

B. Working papers submitted to the Working Group on International Contract Practices at its fourteenth session

1. Independent guarantees and stand-by letters of credit:
uniform law on international guaranty letters:
first draft of general provisions and article on establishment:
note by the Secretariat (A/CN.9/WG.II/WP.67) [Original: English]

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INTRODUCTION

1. At its thirteenth session, the Working Group on International Contract Practices considered, on the basis of a note by the Secretariat (A/CN.9/WG.II/WP.65), possible issues of a uniform law on independent guarantees and stand-by letters of credit (A/CN.9/330). Those issues concerned the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Working Group also engaged in a preliminary exchange of views on issues relating to the form and time of establishment of a guaranty letter. It requested the Secretariat to submit at the next session a first draft set of articles, with possible variants, on the issues considered during the thirteenth session.

2. The present note has been prepared pursuant to that request. It presents a first draft of general provisions relating to substantive scope and to interpretation, as well as a first draft of an article on establishment.

3. The style of presentation aims at facilitating the deliberations and decisions of the Working Group on the various issues dealt with in the draft provisions. Alternative wordings or particularly tentative suggestions are usually placed between square brackets; some alternative wordings that are elaborate or present different approaches are labelled as Variants. A Variant may contain an element that is interchangeable in that it may be used in connection with another Variant, depending on the Working Group's decision on the issue dealt with in that element. Once the Working Group has decided on an alternative wording or part thereof, the selected wording will be reviewed by the Secretariat for comprehensiveness and style.

4. Each draft provision is followed by remarks providing brief explanations of the draft provision and its elements or Variants; individual paragraph numbers of the remarks are placed as indicators (between square brackets, e.g. [3]) at that portion of the draft provision to which the remark most closely relates. For the sake of brevity, the remarks do not normally repeat or refer to the relevant considerations and conclusions of the Working Group at its thirteenth session which may be easily gathered from the report of that session (A/CN.9/330).

I. GENERAL PROVISIONS

Article 1. *Scope of application* [1]

This Law [2] applies to an international guaranty letter [3] [issued in this State] [4].

Remarks

1. The draft provisions in this note are given article headings for ease of reference during the considerations of the Working Group. If it were later decided to maintain headings in the final version, consideration could be given to adding an explanatory footnote like the one found in the UNCITRAL Model Law on International Commercial Arbitration: "Article headings are for reference purposes only and are not to be used for purposes of interpretation".

2. As regards the suggested use of the term "Law", it should be recalled that the mandate of the Working Group is to undertake work on a uniform law, whether in the form of a model law or in the form of a convention, and

that the Working Group agreed to decide that question of form at a later stage. If the decision were to be in favour of the form of a convention, adjustments would have to be made in this and other draft provisions.

3. The term "international" is defined in draft article 4 and a definition of the term "guaranty letter" is provided in draft article 2.

4. The words between square brackets have been added primarily for the purpose of showing an appropriate location for any criterion of the territorial scope of application. While the suggested criterion might invite tentative consideration of the matter, a full discussion would probably be more appropriate at a later stage, in connection with possible rules on conflict of laws.

* * *

Article 2. *Guaranty letter* [1]

A guaranty letter, whether or not named guaranty letter, guarantee, bond, indemnity or stand-by letter of credit, [2] is an independent [3] undertaking, given by a bank or other institution or person ("guarantor") [at the request of its customer ("principal") or on the instruction of another bank, institution or person ("instructing party") acting at the request of its customer ("principal")] [4] [, whether or not so requested or instructed by another institution or person], [5] to pay to another person ("beneficiary") [6] a certain or determinable amount of a specified currency [, unit of account or other item of value] [7] in conformity with the terms of the undertaking.

Remarks

1. This draft provision presents a single definition of guaranty letter encompassing independent guarantees and stand-by letters of credit. This unitary approach seems justified in view of their functional equivalence and essentially similar legal character. If a dual approach with two separate definitions were deemed necessary or preferable, consideration could be given to modelling the definitions on those found in the draft ICC Uniform Rules for Guarantees (URG) and the Uniform Customs and Practice for Documentary Credits (UCP). However, as regards the definition of "credit" in article 2 UCP, it would probably be necessary to express the guarantee function of a stand-by letter of credit, in contrast to the secured payment function of a traditional commercial letter of credit, by adding wording such as "given for the purpose of securing the beneficiary against the default of the principal or against another specified risk".

