

**2. Independent guarantees and stand-by letters of credit:
discussion of further issues of a uniform law:
amendment, transfer, expiry, obligations of guarantor,
liability and exemption: note by the Secretariat
(A/CN.9/WG.II/WP.68) [Original: English]**

CONTENTS

	<i>Paragraphs</i>
INTRODUCTION	1-2
I. AMENDMENT	3-17
A. Parties whose consent is required	6-11
B. Form of amendment	12-15
C. Time of effectiveness	16-17
II. TRANSFER OF RIGHTS AND ASSIGNMENT OF PROCEEDS	18-23
III. EXPIRY	24-43
A. Meaning and effect	25-33
B. Party autonomy and possible limits	34-43
(1) Modalities of determining the time of expiry	35-37
(2) Possible requirement of an expiry clause and possible cut-off period	38-43
IV. OBLIGATIONS OF GUARANTOR	44-64
A. Obligation to pay upon conforming demand	45-60
(1) Standard of examination as to conformity	49-57
(2) Time allowed for examination	58-60
B. Duties of notification	61-64
V. LIABILITY AND EXEMPTION	65-72
A. Liability and standard of care	67-68
B. Exemptions from liability	69-72

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 to the next session a note discussing further possible issues to be covered by the uniform law (A/CN.9/330, para. 110).

2. The present note has been prepared pursuant to that request. It presents a discussion of issues relating to amendment, transfer and expiry of the guaranty letter, to obligations of the guarantor as well as liability and exemption. The Secretariat intends to submit at the fifteenth session of the Working Group a further note discussing the remaining issues: fraud and other objections to payment,

injunctions and other court measures, conflict of laws and jurisdiction.

I. AMENDMENT

3. The Working Group may wish to consider whether the uniform law should contain provisions on the amendment of a guaranty letter. Such provisions could address questions such as the form and time of effectiveness of an amendment and whose consent is necessary for an amendment to be effective.

4. It may be noted that the ICC Draft Uniform Rules for Demand Guarantees (URG)¹ do not contain any special

¹ICC Document No. 460/470-1/Int. 16, 470/622 and 460/382 (7 June 1990). This latest draft, which was not available to the Secretariat when preparing document A/CN.9/WG.II/WP.67, incorporates changes in the title, the introduction, articles 1, 2, 4 and 20. It seems particularly noteworthy that according to article 2 the rules now cover stand-by letters of credit. The introduction states: "Although for the time being UCP 400 also applies to stand-by letters of credit, it is envisaged that the present rules will be those adopted by parties to stand-by letters of credit".

provision on amendment, even though amendments are mentioned in some of its provisions (e.g. articles 1, 3, 16, 23 and 24). Presumably, the provisions on form and time of effectiveness of the original guarantee (articles 2(a) and 6) are meant to apply by analogy to a later amendment.

5. The Uniform Customs and Practice for Documentary Credits (UCP)² contain a number of provisions dealing with amendments to credits. For example, article 12 UCP sets forth the circumstances under which an instruction by any teletransmission to advise an amendment to a credit constitutes the operative amendment. According to article 10 (d) UCP irrevocable "undertakings can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank (if any), and the beneficiary. Partial acceptance of amendments contained in one advice of amendment is not effective without the agreement of all the above named parties." The Working Group may wish to use this list of parties as a basis for its discussion on whose consent is needed for an amendment of the guaranty letter to be effective.

A. Parties whose consent is required

6. It is obvious that an amendment cannot be effective without the consent of the guarantor, whether it issued or confirmed the original guaranty letter. While the consent of the beneficiary may be viewed as an equally obvious requirement, doubts might arise with respect to amendments that increase the beneficiary's rights (e.g. extension of validity period). However, a particular increase in the beneficiary's rights may not necessarily be acceptable to the beneficiary since, for example, it may have requested an even longer extension of the validity period. Moreover, it would not be easy to administer a rule that would depend on whether the amendment in question was to the beneficiary's advantage.

7. As in the context of the establishment of the original guaranty letter, consent need not necessarily mean express acceptance. Along the lines of Variant A of draft article 7(2) (A/CN.9/WG.II/WP.67), an amendment could become effective upon receipt by the beneficiary, unless the beneficiary rejected it promptly or within a specified period of time (e.g. 14 days). An alternative solution could be to treat silence and, possibly, partial or qualified acceptance as a rejection. For example, an amendment could be deemed to be rejected 21 days after its notification to the beneficiary unless the guarantor has received an unqualified acceptance from the beneficiary or has become aware of an act or conduct by the beneficiary in compliance with the terms of the amendment (e.g. submission of a required statement).

8. Another point in need of clarification is who exactly is covered by the term "beneficiary". As indicated in remark 6 to draft article 2 (A/CN.9/WG.II/WP.67), the original guaranty letter may have a number of beneficiaries, in particular in the practice of financial stand-by

letters of credit. As regards amendments that come into play at a later stage yet other beneficiaries may have to be recognized, namely substitute beneficiaries and beneficiaries by operation of law. The substitute beneficiary is found in stand-by letters of credit as a replacement of the original beneficiary when the latter resigns or is removed by the represented beneficiaries, usually the holders of debt or equity securities. This substitution must meet the terms and conditions of the stand-by letter of credit, and compliance with those terms must be ascertained by documentary means. The transferee by operation of law is associated with transfers decreed by statutory, administrative or decisional law in instances where the original beneficiary is insolvent or incapable of acting as a beneficiary. The Working Group may wish to decide whether in any rule requiring the beneficiary's consent those special categories of substitutes or transferees should be expressly mentioned or whether general rules of interpretation would lead to the conclusion that they were covered as well.

