

## LETTER OF SUBMITTAL

Dear,

Herewith I submit for your consideration and for submission to the Congress the United Nations Convention on Independent Guarantees and Standby Letters of Credit. Accompanying this letter is a description of and commentary on the Convention. That Commentary compares each of the Articles of the Convention to existing American law (principally Article 5 of the Uniform Commercial Code).

Also attached is the draft of a proposed Act that could be used as a model for legislation to implement the Convention by the Congress. Federal implementing is recommended to coordinate the provisions of the Convention with state law, especially Article 5, in a way that would be transparent for users of letters of credit. The proposed Act accomplishes this objective in two ways. First, the proposed Act clarifies choice of law issues for the letters of credit that state they are governed by either the Convention or by the state law. If a letter of credit states that it is governed by the Convention, then the law of the Convention applies. If a letter of credit states that it is governed by the law of state, then the law of that state, in particular Article 5, applies. Second, the proposed Act implements 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 which the Convention varies from Article 5, the Convention governs and not Article 5 or other state law.

The Convention was adopted by the United Nations General Assembly in 1995; it became effective in 2000 and has since been ratified by six countries. The United States signed the Convention on 11 December 1997. The United Nations Commission on International Trade Law produced the Convention after five years of work. American letter of credit experts were involved in the drafting process at every stage.

While the United States has an elaborate body of statutory law on letters of credit in the form of Article 5 of the Uniform Commercial Code, the Convention is the first international codification of law with respect to letters of credit. The Convention deals principally with the form of letters of credit known as “standby letters” that are known in international practice as “independent guarantees.”

The main virtue of the Convention from an American point of view is that it will make standby letter of credit law more reliable for transactions that are governed by the law of other countries. Other things being equal, American banks would probably choose Article 5 of the UCC as governing law for their relations, but, for various reasons, it is sometimes necessary or desirable for American parties to letters of credit to commit to foreign law. As matters now stand, there is no developed letter of credit law in many parts of the world, but many nations that do not have a developed letter of credit law have or will ratify the Convention. Since the Convention closely parallels Article 5 of American law, American parties will be comfortable with the Convention and will welcome it as the law where, for some reason, they cannot have Article 5 of the UCC as the governing law.

The adoption of the Convention should also stimulate international trade and, more specifically, trade with developing nations. The Convention itself is generally consistent with and amenable to the application of the standard international published practices such as the

Uniform Customs and Practice for Documentary Credits (UCP) and the International Standby Practices (ISP98).

The following organizations support the ratification of the Convention: the Uniform Law Commission, the American Law Institute, the American Bar Association, [insert others].

## SUMMARY OF THE CONVENTION<sup>1</sup>

### SCOPE

The Convention applies to all “international” standby letters of credit that are issued by a party in a State that has ratified the Convention or, in any case, where the choice of law rules would direct the use of the law of such a State (unless the letter excludes the use of the Convention). International standbys are letters in which two of the parties are from different States. Parties may opt into or out of the Convention.

Article 3 specifies the “independence” of the undertaking. The Convention clearly states what is now well recognized in States with developed letter of credit law, but not so well recognized elsewhere, that an issuer’s liability on the letter of credit undertaking must be fulfilled even if there is a dispute between the beneficiary of the letter and the applicant about the underlying transaction.

### Interpretation

Article 5 directs parties to have due “regard” to the Convention’s international character and do the need for uniform interpretation. Article 6 contains seven important definitions.

### Form and Content of Undertaking

Article 7 follows the modern trend to find that any letter of credit that is silent on revocability is irrevocable. The Convention has standard rules on form, amendment and other ministerial but important details.

Article 8 through 12 have a series of housekeeping details concerning expiration, right to transfer a beneficiary’s right to demand payment as well as rules on the assignment of proceeds and on amendment.

### Rights Obligations and Defenses

Articles 13, 14 and 16 deal with and explain the important obligations of the issuing bank. These obligations and their performance are the heart of letter of credit practice. It is important that all banks - to the extent possible- follow the same procedures and observe the same practices. These Articles invoke the “generally accepted standards of international practice” and, in some places, use the same language that is found in the international practices and in the UCC.

Article 19 specifies that an issuer is entitled to withhold payment in extraordinary

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<sup>1</sup> The commentary was prepared by a Committee representing the Uniform Law Commission, the American Law Institute, the Uniform Law Commission of Canada, the Mexican Uniform Law Center, the American Bar Association and letter of credit experts from the United States, Mexico and Canada.

circumstances. The circumstances specified in Article 19 substantially coincide with the “fraud” defense under which an issuer could justify its refusal to pay under Article 5 of the UCC.

