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Item 5 (c) of the provisional agenda

GUARANTEES AND SECURITIES

(Bank guarantees)

Note by the Secretary-General

1. The United Nations Commission on International Trade Law (UNCITRAL), at its second session, having heard a statement by the observer of the International Chamber of Commerce (ICC) on the work of that organization on the subject of bank guarantees, requested the Secretary-General:

> "To invite the International Chamber of Commerce to submit to the Commission at its third session a report on its work in the field of certain types of bank guarantees, such as performance guarantees, tender or bid bonds and guarantees for repayment of advances made on account in respect of international supply and construction contracts." 1/

2. Pursuant to the Commission's request, the Secretary-General, by a letter dated 13 August 1969, invited the ICC to submit, for transmission to the Commission, a report on its work on bank guarantees. In response to the Secretary-General's invitation, the ICC submitted a report entitled "Bank Guarantees" which is reproduced in annex I below.

3. In addition to the above report, the ICC also submitted the text of a resolution, adopted by its Executive Committee on 2 December 1969, on the subject of bank guarantees. This resolution is reproduced in annex II below.

1/ Report of the United Nations Commission on International Trade Law on the work of its second session, Official Records of the General Assembly, Twenty-fourth Session, Supplement No. 18 (A/7618), p. 27, para. 99.

ANNEX I

BANK GUARANTEES

Report submitted by the International Chamber of Commerce

1. At the meeting held on 29th September 1969, at the Headquarters of the ICC, the Joint Working Party noted with appreciation the interest shown by the United Nations in the ICC's study of bank guarantees, and the invitation given on behalf of the Secretary-General of the United Nations to submit a report on its outcome for consideration by the United Nations Commission on International Commercial Trade Law at its third session in New York in April, 1970.

2. The Working Party further noted the proposal of the Hungarian Delegation to the second session of UNCITRAL in Geneva in March, 1969, that the International Chamber of Commerce

> "should make urgent enquiries into the practical problems connected with bank guarantees, establishing and maintaining permanent contact with other organisations and experts familiar with this domain of banking business, and should outline, as early as possible, 'Draft Uniform Rules' relating to bank guarantees".

3. The Working Party therefore felt it appropriate to place on record that the views expressed by speakers at the Discussion Group on the subject at the Istanbul Congress of the ICC, as well as by other individuals, and the replies so far submitted by eleven National Committees of the ICC to the Questionnaire (Doc. No. 460/94 - Doc. No. 470/177) as a consensus of experience and opinion of both individual and corporate banking, commercial and engineering interests in their respective countries, stressed the importance of the subject, welcomed the study that was being made of it, and favoured a solution of the problems through a standardisation of forms or model clauses for guarantees, backed by a set of "general conditions", rather than through a "code of behaviour".

4. The Working Party noted that apart from a suggestion of preference for the word "bond" rather than "guarantee" the only objections to the terminology used - and explained - in the note which accompanied the Questionnaire were to:

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(a) the paragraph (a) under "2. Subject Matter", which it was felt gave an inadequate indication of the nature of a tender guarantee, and which it was agreed should be amplified to read:

> "at the time of tendering for the contract, and as an indemnity to the beneficiary in the event of the principal becoming the successful tenderer and then failing either to sign the contract or to provide a performance guarantee within the prescribed time limits".

(b) the paragraph relating to "local bank", 3 (b) (iv), which failed to allow for the use of other organisations than a bank. It was agreed that this paragraph should be amended to read:

> "iv) local guarantor, i.e. a guarantor, usually a local bank, a credit insurance company or other financial institution operating in the foreign buyer's or employer's country, requested to issue its own guarantee, and to accept liability thereunder, direct to the beneficiary in cases where local regulations so require, its interests usually being safeguarded by a matching guarantee issued in its favour by a financial institution so instructed by the principal".

(This would necessitate an amendment to 3 (b) (v) also, and it was agreed that this sub-paragraph should be amended to read:

> "v) recipient of guarantee, i.e. the beneficiary receiving the guarantee or the local guarantor or other deposit agency receiving the counter-guarantee according to context".)