9. The above list of parties in UCP whose consent is required does not include the principal or, as the UCP calls it, the applicant for the credit. In contrast, section 5-106 (2) of the Uniform Commercial Code (UCC) provides: "Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent." It may be noted that the Task Force on the Study of UCC Article 5 recommended that the provision should be changed so as not to require the principal's consent.

10. Support for requiring the principal's consent may stem from a concern about the principal's interest in protecting its relationship with the guarantor against interference by third persons as well as the principal's possible desire not to have its name connected with the amended guaranty letter.

11. The main reason for excluding the principal from the list of parties whose consent is required is the independence of the guarantor's undertaking, i.e., the guarantor's undertaking creates a legal relationship only between it and the beneficiary. The consent of the principal to the amendment is relevant to a separate legal relationship, namely that between guarantor and the principal. Accordingly, the guarantor is free to modify its undertaking to the beneficiary without the principal's consent and is bound by the amended undertaking, but it does so at the risk of prejudicing its claim for reimbursement from the principal, depending on the instructions or the terms of the reimbursement agreement between the principal and the guarantor. Consideration might be given to drawing attention to the fact that the principal's consent may well be required under the legal relationship between the principal and the guarantor, by adding to the rule requiring the consent only of the guarantor and the beneficiary such wording as: "This provision does not excuse the failure to obtain the principal's consent, as it may be required by the agreement or instructions between the principal and the guarantor".

²ICC Publication No. 400, reproduced in A/CN.9/251.

B. Form of amendment

12. As regards requirements of form for an amendment to be effective, one approach would be to require the same form as provided for in draft article 7(1) for the establishment of the original guaranty letter (A/CN.9/WG.II/WP.67), subject to any special stipulation in the guaranty letter concerning the form of amendments (see paragraph 15 below). This approach could be based on the view that an amendment constitutes a part of the guaranty letter and as such shares the legal nature and characteristics, including evidentiary value, of the guaranty letter.

13. However, one may also point out that an amendment constitutes but a small part of the terms and conditions of the guaranty letter and that current amendment practice tends to be less formal. It was reported at the thirteenth session that there existed a practice under which an amendment of a written guaranty letter might be made orally and authenticated in that form; while the amendment would then be confirmed by a message that provided a record of the agreement, the oral communication was in practice regarded as determining the point of time of effectiveness of the amendment (A/CN.9/330, para. 106).

14. If the Working Group wished to accommodate this and similar informal practices, it might consider not requiring any particular form but requiring authentication of the source of an amendment. The same requirement of authentication of source, which would include signature, would seem appropriate if the Working Group were to decide in respect of draft article 7(1) not to require any particular form for the establishment of the guaranty letter. If such a provision requiring merely authentication were to be adopted for the establishment or amendment of the guaranty letter and the uniform law was eventually incorporated into a convention, consideration might be given to adding a provision along the lines of article 12 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; hereinafter referred to as "United Nations Sales Convention").

15. While it is conceivable that prior to the establishment of the guaranty letter the guarantor and the beneficiary would have agreed on the required form of the guaranty letter, a stipulation on the required form for later amendments is more likely to exist. Thus, any general rule on form as discussed above would have to be made subject to contrary stipulation. For the sake of clarification, one might include a provision to the effect that the guaranty letter may not be amended other than in the stipulated form (along the lines of article 29(2) United Nations Sales Convention). Consideration might be given to adopting also the last sentence of that paragraph, which reads: "However, a party may be precluded by his conduct from asserting such a provision to the extent that the other party has relied on that conduct." The underlying principle appears to be equally appropriate in the context of guarantee and credit practice, even though in the context of a sales transaction there may be more instances of conduct on which reliance is placed that deserves to be protected.

C. Time of effectiveness

16. The point of time when an amendment becomes effective could be the same as that provided in draft article 7(2) for the establishment of the guaranty letter. However, in view of the required consent of the beneficiary, that result would be less appropriate if Variant B of draft article 7(2), using the time of issue as the time of effectiveness, were to be chosen (A/CN.9/WG.II/WP.67). Even Variant A, using the time of receipt by the beneficiary, might need some qualification.

17. For example, if an amendment would be deemed to be rejected unless accepted in full within a specified period of time, the determining point of time of effectiveness could be the time when the guarantor receives notice of the acceptance. If the opposite solution were to be adopted, namely that there was a presumption in favour of acceptance, the receipt of the amendment by the beneficiary might be appropriate as the determining time, even though its effectiveness might be subject to a rejection or qualified acceptance within the specified period of time. The use of the beneficiary's receipt of the amendment as the determining point of time could also accommodate the practice reported at paragraph 13 above that an oral amendment with authentication as to source would be effective even though a formal confirmation may be required or, at least, suggested by sound banking practice.

