Summary record of the 561st meeting

Thursday, 11 May 1995, at 9.30 a.m.

[A/CN.9/561]

Chairman: Mr. GOH (Singapore)

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

The meeting was called to order at 9.35 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 20 (A/CN.9/408, annex)

1. Mr. GAUTHIER (Chairman of the Committee of the Whole), introducing article 20 on provisional court measures, said that it had been the subject of much discussion and redrafting in the Working Group. The title had been adopted to show that what was involved was not a main action, but a quick process to obtain a court order pending a future final decision.

2. The Working Group's discussion on the words "high probability" was summarized in document A/CN.9/405, paragraph 38. At one time, as shown in document A/CN.9/388, paragraph 48, the proposed wording had been "manifestly and clearly". It had been decided as a compromise to retain the words "high probability" to meet concern as to the possible effects if the level of proof was set too high or too low.

3. The expression "immediately available strong evidence" might also raise questions for some delegations. Paragraph 39 of document A/CN.9/405 referred to the Working Group's discussion on that point. The Working Group had agreed that such a phrase was needed to indicate that the evidence must not only be present and available, but also strong.

4. The Working Group had also decided to retain in the last part of paragraph (1) of article 20 the balance-of-convenience test, since it felt that those words, together with the provision in paragraph (3), allowed adequate room for the interests of the beneficiary to be taken into account (A/CN.9/405, paragraph 41).

5. Mr. VASSEUR (Observer for Monaco) considered that article 20 had no place in the draft Convention. If it were kept in, the European banks would be unable to accept the reference to "high probability", which would only encourage an applicant to invoke it and gain time. Experience showed that when a principal/applicant applied to the court, it was sometimes two or three years before the amount of the guarantee was paid to the beneficiary. A principal/applicant should be able to ask a court to take provisional measures as provided in the last paragraph of the new version of article 19, but in his view such measures were exclusively a matter for national legislation.

6. A previous version of article 20 had mentioned a right of appeal by the beneficiary, whereas the present formulation did not.

7. A judicial measure, provisional or not, ordering a freeze of the amount of the guarantee was not justifiable, since either the guarantee had to be paid or it did not and there was no need for provisional measures. Furthermore the expression "taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm" at the end of paragraph (1) was totally inadequate and should be amended to read "... irreparable harm" as in previous drafts. Some risks had to be incurred in international trade.

8. With respect to paragraph (2), the Convention should not dictate to the court that it should or should not require security. That was a matter for the court to decide.

9. Mr. MAHASARANOND (Thailand) said that under his country's legal system provisional measures could be obtained only when one of the parties initiated an action by suing the other party in court. In the case covered by article 20, the principal/applicant or instructing party would not be able just to apply to the court for provisional measures; he would first have to sue the beneficiary or the guarantor/issuer. He therefore agreed that provisional court measures should be left to national legislation.

10. Mr. FARIDI ARAGHI (Islamic Republic of Iran) said that since a court should consider the matter as a whole, the words "taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm" at the end of paragraph (1) should be deleted.

11. Ms. FENG Aimin (China) asked, in connection with articles 19 and 20, whether once a bank had paid and the payment had left the sphere of control of the issuer, it would be impossible for an applicant to seek a provisional court measure.

12. Mr. GAUTHIER (Chairman of the Committee of the Whole) explained that article 20 focused on the effect of provisional court measures, which could take different forms according to the jurisdiction involved. One form would be to ensure that the beneficiary did not receive payment. A second form would be that the amount of the undertaking was held by the guarantor. A third form would be to intercept or block the proceeds at the beneficiary's level.

13. He was not familiar with the procedures in all jurisdictions, but in a situation where, for instance, under the guarantee or stand-by credit the instructions to the bank were to make payment into an account in the same jurisdiction, an attempt could be made to block the payment there.

14. Mr. LAMBERTZ (Observer for Sweden) considered it important to include a rule on provisional measures in the Convention. However, since the standard of proof required under article 19 ("manifest and clear") was higher than that required under article 20 ("high probability"), in practical terms that would result in a situation in which a bank had to pay, but a court might still issue an order to prohibit it from paying. To make the Convention consistent, the wording therefore had to be changed. One possibility might be to raise the standard of proof in article 20, another to remove the words "manifest and clear" from article 19, which was the solution that he would prefer.