5. The Working Party also noted that the answers received, as well as the specimen guarantees submitted, showed wide differences in the wording used, and that in particular such essential points as an effective expiry date and the nature of the guarantee, i.e. conditional or unconditional, were not always quite clear, whilst such matters as the applicable law, the settlement of disputes or the pro-rata reduction of guarantees as performance of the basic commercial contract was performed were not covered in the text of the guarantee.

It took the view that an unconditional guarantee was one under which the beneficiary was entitled to payment on simple demand, possibly accompanied by a simple statement of certain facts, whereas a conditional guarantee usually stipulated that the demand of the beneficiary for payment had to be accompanied by a document specified in the guarantee, e.g. the written approval of the principal, or an arbitration award, or a Court judgment, or other formal document.

It was also noted that although guarantees usually tended to provide for claims to be payable on first demand against simple demand receipt, there were expressions of preference for the writing into the guarantee of "a requirement

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of assent or justification, if the beneficiary can be persuaded to accept such a condition", and the Working Party therefore decided to recommend the giving of conditional, rather than unconditional, guarantees, except possibly in respect of tender guarantees (tender bonds), which might be regarded as virtually the same as a deposit of cash, so that an obligation of the guarantor to pay on simple demand would only put the principal in the same position as if cash had actually been deposited.

6. The Working Party noted in respect of the important question of abuse that experience seemed to vary, and that there might also be different views taken by guarantors, principals or beneficiaries as to what constituted misuse, so that one national committee was able to report that it had no substantial evidence of actual loss or serious difficulty caused by the abuse of guarantees, whereas other national committees had to report instances of an unsuccessful tenderer being compelled to prolong the guarantee under threat that otherwise payment would be demanded, of similar enforced extension of the validity of a performance bond, or refusal to release a guarantee for a large amount pending settlement of an insignificant claim, or of the inability of a principal (the contractor) to secure effective payment for additional work because the beneficiary (the employer) would at once lodge a claim under the guarantee for a similar amount.

7. The Working Party studied in detail the various replies received to the Questionnaire (summarised in the attached addendum), and decided that, subject to the approval of the two Commissions by which it was set up, it should co-opt two further members to represent the points of view of developing countries, and should then endeavour to draw up appropriate rules as guidelines, using standardised terminology, together with a standardised wording for model clauses, dealing separately with the guarantees called for in respect of supply contracts and those called for in respect of construction contracts, treating the different types of guarantee, i.e. tender, performance and repayment, separately in each case, and taking full note of standardisation already achieved in certain areas, or by certain major "groups of interest".

8. The Working Party finally recommended that this report and the addendum thereto should be sent to the Secretary-General of the United Nations as an interim indication of the progress of ICC activity in this particular sphere.

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Addendum to the report of the ICC on Bank Guarantees

Analysis of replies of eleven National Committees to questionnaire (460/94, 470/177)

Questions Nos. 1 and 2 - "Text" and "variation of texts".

The answers reflected a varied practice, influenced by circumstances, so that, for example, the text of tender guarantees - particularly those in favour of a government body - appear mainly to be determined by the beneficiary or to follow from the invitation to tender, whereas, although this may also be the case with performance guarantees, these latter may equally well commence with a first draft text provided either by the guarantor, or, in the case of construction contracts, by the Consulting Engineer (who, however, acts as adviser to the beneficiary), or may be based upon a text drafted or determined by the two parties acting in common, or may be in accordance with standard forms issued by the guarantor. Further, although there was no evidence that the whole text of a guarantee might be determined by law, there were indications that certain specific points, e.g. the party entitled to act as guarantor, or the time limit for the validity of the guarantee, might be fixed by law.

From the practical angle, however, it seemed that the party most able to influence the text of the guarantee was likely to be the one possessing bargaining power, e.g. a public authority inviting a tender and likely to be able to prescribe the text of the guarantee in the conditions of that tender, or the existence of a "seller's market", enabling the principal to play a greater part in determining the text.