2. This wording is inspired by the words in article 1 URG "however named or described". It serves the purpose of clarifying that an undertaking may qualify as a guaranty letter irrespective of its name and indeed even without bearing any name. The suggested wording may serve the further purpose of illustrating the more common types of independent undertakings likely to fall under the new

heading "guaranty letter". To further this aim of illustration and information, the list of types of undertakings should be carefully considered with a view to presenting the most appropriate names hitherto used in the various regions and languages.

3. The term "independent" is defined in draft article 3.

4. This wording is a shortened version of the corresponding element in article 2 (a) URG. It leaves out, in particular, the words "and under the liability" (of the principal or the instructing party), which do not seem appropriate in the definition of an independent undertaking. The wording does not provide an appropriate context for defining such terms as "counter-guaranty letter" or "confirmation of guaranty letter", even though it covers those types of guaranty letters. The need for such definitions depends on whether any special provisions for these types of guaranty letter will be included in the operative rules of the uniform law.

5. This wording, by not requiring a request (of the principal or instructing party), includes those undertakings given by the guarantor on its own account or behalf, that is where one party is both guarantor and principal. Since this wording does not provide a context for any definitions, they would have to be presented, if deemed necessary, in other provisions.

6. Consideration may be given to adding the words "or persons" so as clearly to cover a possible plurality of beneficiaries as found, in particular, in the practice of financial stand-by letters of credit, which are customarily issued to multiple beneficiaries or to fiduciary representatives of multiple beneficiaries or sub-beneficiaries. This clarification may help to overcome problems in those jurisdictions where the rules of statutory interpretation would not lead to the conclusion that the singular includes the plural.

7. The wording between square brackets would embrace more than the expression "payment of money" found in article 2 URG. It would include units of account, as provided for in greater detail in article 5(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes (hereinafter referred to as "UNCITRAL Bills and Notes Convention"). Moreover, it would meet the concern expressed at the thirteenth session that a reference to the payment of money or currency might be too narrow in that it would exclude, for example, an undertaking to pay in gold (A/CN.9/330, para. 21).

* * *

Article 3. *Independence of undertaking* [1]

Variant A: [2]

(1) An [international] [3] undertaking is [deemed to be] [4] independent, unless its terms [5] show that the payment obligation depends on the existence or validity of an underlying transaction between the principal and the beneficiary or of any other relationship except that

created by the undertaking, or that the guarantor may invoke defences arising from a relationship other than its relationship with the beneficiary [6].

Variant B: [7]

(1) An undertaking is independent if it does not depend on any underlying transaction or other relationship except that created by the undertaking.

[(2)[8] In determining whether or not a given undertaking is independent, any characterization or a single term found in the text of the undertaking shall not be deemed conclusive if the other terms and conditions clearly weigh in favour of the opposite result. In evaluating the terms and conditions in their totality, the following factors may be regarded as points weighing in favour of independence:

(a) Payment promised on "simple demand", "first demand", "demand", "receipt of written request" or words of similar import;

(b) Undertaking to pay qualified by expressions such as "unconditional", "irrespective of valid existence of X-Contract", "waiving all rights of objection and defences arising from said contract" or "without proof of default";

(c) Payment against documents, including statement by beneficiary, and not requiring verification of facts outside guarantor's purview;

(d) Reference to an underlying transaction only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses;

(e) Undertaking stated to be subject to Uniform Customs and Practice for Documentary Credits or Uniform Rules for Guarantees.]

Remarks

1. This draft provision attempts to define the term "independent" used as a qualifying criterion in draft article 2. It may be noted that the term "independent" is defined here not merely as the opposite of "accessory", i.e. dependent on the underlying transaction between the principal and the beneficiary. The principle of independence as embodied in this draft provision is wider in that it establishes the autonomous character also in respect of other relationships such as that of the guarantor with a principal or instructing party.

2. Variant A is considerably more detailed than Variant B; its details will be explained below (remarks 3 to 6). Another difference that may be less obvious is that it incorporates a suggestion which the Working Group agreed to reconsider on the basis of a Secretariat draft. The suggestion was to regard an international undertaking as independent if it could not be interpreted as either independent or accessory (A/CN.9/330, paras. 95-96). While Variant B would not help in such case of doubt, Variant A solves the impasse of interpretation by excluding from the scope of application only those undertakings that are to be characterized as accessory or otherwise dependent, based on whatever rules of interpretation the Working Group may agree on.

3. The word "international" is not necessary in view of draft article 1. However, it might usefully be repeated here so as to emphasize that the suggested rule of favouring, in case of doubt, the independent legal character is limited to international undertakings.