15. Mr. HERRMANN (Secretary of the Commission), replying to the argument of the observer for Sweden, pointed out that the

different standards in articles 19 and 20 had coexisted for some time. Delegations in favour of different standards had clearly distinguished between the situations covered by the two articles. Moreover, almost all laws established that difference.

16. Replying to the remark by the observer for Monaco about the expression "high probability", he said that the Secretariat had found that in national case-law "high probability" was very close to the standard used for provisional measures in a number of continental European countries, although it was not expressed in those terms. The idea in article 20 was that the court might, and in fact should, apply a lower standard, which also explained the additional conditions of the balance-of-convenience test and the possibility of asking the person applying for a provisional order to furnish security if it later turned out that what had seemed almost certain was not certain at all.

17. Mr. LAMBERTZ (Observer for Sweden) said that the link between articles 19 and 20 no longer existed. Most participants in the Working Group, including himself, had previously been in favour of lower standards in article 20 than in article 19. However, that was logical only if there was a mandatory rule in article 19. It was unacceptable to state that the bank "must" pay and that the court "might" order the bank not to pay.

18. Mr. SHIMIZU (Japan) said that his delegation wished to reiterate its proposal that article 20 be deleted in full. If that proposal was not accepted, he would suggest that the words "high" and "strong" in paragraph (1) and the whole of paragraph (3) be deleted. If that proposal also failed to gain support, he would suggest that a new paragraph be added, in the form of a reservation clause.

19. Mr. CHOUKRI SBAI (Observer for Morocco) said that his delegation still believed that article 20 should be retained. Its provisions were consistent with the Moroccan legal system, which allowed for emergency measures. The blocking of payments could only be provisional, since otherwise the beneficiary could apply for cancellation of the court order. He understood that the situation regarding the possibility of adopting provisional measures was not the same in all countries. Article 20 accordingly sought to harmonize the situation.

20. The draft Convention could not deny the issuing bank the right to withhold payment in manifest cases of fraud or disallow the court the option of blocking payment, a decision taken only after it had examined the evidence. Article 2 referred not only to banks but also to other institutions and persons. Thus, limits might be set, through the judicial process, on forms of abuse.

21. In his delegation's view, the word "strong" should be deleted from paragraph (1). The matter of assessing the weight of evidence should be left to the courts.

22. Mr. STOUFFLET (France) reiterated his delegation's misgivings regarding the term "high probability" appearing in paragraph (1). The choice of those words had arisen from the view that, while the issuing bank's decision whether to effect payment had to be made quickly on the basis of scant information, a judge would have some days in which to assess the evidence submitted. In practice, however, judges tended first to issue an order to block the payment and then consider whether the beneficiary was entitled to it. His delegation would therefore prefer to replace "high probability" by a formulation indicating that provisional measures should be adopted only when there was certainty of an improper demand.

23. Mr. OGARRIO (Mexico) associated himself with those speakers who had expressed a preference for domestic law to determine the requirements for granting provisional court measures. His delegation consequently favoured deletion of article 20. If that article was retained, then the standards laid down in it should be high. There should also be no lowering of the standards in article 19. In article 20, paragraph (1), the "high probability" test should match the standard of "manifest and clear" fraud stipulated in article 19, the standard of "strong evidence" could possibly be increased to the level of "irrefutable evidence", and the standard of "serious harm" should be raised to that of "irreparable harm". Paragraph (2) should establish an obligation on the part of the court to require the applicant to furnish a security. The reason for ensuring such high standards was to prevent applicants from obtaining court orders with a view to delaying payment.

24. Mr. GAUTHIER (Chairman of the Committee of the Whole), speaking as observer for Canada, recognized that the procedure differed in different countries. In Canada, if it was necessary to establish fraud irrefutably at the stage where provisional measures were being sought, that would usually be done through *ex parte* proceedings, with a five-day limit, involving an adversarial debate. To require fraud to be so established from the outset would in effect nullify the procedure provided for in article 20. The last clause of paragraph (1), for example, would hardly apply. It was clear from the text of the draft Convention that the guarantor/issuer generally effected payment against a conforming demand and did not enter into a commercial dispute, the sole exception being cases of fraud. Article 19 defined the situations constituting fraud and specified the relevant standard of assessment, namely, manifest and clear evidence. On the question of the link between articles 19 and 20, the principal/applicant's right of access to the courts could be expressly stipulated in order to overcome the lack of an "obligation not to pay" provision. As to the arguments in favour of uniform standards, it should be borne in mind that the court was a disinterested third party and that its needless intervention in the payment process had to be avoided. The granting of provisional measures had thus been limited to the context of fraud. It was therefore hard to see how there could be any question of an invitation to issuing banks to apply to the courts in cases of commercial disputes.

