

MEMORANDUM

TO: ULC Executive Committee

FROM: Edwin E. Smith, Chair, the Committee to Implement the UN Convention on Independent Guarantees and Stand-by Letters of Credit

CC: Professor H. Kathleen Patchell, Division Chair
Professor James J. White, Reporter

DATE: June 1, 2009

SUBJECT: Report from the Committee to Implement the UN Convention on Independent Guaranties and Stand-by Letters of Credit

The Committee (“the Committee”) to Implement the UN Convention on Independent Guarantees and Stand-by Letters of Credit (the “Convention”) will be presenting the report of its work to the Uniform Law Commission at the 2009 annual meeting in July. The report will consist of (a) a draft letter of transmittal from the State Department to Congress, (b) a summary of the Convention and suggested “understandings” relating to the Convention to be considered by Congress in connection with the adoption of the Convention, (c) a more detailed commentary of the Convention in comparison to Article 5 of the Uniform Commercial Code dealing with letters of credit and (d) a draft of legislation that Congress may wish to consider to implement the Convention in the United States as part of the adoption of the Convention by the United States.

Given the confluence of the rules of the Convention with the provisions of Article 5, the work of the Committee over the last year has consisted primarily in determining how best for the United States to implement the Convention consistent with Article 5. The Committee discussed one approach that it was considering for implementation in its memorandum dated December 16, 2008, a copy of which is attached. After further consideration, the Committee is now recommending a more simplified implementation approach through federal legislation. This memorandum explains that approach and the reasons for it.

Approach

The Committee is recommending federal implementing legislation that addresses choice of law. The legislation would be suggested to be enacted by Congress in connection with the Senate’s advice and consent for the ratification of the Convention.

The federal implementing legislation would coordinate the provisions of the Convention with state law, especially Article 5, in a way that would be transparent for users of letters of

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credit. The proposed legislation accomplishes this objective in two ways. First, the proposed legislation would clarify choice of law issues for letters of credit that state that they are governed by either the Convention or by the law of a particular state. If a letter of credit states that it is governed by the Convention, then the law of the Convention would apply. If a letter of credit states that it is governed by the law of a chosen state, then the law of that state, in particular Article 5, would apply. Second, the proposed legislation would implement the Convention by validating the right of parties to choose the law of the Convention to govern their letter of credit or, if the letter of credit does not state a governing law, by implementing the Convention through the Official Text of Article 5. However, in the two instances noted in the legislation in which the Convention varies from Article 5, dealing with so-called “perpetual” letters of credit and the issuer’s rights of setoff, the Convention would govern and not Article 5 or other state law.

Most letters of credit currently issued by banks in the United States do not contain a governing law clause. They typically state merely that they are subject to the Uniform Customs and Practices for Documentary Letters of Credit or to the International Standby Practices. Accordingly, for those letters of credit the Official Text of Article 5, as modified in the two instances noted, would be the law that implements the Convention. Both Article 5 and the Convention permit a letter of credit to be subject to the terms of the Uniform Customs and Practices for Documentary Letters of Credit or the International Standby Practices and thereby to modify the provisions of Article 5 and the Convention.

Reasons for the Approach

The approach for implementing the Convention recommended by the Committee is a middle ground between two other contrasting approaches: self-execution and pre-implementation. Under the self-execution approach, the Convention would replace Article 5 for letters of credit within the scope of the Convention, creating a body of federal law that would parallel the provisions of Article 5. Under the pre-implementation approach the Convention would be implemented through state law, particularly Article 5 as already in effect in all states and the District of Columbia.

Each of the self-execution and pre-implementation approaches has advantages and disadvantages. The self-execution approach would not require federal or state implementing legislation. However, the text of the Convention would supplant the text of Article 5 as enacted by the states, even though the outcomes would largely be the same in all material respects. The pre-implementation approach would respect state law, in particular Article 5, but would run the risk that a foreign party to a letter of credit that wished for the letter of credit to be governed by the text of the Convention would be not be confident that Article 5 would produce the same outcome as under the text of the Convention. Moreover, under the pre-implementation approach, the provisions of the Convention, dealing with perpetual letters of credit and the issuer’s rights of setoff, or conflicting with terms of a particular state’s Article 5 that departed from the Official Text of Article 5, would need to be self-executing even if the rest of the Convention was not. The combination of self-execution in part and pre-implementation in part would be a technique never used before by the United States in implementing a commercial

treaty.

The approach recommended by the Committee for the proposed federal legislation preserves the advantages of the self-execution and pre-implementation approaches while avoiding their disadvantages. Under the proposed federal legislation, parties that wish for a letter of credit to be governed by the text of the Convention may do so, and parties that wish for their letters of credit to be governed by the Article 5 of a particular state may likewise do so. These provisions validate the freedom of parties to a letter of credit to chose for the letter of credit to be governed by the text of the Convention or to “opt out” of the Convention, as permitted by the Convention, so that the Article 5 of a particular state may govern the letter of credit.

However, when a letter of credit is silent as to its governing law, the provisions of the Official Text of Article 5, including its choice of law rules, would apply, as modified by the provisions of the Convention dealing with perpetual letters of credit and the issuer’s setoff rights. Under the choice of law rules of the Official Text of Article 5, a letter of credit issued from the United States will be governed by the substantive provisions of the Official Text of Article 5. And, if the letter of credit states that is subject to the Uniform Customs and Practices for Documentary Letters of Credit or the International Standby Practices, the Uniform Customs and Practices for Documentary Letters of Credit or the International Standby Practices would modify substantive provisions of the Official Text of Article 5, consistent with both Article 5 and the Convention.

The approach has the advantage of preserving state law as a means of implementing the Convention when the parties do not select a governing law for a letter of credit issued from the United States. It does so through federal legislation that adopts the Official Text of Article 5 but modifies it slightly as a matter of federal law to take into account the perpetual letter of credit and issuer setoff provisions of the Convention. It also respects the ability of the parties further to modify the terms of a letter of credit by incorporating the terms of the Uniform Customs and Practices for Documentary Letters of Credit or the International Standby Practices even if a governing law is not stated in the letter of credit.

The Committee is not recommending any changes to the Official Text of Article 5 to conform the Official Text to the provisions of the Convention dealing with perpetual letters of credit and the issuer’s rights of setoff. The Committee felt that these provisions were of little practical importance for issuers and users of letters of credit and that the benefits of technical amendments, to be promulgated by both the Uniform Law Commission and the American Law Institute and adopted on a state by state basis, were not of such significance as to merit that effort.