II. TRANSFER OF RIGHTS AND ASSIGNMENT OF PROCEEDS

18. The Working Group may wish to consider whether the uniform law should address the issue of the beneficiary's transfer of rights and assignment of proceeds. The use of the terms "transfer" and "assignment" is drawn from the UCP, which establish in article 54 a special legal regime for the transferable letter of credit and permit in article 55 the assignment of the proceeds of a credit. The term "assignment", which is used in the broader legal context to refer to a transfer of rights and obligations under a contract, is used in the UCP in the restricted sense of assignment of the proceeds. A change of the holder of the right to claim payment is referred to as "transfer". The UCP provisions on transferability require that the credit be expressly designated as "transferable" by the issuing bank, they require the consent of the bank requested to effect the transfer, whether or not it has confirmed the credit, and they permit only a single transfer of the credit.

19. The URG depart from the terminology and substance of the UCP provisions. Article 4 URG reads as follows: "The Beneficiary's right to claim under a Guarantee is not assignable unless expressly stated in the Guarantee wording itself or in an amendment thereto. This article shall not, however, affect the Beneficiary's right to assign any proceeds to which he may be, or may become, entitled under the Guarantee." Only the term "assignment" is used and, while the UCP distinction between the claim and the proceeds is maintained, no mention is made of a limit on the number of possible transfers.

20. If the Working Group were to decide that the uniform law should contain provisions on transfer of rights and on assignment of proceeds, it might wish to consider the following points concerning the mechanics and consequences of a transfer and of an assignment. As regards assignment of proceeds, it might be useful to clarify that the object of an assignment is merely the proceeds, i.e. any funds that will be forthcoming when the guarantor honours its payment obligation. Accordingly, the assignee is not entitled to claim payment or to present any statement or document that may be required in order to claim payment, since that may change the risk to which the principal and the guarantor have agreed to be exposed. The position of an assignee is thus weaker than that of a transferee in that a beneficiary, having obtained funds from the assignee in exchange for the assignment, would be able to block payment to the assignee by not submitting a claim for payment. Another clarification could be to require a notice of assignment from the beneficiary to the guarantor, or possibly even a notice of acknowledgement by the guarantor, so as to create certainty as to whom the guarantor is supposed to pay and thereby discharge its payment obligation under the guaranty letter. Yet another issue that might be addressed is whether only one assignment of the proceeds should be allowed and whether such an assignment should have to be of 100 per cent of the proceeds.

21. As regards the possible transfer of the beneficiary's right to claim payment, two special features of independent guarantees and stand-by letters of credit need to be taken into account when formulating appropriate rules in view of the different interests involved. Firstly, where a guaranty letter is given in support of an underlying obligation of the principal, the true beneficiary should be the one to whom performance of that underlying obligation is owed and who is in a position to declare, or submit documents establishing, default. While the guarantor does not usually judge the reliability of the beneficiary before issuing its guaranty letter, it is expected to bear in mind the interest of the principal, who usually has judged the reliability of the beneficiary before establishing its relationship with the beneficiary. In this vein, a transfer of the beneficiary's right to demand payment makes sense where the creditor to the underlying obligation has changed.

22. A second special feature becomes apparent in comparison with a traditional commercial letter of credit. There "only the original beneficiary, if it is a non-transferable credit, or the second beneficiary if the credit is transferable, is entitled to tender the documents that will prompt the issuing bank's payment. Yet, where a bank issues a financial standby promising to pay the beneficiary and the holder of the unpaid promissory note, draft or demand for payment, the bank also extends the promise to receive the tender of documents to whomever the original beneficiary transfers the note, draft or demand for payment and accompanying documents, if any. This differs from the promise in the circular-negotiation type of commercial letter of credit (whose language of negotiation, incidentally, is none the less usually incorporated in the text of the financial standby) because the negotiation contemplated in the circular commercial letter of credit is of the draft only. It does not presuppose the transfer of the

right to tender the documents that comply with the text of the credit, a right which, most often, is exercised by the beneficiary prior to negotiating the draft."³

23. These two special features may be taken as suggesting the following conclusions. The beneficiary should not be free to transfer its right to payment whenever it so wishes; it may do so only if permitted under the guaranty letter and thus presumably with the principal's consent. The above description of a financial stand-by letter of credit suggests, however, that a requirement such as express statement or express designation as "transferable" would be too narrow. One might even view the transfers envisaged in such an undertaking as expected changes of the individuals covered by the original undertaking and not as transfers in the technical sense of the term. Yet another conclusion might be that more than a single transfer should be permitted if so stipulated in the guaranty letter. Finally, consideration may be given to clarifying, in the absence of a clear answer in the guaranty letter, whether only the transferee is entitled to claim payment and present any required statement or document or whether the transferor, i.e., the original beneficiary, is supposed to do so on the transferee's account.

III. EXPIRY

24. Certainty about the expiry of the guaranty letter is at least as important as certainty about the time when the guaranty letter becomes effective (see draft article 7(2), A/CN.9/WG.II/WP.67). The uniform law might help to enhance certainty in two respects. It could clarify the meaning and effect of expiry as stipulated in the guaranty letter, and it could address various issues relating to party autonomy in stipulating expiry terms.

A. Meaning and effect

25. A stipulation that the guarantee or stand-by letter of credit expires on a given date is widely understood to mean that a demand for payment, accompanied by any required documents, may be made only before or on that date and that, accordingly, the guarantor is not obliged to pay upon any demand made after that date. However, courts of some jurisdictions have given a different interpretation, namely that merely the contingency for which the guarantee had been given must have occurred before or on the expiry date, and have recognized a demand for payment made after that date, either within a reasonable time thereafter or even during a period of limitation or prescription, which may extend long after the expiry date.

