IV. GUARANTEES AND STAND-BY LETTERS OF CREDIT

A. Report of the Working Group on International Contract Practices on the work of its sixteenth session

(Vienna, 4-15 November 1991) (A/CN.9/358) [Original: English]

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INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,[1] the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce (ICC) and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit (A/CN.9/316). The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

2. The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and entrusted this task to the Working Group.[2]

3. At its thirteenth session (A/CN.9/330), the Working Group commenced its work by considering possible issues of a uniform law as discussed in a note by the Secretariat (A/CN.9/WG.II/WP.65). Those issues related to 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 the guarantee or stand-by letter of credit. The Working Group

[1] *Official Records of the General Assembly, Forty-third Session, Supplement No. 17* (A/43/17), para. 22.

[2] Ibid., *Forty-fourth Session, Supplement No. 17* (A/44/17), para. 244.

requested the Secretariat to submit to its fourteenth session a first draft set of articles, with possible variants, on the above issues as well as a note discussing other possible issues to be covered by the uniform law.

4. At its fourteenth session (A/CN.9/342), the Working Group examined draft articles 1 to 7 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.67). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a revised draft of articles 1 to 7 of the uniform law. The Working Group also considered the issues discussed in a note by the Secretariat relating to amendment, transfer, expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft of articles on the issues discussed. It was noted that the Secretariat would submit to the Working Group, at its fifteenth session, a note on further issues to be covered by the uniform law, including fraud and other objections to payment, injunctions and other court measures, conflict of laws and jurisdiction.

5. At its fifteenth session (A/CN.9/345), the Working Group considered certain issues concerning the obligations of the guarantor. Those issues had been discussed in the note by the Secretariat relating to amendment, transfer, expiry, and obligations of guarantor (A/CN.9/WG.II/WP.68) that had been submitted to the Working Group at its fourteenth session but had not then been considered, for lack of time. The Working Group then considered the issues discussed in a note by the Secretariat relating to fraud and other objections to payment, injunctions and other court measures (A/CN.9/WG.II/WP.70). The Working Group also considered the issues discussed in a note by the Secretariat relating to conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft set of articles on the issues discussed.

6. The Working Group, which was composed of all States members of the Commission, held its sixteenth session at Vienna, from 4 to 15 November 1991. The session was attended by representatives of the following States members of the Working Group: Argentina, Canada, Chile, China, Costa Rica, Cyprus, Czechoslovakia, France, Germany, Iran (Islamic Republic of), Japan, Mexico, Morocco, Netherlands, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland and United States of America.

7. The session was attended by observers from the following States: Austria, Colombia, Finland, Gabon, Indonesia, Lebanon, Peru, Philippines, Poland, Sweden, Switzerland, Thailand, Turkey, Ukraine, Yemen and Zaire.

8. The session was attended by observers from the following international organizations: Hague Conference on Private International Law, International Monetary Fund (IMF), Banking Federation of the European Community, Federación Latinoamericana de Bancos (FELABAN).

9. The Working Group elected the following officers:

Chairman: Mr. J. Gauthier (Canada)

Rapporteur: Mr. R. Sandoval (Chile)

10. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.72) and a note by the Secretariat containing tentative draft articles of a uniform law on international guaranty letters (A/CN.9/WG.II/WP.73 and Add.1).

11. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a uniform law on international guaranty letters.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

12. The Working Group examined draft articles 1 to 13 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.73 and Add.1). The deliberations and conclusions of the Working Group are set forth below in chapter II. The Secretariat was requested to prepare, on the basis of those conclusions, a revised draft of articles 1 to 13 of the uniform law.

II. CONSIDERATION OF DRAFT ARTICLES OF A UNIFORM LAW ON INTERNATIONAL GUARANTY LETTERS

Chapter I. Sphere of application

Article 1. Substantive scope of application

13. The text of draft article 1 as considered by the Working Group was as follows:

"This Law applies to international guaranty letters."

14. A suggestion was made to include the term "independent" so that the uniform law would apply to "international independent guaranty letters". A concern was expressed that the term "guaranty letter" was inappropriate since it did not embrace stand-by letters of credit. While the term "guaranty letter of credit" might do so, neither term was used in practice and the use of either of the terms might lead to the misconception that the uniform law created a new type of instrument. It was also stated that, while the uniform law attempted to regulate in an amalgamated manner independent guarantees and stand-by letters of credit, there was a need to address some issues separately for independent guarantees and for stand-by letters of credit, so as to take full account of the different origin and unique features of the two instruments. In response, it was recalled that the Working Group at its previous sessions had always treated jointly the two kinds of instruments in view of their functional equivalence and common or similar operational legal character; the term "guaranty letter"

had been chosen as a novel term embracing both kinds of instruments.

15. After deliberation, the Working Group concluded that it would be premature to take a final decision on the nominal issue of a common name and on the substantive issue of whether stand-by letters of credit and independent guarantees could be treated jointly in all respects or whether for some issues separate rules were necessary.

Article 2. Guaranty letter

16. The text of draft article 2 as considered by the Working Group was as follows:

"A guaranty letter [, however named or described,] is an [express] undertaking of independent [and essentially documentary] character, given by a bank or other institution or person (["guarantor"] ["issuer"])

Variant A: at the request of its customer ("principal") or on the instruction of another bank, institution or person ("instructing party") acting at the request of that instructing party's customer ("principal"),

Variant B: , whether or not so requested or instructed by another bank, institution or person to pay to another person ("beneficiary") a certain or determinable amount of a specified currency or unit of account [or other item of value] [or to accept or negotiate without recourse a bill of exchange for a specified amount] in conformity with the terms of the undertaking upon receipt of a demand

Variant X: made in the manner prescribed in the undertaking, provided that the undertaking [indicates that it] is given for the purpose of [indemnifying the beneficiary for the consequences of a specified contingency] [securing the beneficiary against the non-fulfilment of certain financial or other obligations by the principal or against another specified risk].

Variant Y: stating or, if so required in the undertaking, certifying or otherwise establishing that payment is due."

Opening words

17. The Working Group noted that the definition of guaranty letter would also apply to a counter-guaranty letter and a confirming guaranty letter and that special definitions of those two terms might later have to be included in the uniform law, in particular, if those terms would be used in operative rules in the uniform law (see A/CN.9/WG.II/WP.73, remark 1 on article 2). It was observed that the terminology concerning the confirmation of a guaranty letter would need to be carefully considered.

18. As regards the words "however named or described" between square brackets, it was recalled that this wording was drawn from the wording of the draft Uniform Rules on Demand Guarantees (URDG) currently under consideration by the International Chamber of Commerce (ICC). It was noted that the wording was used to make it abundantly clear that no specific title or description was needed for making the uniform law applicable to an undertaking that met the requirements contained in the definition of guaranty letter. The prevailing view was that the article defining the guaranty letter should be streamlined to the greatest possible extent and that the wording should be deleted as unnecessary.

19. As regards the mention of the "express" nature of the undertaking, it was stated that the word between square brackets should be deleted, since the rest of the provision made it sufficiently clear that the uniform law did not encompass implied undertakings. The Working Group decided to delete the word "express".

20. As regards the reference to the "essentially documentary" character of the undertaking, it was stated that a reference to documents was not appropriately located in the definition of the undertaking, since the documentary nature became relevant at the stage of execution when the beneficiary made a demand for payment. In response, it was stated that the reference to the essentially documentary character of the undertaking was intended to serve as a reminder of the unresolved problem of the treatment of non-documentary conditions (A/CN.9/342, paras. 111-118) and to indicate a possible location for a restriction of the scope of application to undertakings that were not only independent but also essentially documentary in nature (see A/CN.9/WG.II/WP.73, remark 2 on article 2).

21. The view was expressed that the term "essentially" would be inappropriate in the case of stand-by letters of credit, which were not "essentially" but "invariably" documentary by their very nature. As regards the admissibility of non-documentary conditions, it was recalled that the Working Group, at earlier sessions, had considered various options of treatment without having reached a general consensus. It was also recalled that the Working Group had regarded the reference to the "essentially documentary" undertaking as a way to maintain within the scope of application of the uniform law an intermediate situation where an undertaking inadvertently included a non-documentary condition and yet was so drafted as to be essentially documentary. It was stated that the most difficult part of the problem would be to ascertain what non-documentary conditions that did not have the effect of rendering the undertaking to be accessory were found in practice and how that limited category of conditions should be clearly defined. After discussion, the Working Group decided to maintain the words between square brackets as a reminder and to reconsider the issue at a later stage, after having reviewed the problem of non-documentary conditions in the context of relevant operational provisions.

22. As regards the reference to the "guarantor" or "issuer" between square brackets, it was stated that the term "guarantor" would more appropriately cover the situation where the undertaking was in the form of an independent guarantee, while the term "issuer" would be more suitable in the case of a stand-by letter of credit. A suggestion was made to combine the two words and use the term "guarantor/issuer". Another suggestion was to use only the word "guarantor" and to provide a definition of the guarantor in article 6 indicating that the term "guarantor" encompassed the issuer of a stand-by letter of credit. After discussion, the Working Group decided to leave the matter for consideration by the drafting group that would be set up at a later session.

Variants A and B

23. The Working Group next considered different approaches to requests or instructions by another person for the issuance of the guaranty letter, as embodied in variants A and B as well as in the proposed paragraph (2) contained in remark 4 on article 2. A number of criticisms of a drafting nature were made of variant A. One was that the term "customer" was too narrow since, for example, a parent company instructing its subsidiary to issue a guaranty letter could not be considered a customer of the subsidiary. It was suggested that a more appropriate term would be "debtor" or "obligor"; that substitution was objected to on the ground that it might connote the existence of certain contractual relationships foreign to the guaranty letter. Another suggestion was to refer to the "applicant" for the guaranty letter as this would reflect practice associated with stand-by letters of credit. It was also suggested that additional clarity was needed as to the antecedent of the words "acting at the request of that instructing party's customer". It was further suggested that reference should be made not only to a request, but also to an instruction, since a guarantor may only act upon an instruction.

24. It was noted that variant A would not cover the issuance by the guarantor of a guaranty letter in support of the guarantor's own obligation, while such undertakings would be covered, implicitly, under variant B and, explicitly, under paragraph (2) as proposed in remark 4 on article 2. Differing views were expressed as to which approach to follow. One view was that the traditional understanding of a guarantee involved the guarantor answering for the debt of another and that therefore an undertaking issued by a guarantor in support of its own primary obligation could not properly be regarded as a guaranty letter. The prevailing view was that, because such undertakings, though not particularly common, occurred in practice, they needed to be covered by the uniform law. It was also felt that such undertakings could properly fall within the scope of the uniform law because they involved, as in any guaranty letter, a commitment that was of a documentary character, abstracted from the underlying transaction. A suggestion that the extent to which such undertakings might be covered by the uniform law could be limited somewhat by requiring that issuance should be by entities that engaged in issuance of guaranty letters in the ordinary course of their business did not receive support.

25. The Working Group then considered the exact manner in which guarantees on behalf of the guarantor should be accommodated. One approach was to be silent on such guarantees, an approach that could be implemented by selecting variant B or by deleting, as was proposed, both variants A and B, and thereby eliminating any reference in article 2 to a need for a request or instruction for the issuance of a guaranty letter. The other approach was to include an express reference to guaranty letters issued on behalf and on the account of the guarantor, as contained in subparagraph *(c)* of the proposed paragraph (2). It was stated in support that, absent an express recognition of guaranty letters on behalf of the guarantor, some operative rules (e.g., requirements that the guarantor notify the principal of a demand for payment or obtain the principal's consent to an amendment) might be read as an indication of non-recognition of such instruments. It was also pointed out that silence raised the danger of divergent treatment by implementing States. In particular, the danger would exist that in States which were unfamiliar with the practice, such guarantees might not be recognized. In view of the foregoing, it was decided to add the proposed paragraph (2) as a replacement for both variants A and B. The proposed paragraph (2) was as follows:

"(2) The undertaking may be given

(a) at the request of the customer ('principal') of the guarantor ('direct guaranty letter');

(b) on the instruction of another bank, institution or person ('instructing party') acting at the request of the customer ('principal') of that instructing party ('indirect guaranty letter'); or

(c) on behalf of the guarantor itself ('guaranty letter on guarantor's own behalf')."