25. Article 20 was intended not to establish a procedural rule, but rather to provide a general policy direction for the courts. The test for the granting of provisional measures was already based on very high standards, namely, the high probability of fraud, immediately available strong evidence and the likelihood of serious harm to the principal/applicant. If it were set any higher, the securing of such court orders could be rendered virtually impossible.

26. Mr. GRANDINO RODAS (Brazil) said that his delegation supported the view that article 20 should be deleted. The question of provisional court measures should be left entirely to internal legislations.

27. Mr. GILL (India) said that, in his delegation's view, mere *prima facie* evidence should be a sufficient basis for the courts to issue provisional measures to prevent payment to the beneficiary.

28. Mr. BONELL (Italy) said that the adoption at the previous meeting of option III for article 19 (A/CN.9/XXVIII/CRP.3) constituted a concession to the guarantor/issuer. The equally legitimate interests of the other parties, primarily the applicant/principal, also had to be considered. That was the intention in article 20, together with the proviso contained in article 19, paragraph (3).

29. No delegations had argued that the draft Convention should expressly deny the principal/applicant the right in certain circumstances to apply to the courts for the granting of provisional measures. That right was generally recognized in national laws and could usefully be included in article 20 as a counterbalance.

30. With regard to the question of lower standards, provisional court measures were often sought prior to the beneficiary's submission of its demand for payment. Therefore, the "high probability" test, i.e. *prima facie* evidence, had to be an acceptable basis. Moreover, provisional court orders were granted under the *inaudita altera parte* or non-adversary procedure, and it was difficult to conceive of a judicial ruling based on the establishment of a fact as certain without the other party having been heard. For those and other reasons, he felt that the substance of article 20 should be retained.

31. Mr. SHISHIDO (Japan) said that he shared the views expressed by the observer for Canada. On the subject of the standard of proof, he did not agree with those who considered that the standard required in article 20 was lower than in article 19. Even after the adoption of the "may" approach for article 19, the standard required in article 20 was higher, because the judgement allowing the guarantor/issuer to stop payment was only possible when there was "high probability" that the demand was manifestly and clearly improper. That was presumably the intention, but the wording used was not absolutely clear. He hoped that the drafting group would be able to establish beyond a doubt that the reference to "one of the elements referred to in paragraph (1) of article 19" included the concept of "manifest and clear" impropriety. In his view, the test introduced by the term "high probability" was in fact too strong. As there already existed a "manifest and clear" test at the guarantor level, he did not see why a higher standard was required for an application to the court. It should be possible to rely on the court's impartial judgement. The words "high probability" might therefore be deleted.

32. Mr. HERRMANN (Secretary of the Commission) hoped that Japan would reconsider its suggestion to delete "high probability". In his view, article 20, paragraph (1), meant what it said in speaking of a "high probability that . . . one of the elements referred to in paragraph (1) of article 19 is present". The elements referred to were the three situations involving an abuse of land described in article 19 (1). At least one of them had to be merely "present", not "manifest and clear". It would be too much to expect there to be a "high probability" that the presence of such an element would be "manifest and clear" to everyone. It might be possible to clarify the text by using the word "instances", as in previous versions, or some other word, or by including a more specific reference to the actual phrases used in article 19(1)*(a), (b)* and *(c)*. The aim of the paragraph was to express the link between the evidence presented and the inference to be drawn in order to decide whether one of the elements or instances used to define fraud or abuse was present. That was reflected in the use of the terms "high probability" and "strong" evidence, the effect of which was much the same.