The view was also expressed that it might not necessarily be to the overall advantage of the beneficiary to deprive the principal of any say in determining the text of the guarantee, especially when it tended to be "harsh or oppressive".

The answers further showed that, due especially to the time factor, there was usually little chance of varying the text of tender guarantees once the text had been proposed by the beneficiary, but that the possibilities were greater with, for example, performance guarantees, where the text might be made part of a "package deal", i.e. linked with other points under negotiation.

Almost all the replies stressed that a set of general conditions or a standard form of wording would be of great value, one national committee drawing attention to the fact that both supply and construction contracts already showed a tendency to become standardised in specific countries and/or for individual beneficiaries, whilst another emphasised the value of standard wording for encouraging sound drafting of guarantees ab initio, thereby obviating the need for subsequent negotiation of amended wording.

It was generally felt that all negotiations would be very much facilitated by the existence of a standard form of wording or a set of general conditions, although the comment was made that much would depend upon the acceptability of the standard text - and its sponsors - to the beneficiary. (The Working Party felt, however, that there should be no question as to the acceptability of a text drafted by the I.C.C. and sponsored by UNCITRAL).

Question No. 3 - "Amount".

The answers showed that in respect of tender guarantees the usual amount of the guarantee was 2-5% of the contract sum, or, in the case of large contracts, 1% of the contract sum, although figures as high as 10% were also mentioned.

The percentage varied widely in respect of performance guarantees, with 10% of the contract sum seeming to be a usual figure, but with lower figures and higher figures also being reported. Answers further stressed the facts that under the International Conditions of Contract for Civil Engineering Construction there is an upper limit of 10% for performance guarantees, whilst a figure of 25% is found under World Bank arrangements.

Repayment guarantees were stated usually to cover 100% of the sum to be repaid.

The answers also showed that pro rata reductions in the guarantee tended to be confined to repayment guarantees, although two national committees also quoted instances of reduction being seen "pro rata with performance in the case of a guarantee given re a supply contract".

Question No. 4 - "Claim".

The answers generally indicated differences in practice between tender guarantees and performance guarantees.

Tender guarantees were stated normally to be unconditional, but some answers did instance either differences in wording used to provide for payment on simple demand, both with and without a declaration of renunciation of all rights to raise objections to the claim, or the inclusion of a stipulation requiring the beneficiary to assert certain facts when claiming, although without the guarantor having any right to demand proof of such assertion, or the use of a text expressly ruling out any right of counterclaim by the guarantor, whether on his own behalf or on behalf of the principal. One answer pointed out that a guarantee permitting claims only when made with the assent of the principal would be of no value to the beneficiary, and another stated that it would be unrealistic to require evidence of an arbitration award or a court decision to prove default on a tender - (although yet another committee claimed payment being made subject to an award!) Objection was also raised to wording which had the effect of attributing default to the principal (the party making the tender) when in fact it was attributable to the beneficiary or was the result of circumstances outside the control of either party.

In respect of performance guarantees texts making payment dependent upon certain conditions appeared to be more usual - at any rate from, or to, certain countries - comment being made by one national committee that its "banks as guarantors prefer wording whereby they have no obligation to pay unless the principal has agreed the claim, or unless there is a final award of court or arbitration which determines the principal's liability".

Certain replies further indicated that as far as possible the guarantor may try to take the legitimate interests of the principal into account, at least by allowing time for contact between principal and beneficiary, one national committee, however, amplifying this with the statement that "guarantors sometimes notify principals of claims and that may sometimes provide an opportunity for principals to resist the claims, but no evidence has been given of guarantors themselves offering resistance to claims".

The question of whether the honouring of a claim under a guarantee releases the principal from claims for default under the basic contract, or whether it represents an additional penalty, also drew different answers. One national commitee commented that whilst no evidence had been given that the honouring of a claim represented an additional penalty "payment under the guarantee must be regarded as irrelevant to the final determination of the fault of the principal, the

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parties to the guarantee not being the same as the parties to the basic contract.

Other replies suggested that payment under a guarantee should be regarded as part payments of claims justified according to the contract, and yet another drew attention to a distinction between payments under tender guarantees and payments under performance guarantees.