To pay to another person ("beneficiary")

26. A concern was expressed that the requirement that payment be to "another person" would preclude the application of the uniform law to certain financial stand-by letters of credit in which the issuer itself was designated as beneficiary acting as trustee for a large number of final recipients of the sum owed under the stand-by letter of credit. It was suggested that the problem might be solved by deleting the requirement that payment be to another person, while possibly adding to the uniform law a definition of the "beneficiary" as the person designated in the guaranty letter. An alternate suggestion was to retain in article 2 the requirement of payment to another person, but to include somewhere in the uniform law a provision excluding financial stand-by letters of credit from that requirement. Those proposals were objected to on the ground that issuances in which the issuer was, in effect, also acting as the beneficiary, would raise insurmountable conflict-of-interest concerns in some jurisdictions, and that it was therefore preferable, in a uniform law of international scope, to retain the requirement of payment to another person. Another suggestion was that the problem was one to be properly solved by the issuer through the establishment of a separate corporate entity for the purpose of acting on behalf of the true beneficiaries. In response, it was stated that financial stand-by letters of credit were a practical necessity and therefore widely used, particularly in cases in which there were very large numbers of holders of public bonds, the repayment of the principal and interest of which was secured through stand-by letters of credit. It was reported that such issuances had obtained clearance from regulatory authorities in a number of countries and represented a large volume worldwide. It was further stated that the effects of the practice could not be confined purely to a national arena since in many cases foreigners were the holders of public debt and thereby ultimate beneficiaries of the types of arrangements in question.

27. In order to attempt to meet the concern about coverage of such "direct pay financial stand-by letters of credit", without at the same time deleting the requirement that payment be to another person, it was proposed to add a reference to payment to the issuer when the issuer was acting in

a capacity different from that of issuer. That approach was found to be deficient because such financial stand-by letters of credit typically did not on their face refer to any special capacity in which the beneficiary/issuer was acting. It was also suggested that the problem might simply be solved through interpretation, by considering that an issuer acting in such a capacity could be considered as being "another person". After discussion, the Working Group decided to retain the reference in article 2 to payment to another person, but to include at an appropriate place in the uniform law the language needed to accommodate such stand-by letters of credit.

Object of payment obligation

28. A proposal was made to delete the words "of a specified currency or unit of account" on the ground that it was sufficient to refer simply to the obligation of the guarantor to pay "a certain or determinable amount". That proposal failed to receive sufficient support, in particular because it was felt that reference to a specified currency or unit of account was necessary in order to provide certainty.

29. Differing views were expressed as to the desirability of retaining the words "or other item of value", which would place within the scope of the uniform law guaranty letters in which payment was in a form other than money. A proposal was made to delete those words on the ground that, in the interests of harmonization, the uniform law should concentrate on the types of instruments most commonly used. Even if some instruments were not covered by the law, parties would retain the contractual freedom to agree on alternate forms. In support of retention, it was stated that stand-by letters of credit in which payment was made in a form other than money, typically in precious metals, were used and that their use was likely to increase. The uniform law should therefore include such instruments within its scope so as to avoid restricting the options of the parties, as well as to stay abreast of new forms of payment that might develop in the coming years. It was also suggested that a broad reading of the term "units of account" would not be sufficient to secure coverage of such instruments.

30. A concern was raised that payment through commodities might necessitate investigations to ascertain quality, thus detracting from the independence of the guarantor's undertaking. A related concern was that fluctuating prices of commodities might make it difficult for the parties to determine the actual amount of the guaranty letter, in addition to raising the risk of abusive calls when the value of the commodity escalated sharply. In response to those concerns, it was stated that any such determination of the quality of the commodity used for payment would not involve the underlying obligation secured by the guaranty letter and that the problem of price fluctuation was one that the parties could assess and deal with through appropriate language in the guaranty letter.

31. A further concern was that payment through commodities might implicate various national regulatory laws which might, for example, prohibit certain transfers of commodities and that such instruments should therefore be left to those other laws. In response, it was stated that inclusion of such instruments within the scope of the uniform law would not affect the continued applicability of regulatory laws in question.

32. After discussion, the Working Group decided to defer a final decision on the language in question to a later stage of its deliberations.

33. As to the words "or to accept or negotiate without recourse a bill of exchange for a specified amount", it was observed that the use of the term "negotiate" needed to be reconsidered since the commitment of the guarantor or issuer of an instrument in which payment was to be through a bill of exchange could only be to accept and later honour the bill of exchange. It was also suggested that the words "and to pay at maturity" should be added after the words "to accept". The advisability of the latter modification was questioned from the standpoint of legislative drafting, since the introduction of an element of the law on bills of exchange presented the risk that other relevant elements might be omitted. Another suggestion was that acceptable modes of payment, including, if it were so decided, acceptance of bills of exchange, could be defined in article 6, thus simplifying the definition of the guaranty letter.

34. Beyond those comments of an essentially drafting nature, concerns were expressed as to the desirability of mentioning in article 2 instruments in which the commitment of the issuer was to accept a bill of exchange. The view was expressed that the types of instruments in question were unfamiliar in some parts of the world, particularly where guarantees were traditionally regarded as vehicles for speedy payment to the beneficiary. According to that view, only instruments that fit within that traditional category should fall within the scope of the uniform law. A further ground cited in favour of deletion was that introduction into the guaranty letter of payment through acceptance would result in uncertainty as to the applicable law since the obligations of the guarantor would also become subject to the laws governing bills of exchange.

35. In response to those views, it was stated that, since the uniform law was intended to codify existing practice, it was necessary to cover the presentation of bills of exchange, in particular in order to encompass stand-by letters of credit, which were used extensively and which at times provided for payment through acceptance of bills of exchange. It was suggested that acceptance or payment of a bill of exchange needed to be mentioned in article 2 because it raised not merely the subsidiary question of the object of payment, but concerned the very nature of the guarantor's commitment under the guaranty letter. It was also stated that the possibility of ambiguity as to the applicable law was negligible because the law on guaranty letters and the law on bills of exchange would apply to distinct facets of the transaction. After discussion, the Working Group decided to defer a decision to a later stage of its deliberations.

In conformity with the terms of the undertaking upon receipt of a demand

36. A proposal was made to modify the reference to "the terms of the undertaking" to read "the terms and documentary conditions of the undertaking". Such a change was

said to be necessary to reflect the practice in jurisdictions in which the use of stand-by letters of credit was prevalent. In those legal systems the word "term" connoted items, such as the expiry date of a letter of credit, the occurrence of which were not uncertain, therefore not requiring the presentation of documents, whereas the word "condition" was used to refer to events the occurrence of which was uncertain, thereby necessitating the presentation of documentary evidence of occurrence. The characterization of the conditions as "documentary" was said to be necessary in order to affirm, in the definition of the guaranty letter, that the undertaking was of a documentary nature, thereby minimizing the need to deal with non-documentary conditions in the operative rules.

37. While it was pointed out that in many legal systems the word "term" was sufficient, since what was referred to above as a "condition" would be included as a term in the guaranty letter, it was agreed to add the word "condition" in order to accommodate divergent understandings of the word "term". It was noted that with such a change the uniform law would reflect the language used in the Uniform Customs and Practice for Documentary Credits (UCP). The Working Group did not agree to the suggested addition of the word "documentary", in particular because of a concern that the addition of that word might lead to the exclusion from the uniform law of any instrument with a potential non-documentary condition. Many representatives expressed the view that it was therefore preferable to treat non-documentary conditions in the operative, rather than in the definitional, provisions of the uniform law (see, however, the later decision reflected below, paragraph 61).

38. A view was expressed that the words "upon receipt of a demand" should be deleted or modified so as to avoid giving rise to an interpretation that payment under stand-by letters of credit required the presentation of a distinct document labelled as demand for payment, in addition to any other documents required under the guaranty letter.

Variants X and Y

39. As regards variant X, the view was expressed that the use of the words "indemnifying the beneficiary for the consequences of a specified contingency" between square brackets might unduly suggest a need to measure the damage suffered by the beneficiary. Such measurement of the damage might require a review of the underlying contract and therefore contradict the independent nature of the undertaking. Support was expressed in favour of the second wording between square brackets, which read: "securing the beneficiary against the non-fulfilment of certain financial or other obligations by the principal or against another specified risk". That wording was said to respond to the need of defining the purpose of the undertaking by reference to the potential risk of the beneficiary.

40. It was stated that a reference to the purpose of the undertaking would help to exclude from the definition the commercial letter of credit and other facilities without guaranteeing purpose. It was also stated that an indication of the purpose of the undertaking in the uniform law, not necessarily in the guaranty letter, was needed to identify the common ground between the bank guarantee and the stand-by letter of credit by reference to the guaranteeing function of both instruments. Furthermore, an indication of the purpose of the guaranty letter might also be relevant in the context of an improper demand under article 19.

41. A contrary view was that, although a similar economical function was performed by bank guarantees and stand-by letters of credit, that functional similarity was not specific to those two instruments and could be extended to accessory guarantees and even to insurance contracts. It was suggested that such a broad indication of the purpose of the instruments as that contained in variant X might be of little operative significance.

42. A suggestion was made that, when presenting a demand for payment under the guaranty letter, the beneficiary should be under an obligation to produce a statement that payment of the guaranty letter was justified. In response, it was stated that the creation of the suggested obligation would not be consistent with the current practice of stand-by letters of credit and bank guarantees payable on simple demand.

43. A concern was expressed that the wording of variant X, unlike that of variant Y, would not be fully compatible with the practice of stand-by letters of credit. It was stated that, should variant X be retained, a special rule would need to be devised for certain stand-by letters of credit that were classified as stand-by letters of credit by bank regulatory authorities for capital adequacy reasons but were in effect used as ordinary instruments of payment. Such instruments were not intended to secure the beneficiary against any risk but were used like normal commercial letters of credit.

44. It was also suggested that the wording of the variants, particularly that of variant Y referring to a demand certifying or otherwise establishing that payment is due under the guaranty letter, might not be fully consistent with the description of the independent undertaking provided in draft article 3(2)*(b)*. It was therefore suggested that both variants be deleted and replaced by the words "made in the manner prescribed in the undertaking". It was stated in response that that suggestion would unduly widen the scope of application of the uniform law by covering commercial letters of credit and other independent payment undertakings such as bills of exchange and promissory notes.

45. In this connection the Working Group recalled that it had decided at its twelfth and fourteenth sessions "that the uniform law should focus on independent guarantees, including stand-by letters of credit, and that it should be extended to traditional letters of credit where that was useful in view of their independent nature and the need for regulating equally relevant issues" (A/CN.9/316, para. 125, and A/CN.9/342, para. 18). The Working Group decided to consider at a later stage the question of the inclusion of commercial letters of credit.

46. While the discussion on variants X and Y revealed a certain preference for variant X, the Working Group decided to retain for later reconsideration both variants, to be redrafted by the Secretariat in the light of the above comments.

Article 3. Independence of undertaking

47. The text of draft article 3 as considered by the Working Group was as follows:

"(1) An undertaking is independent if [, according to its terms,] the payment obligation [does not depend on] [is not subject to, or qualified by,] the existence or validity of an underlying transaction [,whether or not referred to in the undertaking,] [between the principal and the beneficiary or between an instructing party and the guarantor] or of any other relationship, and the guarantor may [therefore] not invoke any defence arising from a relationship other than its relationship with the beneficiary. [The independent character of an undertaking is not affected by the fact that the guarantor, as provided in article 17(1)*(c)*, may raise certain objections to payment that might be based on facts relating to any such other relationship.]