26. The uniform law might usefully clarify matters by prescribing the first interpretation, as is done in a number of national laws. For example, the 1963 International Trade Code of Czechoslovakia provides in section 671:

³Kozolchyk, *The Emerging Law of Standby Letters of Credit and Bank Guarantees*, 24 Arizona L.R. (1982), 319, 356.

"If the validity of the banking guaranty is limited in time, the entitled person shall notify the bank of his claims not later than within such time; otherwise his claims under the banking guaranty shall be extinguished."⁴

27. Very similar provisions are found in the laws of Bahrain,⁵ Iraq⁶ and Kuwait. For example, the 1980 Commercial Law of Kuwait provides in article 386:

"The bank shall be discharged of liability *vis-à-vis* the beneficiary if within the validity period of the letter of guarantee no request for payment is received from the beneficiary, unless it had been expressly agreed to renew said term prior to its expiry."⁷

28. As regards uniform rules, the same interpretation of expiry appears in the last sentence of article 22 URG ("Claims received after the Expiry Date or Expiry Event shall be refused by the Guarantor") and in article 19 URG:

"A claim shall be made in accordance with the terms of the Guarantee on or before its expiry and, in particular, all documents specified in the Guarantee for the purpose of claiming shall be presented to the Guarantor on or before its expiry at its place of issue, otherwise the claim shall be refused."

29. If the Working Group were to adopt a provision in support of the first interpretation, i.e., that the claim for payment must be made within the validity period, an exception might have to be made where the expiry clause in the guaranty letter provides otherwise (e.g., undertaking to pay in the event of the principal's default within a definite period of time). A possible solution for that exception might be to grant additional time, either a fixed or a reasonable period, for submitting the demand and the required documents. The same should probably apply where a counter-guarantor promises to indemnify the guarantor for any payment made before the expiry of its guaranty letter, provided the counter-guaranty letter contains no other expiry clause, such as a specific expiry date. Here, as in any other case, each guaranty letter stands on its own as regards its time of effectiveness and expiry.

30. The effect of expiry that payment may no longer be demanded has been described in the above sample provisions (paragraphs 26-28) by such expressions as "claims shall be extinguished", "bank shall be discharged of liability *vis-à-vis* the beneficiary", and "claim shall be refused". A provision to that effect in the uniform law could enhance certainty by making it clear that the effect of expiry does not depend on any further act such as return of the guaranty letter or a declaration of release by the beneficiary. It is submitted that such an automatic effect should obtain even where a clause in the guaranty letter requires the return of the instrument or a declaration of

release. As regards the issue of the return of the instrument, article 24 URG provides:

"Where a Guarantee has terminated by payment, expiry, cancellation or otherwise, retention of the Guarantee or of any amendments thereto shall not preserve any rights of the Beneficiary under the Guarantee."

31. Such a rule is useful in that it prevents uncertainty and the risk of everlasting enforceability. It takes into account that there are various possible reasons for retaining the guaranty letter and that the very idea of return or retention is becoming less applicable in the context of modern means of communication. Above all, it helps to dispel the misconception that the guaranty letter would be an instrument that, as a negotiable instrument does, carried in it the right to payment so as to require possession and presentment of the instrument for the enforcement of that right. The advantage of having in the uniform law a provision along the lines of article 24 URG would be that the uniform law, unlike uniform rules that become effective by agreement, would make inapplicable any contrary provision of law in the State enacting the uniform law.

32. It is doubtful whether the same need exists for incorporating in the uniform law a provision along the lines of article 23 URG, which also touches on the issue of return or retention in dealing with pre-expiry events that free the guarantor from liability and thus make expiry obsolete:

"Irrespective of any expiry provision contained therein, a Guarantee shall be cancelled prior to the Expiry Date or Expiry Event on presentation to the Guarantor of the Guarantee itself or the Beneficiary's authenticated statement of release from liability under the Guarantee, whether or not the Guarantee or any amendments thereto are returned."

33. If a provision along those lines were to be included in the uniform law, the Working Group may wish to consider the following two points. Firstly, the expression "shall be cancelled" might be reworded so as to make clear that the effect is automatic and does not depend on any further act or declaration. Secondly, it might be too rigid to attach the effect of cancellation to the "presentation to the Guarantor of the Guarantee itself" in that it could be construed as extending beyond those cases where the presentation constitutes an implied release or waiver and, for example, covering the case of an erroneous return.

B. Party autonomy and possible limits

34. The preceding discussion of the meaning and effect of expiry assumed the existence of a valid expiry clause. An expiry clause may be found in the guaranty letter or, in particular where the validity period has been extended, in an amendment to the guaranty letter (as discussed above, paragraphs 3-17; it may be noted that the Secretariat intends to discuss the problems surrounding so-called "extend or pay" demands in a future note). To be discussed now are two issues relating to party autonomy

⁴Act No. 101 (of 4 December, 1963) on Legal Relations arising in International Business Transactions, see Introduction and Commentary by Kopac (Prague 1967), p. 201.

⁵Art. 335(1) of the Commercial Code of Bahrain, Law No. 7 of 1987.

⁶Art. 291(1) of the Commercial Code of Iraq, Law No. 30 of 1984.

