payment, which would have to be founded on a possible obligation not to pay. No State with such a legal system would be able to accept the Convention on the understanding that an exception was being made to that principle with sole reference to the limited area of letters of credit. That point might not have been appreciated by representatives of countries with other legal systems.

85. As to the Swedish concern about fraud that was not immediately manifest, he pointed out that whatever was not covered by article 19 was covered by article 17, which provided that payment should be made on a conforming demand.

86. With respect to the Australian proposal, which had caused some misunderstanding, he said that it would make less obvious the original purpose of paragraph (3), which was to say that it did not prejudice any rights of the principal/applicant. The proposed additional rule added nothing and ought to be regarded as self-evident.

The meeting rose at 12.30 p.m.

Summary record of the 560th meeting

Wednesday, 10 May 1995, at 2 p.m.

[A/CN.9/SR.560]

Chairman: Mr. GOH (Singapore)

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

The meeting was called to order at 2.20 p.m.

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

Article 19 (continued) (A/CN.9/408, annex)

1. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that there was no support for option II and that a preference seemed to have emerged for the approach adopted in option III (A/CN.9/XXVIII/CRP.3). But a way had to be found of ensuring that it did not prejudice the right of the principal/applicant to seek provisional court measures before payment was made to the beneficiary in the case of a manifestly improper demand.

2. Ms. CZERWENKA (Germany) said that, if a majority view in favour of option III prevailed, the right of the principal/applicant to take action against the guarantor/issuer in order to stop payment would not be recognized in the draft Convention. National Law would then be applicable to such cases and uniformity would be sacrificed. Moreover, in many jurisdictions the rights of the principal/applicant in the matter were unclear. If article 20 were maintained, it could prove unenforceable in jurisdictions where a claim by the principal/applicant against the guarantor/issuer to stop payment was not recognized. Option III dealt only with the relationship between the guarantor/issuer and the beneficiary and failed to address the relationship between the guarantor/issuer and the principal/applicant.

3. Mr. BYRNE (United States of America) said that the Secretary had suggested at the end of the previous meeting that the problem with regard to article 19 might be associated with a subfamily of the civil-law system and might be partly of a regional nature. However, the difficulty was to some extent conceptual and theoretical and there was no single valid approach to the problem.

4. Clearly, very different integrated systems existed for dealing with extraordinary relief, but he understood from the Secretary's remarks that there was a necessary conceptual link to the ability of a court to grant extraordinary relief under article 20, which depended on the existence of a bank's obligation not to pay. Referring to a hypothetical case involving the Swedish company Volvo as principal/applicant before a Swedish court, he said that he found it difficult to believe that, where there was irrefutable proof of fraud, a court would refuse to grant extraordinary relief because of a lack of linkage between articles 19 and 20 in the Convention. Even where the fraud was not manifest and clear to

the guarantor/issuer, as implied in option I, he found it hard to imagine that a court would fail to grant such relief. The main difficulty that the approach reflected in option I created for the banking community in his own and other countries was that the entire mechanism hinged on the duty not to pay. Qualifications and protections were then required both by the banking community and by the beneficiary. A provision that unduly prejudiced an innocent beneficiary accused of fraud was unacceptable, since it was not uncommon for principals/applicants to allege fraud when what existed was a dispute concerning the underlying transaction.

5. As he saw it, the only possible alternative to option III was something along the lines suggested by the representative of the United Kingdom, namely, to draw a distinction between, on the one hand, situations in which fraud existed and was found to exist by a court and, on the other, situations in which a bank withheld payment on grounds of fraud and the beneficiary could require a court to determine its entitlement to payment in the absence of such fraud.

6. Mr. LAMBERTZ (Observer for Sweden) said that he shared the view previously expressed by the representative of Germany that option I offered the only possibility of achieving international uniformity. The representative of the United States of America, mentioning a hypothetical case involving the Volvo company, had asked whether there was a way of securing the possibility of provisional court measures. Where fraud was proven, the court would probably grant an injunction even if the Convention did not provide for an obligation not to pay. There was therefore no real need to include such a provision because the court would then have to base its ruling with respect to the provisional measure on the implicit rule in national law.

7. He wondered whether there was a large majority in favour of option III. Option I was still a viable alternative since many of the advocates of option III had said they could accept it. The representative of the United States would be willing to support option I if it included an indemnity clause, which he thought was quite acceptable.

8. Mr. BONELL (Italy) said that he doubted whether it was a mere regional peculiarity that had led almost half the Commission to support option I. However, he was prepared, if necessary, to accept option III.