33. Mr. FAYERS (United Kingdom) said that in practical terms, article 20 left many gaps to be filled by national procedures. One of the most important aspects was the speed with which a court measure could be taken. In the United Kingdom, for example, it could be taken within no more than five to ten days, which made it acceptable to have a lower standard. The procedure was particularly quick in the United Kingdom because the banks were very active in going to court to apply for the discharge of an injunction. The speed of the procedure might penalize the principal, because he was given so little time to produce evidence for maintaining the injunction. However, if the procedure took a lot longer, as it appeared to do in certain countries, that could also raise problems. The United Kingdom tended to favour the principle "pay first, argue later".

34. The paragraph as it stood represented a compromise arrived at after many years of discussion. The term "high probability" was equivalent to "a strong *prima facie* case" or the expression "seriously arguable" used in the United Kingdom. He was happy with the text as it stood.

35. Mr. BYRNE (United States of America) said that the Convention would provide not an internal but an international regime that would reassure beneficiaries, applicants, issuers or confirmers in one country that there existed an international regime with a reasonable degree of certainty as to standards for dealing with disputes arising in other countries. That international certainty, though not perfect, was, on the specific issues covered in articles 19 and 20, of great value for independent guarantees and standby letters of credit. Article 20 should therefore be retained. The wording represented the outcome of many years of discussion and, though he and others might have preferred something different, the present text was workable. He did not think that any major change would elicit sufficient support. The report of the Commission should, however, reflect the Working Group's understanding that the insolvency of a principal/applicant could not be a defence for the obligation of the guarantor/issuer to pay or a ground for extraordinary provisional relief.

36. The CHAIRMAN speaking as representative of Singapore said that article 20 should be retained as part of the Convention. He associated himself with the remarks made by the observer for Canada.

37. Mr. EDWARDS (Australia), referring to the comparison made by certain speakers between the "manifest and clear" test in article 19 and the "high probability" test in article 20, said that they were two different concepts, which had been usefully articulated in two different ways. The situation confronting a banker when asked to make a payment was quite different from that confronting a court, and that difference was reflected in the language used. In his view article 20 should be retained as it stood.

The meeting was suspended at 11.15 a.m. and resumed at 11.50 a.m.

38. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that it was his impression that the majority of members wished to retain article 20. After listening to the arguments for and against retaining the words "high probability", he considered that the term should be retained. Regarding the word "elements", it clearly referred only to subparagraphs *(a), (b)* and *(c)* in paragraph (1) of the redrafted article 19 and not to the full text of that article. The drafting group should therefore examine the present text of article 20, paragraph (1), to ensure that the reference made was to those elements in article 19 only. A few comments had been made on the word "strong", but he did not feel there had been sufficient support to warrant its deletion. Nor had there been sufficient support for the deletion or amendment of the last part of paragraph (1), "taking into account whether in the absence of such an order the principal/applicant will be likely to suffer serious harm". In regard to paragraph (2), the suggestion that nothing should be said to courts regarding the provision of any form of security had not received much support. He therefore suggested that the text should remain as it stood. There had been no comments on paragraph (3), which he took to mean that it was acceptable.

39. Mr. AL-NASSER (Saudi Arabia) said that his country had already proposed an amendment with respect to article 20, the purpose of which was to avoid giving the impression of intervening within the jurisdiction of the courts. In the case of an application by the principal/applicant or any other party that produced evidence, proof or a high probability of the presence of the elements referred to in article 19(1) in relation to a demand made, or expected to be made, by the beneficiary, the guarantor could request the court to take action. He therefore suggested that the text of paragraph (1) be amended after the words "paragraph (1) of

article 19 is present" to read "the guarantor may ask the court, on the basis of immediately available strong evidence, to issue a provisional order . . . ".

40. Mr. GAUTHIER (Chairman of the Committee of the Whole) noted an absence of support for the amendment suggested by the representative of Saudi Arabia.