⁷Decree No. 68 of 1980 Enacting the Law of Commerce of Kuwait.

in stipulating expiry clauses. The first issue concerns the modalities of determining the time of expiry, in particular the reference to an expiry event rather than an expiry date. The second issue is whether a guaranty letter must contain an expiry clause and, if so, what the sanction for failure should be. In this context it will be asked whether the uniform law should provide for a cut-off period and, if so, what its legal character should be.

(1) Modalities of determining the time of expiry

35. The time of expiry may be fixed in a number of ways. The most certain way is to fix a calendar date. Another way is to state a definite period of time (e.g. six months). Since some uncertainty might exist as to the exact starting point of that period of time, the uniform law might help by referring to the time of effectiveness (according to draft article 7(2); A/CN.9/WG.II/WP.67). Yet another way is to specify a certain act or event (e.g. completion of principal's performance, acceptance of works by beneficiary, award of contract to another tenderer). Expiry clauses of that kind may create problems in two respects.

36. Firstly, where expiry is linked to an event, the guarantor would have to engage in an undesirable examination of facts and might become entangled in a dispute between the beneficiary and the principal. Since the deliberations of the Working Group on the so-called non-documentary payment conditions (A/CN.9/330, paras. 68-75) seem applicable here, consideration may be given to converting any non-documentary expiry that is not readily determinable by the guarantor into a documentary one. The documentary approach is taken by article 22 URG (first sentence) which appears to qualify the presentation of documents itself as expiry event:

"Expiry of a Guarantee for the presentation of claims shall be upon a specified calendar date ('Expiry Date') or upon presentation to the Guarantor of the document(s) specified for the purpose of expiry ('Expiry Event')."

37. Secondly, expiry that is linked to an event may never occur or at least not for a long time. Even where presentation of a document is required, there may be a risk of an everlasting undertaking, at least if the document is to be furnished by the beneficiary. The most effective cure would be not to recognize expiry clauses based on an event and thus to allow only the specification of a calendar date or a definite period of time. However, that cure might be regarded as too rigid. Another cure might be provided by the cut-off period discussed below (paragraphs 42-43) or, for certain extreme cases, by provisions dealing with fraud or manifest abuse (to be discussed in a future Secretariat note).

(2) Possible requirement of an expiry clause and possible cut-off period

38. The Working Group may wish to consider whether the uniform law should require guaranty letters to contain an expiry clause and, if so, what the consequence of a lack

of such a clause should be. It may be noted that the URG appear not to require an expiry clause and do not provide for any sanction in case of failure to contain such a clause. While article 22 URG (quoted above, paragraph 36, in its essential part) might be read as requiring an expiry date or expiry event, article 3(f) URG takes a hortatory approach by stating that "all guarantees should stipulate the expiry date and/or expiry event of the Guarantee".

39. Expiry clauses might be missing in guaranty letters due to omission or oversight. Even where they are intentionally left out, the result is at least uncertainty and possibly an undertaking of indeterminate effectiveness or perpetual enforceability. As was noted at the thirteenth session (A/CN.9/330, paras. 24 and 44), perpetual undertakings may be regarded as unsettling and commercially undesirable. They may raise regulatory concerns in view of the continuing risk exposure, and they may lead to increased costs under the capital adequacy rules of the Basel Agreement. Finally, they create uncertainty in that they might be affected by a period of limitation or prescription of an applicable law which in itself might be difficult to determine. It may be added that this uncertainty is aggravated by the following disparities between national laws of limitation or prescription: limitation periods vary considerably and may be as long as 30 years; limitation periods may commence to run at the establishment of the guaranty letter, the occurrence of the secured contingency or the time of the demand; limitation periods may or may not be shortened by the parties; foreign guaranty letters may or may not be subjected to domestic limitation periods.

40. The following reasons may be advanced against requiring an expiry clause. Since undertakings that do not specify a period of effectiveness are found in practice, the uniform law should not attempt to change that practice. Concerns relating to undertakings of indeterminate validity are not primarily due to the lack of an expiry clause since the same objections could be raised against clauses providing for perpetual or very long validity.

41. If the Working Group were to decide in favour of requiring an expiry clause, it would have to decide what the consequence of a lack of expiry clause should be. One possible sanction would be to treat the guaranty letter as invalid or ineffective. However, that sanction would probably be too extreme.

42. A more acceptable solution, as suggested during the thirteenth session of the Working Group (A/CN.9/330, paras. 25 and 46), would be to provide for a cut-off period of, say, five years. The cut-off period would apply only if the guaranty letter or an amendment thereto were not to contain an expiry clause. Due to its supplementary character, it would not prevent the stipulation of a longer period of effectiveness.

43. However, that solution would not meet the above concerns relating to undertakings of perpetual or excessively long validity. Consideration might thus be given to providing that the cut-off period may not be derogated from. If the cut-off period were to be mandatory, it should probably be longer than if it were to be supplementary

(e.g. 10 years). Whether mandatory or not, the cut-off period should be given the meaning and effect discussed above (paragraphs 25-33).

IV. OBLIGATIONS OF GUARANTOR

44. The following discussion deals with the most crucial situation in a guaranty letter transaction, i.e., when the beneficiary demands payment. It focuses on various issues relating to the obligations of the guarantor and is meant to include the counter-guarantor and the confirming guarantor. In considering those issues, a recurrent question will be whether they should be addressed in provisions of the uniform law and, if so, whether the provisions should be of mandatory or supplementary character. The question seems particularly pertinent in respect of issues on which rules are provided in the URG.