4. The words "deemed to be" may, strictly speaking, not be correct as regards clearly independent undertakings. However, they may help to emphasize the above rule of doubt that, for the purposes of the uniform law, an undertaking will be treated as independent if it cannot be characterized as dependent.

5. Consideration may be given to adding after the words "its terms" the words "as interpreted in accordance with article 6 and paragraph (2) of this article". If the referred rules of interpretation were to be included in the uniform law, the suggested addition might help to clarify that a serious process of interpretation is required before such a level of doubt is established as to trigger the operation of the above rule.

6. Variant A defines in substance the term "dependent" by spelling out the possible links that negate the independent or autonomous character of the undertaking. It is submitted that the suggested demarcation line between "dependent" and "independent" is correct in principle. However, it will have to be reviewed and possibly refined in the light of the Working Group's conclusions on such issues as non-documentary conditions of effectiveness or payment, possible effect of illegality of the underlying transaction on the guarantor's obligation, and the extent to which facts pertaining to the underlying transaction may be asserted in the context of invoking fraud or manifest abuse.

7. Variant B is presented for two reasons. First, it is to show the opening words of a straightforward definition that does not incorporate the above rule of favouring independence in case of insoluble doubt. Secondly, it is to invite consideration of another definition of "independent" that is considerably shorter than that presented in Variant A.

8. Paragraph (2) is presented between square brackets with a view to soliciting the views of the Working Group on whether the uniform law should contain special guidelines for determining the independent character of an undertaking and whether it should go into such details, embracing current practice and actual language, as found in the sample indicators of independence. The paragraph also incorporates the suggested rule that a label or characterization may be disregarded in the light of conflicting terms found in the guaranty letter.

* * *

Article 4. *Internationality* [1]

Variant A: [2]

A guaranty letter is international if:

(a) any two of the following places specified in the guaranty letter are situated in different States:

- (i) [The place where the guaranty letter was issued][the place of business of the guarantor];
- (ii) The place of business of the beneficiary;
- (iii) The place of payment;
- (iv) The place of business of [a principal or an instructing party][the person at whose request the guaranty letter was issued];
- (v) The place of business of a confirming guarantor;

or

- (b) if it expressly so states.

Variant B: [3]

A guaranty letter is international if any two of the following [persons][parties] have their place of business in different States: guarantor, beneficiary, principal, instructing party, confirming guarantor.

Variant C: [4]

A guaranty letter is international if:

- (a) the guarantor and the beneficiary have their place of business in different States; or
- (b) the place of issue and the place of business of a principal or an instructing party are situated in different States; or
- (c) the place of issue and the place of payment are situated in different States;

or

- (d) the guaranty letter relates in any other [significant] manner to more than one country.

Variant D: [5]

A guaranty letter is international if it relates to an international operation, whether commercial or financial.

Remarks

1. This draft provision defines the term "international" used in draft article 1 and might later be added to that article. It presents four variants pursuant to the Working Group's request that the Secretariat prepare alternative draft versions of a test of internationality, taking into account the views and suggestions expressed at the thirteenth session (A/CN.9/330, paras. 51-57).

2. Variant A, like Variant B, lists a number of places out of which two must be in different States for a guaranty letter to be international. However, it requires those places to be specified in the guaranty letter so that banking and other personnel handling it may easily ascertain whether it is international. While the list of places in subparagraph (a) already covers the bulk of possible international links, subparagraph (b) would widen the scope of application by giving effect to a statement in the guaranty letter that it be regarded as international—in effect an opting-in clause in disguise. Such an option, which might also be included in Variant B, seems more appropriate in the context of Variant A with its requirement of

specification. It could, for example, be used by the issuer of a financial stand-by letter of credit even though the place of business of the beneficiary or beneficiaries, likely to be foreign, is not specified or not even known.

3. Variant B differs from Variant A in two additional respects. It does not include the place of payment, which rarely differs from that of issue, and it lists the places of business of a principal and an instructing party as separate connecting factors, thus covering the case where a principal requests a bank in a different State to instruct another bank in that State to issue the guaranty letter. As regards the term "place of business", used also in Variants A and C, consideration may be given to supplementing the term by rules for those cases where a party has more than one place of business or does not have a place of business (along the lines of, e.g., article 10 United Nations Convention on Contracts for the International Sale of Goods, hereinafter referred to as "United Nations Sales Convention").

4. Variant C envisages only three defined links but embraces an uncertain number of other possible links by its subparagraph (d). This flexible formula introduces a degree of imprecision that may be undesirable at least if serious legal consequences would ensue.

5. Variant D is even more flexible and uncertain. While it may be appropriate in a given national law, where it is likely to have been developed by established case law, it seems less appropriate in a new uniform law of global origin and design.