9. Leaving the question of provisional court measures to be decided under national law would, in his view, make sense and seemed to be the only logical solution in some legal systems. At the same time, it would be preferable to make some provision for such cases in the Convention. Saying that banks had a right not to pay in the event of fraud was merely stating the obvious.

10. He was in favour of keeping paragraph (3) of option III as it stood, without the Australian amendment, and also of maintaining article 20, in order to make it clear that in many jurisdictions provisional court measures should still be possible, notwithstanding the amendment to paragraph (1). He wondered whether the words "as against the beneficiary" in the last line of paragraph (1) could be interpreted as implying that the guarantor/issuer had what amounted to a duty, *vis-à-vis* the principal/applicant, to withhold payment.

11. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that there seemed to be a general feeling that a principal/applicant should have the right to apply for provisional measures in the context of fraud. He asked for comments on the possibility of amending paragraph (3) of option III to state positively that principal/applicant had the right to seek provisional court measures in the circumstances set out in paragraph (1) instead of saying that such a right was not prejudiced.

12. Mr. BURMAN (United States of America) said such an amendment could be helpful in countries where there was inadequate linkage under national legislation and he would therefore support it.

13. The Convention should be drafted in a way that would make it acceptable to banking associations and hence more likely to be ratified by a wide variety of States. Many banking associations would be unwilling to support an instrument that adopted the "obligation not to pay" approach, not only because it would encroach on what they perceived as their business judgement capacity but also because of a concern about what were known as "rating agencies" in his country—agencies that assessed the risk attached to international commercial documents and set the discount rate for stand-by letters of credit and bank guarantees in the light of that assessment. For those agencies, a duty not to pay would probably downgrade the discount value of the paper concerned. He therefore cautioned against an approach that restricted the discretionary function of banks.

14. Mr. MARKUS (Observer for Switzerland) wondered whether the amendment suggested by the Chairman of the Committee of the Whole might be interpreted as encouraging principals/applicants to have immediate recourse to the courts to obtain provisional relief when they believed that an improper demand was being made by the beneficiary. There seemed to be some inconsistency between the right of the principal/applicant to seek an injunction and the right of the guarantor/issuer to exercise discretion in the matter of withholding payment.

15. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that some delegations seemed to favour option I because of their concern about provisional court measures and the establishment of grounds for going to court. Where the principal/applicant had a right to apply to a court for provisional measures, the manner in which that right was discharged was covered by article 20.

16. Mr. EDWARDS (Australia) said that he had been seeking a form of words that covered not only a right to go to court, but also a right on which to found an action before the court. Perhaps it could be stated that under paragraph (1), the guarantor/issuer had a right to withhold payment and would be required to exercise that right where not to do so would constitute a breach of faith towards the principal/applicant.

17. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that he had intended to convey both standing before a court and the foundation for an action. Paragraph (3) should squarely fix a course of action for the applicant.

18. Mr. SHISHIDO (Japan) thought that the Convention should not create standing without a duty of the guarantor/issuer not to pay. That would be necessary in a civil-law country like Japan. Even the inclusion of wording in paragraph (3) to indicate that the principal/applicant had a right to seek provisional court measures would not suffice to create standing before a court. Option III stated that, under certain circumstances, the guarantor/issuer had a right, as against the beneficiary, to withhold payment. It was not stated, however, that, at the same time, the guarantor/issuer had a duty towards the principal/applicant to withhold payment.

19. He advocated retention of the existing text of paragraph (3).

20. Mr. SHIMIZU (Japan) said he thought that the proposal made by the Chairman of the Committee of the Whole would not be acceptable to some delegations.

21. Some delegations believed that articles 19 and 20 could not be separated. However, in the view of his delegation, the

Convention would achieve a degree of uniformity in substantive law, even without article 20.

22. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that the Convention could indeed establish standing for a party in court.

23. Mr. BONELL (Italy) felt that there was a triangular relationship, which could be covered by option III. His delegation could accept wording to the effect that the guarantor/issuer had a right, as against the beneficiary, to withhold payment, provided that it was stipulated that the principal/applicant also had rights if the situation mentioned in paragraph (1) should occur. To express that idea, the current text of paragraph (1) could be retained and paragraph (3) could be amended along the lines suggested by the Chairman of the Committee of the Whole; the Australian proposal should also be adopted.

24. Mr. OGARRIO (Mexico) suggested that the title of the article should be changed to mention a right to withhold payment.

25. Two ideas had emerged when touching on article 20 and in the current discussion on article 19, namely, whether provisional measures should be left to local legislation and whether the standards established in article 20 were sufficiently high to be uniform rules. A change in paragraph (3) along the lines proposed by the Chairman of the Committee of the Whole might further lower the standards prevailing in many domestic legislations. The Chairman of the Committee of the Whole had said that Canadian law required the mention of an obligation, and the representative of Germany and the observer for Sweden had confirmed that there was a similar requirement in their countries. He concurred with the comments of the observers for Sweden and Monaco that the requirements for obtaining provisional court measures should be left to national legislation.

26. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that the purpose of his proposal was to establish a right in law and not to set up a code. He asked the representative of Mexico to clarify his remarks about standards.

27. Mr. OGARRIO (Mexico) explained that article 20 referred to high probability, a standard which would perhaps be too high in some countries and too low in others. The same applied to the standard of strong evidence. His concern was that it was now proposed that, although the issuing bank was under no obligation to refuse payment, it should have a right to refuse payment and that provisional court measures could be issued in any case.

28. Ms. CZERWENKA (Germany) expressed her delegation's support for the proposal made by the Chairman of the Committee of the Whole to create a right for the principal/applicant.

29. Mr. LAMBERTZ (Observer for Sweden) said that the proposal made by the Chairman of the Committee of the Whole could possibly also be acceptable to Sweden. The remaining major problem in option III was the wording of paragraph (1). He thought that the guarantor/issuer had a right to withhold payment under certain circumstances but that the level of evidence needed was not its concern. It might be better, for example, in paragraph (1), to say that the guarantor/issuer had a right to withhold payment "if any document is not genuine or has been falsified" and to remove the reference to "manifest and clear". Paragraph (2) could be retained and paragraph (3) could be changed to state that, if the principal/applicant believed that there had been a falsification, he could go to court for a provisional measure. The text would then be acceptable to Sweden. That text would not contain an explicit rule on the cases in which there was a duty not to pay, but would be an acceptable compromise.

30. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that deletion of the words "manifest and clear" might admit the interpretation that a guarantor/issuer had a right to withhold payment on the basis of a mere suggestion of impropriety.

31. Mr. FAYERS (United Kingdom) thought that the wording of the Convention should fix the link between articles 19 and 20. He referred to an approach by a German bank to a London court for a provisional measure in a case involving a stand-by letter of credit. The court had ruled that, in the exceptional cases of commercial letters of credit, there was no need for the principal to show a cause of action or that there had been a breach of the obligation. He wondered whether paragraph (3) could be made more general in the context of the inherent power of the court to intervene where it considered it necessary to prevent fraud.

32. Mr. GAUTHIER (Chairman of the Committee of the Whole) pointed out that, in some jurisdictions, there was no inherent power of the court so that it was necessary to create a right.

33. Mr. GILL (India) said that Indian courts had the inherent power to issue an interim injunction if there was evidence of fraud.

34. He was concerned that some countries might find it difficult to reconcile the Convention, in its current wording, with their domestic legislative provisions.

The meeting was suspended at 3.45 p.m and resumed at 4.10 p.m.

35. Mr. GAUTHIER (Chairman of the Committee of the Whole) said he took it that the Commission wished to maintain paragraphs (1) and (2) of option III. Subject to redrafting, paragraph (3) would provide that, in the circumstances set out in paragraph (1), the principal/applicant had a substantive right to obtain a provisional court order in accordance with article 20.

36. Mr. SHISHIDO (Japan) asked whether the intended meaning was that the guarantor/issuer had a duty not to pay and the principal/applicant had a right to obtain a provisional court measure, or rather that the guarantor/issuer was under no obligation to withhold payment but the principal/applicant had a right to obtain a provisional court measure. He also asked whether option III was a mandatory or non-mandatory provision.

37. Mr. GAUTHIER (Chairman of the Committee of the Whole) replied that the substance of the first paragraph was that the guarantor/issuer had a right as against the beneficiary to withhold payment. The third paragraph established the substantive right in favour of the principal to obtain provisional court measures in accordance with article 20. With regard to the question whether the provision was mandatory or not, he pointed out that the text did not include any provision allowing the parties to agree otherwise.

38. Mr. EDWARDS (Australia) said that he had difficulty in relation with the distinction between the right to go to court and the right prosecuted in court. There was some doubt whether a party which had obtained a provisional order could obtain permanent relief if it did not have both a substantive right and a right of access. If a substantive right were established onto which article 20 could then attach, that right flowed through to obtaining both permanent and provisional relief.

39. That point might be covered by the drafting group, but it should not be ignored.

40. Mr. LAMBERTZ (Observer for Sweden) concurred with the representative of Australia but said that the question should be dealt with by those who had to apply the law.