"(2) *(a)* An undertaking is [irrebuttably] deemed to be independent when it contains the heading '[Independent guaranty letter] [Independent documentary promise] [First demand guaranty letter]' and contains the same words also in its text. [Where an undertaking is deemed to be independent, any term or condition that would have the effect of rendering the undertaking to be accessory shall be treated as void.]

(b) [Otherwise] [Subject to the provisions of subparagraph *(a)* of this paragraph], any characterization or a single term found in the text of the undertaking shall not be deemed conclusive [of whether or not the undertaking is independent] if other terms clearly weigh in favour of the opposite result. In evaluating the terms in their totality, the following factors may be regarded as points weighing in favour of independence:

(i) The undertaking to pay is expressed to be 'on simple demand', 'on first demand', 'on demand', 'upon receipt of a written request', 'unconditional', 'irrespective of the validity or existence of X-Contract', 'waiving all rights of objection and defences arising from said contract', 'without proof of default' or is qualified by any other words of similar import;

(ii) Payment is due upon receipt of a statement by the beneficiary or any document by a third party, and the guarantor is not required to verify any fact outside its purview;

(iii) Any underlying transaction is referred to in the undertaking only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses [, provided that the text of the undertaking is divided in that manner];

(iv) The undertaking is stated to be subject to the Uniform Customs and Practice for Documentary Credits or the Uniform Rules for Demand Guarantees of the International Chamber of Commerce."

Paragraph (1)

48. The Working Group considered, on the basis of the definition of an independent undertaking as suggested in paragraph (1), the concept of independence as an appropriate element delimiting the scope of application of the uniform law. It was agreed that, as a general matter of principle, the relationship between the guarantor and the beneficiary created by the guaranty letter was separate and independent from any other relationship, in particular, from any underlying transaction between the principal and the beneficiary. That independence, which distinguished the guaranty letter from an accessory undertaking such as a suretyship, led to the result that the rights and obligations of the parties to the guaranty letter were exclusively determined by the terms and conditions of the guaranty letter. It was realized, however, that the concept of independence was a complex matter that needed clarification and refinement in various respects.

49. One concern was that a strict interpretation of the rule that the undertaking did not depend on the existence or validity of an underlying transaction would necessarily lead to the conclusion that any illegality of the underlying transaction or its violation of public policy would under no circumstances have any effect on the guarantor's payment obligation. In this connection, a question was raised as to whether the terms of the guaranty letter might refer to the possible illegality of an underlying transaction without compromising the independent character of the undertaking. A related concern was that a strict interpretation of the rule of independence might lead to the conclusion that fraud or manifest abuse of rights by the beneficiary could not constitute an objection to payment; in that connection, a view was expressed that inserting the words "unless otherwise provided in this Law" in the first sentence of the paragraph would be more adequate than retaining the second sentence. It was stated in response to that concern that the so-called "fraud exception", as addressed in draft articles 17(1)*(c)* and 19, was conceptually not an exception to independence but rather a defence against an (independently) existing claim under the guaranty letter and that, at any rate, the concern was met by the second sentence of paragraph (1), which made it clear that the definition of independence did not preclude reliance on fraud or abuse as an objection to payment.

50. As regards the definition of independence suggested in the first sentence of paragraph (1), it was stated that the reference to "the existence or validity of an underlying transaction" was too narrow in that it did not encompass the fulfilment or non-fulfilment of the principal's obligations under an existing and valid underlying transaction. That element was said not to be covered with sufficient clarity by the additional wording that "the guarantor may not invoke any defence arising from a relationship other than its relationship with the beneficiary" created by the undertaking. The Working Group adopted the suggestion to delete the specific reference to existence and validity and instead to include a general reference to the underlying transaction.

Various approaches to independence

51. It was realized that the guarantor's undertaking was truly independent only if it was in no way linked to the actual fulfilment or non-fulfilment of the principal's obligations under the underlying transaction; at the same time,

the non-fulfilment of the principal's obligations often constituted the contingency against which the beneficiary was intended to be secured by the guaranty letter. It was felt that this seemingly paradoxical situation illustrated the gist of the problem of defining the concept of independence as an appropriate criterion for delimiting the scope of the uniform law. The ensuing discussion in the Working Group revealed somewhat different approaches to that crucial matter, particularly as regards the treatment of non-documentary conditions.

52. One approach was to rely primarily, if not exclusively, on the use of expressions in the undertaking revealing the intent of the parties to make the payment obligation independent from other relationships. Under that approach, any stipulation by the parties that the guarantor, upon presentation of a demand, needs to do more than merely verifying the conformity of documents presented by the beneficiary would not necessarily destroy the independent character of the undertaking.

53. Another, similar approach was to regard as autonomous an undertaking that did not have any direct connection with the underlying transaction; any contingency forming the object of the undertaking (e.g., non-fulfilment of principal's obligations) would be dealt with in an indirect manner by focusing on the evidence of its occurrence. Under that approach, the inclusion of a condition of effectiveness (e.g., receipt of advance payment in the context of a repayment guarantee) or of a payment condition stated as an objective fact or result without reference to any underlying transaction (e.g., non-arrival of named ship in specified port at certain date) would not necessarily negate the independent nature of the undertaking. However, in the rare case of inclusion of such a condition without stipulation of the required proof, it was very likely that the guarantor would request evidence of the occurrence of the contingency and that a court would confirm the appropriateness of such request.

54. Yet another approach was to require the undertaking to be of a purely documentary character, thus excluding any undertakings where the guarantor would have to verify any acts or events outside its purview. Any contingency or risk against which the beneficiary was to be secured was relevant only as "notional or representational default" to be determined exclusively on the basis of documents specified in the undertaking. The presentation of documents in conformity with the terms and conditions of the undertaking triggered the payment obligation irrespective of any ultimate determination of the facts evidenced in those documents. The purely documentary approach was orientated at the traditional function of banks to "deal in documents and not in goods or services" and designed to ensure prompt payment (a feature labelled as "moneyness").

Non-documentary conditions in independent undertakings

55. In considering the above approaches, it was realized that their main difference related to the treatment of non-documentary conditions. While the purely documentary approach excluded any undertakings containing, intentionally or inadvertently, a non-documentary condition of effectiveness or of payment, the two other approaches covered those non-documentary conditions that would not render the undertaking to be accessory. It was stated that a result similar to that of the purely documentary approach could be reached by converting any such non-documentary conditions into documentary ones. It was also observed that the more rigid documentary approach might be more appropriate in a legal system where the determination of an undertaking given by certain institutions as being accessory would entail nullity of the undertaking than in legal systems where such determination would merely lead to the application of a different body of law (i.e., law of suretyship).

56. With a view to quantifying the problem by getting a clearer picture of the practical dimension of non-documentary conditions in independent undertakings, the Working Group engaged in an overview of the kinds of non-documentary conditions encountered in the practice of bank guarantees and stand-by letters of credit.

57. It was reported that, in addition to factors having to do with time and calendar dates, a number of categories of non-documentary conditions were found. One category related to the establishment of the guarantee. For example, the establishment of a substitute guarantee might be conditioned on the return of the original guarantee instrument. A second category concerned pre-conditions for the effectiveness of the undertaking, for example, in an advance payment guarantee, that the advance payment had been made. A third category encompassed conditions in connection with the demand for payment that were mentioned in a guarantee without a stipulation as to how the fulfilment of the condition was to be evidenced. For example, a tender guarantee might be conditioned on the fact that the contract had been awarded, or a guarantee might state that payment was due if a certain event occurred that was or was not stated to be linked to an underlying transaction, or a counter-guarantee might be payable when the ultimate beneficiary demands payment from the beneficiary of the counter-guarantee. A fourth category concerned increases and reductions in the guarantee amount. For example, a guarantee might provide that the amount was to be increased in accordance with the opening of letters of credit by an importer or as the volume of goods delivered increased. Such automatic provisions were also associated with the reduction of the guarantee amount, for example, as deliveries or works progressed. A final category of non-documentary conditions had to do with expiry clauses. For example, a guarantee might make reference to the completion of works or deliveries as the point of expiry. It was pointed out that such indefinite expiry terms were often accompanied by fixed, ultimate expiry dates.

58. Examples of non-documentary conditions in stand-by letters of credit included that the demand for payment be signed by a duly authorized officer, non-calendar time periods for demands such as bond-maturity periods, deadlines for submission of a demand in order to obtain same-day payment, restriction of presentation of documents and of payment to a particular location, and indefinite expiry terms (accompanied by fixed, ultimate expiry dates) such as those mentioned above in relation to guarantees.

59. Various observations were made as a result of the overview. One observation was that the manner in which

non-documentary conditions came about varied, being in some instances due to oversight or poor drafting, and in other instances due to the intention of the parties. An example of the former case would be an undertaking that failed to specify the manner in which the fulfilment of only one of a number of demand-related conditions was to be evidenced. An example of intentional insertion might be the repayment guarantee where the guarantor was in many cases willing to establish for itself that the advance payment had indeed been made.

60. It was also observed that, as to the acceptability from the operational point of view, there was a spectrum of non-documentary conditions. On one end of the spectrum there were those factors that were not truly conditions defined as uncertain future events. Those factors related to time, calendar date, and any other event the occurrence of which was certain. Also at this end of the spectrum were conditions that related to events which fell within the guarantor's purview or sphere of influence. For example, as regards the case cited above of a non-documentary condition for the establishment of a substitute guarantee, the guarantor was in a position to determine, without investigation beyond its own purview, whether it had received the original guarantee instrument. Similarly, when an advance payment guarantee conditioned its effectiveness or a demand for payment upon the deposit of the advance payment into an account held by the guarantor, the determination of whether that condition was fulfilled fell within the guarantor's purview as a banker. It was doubtful, however, whether it fell within the purview of the issuer of a stand-by letter of credit to determine whether a requirement that the demand for payment be signed by a duly authorized officer had been met. At the other end of the spectrum lay conditions that involved facts or events the occurrence of which was uncertain and the determination of which lay outside the purview of the guarantor.

Conclusions

61. In view of the foregoing, in particular the impression that the vast majority of instruments being contemplated for coverage by the uniform law were of a documentary character, it was agreed that the provisions in the uniform law should focus on instruments containing only documentary conditions. It was understood that the independent nature of the undertaking and the documentary nature of the conditions in a guaranty letter, while not equivalent concepts, were closely intertwined. It was therefore agreed that terms should be added elsewhere in the uniform law relating to the documentary nature of the conditions in a guaranty letter that reflected the deliberations of the Working Group concerning non-documentary conditions. It was further agreed to consider, after having completed the current review of the tentative draft text of a uniform law, whether independent undertakings containing non-documentary conditions should be covered by the uniform law and, if so, how such conditions should be treated.

Paragraph (2)

62. While some expressions of support and of reservations were made concerning paragraph (2), it was generally agreed that the Working Group should defer consideration of paragraph (2) since its deliberations and decisions with respect to paragraph (1) would result in significant revisions of the latter paragraph, which in turn might affect the function and content of paragraph (2).

Article 4. Internationality of guaranty letter

63. The text of draft article 4 as considered by the Working Group was as follows:

"(1) A guaranty letter is international if:

Variant A: (a) the places of business specified in the guaranty letter of any two of the following parties are in different States: guarantor, beneficiary, principal [instructing party, confirming guarantor]

Variant B: (a) any two of the guarantor, beneficiary and principal have their place of business in different States, provided that this fact is apparent to the guarantor and the beneficiary either from the undertaking or from information disclosed no later than the time of receipt of the guaranty letter by the beneficiary.

[, or

(b) if the guaranty letter expressly so states].