### Provisional Court Measures

Article 20 forces a party to clear a high bar in order to get a court order that would bar payment under a letter. It is imperative for the sound operation of letters of credit that courts not be too free in granting injunctions against honor.

### Conflict of Laws

The conflict of laws rules bow first to the parties’ choice of law under Article 21. Failing such a choice by the parties, Article 22 provides that the law of the State “where the guarantor/issuer has that place of business at which the undertaking was issued” governs the rights and liabilities under the credit.

### AMERICAN UNDERSTANDINGS

At no place does the Convention deviate far enough from Article 5 of the Uniform Commercial Code to justify the United States’ adopting Declarations to state its disagreement with or divergence from the terms of the Convention, but the Joint Committee<sup>1</sup> has identified four areas where the United States should adopt Understandings concerning the meaning of terms in the Convention.

These have to do with certain definitions in Article 6 of the Convention, with the circumstances under which a court would be authorized to order an issuer of a letter of credit to refuse to pay, with the choice of law rules and with the determination of the applicable law in the absence of a choice of law clause.

The Joint Committee recommends the following four understandings be included in the United States instrument of ratification:

#### **Article 6. Definitions**

The United States understands as follows: Terms used but not defined in the Convention a) have the same or substantially similar meanings to the terms defined in the official text of Article 5 of the UCC (Official Text of 2009) (e.g., "good faith" as defined in UCC 5-102), or b) if there is no definition in UCC Article 5, have the meaning found elsewhere in the UCC, or c) if there is no definition in the UCC, have meanings equivalent to the same or substantially similar terms used in Article 5 of the UCC (e.g., "documentary" and "non-documentary" as used in the Convention or the UCC to describe a type of undertaking, condition, or presentation).

#### **Article 20. Provisional Court Measures**

*(3) The court may not issue a provisional order...based on any objection other than those referred to in...article 19, or use of the undertaking for a criminal purpose.*

The United States understands as follows: The phrase "or use of the undertaking for a criminal

purpose" applies only to laws that make it a crime to pay an independent undertaking (See e .g. the United States federal foreign asset control laws).

### **Article 21. Choice of Applicable Law**

*The undertaking is governed by the law the choice of which is: (a) Stipulated in the undertaking or demonstrated by the terms and conditions of the undertaking; or (b) Agreed elsewhere by the guarantor/issuer and the beneficiary.*

The United States understands as follows: An international undertaking issued from the United States which provides for application of the law of a state of the United States would be governed by the substantive law in the UCC (by virtue of the uniform state choice-of-laws rules provided in Section 5-116(a) of the UCC and in Article 21 of the Convention).

### **Article 22. Determination of Applicable Law**

*Failing a choice of law in accordance with Article 21, the undertaking is governed by the law of the State where the guarantor/issuer has that place of business at which the undertaking was issued.*

The United States understands as follows: An international undertaking issued from the United States that fails to choose the applicable law would be governed by the substantive law provided in the Convention, supplemented by the substantive law in the UCC. Section 5-116(b) of the UCC would determine which state's version of the UCC would provide that supplementary law.

The term "where the guarantor/issuer has that place of business at which the undertaking was issued" has a meaning equivalent to the jurisdiction in which the [issuer] is located" as that term is used in Section 5-116(b) of the UCC.

## **CONCLUSION**

The widespread adoption of the Convention will make the law on international standby letters of credit and independent guarantees clearer, sounder and more reliable than current law. Because of its close coincidence with Article 5 of the Uniform Commercial Code (the law of all 50 states), the text of the Convention will be familiar to American lawyers and bankers. Because of its deference to parties' intentions (as expressed in the terms of their undertakings) and because of its deference also to international practice, the Convention will readily adapt even to the most unique and unusual transaction. Ratification of the Convention will facilitate international trade by American companies, international lending by American banks and sensible development of law dealing with international undertakings in courts all over the world.

Respectfully Submitted,

# THE CONVENTION WITH UNITED STATES COMMENTARY

## Introduction

Below is the complete text of the Convention. Each article of the Convention is followed by United States commentary prepared by the Joint Committee. The Committee was composed of representatives of the Uniform Law Commission, the American Law Institute, the Uniform Law Commission of Canada, the Mexican Inform Law Center, the American Bar Association and letter of credit experts from Canada, Mexico and the United States.