41. He reiterated that his real problem with the proposed solution was the phrase "manifest and clear" in paragraph (1).

42. Mr. STOUFFLET (France) agreed with the observer for Sweden. If one considered the relationship between the guarantor and the beneficiary, the phrase "manifest and clear" made no sense, although it did make sense in the context of the relationship with the principal/applicant. The guarantor could be accused of having made payment even though it was "manifest and clear" that certain circumstances had arisen, but, vis-à-vis the beneficiary, the phrase was out of place.

43. Mr. GAUTHIER (Chairman of the Committee of the Whole) asked if the Commission objected to deleting the words "it is manifest and clear that", so that the paragraph would begin: "If: *(a)* . . .".

44. Mr. AL-NASSER (Saudi Arabia) proposed that the words "for example" be added after the phrase "manifest and clear" in order to include situations not explicitly covered under option III. That would meet the concerns raised by Sweden.

45. Ms. CZERWENKA (Germany) sympathized with the concern expressed by the observer for Sweden but objected to the deletion of the phrase "manifest and clear". The criteria had originally been included in order to define the conditions under which the principal/applicant had a right to take action against the guarantor/issuer. The whole structure of the article had now been changed, and the right on the part of the principal/applicant was now stated in paragraph (3), so that the reference to the "manifest and clear" conditions under which there was such a right should be indicated there as well.

46. Mr. BONELL (Italy) agreed with the representative of Germany but thought that the deletion of the phrase "manifest and clear" from paragraph (1) of the amended article 19 would entail changes not in paragraph (3) but in article 20.

47. Deletion of the words "there is a high probability that" from paragraph (1) of article 20, in conjunction with the reference to "immediately available evidence", would express what was intended by the phrase "manifest and clear" in article 19. It was unnecessary to refer to "strong" evidence.

48. All that would then be needed in article 19(3) would be a reference to article 20, with or without the additional language proposed by the representative of Australia.

49. Mr. GAUTHIER (Chairman of the Committee of the Whole) suggested that the Commission should not anticipate too much its consideration of article 20.

50. As he understood it, the concept that a bank could decide to withhold payment only if certain facts were manifest and clear had been introduced in article 19 as a guideline to banks. If that concept were eliminated, the provision might be taken to mean that a decision to withhold payment could be based on a mere allegation.

51. The concept was counterbalanced by the concept of the bank's acting in good faith. Deletion of one would also affect the other.

52. Mr. OGARRIO (Mexico) said that, in all its discussions on the concept of "manifest and clear", the Working Group had never intended to leave the matter to the discretion of the issuing banks. The issuer must pay in all cases, unless some manifest and clear facts such as those described in the three subparagraphs of paragraph (1) had come to light. Deleting the phrase might endanger the rights of the beneficiary because the impression would be given that the issuer might exercise its right to refuse payment on the basis of a mere suggestion by the principal, which would expand the right to withhold payment well beyond what had been intended. The phrase should be retained in order to preserve the general principle that, in the absence of exceptional circumstances, payment must be made.

53. Ms. EKEMEZIE (Nigeria), agreeing with the representative of Mexico, said that it was extremely important to keep the phrase in order to avoid situations of possible abuse.

54. Mr. FAYERS (United Kingdom) supported the remarks of the representative of Germany and of the Chairman of the Committee of the Whole on deletion of the words "manifest and clear". He did not agree with the representative of France that the phrase had no meaning in the relationship between the guarantor and the beneficiary, since it was the basis of the understanding whereby the guarantor could disregard its solemn obligation to pay. As the representative of Germany had said, if the phrase were deleted it would have to be inserted somewhere else. It should be left where it was.

55. Mr. LAMBERTZ (Observer for Sweden) said that he had not intended to imply that the bank did not need a factual basis for its assessment of whether there was falsification or fraud. However, the text as it stood did not, in his view, address the question of the time when the bank had a right not to pay. If a court later established that there had been fraud, it would rule that the bank had been under no obligation to pay.

56. The representative of Mexico had correctly stated that the question of manifest and clear facts had been discussed at length on earlier occasions; however, such discussion had focused on the "duty-not-to-pay" approach and not on the "may" approach, in which context the phrase was inappropriate.

57. If the phrase were deleted, the bank would have to assess the facts and make its decision. That was how it should be.

58. He agreed with the representatives of Germany and Italy that, if the phrase were deleted from the *chapeau* of paragraph (1), it would have to be inserted elsewhere.

59. Mr. AL-NASSER (Saudi Arabia) supported the deletion of the phrase. Very skilfully produced counterfeit currency was being presented to banks day by day, the fact not being discovered until later. Such fraud could not be referred to as immediately manifest and clear.

60. Mr. GAUTHIER (Chairman of the Committee of the Whole) said he took it that the Commission as a whole did not endorse deletion of the phrase "manifest and clear".

61. *It was so agreed.*

The meeting rose at 5.05 p.m.