"(2) For the purposes of the preceding paragraph:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the guaranty letter;

(b) if a party does not have a place of business, reference is to be made to its habitual residence."

Paragraph (1)

64. The Working Group expressed a preference for variant A on the ground that it would provide significantly more certainty than variant B in determining whether a given instrument met the test of internationality so as to trigger application of the uniform law. This greater degree of certainty resulted from the fact that variant A, unlike variant B, permitted internationality to be determined from an examination of the face of the instrument, without the necessity of any further investigation, an approach that was considered more consistent with the independent nature of the undertaking. At the same time, however, the view was expressed that an approach such as that in variant B might provide, in some cases, a more accurate determination of internationality, for example, when the place of business of a party situated in a foreign country was not specified in the guaranty letter.

65. Despite the agreement with the thrust of variant A, there was a general concern that, under the present formulation of variant A, certain instruments that were closely tied to international commerce, though perhaps not meeting a literal test of internationality, would be excluded from the scope of the uniform law. As an example, it was pointed out that, under variant A, a wholly domestic counter-guarantee backing an international guarantee or a domestic guarantee securing an international commercial transaction would not meet the internationality requirement of the uniform law. It was suggested that such a limitation on the scope of the uniform law would detract from its effectiveness in achieving harmonization.

66. In connection with the discussion of a possible need to broaden the scope of the definition of internationality, it was recalled that the Working Group had previously discussed, and left open the final decision on, whether the uniform law should extend to domestic transactions. At the same time, a note of caution was struck about going too far in the direction of regulating domestic transactions since this might affect the acceptability of the uniform law; States would anyway remain free to adopt the uniform law to govern their domestic transactions. In this regard, it was suggested that the uniform law might be accompanied by a recommendation that enacting States might consider the option of dispensing with article 4 in its entirety.

67. Various approaches were suggested to broadening the scope of the definition of internationality. One suggestion was to add a statement to paragraph (1) that intruments that involved the interests of international commerce or in which the underlying transaction was international would meet the internationality requirement. Reservations were expressed as to such an approach on the ground that it would not be apparent on the face of an instrument whether such a requirement had been met, thus injecting an unacceptable degree of uncertainty.

68. There was considerable support for expanding the definition of internationality by retaining the terms "instructing party" and "confirming guarantor" in the list of parties in variant A whose places of business, if appearing on the instrument, would be relevant to determining internationality. As to the confirming guarantor, it was suggested that a more appropriate term might be "confirmer" since it could be considered that a confirmation of a guaranty letter did not involve the issuance of a separate guaranty letter. There was also support for referring to the counter-guarantor, as there were occasionally cases in which the counter-guaranty letter was issued by someone other than the instructing party. A view was expressed, however, that the relationship between a counter-guarantor and a guarantor was one of indemnity and therefore should not be mentioned in the same breath with the other parties being listed. It was further suggested that the terms "applicant" and "issuer" be added in order to reflect stand-by letter of credit practice.

69. Another proposal was to provide that stand-by letters of credit that referred to the UCP would be considered international under the uniform law. It was stated that such a technique would promote application of the uniform law and at the same time fill a vacuum left by the fact that the UCP did not regulate all important aspects of stand-by letters of credit. It was also pointed out that some jurisdictions had used a comparable technique in passing statutory enactments that permitted the applicable law to be supplanted by the UCP when the parties so chose. The reservations that were expressed about that proposal involved concerns over the propriety of referring in the uniform law to a set of contractual rules, rules that undoubtedly would be modified, the appropriateness of providing a technique resulting in the characterization of wholly domestic transactions as international, the danger of defeating the expectations of unsuspecting parties as to the applicable law, and the possibility of conflicts between the provisions of the UCP and of the uniform law. The necessity of such a provision was also questioned in view of the fact that parties were free to use subparagraph *(b)* to obtain applicability of the uniform law. Because of these considerations, the proposal in its present form failed to gain support. There was, however, a greater degree of sympathy for somewhat modified versions of the proposal. For example, it was proposed that any possibility of fulfilling the internationality requirement through a reference to the UCP should be limited to relationships between professionals. Such a limitation would be intended, in particular, to protect the interests and expectations of consumers attempting to obtain the issuance of suretyships rather than simple-demand instruments. It was also proposed to provide that the requirement of internationality could be met by a reference to internationally accepted rules or usages, which could be interpreted as including the UCP.

70. The Working Group next considered the merits of retaining subparagraph *(b)*, which provided that an instrument could meet the internationality requirement by merely calling itself international. The effect of this provision in broadening the scope of application of the uniform law was cited in support of retention. At the same time, the appropriateness of retaining the provision was questioned, in particular because it was felt to be inappropriate to describe a domestic intrument as international. There was also a concern that such a device for application of the uniform law to wholly domestic instruments might be regarded as an intrusion into the sphere of domestic legislation. However, there was substantial support for inclusion in the uniform law of a provision permitting parties to opt for the application of the uniform law, and this should be done in a straightforward manner, rather than through a provision on internationality. It was observed that such an "opting-in" provision might go some of the way in meeting the objectives of the proposal that application of the uniform law be triggered by a reference to internationally accepted rules.

Paragraph (2)

71. A question was raised as to whether paragraph (2) would have any continuing relevance following the selection of variant A in paragraph (1). It was noted that paragraph (2) had been included with a view primarily to the possibility that the Working Group would select variant B in paragraph (1), necessitating the inclusion of the guidelines in paragraph (2) for the determination of the relevant place of business or habitual residence of a party. While it was agreed that much of the rationale for the inclusion of paragraph (2) had fallen away with the disappearance of variant B, it was recognized that there might nevertheless be situations arising under variant A which would warrant the retention of the substance of paragraph (2). It was pointed out that the continued relevance of paragraph (2) might be assured because of the possibility that a guaranty letter might list two places of business for a party, for example, when a guarantor with multiple places of business issued a guaranty letter with its letterhead listing more than one place of business. Another observation was that, if paragraph (2) were to be retained, its formulation should remain essentially the same, since it was based on similar provisions that had successfully been incorporated in a number of international conventions and that were therefore widely accepted and understood.

72. In view of the foregoing, it was agreed that a final determination on paragraph (2) would have to be deferred to a later stage. The Secretariat was requested to prepare an alternative draft version that was geared to the future text of paragraph (1) based on variant A.

Chapter II. Interpretation

Article 5. Interpretation of this [Law] [Convention]

73. The text of draft article 5 as considered by the Working Group was as follows:

"*Version for Model Law:* In the interpretation of this Law, regard is to be had to its international origin and to the need to promote the observance of good faith in international guaranty and credit practice.

"*Version for Convention:* In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international guaranty and stand-by letter of credit practice."

74. It was noted that this article presented two versions, pending the decision of the Working Group on whether the uniform law should take the form of a model law or of a convention, and that a decision on which version to select would therefore have to be deferred until the decision on the form of the uniform law had been reached. It was agreed that the reference to "stand-by letter of credit practice", found in the convention version, was preferable to the reference simply to "credit practice", found in the model law version, and should be retained in both versions. It was suggested that a definition should be added to the uniform law of the term "stand-by letter of credit", the first mention of which appeared in the present article. That suggestion was accepted by the Working Group, which noted that a clearer picture of the terms that needed definition would emerge as work on the uniform law progressed.

Article 6. Definitions and rules of interpretation

75. The text of draft article 6 as considered by the Working Group was as follows:

"[For the purposes of this Law and unless otherwise indicated in a provision of this Law or required by the context:

(a) 'guaranty letter' includes 'counter-guaranty letter' and 'confirming guaranty letter,' and 'guarantor' includes 'counter-guarantor' and 'confirming guarantor';

(b) any reference to the terms of the guaranty letter or the undertaking of the guarantor is to the text as originally established in accordance with article 7 or, if later amended in accordance with article 8, to the text in its last amended version;

(c) where a provision of this Law refers to a possible agreement of the parties, the parties meant are the guarantor and the beneficiary of the guaranty letter in question and the reference is to any term of the guaranty letter or its amendment or to any separate agreement between the guarantor and the beneficiary.]"

76. Support was expressed for the rule of interpretation concerning the term "guaranty letter" in subparagraph *(a)*. It was suggested, however, that the provision should be expanded to include stand-by letter of credit terminology.

77. A view was expressed that the necessity and purpose of subparagraphs *(b)* and *(c)* was unclear. As to the content of subparagraph *(c)*, it was suggested that the use of the word "agreement" be reconsidered, since that term might unnecessarily raise the question of the contractual nature of the undertaking. A suggestion was made that subparagraph *(c)* might need to be reformulated in order to take account of the transferability of stand-by letters of credit and the resultant presence of more than one beneficiary. An observation was made that subparagraph *(c)* did not adequately reflect the complications that might arise when the confirmer of a stand-by letter of credit refused to agree to an amendment thereof.

78. It was proposed that a definition of "counter-guaranty letter" should be added, and that it should take into account the independence of the counter-guaranty letter not only from the underlying commercial transaction, but also from the guaranty letter issued by the beneficiary of the counter-guaranty letter. Suggestions for additional terms to be defined included "counter-guarantor" and "confirmation of guaranty letter".

Chapter III. Effectiveness of guaranty letter

Article 7. Establishment of guaranty letter

79. The text of draft article 7 as considered by the Working Group was as follows:

"(1) *Variant A:* A guaranty letter may be established by any means of communication that [itself] provides a record of the text of the guaranty letter.

Variant B: A guaranty letter may be issued in any form which preserves a complete record of the information contained therein [and is authenticated as to its source by generally accepted means or by a procedure agreed upon by the parties].

Variant C: The guaranty letter shall be issued by a means of communication that provides a record thereof, including by an authenticated teletransmission or equivalent electronic data interchange message.

"(2) *Variant X:* The guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt]. The guaranty letter becomes effective at that time, unless it states a different time of effectiveness [, by reference to a fixed date or to a determinable period of time,] or [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor on the basis of a document specified in the guaranty letter] [it makes its effectiveness depend on the

occurrence of a specified, uncertain future event, in which case the guarantor may require the beneficiary to certify that occurrence, unless the parties have agreed on another means of establishing that occurrence or its verification is within the purview of the guarantor].

Variant Y: Unless otherwise stated therein, a guaranty letter becomes effective and irrevocable when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt]."

80. The view was expressed that it would be preferable, from the standpoint of clarity, to place into separate articles the provisions on the form of establishment of a guaranty letter, presently contained in paragraph (1), and the provisions governing the time of establishment of the guaranty letter, which were presently in paragraph (2).

Paragraph (1)

81. As to the three variants of paragraph (1), one view favoured variant C because it specifically mentioned electronic and other paperless means of communication that were currently used in the issuance of guaranty letters. However, the widely prevailing view was that variant B should be selected. The primary ground for that choice was a perception that variant B contained the formulation that not only covered the currently used means of communication but also accommodated possible future developments. variant B was also said to be preferable because, unlike variant A, it required authentication and because it was clearer than variant C as to the required record. Particular reference was made to the need to make it clear that the uniform law did not embrace purely oral forms of issuance. Another observation was that additional clarity might be achieved by including in the uniform law a definition of "issuance".

Paragraph (2)

82. The Working Group next considered the two variants of a rule on the time of establishment and effectiveness of the undertaking embodied in the guaranty letter. It was noted that paragraph (2) contained three distinct terms addressing discrete issues relating to the existence and effect of the undertaking. The term "binding" was designed to refer to the existence of a commitment that could not be withdrawn and would, for example, entitle the guarantor to the agreed fee or charges. The term "irrevocability" referred to the firm character of an existing undertaking that could not be revoked; that term was not to be equated with the term "binding", since the notion revocation presupposed a binding undertaking. Finally, the term "effective" was designed to refer to the fact that the guaranty letter, either at the time of establishment or at a point subsequent thereto, is available for draw, i.e., open for making a demand for payment in conformity with the payment requirements.