The Committee made a rigorous comparison of the Convention with Article 5 of the UCC. The commentary that follows explains the relation between the text of the Convention and the text of Article 5 of the UCC. It notes similarities and differences. Where the language of the two texts deviates from one another, the commentary explains how the language of each text would apply to common legal scenarios. In most cases the Committee concluded that the differing texts would not cause inconsistent legal results.

### *Article 1. Scope of Application*

*(1) This Convention applies to an international undertaking referred to in article 2:*

*(a) If the place of business of the guarantor/issuer at which the undertaking is issued is in a Contracting State, or*

*(b) If the rules of private international law lead to the application of the law of a Contracting State,*

*unless the undertaking excludes the application of the Convention.*

*(2) This Convention applies also to an international letter of credit not falling within article 2 if it expressly states that it is subject to this Convention.*

*(3) The provisions of articles 21 and 22 apply to international undertakings referred to in article 2 independently of paragraph (1) of this article.*

An undertaking's incorporation of the UCP or ISP is not the adoption of "other law" as that term is discussed in the introduction to this Commentary, but such incorporation might add terms and might otherwise change the rule that would prevail under the Convention but for the incorporation.

For consideration of the effect of various choice of law terms on the reach of the Convention and its scope, consult the Commentary attached to Articles 21 and 22 and the Understandings concerning those Articles.

To understand the relationship between Article 1 and Articles 21 and 22, consider the following example. Assume that Canada has adopted the Convention and that litigation arises in a Canadian court involving a standby letter of credit that chooses English law to govern the rights of a Canadian issuer and an English beneficiary. In that case the Canadian court should apply English law as directed by Article 21 of the Convention. Even though the Convention would not govern the substantive rights of the parties, it would provide the choice of law rule that the Canadian court should follow.

## *Article 2. Undertaking*

*(1) For the purposes of this Convention, an undertaking is an independent commitment, known in international practice as an independent guarantee or as a standby letter of credit, given by a bank or other institution or person ("guarantor/issuer") to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person.*

*(2) The undertaking may be given:*

*(a) At the request or on the instruction of the customer ("principal/applicant") of the guarantor/issuer;*

*(b) On the instruction of another bank, institution or person ("instructing party") that acts at the request of the customer ("principal/applicant") of that instructing party; or*

*(c) On behalf of the guarantor/issuer itself.*

*(3) Payment may be stipulated in the undertaking to be made in any form, including:*

*(a) Payment in a specified currency or unit of account;*

*(b) Acceptance of a bill of exchange (draft);*

*(c) Payment on a deferred basis;*

*(d) Supply of a specified item of value.*

*(4) The undertaking may stipulate that the guarantor/issuer itself is the beneficiary when acting in favour of another person.*

Undertakings brought within the Convention include 1) standby letters that require the presentation of only a demand ("clean" letters of credit) and 2) letters of credit known as "direct pay" letters, see paragraph 8 of the Secretariat's Note, but do not include commercial letters of credit, except for commercial letters that expressly state that they are covered.

The limitation in Article 2 to undertakings that require payment upon presentation of a "demand," possibly accompanied with "documents," is the same as the limitation imposed in Article 5 of the UCC by Sections 5-102(a) (10) and 5-103(d). That an issuer not be burdened with the duty of a conventional guarantor – to make an independent investigation of default – is a critical distinction between letters of credit and independent guarantees on the one hand and dependent or conventional guarantees on the other. Paragraph 9 of the Secretariat's Note similarly states that the "guarantor/issuer is not called on to investigate the underlying transaction, but is merely to determine whether the documentary demand for payment conforms on its face to the terms of the guarantee or standby letter of credit."

## *Article 3. Independence of Undertaking*

*(1) For the purposes of this Convention, an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not:*

*(a) Dependent upon the existence or validity of any underlying transaction, or upon*

*any other undertaking (including standby letters of credit or independent guarantees to which confirmations or counter-guarantees relate); or*

*(b) Subject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents or another such act or event within a guarantor/issuer's sphere of operations.*

Certain fundamental non-documentary conditions in a writing purporting to be a letter of credit or an independent guarantee would deprive the writing of that status and so remove it from the coverage of the Convention. If, for example, the issuer undertook to pay not on a documentary certification of default but upon the issuer's own determination that a person had defaulted, the writing would be a contract but not a letter of credit or independent guarantee subject to the Convention. On the other hand, the presence of a less fundamental non-documentary condition (e.g. issuer shall pay on a decision from a "duly appointed arbitrator") would not deprive the writing of its status as a letter of credit. In the latter case the issuer should disregard the non-documentary condition, See, Section 5-108(g) of the UCC, ISP Rule 4.11, and UCP 600 Art. 14h.