* * *

Article 5. *Interpretation of this Law*

In the interpretation of this Law, regard is to be had to its international [character][origin][1] and to the need to promote uniformity in its application and the observance of good faith in international [transactions][guaranty or credit practice].[2]

Remarks

1. The term "character" has been used in various Conventions emanating from the Commission's work and would certainly be appropriate if the uniform law were to be adopted in the form of a convention. It might also be appropriate if the uniform law were to be promulgated in the form of a model law. In that case, it may, however, be technically more accurate to refer to its international origin.

2. The general term "transactions" has been used in the UNCITRAL Bills and Notes Convention and appears to be equally appropriate for the uniform law. However, if a more specific term were to be sought, the suggested alternative wording "guaranty or credit practice" might be the answer, particularly if the final uniform law would cover traditional commercial letters of credit.

* * *

Article 6. *Construction of guaranty letter* [1]

Variant A: [2]

(1) Subject to the provisions of this Law [and of any other applicable law][3], the rights and obligations of the parties are determined by the terms and conditions set forth in the guaranty letter, including any rules, conditions or usages referred to therein[4] [, and, unless otherwise stipulated, any international usage of which the parties knew or ought to have known and which is widely known to, and regularly observed by, parties to guaranty or credit transactions][5].

(2) The terms and conditions of the guaranty letter are to be interpreted according to the intent of the parties[6], taking into account the ordinary meaning in the understanding of a reasonable person with an appreciation of the commercial purpose of the transaction and with due consideration of any practices which the parties have established between themselves.[7]

Variant B: [8]

In determining the rights and obligations of the guarantor and the beneficiary, the terms and conditions set forth, or referred to, in the guaranty letter are to be interpreted according to the ordinary meaning given to them by a reasonable person.

Remarks

1. The article heading might be modified if Variant A is maintained. It could, for example, read: "Determination of rights and obligations".

2. Paragraph (1) of Variant A is designed to introduce the principle of strict construction and to address the issue of party autonomy and its limits. The combination of both matters serves to draw attention to the fact that the rights and obligations flow from the terms of the undertaking but may be affected by mandatory provisions of law. As regards provisions of the uniform law itself, it will have to be decided for each provision whether or not parties may derogate therefrom.

3. The bracketed reference to "any other applicable law" might serve as a useful reminder of the fact that the rights and obligations of the parties may be affected by various mandatory provisions of law dealing with issues not governed by the uniform law (e.g. exchange control, supervision of banks, capacity of parties or bankruptcy). However, such a reference has not normally been included in comparable legal texts and might be regarded as too general to be useful.

4. A reference in the guaranty letter to rules (e.g. uniform rules), conditions (e.g. general conditions) or usages does not affect the parties' rights and obligations if the reference is not valid under the applicable law. However, it does not seem necessary to express the requirement of validity in the draft provision.

5. The wording between square brackets is modelled on article 9(2) of the United Nations Sales Convention.

Despite the difference in subject matter, there may be a need in the uniform law for giving effect to an international usage by way of implied agreement. However, the need might be less felt if the Working Group were to retain the incorporation of rules and usages in the guaranty letter (see above, remark 4) and the reference to any other applicable law (see above, remark 3) which could, for example, be customary law on letters of credit. If a more straightforward formula were to be desired, an international usage could be recognized even without an implied agreement and the element of knowledge.

6. The reference to the parties' intent as primary criterion of interpretation is inspired by article 8(1) of the United Nations Sales Convention. However, it is there used in respect of an individual party and given effect only where the other party knew or could not have been unaware what the intent was. The uniform law could use that individualized formula if, focusing on the undertaking, it would restrict the rule of interpretation to the rights and obligations of the guarantor. If applied to both parties, the criterion of intent retains its importance but seems in need of qualification by some flexible wording.

7. The suggested rule of interpretation attempts to strike a balance between the need for strictness in giving full faith and credit to the letter of the undertaking and the need for flexibility in introducing factors not necessarily apparent from the guaranty letter. While the balance is not easily struck, the suggested rule is thought to further two important policy objectives, namely to meet the expectations of the parties and to ensure the commercial utility of independent undertakings.

8. Variant B introduces the rule of interpretation with opening words that state the purpose of the interpretation and thereby reflect the idea of strict construction less directly than does paragraph (1) of Variant A. In respect of both Variants, it may be noted that the related issue of the standard of compliance of the claim with the terms of the guaranty letter will be addressed in a separate draft provision, in a future chapter devoted to the demand for payment.