83. As to the content of a rule on time, one view was that the guaranty letter would be established at the time of receipt by the beneficiary. Such a rule was said to have the benefit of giving guarantors the opportunity to withdraw or amend guaranty letters prior to receipt. The prevailing view, however, was in favour of the time of issuance, that is, when the guaranty letter leaves the guarantor's sphere of control.

84. In support of a rule based on issuance, reference was made to the inter-bank practice of sending guarantee and stand-by letter of credit messages through the S.W.I.F.T. network. It was pointed out that in such inter-bank practice establishment was deemed to take place upon release of the message. The certainty provided by a rule based on issuance, with no question of proof of receipt, was said to be necessary in order for banks to be able to carry out instructions for the issuance of guaranty letters without the risk that, after those instructions had been carried out, the original instructions would be withdrawn. Some hesitation was expressed as to the extent to which such a closed inter-bank network could shed light on the issues to be dealt with in the uniform law. It was suggested that different considerations might be relevant to a decision on establishment with respect to the beneficiary than those at play in inter-bank dealings, and that the resulting rules for the two sets of relationships might have to be different. Such a dual approach failed to generate substantial support in the Working Group, because of the concern that a dual rule would create considerable uncertainty. As had been the case at previous sessions of the Working Group, the prevailing view was that the establishment of the guaranty letter should be linked to issuance and not to receipt, and that there should only be one rule in this respect.

85. Having affirmed the rule of establishment upon issuance, the Working Group decided that the formulation of that rule in variant Y, in particular because of its relative simplicity, was preferable to that contained in variant X. As to the specific formulation of variant Y, it was proposed that the words "unless otherwise stated therein" should be deleted on the ground that such language was generally applicable to all non-mandatory portions of the uniform law. However, support was expressed for the retention of those words on the ground that they served not only an educational function but also constituted an essential reference to the possibility that the guaranty letter might contain conditions relating to the commencement of effectiveness and irrevocability at some point subsequent to establishment. It was noted that such a possibility had been set forth more explicitly in variant X and should be included in variant Y since stipulations on effectiveness were often found in practice.

86. Differing views were expressed as to the language between square brackets that provided that the guaranty letter would not take effect if the beneficiary rejected it promptly upon receipt. One view was that the language should be retained because it would permit the guarantor, in the event of a rejection, to have a clearer picture of its obligations than would be the case without the language. In particular, a guarantor would be able to remove a rejected guaranty letter from its books. It was suggested that the word "promptly" needed to be reconsidered in view of the variations in communications and other circumstances encountered from country to country. It was also suggested that reference should be made to "complete rejection" since it might otherwise be uncertain whether a beneficiary that protested the exact duration or amount of a guaranty letter was rejecting it in its entirety.

87. The prevailing view was that the language within square brackets should be deleted. One reason advanced in support of deletion was that the proviso injected an unacceptable degree of uncertainty in the determination of the time of effectiveness. Another reason was that the establishment of a guaranty letter was generally to the benefit of the beneficiary and that any objections on the part of the beneficiary would in all likelihood relate only to individual terms, in which case the beneficiary would request an amendment rather than reject the entire guaranty letter. In the unlikely case that the beneficiary indeed wanted to reject the entire guaranty letter, draft article 10 *(a)* or *(b)* would provide an appropriate way to achieve that result.

Article 8. Amendment

88. The text of draft article 8 as considered by the Working Group was as follows:

"(1) A guaranty letter may be amended in the form agreed upon by the parties or, failing such agreement, [in the form in which the guaranty letter was established] [in any form referred to in paragraph (1) of article 7]. [A party may be precluded by its conduct from asserting non-compliance with such form requirement to the extent that the other party has relied on that conduct.]

"(2) The amendment becomes effective, unless it states a different time of effectiveness,

Variant A: when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt].

Variant B: when it is issued by the guarantor, provided that the guarantor receives notice of the acceptance by the beneficiary within [ten] business days.

Variant C: when the guarantor receives notice of the acceptance by the beneficiary.

"(3) *Variant X:* The provisions of paragraphs (1) and (2) of this article do not excuse the failure of the guarantor to obtain the consent of the principal as may be required by the instructions of the principal or an agreement with the principal.

Variant Y: The provisions of paragraphs (1) and (2) of this article do not entitle the guarantor to invoke the amendment in support of any claim for reimbursement against the principal if the guarantor failed to obtain the consent of the principal as required by instructions of the principal or an agreement between the principal and the guarantor.

Variant Z: When issuing an amendment, the guarantor shall promptly dispatch a copy thereof to the principal."

Paragraph (1): Form of the amendment

First sentence

89. The Working Group considered the two alternative wordings placed between square brackets. It was recalled that a possible reason for requiring that the amendment be established in the form in which the given guaranty letter was established might be the consideration that the amendment modified in part that guaranty letter. However, the Working Group was agreed that such a requirement would be too restrictive in practice. The Working Group adopted the second wording that allowed any form referred to in article 7(1) and, in effect, only excluded purely oral communications unless otherwise agreed by the parties.

Second sentence

90. It was recalled that the sentence between square brackets was modelled on article 29 of the United Nations Sales Convention, pursuant to a proposal made at the fourteenth session (A/CN.9/342, para. 85). The view was expressed that the sentence might be useful in the situation where the parties had agreed on a specific form for amendments but later not complied with that requirement; subsequent conduct of a party might then preclude reliance on the non-compliance.

91. In response, it was stated that such a situation was more likely to arise in the context of a relationship between buyer and seller than in the context of a more limited and more formalistic guaranty operation. It was also stated that the provision of article 7(1) relied on a formalistic approach of the guaranty letter by requiring a record thereof. There might therefore be some contradiction in focusing on the conduct of the parties as regards the amendment of the guaranty letter. The view was also expressed that the principle contained in the sentence would most probably be applied by courts in all legal systems even in the absence of a specific provision.

92. After discussion, the Working Group decided to delete the sentence between square brackets.

Paragraph (2): Time of effectiveness

93. As regards the opening words, the view was expressed that it might be useful to distinguish clearly between an agreement of the parties in the amendment concerning the postponement of the time of its effectiveness and a previous agreement, probably contained in the guaranty letter, concerning the time of effectiveness of any future amendment.

94. As regards the proposed variants, the Working Group noted that while variant A embodied the concept of implied or silent acceptance, variants B and C required express acceptance. Variant B differed from variant C in that it did not use the time of receipt of the notice of acceptance as the point determining the time of effectiveness, as did variant C, but used for that purpose the earlier point of time of the issuance of the amendment, subject to timely receipt of the notice of acceptance.

95. The view was expressed that the rule on amendment should be parallel to the rule retained for the time of effectiveness of the guaranty letter itself. Another view was that the rule of variant A should be accompanied by the proviso that "the beneficiary, as long as it has not accepted the amendment, may rely on the terms of the unamended guaranty letter". That view was based on the consideration that a beneficiary should not be bound without acceptance.

96. Yet another view, based on the same consideration, was to require in each case an express acknowledgement

by the beneficiary, as provided for in variant C. Consideration should be given to including in the uniform law the principle, as found in draft article 10*(e)* of the proposed revision of the UCP, that an amendment would become effective only with the agreement of all parties bound by the undertaking, namely the issuer, the beneficiary and any confirmer. As regards the confirmer, it was, however, questioned whether its acceptance should be a condition of the effectiveness of an amendment as between the guarantor and the beneficiary.

97. Yet another view was that it might not be appropriate to include a general provision to the effect that notice of acceptance would need to be given by the beneficiary. It was observed that in practice the vast majority of amendments were made at the request of the beneficiary and very often consisted of an extension of the period of validity. Some other amendments related, for example, to the place or the currency of payment and were also often made at the request of the beneficiary. Where an amendment was based on a request by the beneficiary presented to the guarantor either directly or indirectly through the principal, the consent of the beneficiary should be presumed. It was stated in response that the time of effectiveness should not be made dependent on such uncertain and not easily verifiable criteria as whether the amendment originated from a request by the beneficiary and whether the amendment was in full conformity with that request.

98. Yet another view was that the rule expressed in variant A should apply to those situations where the amendment was in favour of the beneficiary while variant C should be retained only for the very few cases where the amendment was detrimental to the beneficiary. In response, it was recalled that the Working Group at a previous session had examined a proposal to prepare a dual set of rules depending on whether a given amendment was beneficial or detrimental to the beneficiary. As had been felt then, rules that involved subjective judgements were not easy to administer and did not provide the certainty required in practice. As an example, it was stated that it might be difficult to decide whether a change in the place or currency of payment would be favourable to the beneficiary.

99. In the light of the foregoing considerations, the Working Group searched for a solution that would provide certainty without compromising the beneficiary's interests, taking into account the fact that beneficiaries tended to remain silent in cases where amendments had been initiated by them or were otherwise in their favour. The Working Group focused its attention on the following two proposals.

100. The first proposal was to take variant B with the following modified proviso: "unless the guarantor receives a notice of rejection by the beneficiary within [10] business days". The second proposal was to take variant A for all those amendments that concerned an extension of the validity period of the guaranty letter and to take variant C for all other amendments.

101. In support of the first proposal, it was stated that it constituted a uniform rule for all types of amendment and provided a clear answer, for example, in the mixed case of an amendment that provided for an extension of the validity period and contained another modification as well. In support of the second proposal, it was stated that, unlike the first proposal, it implied or presumed acceptance by the beneficiary only in cases where the amendment was without doubt to its advantage. As to the query concerning the case of a mixed amendment, a clear answer could be obtained by refining the proposal so as to apply variant A to those cases where the amendment consisted solely of an extension of the validity period.

102. After discussion, the Working Group requested the Secretariat to prepare alternative draft provisions corresponding to the two proposals for further consideration at a later session.

Paragraph (3)

103. Divergent views were expressed as to the appropriateness of retaining paragraph (3), which addressed the relationship between the guarantor and the principal that was independent from the relationship established between the guarantor and the beneficiary. Doubts were expressed as to the need for including a provision in the uniform law to the sole effect of reminding the guarantor of its obligations to the principal in the context of an amendment of the guaranty letter. It was also noted that the provision did not provide for any sanction for failure to give notice under variant Z. It was further stated that it would not be appropriate for the uniform law to cover only a limited aspect of the relationship between the guarantor and the principal.

104. A contrary view was that the indirect link between the two relationships needed to be reflected in the uniform law. Support was expressed in favour of variant Y since it accurately reflected the indirect link between the two relationships and the fact that the amendment might affect the final obligation of reimbursement owed by the principal to the guarantor. Support was also expressed in favour of variant Z as it would add an element of certainty to the practice of amendments. The view was also expressed that both variants should be combined.

105. After discussion, the Working Group was agreed that variants Y and Z would be retained between square brackets for further consideration at a later session, when it would be clearer to what extent the uniform law would contain provisions concerning the relationship between the guarantor and the principal.

Article 9. Transfer of rights; assignment of proceeds

106. The text of draft article 9 as considered by the Working Group was as follows:

"(1) The beneficiary may not transfer its right to make a demand for payment under the guaranty letter,

Variant A: unless so authorized by the guarantor [, either in the guaranty letter or by separate consent in any form referred to in paragraph (1) of article 7].

Variant B: except where the guaranty letter was given for the purpose of securing the beneficiary against the non-performance of certain obligations by the principal and the right to claim performance from the principal has passed from the beneficiary to the intended transferee.

"(2) However, the beneficiary may assign to another person any proceeds to which it may be entitled under the guaranty letter. If the guarantor has notice of the assignment, only payment to the assignee discharges the guarantor from its liability towards the beneficiary."