#### *Article 4. Internationality of Undertaking*

*(1) An undertaking is international if the places of business, as specified in the undertaking, of any two of the following persons are in different States: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer.*

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

*(a) If the undertaking lists more than one place of business for a given person, the relevant place of business is that which has the closest relationship to the undertaking;*

*(b) If the undertaking does not specify a place of business for a given person but specifies its habitual residence, that residence is relevant for determining the international character of the undertaking.*

Article 4 is only a definition of the adjective "international" that is used in Article 1 to establish the Scope of the Convention. Article 1 limits the application of the Convention to undertakings that are "international" as that term is used here.

#### *Article 5. Principles of Interpretation*

*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 the international practice of independent guarantees and stand-by letters of credit.*

Article 5 should be read with Articles 13, 14 and 15, all of which have to do with the interpretation and application of letters of credit. Article 5 does not mean that a court interpreting the Convention should ignore the local law that may implement the Convention but merely that the court should be due attention to cases that interpret the Convention and to internationally followed rules of practice such as UCP 600.

## Article 6. Definitions

*For the purposes of this Convention and unless otherwise indicated in a provision of this Convention or required by the context:*

- (a) "Undertaking" includes "counter-guarantee" and "confirmation of an undertaking";*
- (b) "Guarantor/issuer" includes "counter-guarantor" and "confirmer";*
- (c) "Counter-guarantee" means an undertaking given to the guarantor/issuer of another undertaking by its instructing party and providing for payment upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment under that other undertaking has been demanded from, or made by, the person issuing that other undertaking;*
- (d) "Counter-guarantor" means the person issuing a counter-guarantee;*
- (e) "Confirmation" of an undertaking means an undertaking added to that of the guarantor/issuer, and authorized by the guarantor/issuer, providing the beneficiary with the option of demanding payment from the confirmer instead of from the guarantor/issuer, upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the confirmed undertaking, without prejudice to the beneficiary's right to demand payment from the guarantor/issuer;*
- (f) "Confirmer" means the person adding a confirmation to an undertaking;*
- (g) "Document" means a communication made in a form that provides a complete record thereof.*

That “document” is defined broadly enough to include digital documents does not by itself authorize one who is making presentation under the Convention to present documents in digital or other non-paper form. Thus where there is no authority in the undertaking or in the practice applicable to the undertaking to authorize the use of a digital document, the presentation of a digital document would render the presentation non-complying both under the Convention and under Article 5 of the UCC.

According to the United States Understanding concerning Article 6, terms used but not defined in the Convention have the same meaning as that stated for the same or substantially similar terms in the UCC. *See* United States Understanding on Article 6.

## Article 7. Issuance, Form, and Irrevocability of Undertaking

- (1) Issuance of an undertaking occurs when and where the undertaking leaves the sphere of control of the guarantor/issuer concerned.*
- (2) An undertaking may be issued in any form which preserves a complete record of the text of the undertaking and provides authentication of its source by generally accepted means or by a procedure agreed upon by the guarantor/issuer and beneficiary.*
- (3) From the time of issuance of an undertaking, a demand for payment may be made in accordance with the terms and conditions of the undertaking, unless the undertaking stipulates a different time.*

*(4) An undertaking is irrevocable upon issuance, unless it stipulates that it is revocable.*

Article 7 adopts the common modern rule that undertakings which are silent on revocability are irrevocable. The Article also anticipates the issuance of letters in digital and other formats in addition to writing as long as those formats permit preservation of the text of the undertaking.