A. Obligation to pay upon conforming demand

45. As suggested in draft article 2 (A/CN.9/WG.II/WP.67), the guarantor is obliged to pay "in conformity with the terms of the undertaking". Upon receipt of a demand for payment, the guarantor would thus examine its conformity with the terms of the guaranty letter. It may be noted that a future Secretariat note will discuss possible grounds for refusing payment that are not instances of non-conformity (e.g. fraud, manifest abuse).

46. The points that the recipient of a claim would have to verify in order to decide whether it is obliged to pay under the guaranty letter may be illustrated by the following list:

Timeliness, i.e., the claim is not made after expiry

Proper claimant, i.e., the person demanding payment is the beneficiary designated in the guaranty letter

Proper form, i.e., the claim meets any requirement of form laid down in the guaranty letter or in the applicable law

Proper addressee and place of presentment, i.e., payment is demanded from the obliged party (e.g. guarantor, but not the advising bank) and the claim is presented at the right place in respect of that party (e.g. issuing bank or confirming bank)

Appropriate amount, i.e., the amount claimed does not exceed the maximum amount as stated in the guaranty letter or as reduced either by a previous payment or according to an express reduction clause

Fulfilment of payment conditions, i.e. presentment of specified documents or fulfilment of other requirements upon which payment is predicated

47. As regards the proper form of the demand, the Working Group may wish to consider whether the uniform law itself should contain any requirement as to form and, for example, whether it should exclude purely oral demands.

48. The Working Group may wish to consider whether the uniform law should contain a provision on the proper place. The rule in article 19 URG that a claim under the guarantee shall be made "at the place of its issue" might be refined so as clearly to link presentment to the particular addressee, e.g. confirming instead of issuing bank, and to give effect to any stipulation of a different place of presentment.

(1) Standard of examination as to conformity

49. Article 9 URG provides:

"All document(s) specified and presented under a Guarantee, including the claim, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such document(s) do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused."

50. It is primarily in the context of verifying payment conditions that the standard of examination for facial conformity comes into play. Even where payment depends on the occurrence of an event and that occurrence is not within the guarantor's purview, an examination of documents would be required if the uniform law would incorporate the prevailing view at the thirteenth session (A/CN.9/330, para. 75) that non-documentary payment conditions should be converted into documentary ones obliging the beneficiary to submit a statement affirming the occurrence of the event in question or a certificate of an appropriate third person.

51. The standard of facial compliance may also play a role in the examination of other points included in the above illustrative list (paragraph 46). For example, where expiry is linked to an event, verification of timeliness may involve examination of documents, in particular if the uniform law were to adopt the documentary approach suggested above (paragraph 36). Similarly, where a reduction clause refers to an event, determination of the appropriate amount may involve examination of documents, in particular if the uniform law were to require that, as suggested at the thirteenth session (A/CN.9/330, para. 22), the available amount be readily determinable by the guarantor, for example, on the basis of clearly specified documents.

52. The Working Group may wish to consider whether a rule such as the one in article 9 URG would be appropriate for the uniform law and whether it should be refined or supplemented. In doing so, the Working Group may build on its discussion of the thirteenth session relating to the doctrine of strict compliance and to the possible use of the understanding and established practices of bankers as a criterion of the standard of construction and care (A/CN.9/330, paras. 86-91).

53. As was noted at the thirteenth session, the term "strict compliance", as distinguished from "substantial

compliance", could be understood as meaning true strictness down to the comma or it could be understood as allowing a marginal latitude to correct typographical errors or similar minimal deviations. In fact, there exists no uniform understanding, and the handling of discrepant documents in letter of credit practice appears to be a primary source of disputes and litigation.

54. In considering whether a rigid or a more flexible standard of compliance would be appropriate, account should be taken of certain differences between the commercial letter of credit and the guaranty letter. Firstly, the commercial letter of credit provides a secured payment mechanism likely to be utilized in the ordinary course of the transaction, while the guaranty letter is designed to indemnify the beneficiary for the consequences of a contingency that is unlikely to occur. Secondly, the documents tendered under a commercial letter of credit (e.g. bill of lading) are likely to be merchantable, while the statements or documents required under a guaranty letter are rarely of such type. Thirdly, the documents required under a commercial letter of credit tend to be more standardized than those required under a guaranty letter, and they are explained and regulated in detail by the UCP.

55. The following three examples might help to assess the possible role of the standard of facial compliance in guaranty letter practice:

(A) A financial stand-by letter of credit contains in its annex the text of three statements describing the possible contingencies for which the undertaking is given and leaving blanks for the amount to be filled in by the beneficiary.

(In such case, the well-known maxim of the doctrine of strict compliance is clearly applicable: There is no room for documents that are almost the same, or that will do just as well.)

(B) A tender guarantee is payable on first demand accompanied by a written statement of the beneficiary certifying that the tenderer did not honour its commitment. The beneficiary sends the following facsimile message to the guarantor: "We hereby demand payment of 125.000 USD, confirming Company X did not sign awarded contract. Signed B." The guarantor refuses to pay because the beneficiary's statement contained neither the word "certify" nor the words "did not honour its commitment".