107. It was noted that the draft article drew a distinction between the transfer of the rights to demand payment under the guaranty letter and the assignment of any proceeds that might be forthcoming by way of payment of the guaranty letter. It was recalled that that distinction had been agreed upon by the Working Group at an earlier session and that it was also drawn in the UCP and the draft URDG.

Paragraph (1)

108. It was noted that variant A limited the transferability of the right to demand payment under the guaranty letter to the case where the guarantor authorized such transfer, while variant B limited the right of transfer to those cases where the secured creditor under the underlying relationship changed, whether by assignment of the underlying contract or by operation of law. While variant B was said to have the advantage of providing certainty about the effect of such a change on the relationship between the beneficiary and the guarantor (by indirectly rejecting the notion of an automatic termination of the guaranty letter or of an automatic transfer of the beneficiary's rights), it was generally viewed as undermining the independent nature of the guaranty letter and as being contrary to the interest of the guarantor who did not want to be faced with an unknown and possibly unreliable beneficiary.

109. The Working Group thus agreed with the idea underlying variant A that a transfer of the right to demand payment under the guaranty letter should not be binding on the guarantor unless the guarantor had consented to the transfer. Various questions were raised as regards the concept of transfer and its authorization as embodied in variant A.

110. It was asked, for example, what sanction would apply in the case where a transfer had taken place without prior authorization by the guarantor and whether an unauthorized transfer might affect the validity of the undertaking. In response, it was stated that, for the purpose of the uniform law, an unauthorized transfer would be deemed not to have taken place and would not have any impact on the validity of the undertaking under the uniform law.

111. Another question was whether the necessary authorization had to be given before the transfer or whether it might be given at a later time, for example, until payment would be demanded from the guarantor. In the latter case, the guarantor would in effect have an option, by deciding on whether or not to consent to the transfer, to select between the (original) beneficiary and the (intended) transferee as the person entitled to demand and receive payment. It was agreed that the question should be clearly answered in the uniform law, probably in favour of a consent to be given prior to transfer.

112. In this connection, it was stated that while the current wording of variant A suggested that the transfer would be authorized by the guarantor and effected by the beneficiary, the practice of stand-by letters of credit was different. Stand-by letters of credit were often designated as transferable and, under the proposed revision of the UCP ("UCP 500"), the actual transfer could only be effected by the issuing bank itself or by an entity referred to as the transferring bank, either by re-issuing or by amending the stand-by letter of credit. Moreover, stand-by letters of credit frequently were transferable more than once and therefore did not meet the requirement contained in article 54 *(e)* of the UCP that transferable credits be transferable once only. A suggestion was made that specific wording should be included in the text of variant A to reflect that practice. Referring to guaranty letters, some representatives pointed out that it would be helpful to establish a rule stating that a guaranty letter should be transferable only once.

113. Yet another question was whether a transfer needed to relate to the whole amount or whether a partial transfer was allowed. It was noted that this and other questions were addressed in detail in article 54 of the UCP and in even greater detail in the proposed revision of the UCP. It was suggested that at least some of the questions addressed in the UCP might usefully also be dealt with in the uniform law.

114. After discussion, it was agreed to retain the substance of variant A and to request the Secretariat to prepare draft provisions on those additional questions that might usefully be dealt with in the uniform law, taking into account the difference in legal character of a law and of operational rules such as the UCP.

Paragraph (2)

115. The Working Group was agreed that the first sentence served a useful purpose in that it established a clear distinction between the transfer of the right to make a demand for payment and the mere assignment of proceeds under a guaranty letter.

116. Divergent views were expressed as regards the second sentence. One view was that the provision should be deleted as unnecessary; the uniform law should not attempt to regulate such matters as the effect of payment, which would be addressed by the relevant provisions of the law applicable to the discharge of obligations.

117. Another view was that the provision was useful in that it relieved the guarantor from the need to examine the validity of the assignment. The provision did not attempt to unify the disparate national laws on assignment, for example, by making notice to the guarantor a requirement of validity of the assignment. It rather limited itself to addressing the effect of an assignment known to the guarantor by providing that payment should be effected to the assignee and that such payment discharged the guarantor's liability towards the beneficiary. It was suggested that the second sentence should be maintained without the word "only" and with additional wording to the effect that it was subject to the provisions on set-off in article 20.

118. Yet another view was that the reality was more complex than suggested in the draft provision and that the second sentence should be rephrased to take into account such

questions as what would be the obligations of the guarantor regarding payment upon receipt of several assignment notices exceeding the amount of the guaranty letter. In this connection, it was suggested that, for practical reasons, the provision should not focus on the assignment between the beneficiary and the assignee but on an acknowledgement by the guarantor that would lay down how to proceed when payment is demanded.

119. After discussion, the Working Group requested the Secretariat to prepare draft provisions reflecting the above stated views for consideration at a later session.

Article 10. Cessation of effectiveness of guaranty letter

120. The text of draft article 10 as considered by the Working Group was as follows:

"The guaranty letter ceases to be effective, irrespective of whether [the instrument] [any document embodying it] is returned to the guarantor, when:

(a) the guarantor receives from the beneficiary a statement of release from liability [in any form referred to in paragraph (1) of article 7];

(b) the beneficiary and the guarantor agree on the termination of the guaranty letter;

(c) the guarantor pays the maximum amount stated in the guaranty letter or, if that amount has been reduced according to an express provision in the guaranty letter [for reduction by a specified or determinable amount on a specified date or upon presentation to the guarantor of a document specified for this purpose in the guaranty letter], the remaining balance;

or

(d) the validity period of the guaranty letter expires in accordance with the provisions of article 11."

Chapeau

121. There was general support for the retention of the rule in the opening words that the non-return of the guaranty instrument was irrelevant to the cessation of the effectiveness of the guaranty letter. The rule was considered useful because there still were a limited number of jurisdictions in which the expiry date appearing in a guarantee was considered to be a mere indication of the expected time for the completion of the underlying transaction and, accordingly, of the expected duration of the guarantee, rather than the point of time at which the guarantee could definitely be considered as losing its effectiveness. It was also pointed out that in some jurisdictions a distinction was made between the expiry date of the guarantee, before which the default covered by the guarantee had to occur in order for a demand for payment to be in order, and the prescription period under the applicable law for the making of a demand for payment under the guarantee.

122. A number of suggestions and views were expressed as to the exact formulation of that rule. One suggestion was that the rule should be patterned on draft article 24 of the URDG and, for the purposes of emphasis, placed in a separate provision. Another suggestion was that the matter might be limited to the expiry of the guaranty letter and therefore dealt with in article 11. Differing views were expressed as to whether, in the context of the return of the guaranty letter, reference should be made to the return of "the instrument" or of "any document embodying" the guaranty letter. The view was also expressed that the provisions of the uniform law, and in particular this provision, should indicate clearly whether they were of a mandatory or non-mandatory character. As to the latter comment, it was generally felt that the parties should be permitted to vary by agreement the rule on the effect of non-return of the instrument.

123. In the discussion of the rule on return of the instrument, reference was made to the dangers associated with the presence of instruments whose effectiveness has ceased. In particular, a concern was expressed that such instruments could, by giving the impression that they continued to represent a right to demand payment, serve fraudulent purposes. In order to counter that danger, it was proposed that the uniform law should, completely apart from the the question of the cause of cessation of effectiveness, require the return of the ineffective guaranty instrument by the person in possession of it. Reservations were expressed to that proposal on the ground that, once the events specified in subparagraphs *(a)*, *(b)*, *(c)* or *(d)* had occurred, there existed no longer a payment obligation under the guaranty letter. Moreover, the inclusion of such a requirement would be inconsistent with the rule on the irrelevance of the non-return of the guaranty letter since it would lend credibility to the notion that legal consequences were in fact attached to non-return of the instrument. A concern was also expressed that such a requirement would result in uncertainty as to the legal consequences of a failure to return the instrument. In response to the latter concern, it was suggested that a failure to return the instrument would, under general contract law, leave the party in possession responsible for the damages resulting from the non-return of the instrument.

124. As to the remaining language in the *chapeau*, a question was raised as to the precise meaning of the words "ceases to be effective". A suggestion in the same vein was that particular care needed to be taken to ensure that the terminology used in article 10 did not conflict with that used in article 7.

Subparagraphs (a) *and* (b)

125. The Working Group agreed to retain subparagraph *(a)* in its present form, including the reference to formal requirements for the statement of release. It was observed that the present formulation of subparagraph *(b)*, as well as of subparagraph *(a)*, did not take account of the fact that, in particular in the case of a transferable stand-by letter of credit, there might be more than one beneficiary in the life of a guaranty letter due to successive transfers. Furthermore, the simultaneous presence of more than one beneficiary could result under a stand-by letter of credit that provided for a splitting of the payment between two or more beneficiaries. It was suggested that, in order to take account of the possibility of multiple beneficiaries, a term such as the "current beneficiary" might be used. It was also suggested that the problem might be dealt with by a rule of interpretation in conjunction with the provisions on transfer.

126. A question was raised as to whether subparagraph *(b)* should be more precise as to the form of the termination agreement between the beneficiary and the guarantor by including the same type of reference to formal requirements as was contained in subparagraph *(a)*. In favour of the addition of such language, it was stated that the guarantor needed to have the termination in writing, in particular when the termination would result, as was often the case, in a reduction of the guarantor's security interest in the principal's assets. In favour of the existing text, it was stated that there was an advantage to having fewer formal requirements for the termination than for the establishment of a guaranty letter. For example, under the present text, the parties could agree orally to terminate the guaranty letter by way of the return of the instrument, with no additional formalities. After deliberation, the Working Group decided to add provisionally a reference to formal requirements similar to the one contained in subparagraph (a) and to review the question at a later stage.

Subparagraph (c)

127. The Working Group agreed with the basic premise of subparagraph *(c)*, in particular that cessation of the effectiveness of the guaranty letter should result when the guarantor had paid the amount available under the guaranty letter. At the same time, there was a widely held view that subparagraph *(c)* needed to be refined or elaborated. This view was based on the perception that the simple reference to payment by the guarantor of "the maximum amount stated in the guaranty letter" did not take adequate account of a previous partial payment and particular characteristics of some types of transactions, in particular certain types of stand-by letter of credit transactions, thereby causing anomalous results in those transactions. For example, in the case of a stand-by letter of credit that did not envisage partial drawings, if the single drawing permitted to the beneficiary was for less than the maximum amount, subparagraph *(c)* would not operate to terminate effectiveness.

128. It was suggested that the present formulation of subparagraph *(c)* was, for similar reasons, incapable of dealing with stand-by letters of credit that operated on a revolving basis. Such "revolving credits", which were based on commercial credit practice, provided, under the same credit, for a series of periods in which drawings up to a specified maximum amount were permitted, with a maximum cumulative amount. The rationale behind this practice was to provide coverage for a series of transactions without the need for repeated issuances of stand-by letters of credit. Such arrangements varied as to whether the unused drawing capacity from one subperiod could be carried over to the next subperiod, or whether, in such cases, the cumulative amount of the credit would be reduced by the unused amount. It was also suggested that some elaboration was needed in order to take account of the practice used by some issuers, at the point when a stand-by letter of credit had been drawn down, of amending the credit so as to increase the amount. As in the case of revolving credits, this practice was intended to avoid multiple issuances of credits.

129. A number of suggestions of a drafting nature were made with a view to dealing with the above problems. One suggestion was to refer to the guaranty letter as not having been "renewed or renewable" or to include some other specific language to cover the cessation of effectiveness in special cases such as revolving credits. Another suggestion was to delete the word "maximum". Yet another suggestion was to refer simply to the payment of the maximum amount "available" under the guaranty letter. A further suggestion was to refer to the cessation of effectiveness when the "stipulated amount is paid".