#### *Article 8. Amendment*

*(1) An undertaking may not be amended except in the form stipulated in the undertaking or, failing such stipulation, in a form referred to in paragraph (2) of article 7.*

*(2) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, an undertaking is amended upon issuance of the amendment if the amendment has previously been authorized by the beneficiary.*

*(3) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, where any amendment has not previously been authorized by the beneficiary, the undertaking is amended only when the guarantor/issuer receives a notice of acceptance of the amendment by the beneficiary in a form referred to in paragraph (2) of article 7.*

*(4) An amendment of an undertaking has no effect on the rights and obligations of the principal/ applicant (or an instructing party) or of a confirmer of the undertaking unless such person consents to the amendment.*

Both the UCC and rules of practice would find that a beneficiary's presentation under an amended undertaking that invokes the amended terms of the undertaking constitutes the beneficiary's agreement to the amendment. See Section 5-106 of the UCC, comment 2, UCP Article 10c and ISP section 2.06c.ii. Article 8, operating in conjunction with Article 13, is not different.

#### *Article 9. Transfer of Beneficiary's Right to Demand Payment*

*(1) The beneficiary's right to demand payment may be transferred only if authorized in the undertaking, and only to the extent and in the manner authorized in the undertaking.*

*(2) If an undertaking is designated as transferable without specifying whether or not the consent of the guarantor/issuer or another authorized person is required for the actual transfer, neither the guarantor/issuer nor any other authorized person is obliged to effect the transfer except to the extent and in the manner expressly consented to by it.*

Like Section 5-112 of the Uniform Commercial Code, Article 9 preserves the applicant's expectation that the beneficiary's and only the beneficiary's performance will be accepted by the issuer of a letter of credit unless the letter instructs otherwise.

#### *Article 10. Assignment of Proceeds*

*(1) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, the beneficiary may assign to another person any proceeds to which it may be, or may become, entitled under the undertaking.*

*(2) If the guarantor/issuer or another person obliged to effect payment has received a notice originating from the beneficiary, in a form referred to in paragraph (2) of article 7, of the beneficiary's irrevocable assignment, payment to the assignee discharges the obligor, to the extent of its payment, from its liability under the undertaking.*

The statement in paragraph (2) that an issuer's payment to an assignee would, in the circumstances there stated, lead to the discharge of its obligation to pay, does not determine whether the issuer would have an obligation to pay the assignee nor does it determine whether payment to the assignor would discharge any obligation that the issuer might have under the undertaking. Those matters are left to domestic letter of credit law and to rules such as ISP Rule 6.06 ff.

#### *Article 11. Cessation of Right to Demand Payment*

*(1) The right of the beneficiary to demand payment under the undertaking ceases when:*

*(a) The guarantor/issuer has received a statement by the beneficiary of release from liability in a form referred to in paragraph (2) of article 7;*

*(b) The beneficiary and the guarantor/issuer have agreed on the termination of the undertaking in the form stipulated in the undertaking or, failing such stipulation, in a form referred to in paragraph (2) of article 7;*

*(c) The amount available under the undertaking has been paid, unless the undertaking provides for the automatic renewal or for an automatic increase of the amount available or otherwise provides for continuation of the undertaking;*

*(d) The validity period of the undertaking expires in accordance with the provisions of article 12.*

*(2) The undertaking may stipulate, or the guarantor/issuer and the beneficiary may agree elsewhere, that return of the document embodying the undertaking to the guarantor/issuer, or a procedure functionally equivalent to the return of the document in the case of the issuance of the undertaking in non-paper form, is required for the cessation of the right to demand payment, either alone or in conjunction with one of the events referred to in subparagraphs (a) and (b) of paragraph (1) of this article. However, in no case shall retention of any such document by the beneficiary after the right to demand payment ceases in accordance with subparagraph (c) or (d) of paragraph (1) of this article preserve any rights of the beneficiary under the undertaking.*

The last sentence of paragraph (2) is consistent with Article 5 of the UCC, as stated in Paragraph 34 of the Secretariat's Note.

#### *Article 12. Expiry*

*The validity period of the undertaking 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 undertaking, provided that, if the expiry date is not a business day at the place of business of the guarantor/issuer at which the undertaking is issued, or of another person or at another place stipulated in the undertaking for presentation of the demand for payment, expiry occurs on the first business day which follows;*

*(b) If expiry depends according to the undertaking on the occurrence of an act or event*

*not within the guarantor/issuer's sphere of operations, when the guarantor/issuer is advised that the act or event has occurred by presentation of the document specified for that purpose in the undertaking or, if no such document is specified, of a certification by the beneficiary of the occurrence of the act or event;*

*(c) If the undertaking does not state an expiry date, or if the act or event on which expiry is stated to depend has not yet been established by presentation of the required document and an expiry date has not been stated in addition, when six years have elapsed from the date of issuance of the undertaking.*

Neither the Convention nor Section 5-106 of the UCC permits an undertaking to operate in perpetuity, but the time periods differ. Under Section 5-106 undertakings that claim to be perpetual expire after 5 years and those without an expiration date expire after 1 year; under the Convention all undertakings without fixed expiration dates expire in 6 years.