(However one may judge the reasons given for rejecting the claim, it is submitted that this case illustrates the limitations of the doctrine of strict compliance, whether or not interpreted in its literal, rigid sense.)

(C) A performance guarantee states that it is payable on simple demand and that it is subject to the URG. The beneficiary supports its demand by a declaration to the effect that the principal defaulted on its obligations, in particular, its main obligations under the contract. The principal instructs the guarantor not to pay because the beneficiary did not state, as required under

article 20 (a)(ii) URG, "the respect in which the Principal was in breach".⁸

(This latter wording, which may equally be found in an individually drafted text of a guaranty letter, exemplifies the frequent vagueness of the description of the required contents of a statement by the beneficiary and, in turn, of the limited utility of a standard based on strict compliance. In determining the conformity of a statement with the requirements contained in the guaranty letter, construed in accordance with draft article 6 of the uniform law, a process of interpretation and judgment is needed that cannot be appropriately covered by a single term such as "strict compliance", and probably also not "substantial compliance".)

56. One conclusion would be that it is primarily for the parties to provide greater certainty by formulating precise requirements, illustrated in the first example. As regards the uniform law, a standard of facial compliance, however strict or flexible it may be, might have less significance than the standard of reasonable care in examining the conformity of the claim, including any required documents, with the terms of the guaranty letter.

57. In this connection consideration may be given to refining the standard of care, for example, by referring to the understanding of a reasonable and experienced documents checker. Such refinement might help to prevent an overly rigid attitude towards conformity where a process of interpretation and judgement is needed. However, one might regard such refinement as unnecessary in view of the fact that any legal standard of care tends to be judged with regard to the relevant group of persons and that the uniform law may be expected to include the mandatory requirement that guarantors act in good faith and with reasonable care (as provided in the new version of article 15 URG; see paragraphs 67-68 below).

(2) Time allowed for examination

58. Article 10(a) URG provides:

"A Guarantor shall have reasonable time in which to examine a claim under a Guarantee and to decide whether to pay or to refuse the claim."

59. Except for minor drafting changes, this provision corresponds with the previous version which the Working Group reviewed at its twelfth session (A/CN.9/316,

⁸Article 20 (a) URG reads: "Any claim for payment under the Guarantee shall be supported by a written statement (whether in the claim itself or in a separate document or documents accompanying the claim and referred to in it) stating:

- (i) that the Principal is in breach of his obligation(s) under the underlying contract(s);
- and
- (ii) the respect in which the Principal is in breach."

(Article 20 (c) URG reads: "This Article applies except to the extent that it is expressly excluded by the terms of the Guarantee or Counter-Guarantee.")

paras. 50-51). As was then noted in favour of retaining the notion of "reasonable time", the notion is well known, in particular from article 16(c) UCP, and takes into account differences in circumstances found in individual cases as well as regional and national variations in practice.

60. However, such flexibility is necessarily coupled with uncertainty that might not be desirable in international practice. With a view to achieving certainty, various proposals were made concerning inclusion of a definite period, e.g. five days or, as provided by section 5-112(1)(a) UCC, three days. One compromise suggestion was to use a rebuttable presumption of a certain fixed length of time as appropriate, unless agreed or proven otherwise, with the burden being on the party alleging its reasonableness.

B. Duties of notification

61. The Working Group may wish to consider whether the uniform law should oblige the guarantor, upon receipt of a claim, to inform the principal or instructing party thereof.⁹ It may also wish to consider the time and modalities of the notice to the beneficiary that the guarantor would be obliged to give if it rejected the claim. Both duties are laid down in provisions of the URG (which in an earlier, somewhat different version were reviewed by the Working Group at its twelfth session, A/CN.9/316, paras. 50, 52, 72-75):

Article 10(b)

"If the Guarantor decides to refuse a claim, it shall immediately give notice thereof to the Beneficiary by teletransmission or, if that is not possible, by other expeditious means. Any documents shall be held at the disposal of the Beneficiary."

Article 17

"Without prejudice to the terms of Article 10, in the event of a claim the Guarantor shall without delay so inform the Principal or where applicable its Instructing Party and in that case the Instructing Party shall so inform the Principal."

62. With respect to the provision on notice of rejection, the Working Group suggested at its twelfth session that the notice should include a statement of the reasons for the rejection since a beneficiary, if informed of the nature of a documentary discrepancy, might be in a position to cure the discrepancy and resubmit the document in question. A consequential proposal was that the provision might include a rule of preclusion, perhaps similar to the one contained in article 16 UCP, thereby limiting the right of a guarantor to reject a submission of documents on the basis of discrepancies that could or should have been notified to a beneficiary during an earlier submission (A/CN.9/316, para. 52). It may be added

that a rule of preclusion that was closely modelled on article 16(e) UCP would have the further consequence of precluding a guarantor who failed to examine the documents within the required period of time from claiming that they were not in accordance with the terms and conditions of the guaranty letter. The rule of preclusion would thus provide the sanction for failure to comply with the rule on the time for examination discussed above (paragraphs 58-60).