130. As to the reference in subparagraph *(c)* to clauses in the guaranty letter for the reduction of the amount, a view was expressed that the uniform law should present, either in article 2 or, perhaps, in article 10, a more elaborate provision on the reduction of the amount of the guaranty letter. It was stated that reduction clauses were often characterized by an insufficient degree of detail or clarity and that, as a result, such clauses gave rise to a high number of disputes. Support for that view was limited on the ground that the problem was less likely to arise under the uniform law since clauses on reduction mechanisms in instruments falling within the scope of the uniform law would operate on a documentary basis and that therefore no additional language in the uniform law was necessary. Another objection to the inclusion of additional details on reduction clauses was the difficulty of assigning legal consequences to the failure to comply with requirements that would be set forth in the uniform law as to reduction mechanisms. In response to that objection, it was stated that the uniform law could provide that, in cases of non-compliance, the reduction provision would be stripped of its effect, and the guarantor would be justified in paying the entire amount.

131. The view was expressed that subparagraph *(c)* should refer to payment in a specified currency, in view of the risks posed by exchange rate fluctuations.

132. After deliberation, it was decided to request the Secretariat to review the precise formulation of subparagraph *(c)* with a view to reflecting the deliberations of the Working Group.

Subparagraph (d)

133. The Working Group adopted subparagraph *(d)* unchanged.

Article 11. Expiry

134. The text of draft article 11 as considered by the Working Group was as follows:

"(1) The validity period of the guaranty letter expires:

(a) at the expiry date [, which may be a specified calendar date or the last day of a fixed period of time stipulated in the guaranty letter];

(b) if expiry depends according to the guaranty letter on the occurrence of an event, when the guarantor receives confirmation that the event has occurred by presentation of the document specified for that purpose in the guaranty letter [or, if no such document is specified, a statement of the beneficiary or other conclusive evidence of the occurrence of the event].

"(2) If the guaranty letter states neither an expiry date nor an expiry event or if a stated expiry event has not yet been established, the validity period expires [five] years after the establishment of the guaranty letter, unless the parties agree on an extension of the validity period."

Paragraph (1)

Subparagraph (a)

135. Wide support was expressed for the retention of the draft subparagraph, including the text between square brackets.

136. A concern was expressed regarding the situation where a counter-guaranty letter carried the same expiry date as the guaranty letter issued by the beneficiary of the counter-guaranty letter. While recognition of the independent nature of the two undertakings would normally lead to the conclusion that there could exist no link between the validity periods of the two instruments, it was suggested that the difficulties that were likely to arise in practice might call for a specific rule. Where a demand for payment was presented under the guaranty letter on the last day of the validity period of the guaranty letter, it would be impossible for the guarantor, in most instances, to present a demand to the counter-guarantor before the counter-guaranty letter had expired.

137. A view was expressed that, in this case, the guarantor had the possibility to make a conditional demand for payment under the counter-guaranty letter on the last day of validity of the counter-guaranty letter. That view was objected to on the ground that, in some jurisdictions, such a conditional or preventive call would be regarded as unfounded or abusive. Some support was given to the suggestion that the uniform law should provide for a limited extension of the validity period of the counter-guaranty letter beyond the expiry of the validity period of the guaranty letter; that extension, referred to as a period of grace, should be limited to the two or three days that would be necessary for the guarantor to present its demand to the counter-guarantor.

138. The contrary view was that the situation where the two instruments had the same date of expiry would be a consequence of an error or careless drafting and that it would not justify an exception to the principle of independence of the undertakings. After discussion, the Working Group was agreed that no exception should be made to the independent character of the guaranty letter.

139. In connection with the above discussion, the Working Group decided that a definition of the counter-guaranty letter should be included in the uniform law to make it clear that the counter-guaranty letter was as independent as any other guaranty letter and that it was not to be confused with any underlying obligation that might arise from an inter-bank indemnity or reimbursement agreement.

140. A suggestion was made to include in article 11 a provision to the effect that, should the validity period of the guaranty letter expire on a holiday, the validity period would be extended to the following business day. The Secretariat was requested to prepare a draft provision implementing that suggestion for consideration at a later session.

Subparagraph (b)

141. It was observed that, in subparagraphs *(a)* and *(b)*, expiry through the passage of time and expiry upon the occurrence of an event were presented strictly as alternatives. It was pointed out, however, that in practice often a combined approach was used in that the guaranty letter contained an expiry date, but at the same time provided for expiry prior to that date upon the occurrence of a specified event. In order to accommodate that practice, it was suggested that the uniform law should reflect the possibility of combining the approaches contained in subparagraphs *(a)* and *(b)*.

142. The view was expressed that the notion embodied in subparagraph *(b)* of an expiry of a guaranty letter upon the occurrence of an event was inappropriate. According to that view, the notion of expiry of the guaranty letter was properly linked to the passage of time, rather than to the occurrence of an event. The appropriate place for dealing with the issues raised in subparagraph *(b)* was said to be in subparagraph *(a)* or *(b)* of article 10, which dealt with the termination of the effectiveness of the guaranty letter. For example, it was suggested that the statement by the beneficiary referred to in subparagraph *(b)* might be considered to fall into the category of a release by the beneficiary as provided for in article 10*(a)*. Along the same lines, it was suggested that the reference in subparagraph *(b)* to the occurrence of an event, aside from raising the danger of non-documentary conditions, was superfluous since, in a documentary instrument, it was not the occurrence of an event that was critical, but the presentation of a document. In response to the latter point, it was pointed out that the documentary guaranty letter would nevertheless refer to the occurrence of an event, albeit one the occurrence of which would be conclusively evidenced by a document.

143. Some of the same issues were raised in the discussion of whether to retain the text in square brackets, which indicated that, when the guaranty letter failed to specify the document to be submitted, the occurrence of the expiry event could be evidenced either by a statement from the beneficiary or by some other conclusive evidence. In particular, it was suggested that the retention of the language in question, which raised the spectre of non-documentary conditions, was inconsistent with the decision that the focus of the uniform law should be on instruments that bore only documentary conditions. The view was expressed that, were the language to be retained, its applicability to stand-by letters of credit would have to be specifically excluded.

144. Support was expressed for retention of the language in question on the ground that practice showed a significant degree of use, in guarantees as well as in stand-by letters of credit, of expiry-event clauses that did not specify the presentation of a particular document. It was suggested that, in the face of that practice, not recognizing such clauses in the uniform law would create uncertainty as to the law applicable to a significant number of instruments. It was further suggested that recognition of such a practice would not be inconsistent with a focus in the uniform law on documentary undertakings because non-documentary conditions relating to expiry could be distinguished from non-documentary conditions relating to payment. That distinction did not receive universal support, however, as it

was pointed out that the presence of a non-documentary condition as to expiry could force the guarantor to engage in an investigation of some sort.

145. A number of points were made and differing views expressed with regard to the proposition that a statement from the beneficiary or some other conclusive evidence as to the occurrence of the expiry event could be relied upon by the guarantor when no document was specified. It was suggested that, since it could be assumed that the issuance of such a statement would not be in the interest of the beneficiary, the reference to the beneficiary's statement was of limited value. It was also suggested that entrusting the beneficiary with the decision as to the expiry of the guaranty letter in such a manner would raise the possibility of a fraudulent call by a beneficiary that, rather than issuing the statement after the occurrence of the expiry event, made a demand for payment. In response to those observations, it was pointed out that, precisely because the expiry of the guaranty letter was not in the beneficiary's interest, the beneficiary's statement could be considered the most reliable evidence of the occurrence of the expiry event.

146. Reference was also made to the use in practice of guarantees which provided that evidence of the occurrence of the expiry event was to be provided by the principal. The Working Group was informed that such guarantees rarely raised any difficulties, if for no other reason than that principals were typically not in a position to present evidence of the occurrence of the event (e.g., completion of construction) prior to the expiry date specified in the guarantee. It was noted that subparagraph *(b)*, in particular through its reference to "other conclusive evidence", opened the door to the presentation by the principal of evidence of the occurrence of the expiry event. However, conferring the right on the principal to trigger the expiry of the guaranty letter in such a fashion was questioned on the ground that, at least from the standpoint of the beneficiary, it would diminish the value of the guaranty letter as an independent undertaking.

147. The Working Group went on to note that the words "conclusive evidence" were not meant to refer to clauses containing similar wording that were used in some settings to identify documents that parties agreed would be sufficient proof of the occurrence of an event. As to whether the use of those words was appropriate, the view was expressed that they were unacceptable on the ground that it might suggest that the proper role of the issuer of a guaranty letter went beyond the mere checking of documents for facial compliance. However, support was expressed for the retention of the reference to other conclusive evidence that satisfied the guarantor, on the ground that it afforded a necessary degree of protection to the principal.

148. After deliberation, the Working Group decided, pending further review, to retain subparagraph *(b)* in its present form, including the continued retention in square brackets of the reference to non-documentary provisions on expiry events.

Paragraph (2)

149. There was general agreement with the basic proposition of paragraph (2), namely that the uniform law should provide for a maximum period of validity for guaranty letters that do not state an expiry date, in particular because a rule on this issue was considered necessary to provide legal certainty. No objections were raised to setting that period at five years.

150. Several observations were made as to the precise formulation of the rule. One observation was that it was imperative that the rule should not be cast in terms of a prescription period, as this might preclude renunciation prior to the expiry of the five-year period. Another observation was that the reference to the extension of the validity period by the agreement of the parties would have to be aligned with the text that would finally be agreed upon for amendment of the guaranty letter, in particular under article 8(2). A further observation was that, by making reference to the occurrence of an expiry event, paragraph (2) raised the same issue of non-documentary conditions that had been discussed in connection with paragraph (1)*(b)*.

151. The attention of the Working Group was drawn to the fact that there were cases in which the parties intended that a guarantee should be of indefinite duration, and that such arrangements were sometimes used in response to administrative requirements, for example, when the beneficiary was a State involved in a transaction of indefinite duration. Reference was also made to instruments containing "evergreen clauses", which provided, upon expiry, for the repeated, automatic extension of the period of validity, an indefinite number of times, with the possibility of termination upon notice. Such instruments were distinguished, however, from guarantees that contained no expiry provision or that expressly referred to indefinite validity.

152. There was support for the view that a degree of flexibility needed to be injected into the present formulation so as to accommodate cases in which it was the intent of the parties to establish an indefinite validity period. The Working Group noted that various approaches were found in legal systems as to the question of indefinite duration of a guarantee, with some legal systems permitting indefinite validity on the basis of silence in the guarantee on the question of expiry, and others requiring an express clause in the guarantee as to indefinite validity; it was stated that, should any of these approaches be taken, an exception would need to be made for stand-by letters of credit. A consensus was reached that the uniform law should follow the latter approach, namely, that the five-year limit in paragraph (2) would apply, unless otherwise expressly stated in the guaranty letter. It was observed, at the same time, that the proposition that a party could not be bound indefinitely without the possibility of renunciation was universally recognized and that the modification of paragraph (2) should not be seen as supervening that basic principle.

Chapter IV. Rights, obligations and defences

Article 12. Determination of rights and obligations

153. The text of draft article 12 as considered by the Working Group was as follows:

"Subject to the provisions of this Law, the rights and obligations of the parties are determined by the terms

[and conditions] set forth in the guaranty letter, including any rules, [general] conditions or usages referred to therein."

154. The Working Group noted that the word "general" had been added to the text adopted at the fourteenth session (A/CN.9/342, para. 48) with a view to distinguishing more clearly between the conditions incorporated into the guaranty letter by way of reference and the individual conditions set forth in the guaranty letter, mentioned earlier in the text of this article.

155. A concern was expressed that the opening words of the article, at least in the French language version, might be interpreted as conferring a mandatory character on the provisions of the uniform law. In response, it was stated that those opening words were not intended to take a stand as to the mandatory character of the provisions of the uniform law. The wording as found in the English language version had been used in previous international instruments and was commonly interpreted as meaning that, where the uniform law contained provisions of a mandatory nature that would conflict with the stipulations of an individual agreement, those mandatory provisions would be applicable notwithstanding the contrary stipulations of the agreement. Similarly, the suppletive provisions of the uniform law would apply in the absence of an agreement by the parties on the matters regulated by those provisions. It was agreed that the text, in its various language versions, should be reviewed so as to prevent any misinterpretation.