Question No. 5 - "Validity (expiry date)".

Answers showed it to be generally customary - and desirable - for the guarantor to endeavour to set a time limit to his liability by including an expiry date in his guarantee, whether a fixed date or a date determinable on the future happening of a specified event, although it was also stressed that the threat of the beneficiary to lodge an immediate daim as an alternative to an extension of the expiry date limited the practical effect of the inclusion of an expiry date.

Attention was further drawn to the effect of legislation in certain recipient countries, which either prohibited the specific inclusion of an expiry date, or permitted the lodging of claims within an extremely long term of years (60 years was stated to be the period in respect of one country), or - particularly in the case of performance guarantees - made the cancellation of the guarantee dependent upon its physical return to the guarantor.

Answers showed varying experience regarding the return of guarantees, one national commiteee suggesting that the impression might be of greater difficulty than is really experienced but all replies showing that difficulties and delays were experienced, both in respect of tender guarantees and performance guarantees.

Question No. 6 - "Language".

Answers showed a use of the language of both guarantor and beneficiary, with a preponderant use by guarantors of the major world "commercial languages" and with local guarantors often using their own language, although without a binding translation.

Question No. 7 - "Mechanics of issue".

Answers to this question failed to show any well defined practice - except in respect of construction contracts, where one national committee reported an established practice of the completed tender guarantee being lodged with the tender itself.

This same national committee stated also that it was usual for a local guarantor to be involved, normally being nominated by the beneficiary, but other replies suggested that a local guarantor was only involved when so requested by the beneficiary.

Question No. 8 - "Security".

Answers to this question suggested that the rights and duties as between principal and a bank acting as guarantor were usually laid down in a standard form contract between them, with the principal providing security on the same basis as when asking for credit facilities - for which reason a preference was indicated in certain quarters for insurance companies as guarantors, as a means of reducing costs for the principal.

It was also indicated that between guarantor and local guarantor the security is usually a matching guarantee, although it was stated that in some countries government requirements may include an actual deposit of cash.

Question No. 9 - "Law".

While answers generally showed that the applicable law is not often stated in the guarantee, it was also pointed out that certain countries require the guarantee to be governed by their law, that the text of the guarantee is often influenced by the law of all the countries concerned and that some countries distinguish between guarantees and indemnities, with different legal treatment for each. Comments also showed that where the guarantee failed to specify the applicable law some favour that of the guarantors or the law governing the basic contract. (It might therefore be desirable to insert a reference to applicable law in the guarantee).

Most replies indicated a need for further study before answering regarding problems arising by virtue of the applicable law.

Question No. 10 - "Miscellaneous".

Answers were varied, although some did name countries where guarantees are specifically demanded.

ANNEX II

BANK GUARANTEES

Resolution adopted by the Executive Committee of the ICC

The International Chamber of Commerce appreciates the outstanding importance in practice of bank guarantees, whether tender guarantees, performance guarantees or repayment guarantees, issued in connection with international contracts for the supply of goods or for construction works.

It further considers the moment opportune to seek ways and means to resolve the various difficulties which nowadays arise in connection with the use of such guarantees.

Having completed a preliminary study of the problems the ICC has identified the absence of uniform practice as a principal cause of these difficulties. The resultant uncertain terminology and the often unsatisfactory wording of guarantees tend to create misunderstandings and to encourage abuse.

In these circumstances, the ICC intends to continue its work towards a solution by the establishment of a standardized terminology and the drawing up - and making available to interested parties - of model clauses for guarantees, backed by a set of general conditions, dealing separately with the guarantees called for in respect of supply contracts and those called for in respect of construction contracts.

Finally, the ICC notes with appreciation the interest shown in its work by the United Nations and, in particular, by the United Nations Commission on International Trade Law (UNCITRAL). It welcomes the opportunity to continue its co-operation in the spirit both of the decisions reached at the 2nd session of UNCITRAL in Geneva in March 1969 and of the proposals submitted thereat on behalf of certain governments.