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II. ESTABLISHMENT, AMENDMENT AND EXPIRY

Article 7. *Form and time of establishment* [1]

(1) A guaranty letter may be established by any means of communication that provides a record thereof.[2]

Variant A [3]:

(2) A guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is received by the beneficiary [4][, unless the beneficiary promptly rejects it]. The guaranty letter

becomes effective at that time [5], unless [it states a different time of effectiveness or makes its effectiveness depend on the occurrence of a specified, uncertain future event, in which case the guarantor may require a declaration from the beneficiary or an appropriate third party stating the occurrence of the event, if verification of that occurrence is not within the control of the guarantor][6] [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor][7].

Variant B: [8]

(2) Unless otherwise stated, a guaranty letter is effective and irrevocable, when it is issued by the guarantor to the beneficiary or to the principal or instructing party.[9]

Remarks

1. This draft provision on form and time applies to the establishment of a guaranty letter, that is, an undertaking meeting the essential requirements set forth in draft article 2. Whether the same rules on form and time should be applicable to later changes (e.g., amendment or cancellation) and to other communications (e.g. demand or notice) will be considered in a note by the Secretariat discussing further possible issues of the uniform law (A/CN.9/WG.II/WP.68).

2. Paragraph (1) is modelled on article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration. It is based on the view, widely supported at the thirteenth session (A/CN.9/330, para. 105), that the guaranty letter should be manifest or recorded in some tangible or material form, to the exclusion of purely oral undertakings.

3. Variant A of paragraph (2) is considerably more detailed than Variant B. While Variant B uses the expression "unless otherwise stated" for the entire paragraph, Variant A specifies what stipulations to the contrary would be admissible, in particular, as regards the time of effectiveness. Both Variants implement the Working Group's decision that the uniform law should provide for the irrevocability of all undertakings covered by it unless otherwise stated in the guaranty letter (A/CN.9/330, para. 102). That rule would override current article 7(c) UCP which, in case of silence, treats letters of credit as revocable.

4. Variant A uses as the determinant point of time the receipt of the guaranty letter by the beneficiary. That is based on the consideration that it is only at that time that the beneficiary is in a position to rely on the guarantor's undertaking. The suggested rule does not take a stand on whether the undertaking is to be characterized as a contract, be it bilateral or unilateral, or as a special creation of commercial law. Whichever characterization would be appropriate, there appears to be general agreement in law and practice that no express acceptance by the beneficiary is required. However, consideration may be given to

including a proviso on possible refusal of acceptance, as suggested at the end of the first sentence. If that proviso were maintained, consideration may be given to addressing such issues as qualified acceptance, legal effect of undertaking before rejection, or decisive point of time of rejection.

5. Variant A draws a distinction between "binding" and "effective". Without attempting here to define these terms, "binding" would indicate the existence of a promise made with the intention to be legally bound; such binding promise may, for example, establish the guarantor's right to charge a fee and it may be revoked, if revocable. "Effective" would indicate the operative character of the undertaking, entitling the beneficiary to demand payment in conformity with the payment conditions. For example, a repayment guarantee would be binding, but not effective, before the advance payment was made by the beneficiary or known to the guarantor.

6. The wording between square brackets presents two exceptions to the rule on the point of time of effectiveness. First, the guaranty letter may postpone the effectiveness to a later point of time, either a fixed date or a determinable time. Secondly, the guaranty letter may make its effectiveness subject to a condition; the suggested wording would not invalidate non-documentary conditions of effectiveness but would convert them into documentary ones. While conditions of effectiveness might be treated differently from payment conditions, as discussed during the thirteenth session (A/CN.9/330, para. 69), consideration may later be given to dealing with both types of conditions in one draft provision.

7. The alternative wording between square brackets is modelled on article 6 URG. It does not include the first exception, i.e. different time of effectiveness, and would invalidate or disregard any condition of effectiveness that was not determinable by the guarantor.

8. As indicated above (remark 3), Variant B would permit the parties to derogate from the entire draft provision. If it were adopted, the issue of non-documentary conditions of effectiveness would have to be dealt with in a separate provision, possibly in connection with non-documentary conditions of payment.

9. Variant B uses as the determinant point of time the issuance of the guaranty letter. That is based on the consideration that the guaranty letter, when issued or sent, leaves the sphere of control of the guarantor. In this respect, it might be regarded as irrelevant whether the guaranty letter is released towards the beneficiary or towards the principal or instructing party. While the rule would place the risk of transmission on the beneficiary, consideration may be given to distinguishing between the point of time of effectiveness and the risk of transmission.