156. As regards the extent to which commercial usage might govern the rights and obligations under a guaranty letter, the Working Group noted that the current draft only mentioned the usages that were referred to in the text of the guaranty letter. The view was expressed that rules and usages commonly used in international commercial practice, in so far as they did not conflict with mandatory provisions of the uniform law, should also be made applicable to the guaranty letter through article 12 even if they were not referred to in the guaranty letter.

157. The Working Group recalled that the question of the relevance of international usages had been discussed at the fourteenth session on the basis of the following variant of what was then article 6(1):

"Subject to the provisions of this Law [and of any other applicable law], 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 [, 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]."

158. At the fourteenth session, divergent views had been expressed in respect of the bracketed reference to international usage at the end of the paragraph. One view had been that the wording should be retained since it would accommodate those jurisdictions that gave effect to the UCP or the Incoterms even if not referred to in the guaranty letter and since relevant international usages provided a useful or even necessary source for determining the rights and obligations of the parties and for interpreting the terms and conditions of the guaranty letter. The prevailing view, however, had been that the reference to international usages should not be retained since it created uncertainty and might provide a trap to unwary parties (A/CN.9/342, para. 47).

159. The Working Group resumed its discussion of the issue. The proponents of the divergent views advanced the following reasons, in addition to those presented at the fourteenth session. In support of requiring a reference in the guaranty letter, it was stated that usage and practice were of little significance once a law was enacted that itself was built on prevailing usage or practice. Moreover, it would seem to be unjustified to impose rules of usage or practice on parties that had not availed themselves of the option of referring in the guaranty letter to any rules of usage or practice.

160. In support of not requiring a reference in the guaranty letter, it was stated that no uncertainty would result since the only relevant international usage in the field of bank guarantees and stand-by letters of credit were the draft URDG and the UCP that reflected widely known and accepted practices. Furthermore, a mention in the uniform law of the general applicability of international usage would merely confirm existing case law in some jurisdictions, while in others it would provide national courts with the necessary guidance to address those situations where a solution had to be found outside the stipulations of the guaranty letter and the provisions of the uniform law. Reference to international usage would therefore create unity and certainty.

161. An intermediate view was that usages that were not referred to in the guaranty letter might be made applicable to the interpretation of terms and conditions used in the guaranty letter.

162. With reference to the practices concerning an international guaranty letter, it was stated that a large number of parties might be involved that might reside in different countries and refer to different local practices, for example, as regards the time and modalities for payment, or the methods used by the guarantor to decide whether a demand for payment was proper or not. It was pointed out that reference to practice inherently involved a degree of uncertainty and that, in any event, relevant practices would be difficult to prove. In that connection, a proposal was made to provide in the draft article that the international usage should be "expressly" described in the guaranty letter, in the sense that the usage should be specified. It was added that the obligation to expressly describe the usage should not be misinterpreted as precluding a court from referring to well-known usages such as the UCP where no answer was provided by the guaranty letter itself or by the uniform law.

163. The Working Group then considered the legal value of usages that were not mentioned in the guaranty letter in comparison with the suppletive provisions of the uniform law. One view was that any applicable usage not referred to in the guaranty letter should have the same legal value as if it were referred to in the guaranty letter and thus

displace, or prevail over, any suppletive provision of the uniform law. Another view was that any applicable usage not referred to in the guaranty letter should be accorded a lower status than any incorporated rules of usage and thus merely supplement the suppletive rules of the uniform law.

164. After deliberation, the Working Group requested the Secretariat to add to article 12, for consideration at a future session, alternative wording between square brackets, taking into account the above views on the relevance and legal value of international usages not referred to in the guaranty letter.

Article 13. Liability of guarantor

165. The text of draft article 13 as considered by the Working Group was as follows:

> "[The guarantor shall act in good faith and exercise reasonable care as required by good guaranty and credit practice.] Guarantors [and instructing parties] may not be exempted from liability for their failure to act in good faith or for any [grossly negligent conduct] [act or omission done either with the intent to cause damage or recklessly and with the knowledge that damage would probably result]."

First sentence

166. Comments were made about several components of the standard of care set forth in the first sentence. As regards the reference to "good faith", it was observed that, in understanding that reference, the distinction had to be kept in mind between the contractual freedom of the parties to define the performance expected from the guarantor and the execution of that performance in good faith by the guarantor. It was also suggested that, from a practical standpoint, it would in some cases be difficult to determine what constituted good faith conduct on the part of the guarantor because of conflicting interests of the principal and the beneficiary.

167. It was noted that the duty to exercise reasonable care set forth in the first sentence of article 13 was reflective of draft article 15 of the URDG and, as regards the examination of documents for facial conformity with the terms of a documentary credit, of article 15 of the UCP. A question was raised as to the relationship between that type of duty to exercise reasonable care in the examination of documents and the notion of exemption of responsibility for the genuineness or legal effect of documents, as that notion was embodied in article 17 of the UCP. It was suggested that the mainstream view on this question was that the scope of the documentary examination was limited to ascertaining, with reasonable care, the conformity of documents with the documentary requirements set forth in the letter of credit.

168. It was reported that in many instances guarantors had, due to the business needs of principals, little choice but to incorporate terms and conditions into guarantees that were not of their own choosing and that this needed to be taken into account when considering the notion of reasonable care on the part of the guarantor. Reference was also made to different approaches to the taking up of and payment against documents. It was said that letters of credit tended to be more uniform in defining clearly the documents to be presented and in requiring strict documentary compliance, whereas there was a greater tendency in guarantee practice to define the contents of required documents in a looser fashion since the types of documents needed for default instruments were not yet standardized. The view was expressed that that distinction should be kept in mind during the preparation of the uniform law.

169. As regards the reference to "good guaranty and credit practice", the view was expressed that the reference was useful because it served to narrow the focus of the reasonable care standard to the particular domain of guarantees and stand-by letters of credit and to foster reliance on good banking practice. However, questions were raised as to the meaning and necessity of such a reference, in particular because of a concern that it was vague and might give rise to the same type of uncertainty that had been dicussed in connection with the reference in article 12 to "usages". In particular, it was pointed out that the definition of good guaranty and credit practice might differ depending upon the type of instrument in question as well as on the local law and practice. A suggestion was made that the reference to good guaranty and credit practice might be deleted, bearing in mind that, even in the absence of such a reference, courts would look to practice in order to measure the sufficiency of the guarantor's conduct. Another proposal was that an adequate level of certainty could be achieved by referring instead to the guarantor's duty to exercise reasonable care "in the discharge of its obligations under the guaranty letter".

Second sentence

170. Differing views were expressed as to whether the uniform law should permit guarantors to exempt themselves from liability for failure to act in good faith or to exercise reasonable care. One view was that article 13, which permitted exemptions for conduct in good faith not amounting to gross negligence, should be modified so that no exemptions at all would be permitted. In support of that view, it was stated that permitting exemptions for simple negligence would create an imbalance of the obligations of the parties and an opportunity for a strong party to dictate terms unfavourable to another party, particularly when one of the parties was not habitually involved in international trade. In particular, it was suggested that the interests of the principal would not receive adequate protection if there was room under the uniform law for the guarantor to act in other than a prudent manner. It was added that a certain limitation of liability might nevertheless be achieved by a narrow description of the guarantor's obligations under the guaranty letter or by a restriction of liability to foreseeable damages.

171. The other view, however, was that the current approach in article 13 should be retained, in particular because it preserved the contractual freedom of the parties to define what the conduct of the guarantor should be. It was suggested that such an approach would be in line with the general tendency in the law to give effect to contractual exemptions except for grossly negligent conduct. It was also stated

that exemptions should be permitted because the transactions in question typically involved banks and commercial parties, and not consumers. It was further suggested that providing for exemptions benefited commerce by permitting parties, when they so wished, to agree to a reduction in the liability of the guarantor, thereby making possible lower-cost instruments. An intermediary view supported in principle the approach in article 13 but advocated a higher standard of mandatory liability in respect of the responsibilities of the guarantor under article 16. If the rule permitting exemptions were to be retained, a clear preference was expressed for the term "grossly negligent conduct" over the wording modelled on article 8(1) of the Hamburg Rules.

172. It was noted that the duties of a guarantor differed depending upon the relationship in question and that the question of the relationships to be covered by the liability provision could be considered in the light of provisions imposing duties on the guarantor towards different parties. This could be seen, for example, in the UCP which established different duties on the part of the issuer to different parties. For example, article 17 of the UCP was particularly relevant to the relationship between the issuer and the principal, article 18 of the UCP to the relationship of the issuer to both the principal and the beneficiary, and article 19 of the UCP perhaps more to the relationship with the beneficiary. It was suggested that a similar breakdown could be found in the draft URDG, as well as in the description of a guarantor's duties set forth in general conditions governing a guaranty letter. It was suggested that, because of these different duties and parties involved, consideration might be given to applying different liability rules to the different relationships involved, with the further possibility of rules for liability of the guarantor prior to issue being distinct from rules governing liability after issue. This would, for example, allow guarantors and principals to agree on a lower standard than would apply to the guarantor's relationship with the beneficiary. In favour of establishing one standard to govern all relationships in question, reference was made to the increasing frequency with which parties involved in undertakings of a documentary character acted in multiple capacities, in that banks often were in the position of beneficiaries tendering documents, acted as instructing parties or principals, and might be regarded as account parties of confirming banks.

173. It was noted that, while mention of the instructing party was made in the second sentence, no such mention appeared in the first sentence. The reason for not referring to the instructing party in the standard of care set forth in the first sentence for the performance of obligations under the uniform law was that the uniform law, in its present form, did not make any specific reference to obligations of an instructing party. Mention of the instructing party was made in the second sentence, however, because that sentence established a minimum or unbreakable standard of liability for all obligations under the guaranty letter, irrespective of the source of those obligations. The need for including a reference to the instructing party was questioned on the ground that it was not the usual practice for instructing parties to seek exemptions of the type permitted under the second sentence. The view was expressed, however, that including instructing parties within the ambit of article 13 would be useful, for example, to address the possibility that the conduct of the instructing party might be responsible for delay in the issuance of a guaranty letter and to cover the possible breach of other obligations that were imposed on instructing parties by draft articles of the URDG or the UCP.

174. A question was raised as to the interaction of the rule on liability set forth in article 13 with related provisions in the UCP and the draft URDG, either of which might be incorporated in the guaranty letter pursuant to article 12. It was noted that the approach in the present version of article 13 differed somewhat from the approaches taken in those two sets of rules and, furthermore, that the UCP and the draft URDG differed from each other. In the UCP, articles 17 through 20 exempted the issuer from liability on a wide variety of points such as genuineness, falsification and legal effect of documents, delay or loss in transmittal of documents, and the utilization of the services of other banks. The draft URDG exempted guarantors and instructing parties as to the same types of questions, but differed from the UCP in that the exemption did not apply, according to draft article 15 of the URDG, to failures to act in good faith and with reasonable care. Unlike the draft URDG, the UCP did not generally preclude exemptions in the case of negligence. Accordingly, a guaranty letter incorporating the URDG as currently drafted would not be affected by article 13 of the uniform law since the draft URDG contained a stricter standard as to exemption. By contrast, were a guaranty letter to be issued subject to the UCP, article 13 would, in the case of gross negligence, come into play to restrict the broad exemptions contained in the UCP.

175. After deliberation, the Working Group requested the Secretariat to prepare, in the light of the above suggestions and observations, a revised draft of article 13, including alternative versions of a rule on exemption from liability.