63. As regards the guarantor's duty to inform the principal or instructing party in the event of a claim, it is likely to be controversial in principle and to create difficulties in its implementation, in particular with respect to the guarantor's duty to pay upon a conforming demand. For example, questions were raised at the twelfth session as to whether notice should be given prior to payment, or whether payment could validly be made without notice and whether the notification, if made prior to payment, should contain information concerning the guarantor's intention to honour or dishonour the claim. In considering these and other questions relating to this duty, the Working Group may wish to take into account the opening words that were added to the new version of article 17 URG: "Without prejudice to the terms of Article 10", i.e. the provisions on the time for examination and on the duty to give notice of rejection.

64. Finally, the Working Group may wish to consider whether the uniform law should deal with further duties of notification. For example, consideration might be given to requiring financial institutions that receive a request for issuing a counter-guaranty letter or for confirming or advising a guaranty letter and that elect for any reason not to comply with such request to so inform the requesting party within a specified time, e.g. five days, after the receipt of the request.

V. LIABILITY AND EXEMPTION

65. The Working Group may wish to consider whether the uniform law should contain provisions on the liability of guarantors and, possibly, instructing parties. It may use as a basis of its discussion the pertinent URG provisions, an earlier version of which it reviewed at its twelfth session (A/CN.9/316, paras. 53-69). The relevant provisions of URG are:

Article 11

"Guarantors and Instructing Parties assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification, or legal effect of any document presented to them or for the general and/or particular statements made therein, or for the good faith or acts and/or omissions of any person whomsoever."

Article 12

"Guarantors and Instructing Parties assume no liability or responsibility for the consequences arising out of

⁹As to the term "instructing party", see draft article 2, A/CN.9/WG.II/WP.67.

delay and/or loss in transit of any messages, letters, claims or documents, or for delay, mutilation or other errors arising in the transmission of any telecommunication. Guarantors and Instructing Parties assume no liability for errors in translation or interpretation of technical terms and reserve the right to transmit Guarantee texts or any parts thereof without translating them."

Article 13

"Guarantors and Instructing Parties assume no liability or responsibility for consequences arising out of the interruption of their business by acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control or by strikes, lock-outs or industrial action of whatever nature."

Article 14

(a) "Guarantors and Instructing Parties utilizing the services of another party for the purpose of giving effect to the instructions of a Principal do so for the account and at the risk of that Principal."

(b) "Guarantors and Instructing Parties assume no liability or responsibility should the instructions they transmit not be carried out even if they have themselves taken the initiative in the choice of such other party."

(c) "The Principal shall be liable to indemnify the Guarantor or the Instructing Party, as the case may be, against all obligations and responsibilities imposed by foreign laws and usages."

Article 15

"Guarantors and Instructing Parties shall not be excluded from liability or responsibility under the terms of Articles 11, 12, and 14 above for their failure to act in good faith and with reasonable care."

66. The discussion may conveniently be divided into two parts, dealing first with issues addressed in article 15 URG, the only provision imposing liability, and then with issues raised by articles 11 to 14 URG, which, while presented in the URG under the heading "Liabilities and responsibilities", contain in substance exemption clauses.

A. Liability and standard of care

67. It may be recalled that the previous version of article 15 URG imposed liability on guarantors and instructing parties "for their grossly negligent or willful acts". The new basis of liability, "failure to act in good faith and with reasonable care", reflects the view widely supported in the Working Group that guarantors and instructing parties should exercise reasonable care in performing their obligations (A/CN.9/316, para. 69).

68. A provision in the uniform law along the lines of article 15 URG would have a different legal character and possibly a different scope. Article 15 URG limits the effect of exemption clauses contained in the same set of rules, all of which, including article 15, become effective by agreement of the parties and may thus be excluded or varied. The uniform law, however, would be in a position to impose liability in a mandatory fashion. Thus it could effectively limit any exemptions from such liability, whether they be found in individually drafted clauses of guaranty letters or in general conditions or uniform rules referred to in guaranty letters.

B. Exemptions from liability

69. As regards articles 11 to 14 URG, the current provisions are essentially the same as those reviewed by the Working Group at its twelfth session. It may be recalled that serious objections were raised, in particular, in respect of articles 12 to 14 URG which were regarded as unduly favouring guarantors and instructing parties. Suggestions were made that those exempting provisions should be deleted or drafted in a more balanced manner.

70. It was pointed out in response that the provisions were closely modelled on articles 17 to 20 UCP which had not given rise to difficulties. As regards the exemption for *force majeure* it was stated that guarantee texts often contained *force majeure* clauses and that even without any contractual exemption a similar result would obtain from the applicable national law. However, since national laws differed as to the scope of exempting impediments, it might be desirable to strive for a greater degree of harmony.

71. In discussing whether the uniform law should include any of the exemptions contained in articles 11 to 14 URG, the Working Group may wish to take into account the following considerations based on differences between the URG and the uniform law. While the future acceptability of the text to bankers as the primarily concerned persons will be an important factor in a State's decision about the acceptance of the uniform law, that may be less so in respect of exemption clauses since these are more commonly promulgated by the interested circles, for example, in general conditions.

72. Moreover, the need for including in the uniform law provisions on exemption appears to be reduced by the very fact that the URG contains exemption clauses. Finally, exemption clauses seem to be more appropriate in a text that itself spells out the various obligations, the breach of which raises the question of liability and exemption therefrom. There may thus be less need for including exemption clauses in the uniform law, which, whatever its final coverage will be, is certain to contain fewer "rules of traffic" and provisions imposing duties than the URG.