41. Mr. STOUFFLET (France) said he wished to propose additional language on counter-guarantees or counter-guarantors in order to cover a situation which was quite common in European and French practice but which was not dealt with in the present text. In that type of situation, a guarantee had been requested and paid and the first principal/applicant—most frequently an exporter—considered the request to have been made in bad faith, i.e. the beneficiary should not have requested the guarantee, but had done so anyway and received payment, the exporter would then try to block the counter-guarantee by obtaining a provisional measure. His solution was that provisional measures *vis-à-vis* counter-guarantees should be possible only with evidence that the guarantor, upon making payment, had been in bad faith, i.e. that it had paid even though it knew that the final beneficiary had made an improper demand. That solution, which was the principle applied by French courts, was a balanced one, as the first guarantor could not be penalized if it had acted in good faith simply because the beneficiary had acted in bad faith. Accordingly, language might be added to the following effect: "A provisional order may be issued with regard to a counter-guarantee only if the undertaking to which the counter-guarantee refers has been executed in bad faith by the guarantor/issuer".

42. Mr. HERRMANN (Secretary of the Commission) said that it was not true that article 20 did not apply to a counter-guarantor, because in accordance with article 6, the word "guarantor/issuer" could equally be read as "counter-guarantor"; the counter-guarantor was in fact a guarantor. In the situation raised by the representative of France, the procedure would be to determine whether the demand by the first guarantor on the counter-guarantor fell within the scope of subparagraph *(a)*, *(b)* or *(c)* of article 19, paragraph (1). The purpose of adding a reference to the counter-guarantor could thus only be to either widen or narrow the area of possible fraud. There were a number of substantive questions about the instances of fraud or abuse that should be covered. But if it was wished to deal specifically with provisional measures against counter-guarantors, it might be more appropriate to do so by including a corresponding instance in article 19, to which article 20 would then refer.

43. Mr. STOUFFLET (France) said that none of the situations described in article 19(1)*(a)*, *(b)* or *(c)* specifically covered the case he had mentioned. In that example payment had been made, and therefore it could not be said that the first guarantor was demanding something which it had not paid. Payment had in fact been made, but in something approaching complicity with the beneficiary. He agreed that the matter might be dealt with by adding to the instances given in article 19.

44. Mr. BYRNE (United States of America) said that he had a similar question regarding a confirming bank or another bank nominated to pay and which had in good faith paid. The technique used in the Convention with regard to confirming banks was to subsume them in the term "issuer". He wondered if, in the application of article 20, that technique was satisfactory to deal with a situation where a request was made for provisional relief as to payment by an issuing bank and where a confirming bank or other bank nominated to make payment had already done so, and was now applying to the issuing bank for reimbursement. If that bank had acted in good faith, a provisional measure would not be appropriate. He did not think that was clear from the text and wondered whether it was supposed to be self-evident or whether the Commission needed to consider the matter.

45. Mr. HERRMANN (Secretary of the Commission) said that the issue was not dealt with as such in the Convention. It would be approached through article 2, which explained to which types of undertaking or commitment the Convention applied. The Working Group had discussed whether it should cover other types of commitments, including reimbursement undertakings, and had decided to mention only stand-by letters of credit and independent guarantees. In fact, a counter-guarantee was a guarantee; according to the definitions in article 6, the term "undertaking" included counter-guarantees. If any such instrument was given for reimbursement, then it was covered. Hence, the question of whether there was or was not a reason for provisional measures should be covered by a single provision, relating to guarantees and counter-guarantees alike.

46. Mr. BYRNE (United States of America) said he disagreed with the Secretary's conclusions. Article 20 provided for provisional relief which was not sufficiently narrowed in scope, so that it could have an impact on a reimbursement obligation. The solution might be to make it clear that the reference was only to situations where the beneficiary was the object of the order or payment, but the existing language raised the possibility that those funds could be blocked in situations other than ones in which the beneficiary was applying for payment directly to the issuer, and that would constitute an intrusion into an area which the Commission did not mean to regulate, namely, reimbursement on the undertaking by the issuer to the confirmer. The drafting should clarify the idea that there would be no ability to interfere in situations where the confirming bank or other nominated bank had paid in good faith.

47. Mr. VASSEUR (Observer for Monaco) said it could simply be stated somewhere, perhaps in article 6, that the rules applicable to guarantees were equally applicable to counter-guarantees and confirmations. That would cover both article 19 and article 20, which would then apply to all situations involving counter-guarantees—for example, when the first guarantee was being extended.

48. Mr. GAUTHIER (Chairman of the Committee of the Whole) said that the Working Group had always felt that the rules applied equally to counter-guarantees and confirmations and that the matter had been sufficiently clarified through the definitions in article 6.

The meeting rose at 12.35 p.m.