The rule on undertakings without expiration dates does not affect undertakings that contain automatic extension clauses even though such undertakings may state no final expiration date. In those cases the undertaking is to be terminated by payment or by the issuer's giving notice that it will not extend the undertaking.

#### *Article 13. Determination of Rights and Obligations*

*(1) The rights and obligations of the guarantor/issuer and the beneficiary arising from the undertaking are determined by the terms and conditions set forth in the undertaking, including any rules, general conditions or usages specifically referred to therein, and by the provisions of this Convention.*

*(2) In interpreting terms and conditions of the undertaking and in settling questions that are not addressed by the terms and conditions of the undertaking or by the provisions of this Convention, regard shall be had to generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice.*

The references here to “usages” and to “generally accepted international rules and usages” tell a court or a party to consult such widely accepted terms as the Uniform Customs and Practices that have been adopted by the International Chamber of Commerce. Frequently those rules of practice (currently known as “UCP 600”) are incorporated into undertakings by specific reference.

#### *Article 14. Standard of Conduct and Liability of Guarantor/issuer*

*(1) In discharging its obligations under the undertaking and this Convention, the guarantor/issuer shall act in good faith and exercise reasonable care having due regard to generally accepted standards of international practice of independent guarantees or standby letters of credit.*

*(2) A guarantor/issuer may not be exempted from liability for its failure to act in good faith or for any grossly negligent conduct.*

Despite the explicit reference to good faith and to reasonable care, the standard of conduct stated in this Article is consistent with the standard stated in Section 5-108 of the UCC. Note that Article 1 of the UCC imposes a duty of good faith on the issuer's responsibilities in Section 5-108, but that any duty under Article 5 of the UCC or under the Convention would be measured by the

restricted definition of good faith in 5-102 of the UCC. See the United States Understanding concerning Article 6.

Exercise of “reasonable care” would not be a defense under Articles 14, 15 and 17 for an issuer who dishonored a presentation that strictly complied (absent the circumstances stated in Article 19).

Observance of the relevant standard practice constitutes the exercise of reasonable care. Paragraph 38 of the Secretariat’s Note similarly states that the standard of conduct “is to be defined by reference to generally accepted standards of international practice.” However, it also explains that Article 14(2) “prohibits any exemption of the guarantor from liability for a lack of good faith or gross negligence.”

#### *Article 15. Demand*

*(1) Any demand for payment under the undertaking shall be made in a form referred to in paragraph (2) of article 7 and in conformity with the terms and conditions of the undertaking.*

*(2) Unless otherwise stipulated in the undertaking, the demand and any certification or other document required by the undertaking shall be presented, within the time that a demand for payment may be made, to the guarantor/issuer at the place where the undertaking was issued.*

*(3) The beneficiary, when demanding payment, is deemed to certify that the demand is not in bad faith and that none of the elements referred to in subparagraphs (a), (b) and (c) of paragraph (1) of article 19 are present.*

Consistent with Section 5-110 of the UCC, a false or inaccurate certification under paragraph 3 does not justify dishonor. (Of course, the beneficiary’s fraudulent behavior might give the issuer a right to dishonor under Article 19.) Whether the beneficiary’s giving of a false or inaccurate certification gives a claim for damages or other remedy, and to whom, is left to other law such as Section UCC 5-110, Cf. Paragraph 40 of the Secretariat’s Note.

Paragraph 2’s requirement that one present to the “guarantor/issuer” does not apply to undertakings that allow presentation to a nominee or confirmer and does not override normal letter of credit practice that might allow for presentation to a nominated bank or to a confirmer, *see, e.g.*, UCP600 and ISP.

#### *Article 16. Examination of Demand and Accompanying Documents*

*(1) The guarantor/issuer shall examine the demand and any accompanying documents in accordance with the standard of conduct referred to in paragraph (1) of article 14. In determining whether documents are in facial conformity with the terms and conditions of the undertaking, and are consistent with one another, the guarantor/issuer shall have due regard to the applicable international standard of independent guarantee or standby letter of credit practice.*

*(2) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, the guarantor/issuer shall have reasonable time, but not more than seven business days following the day of receipt of the demand and any accompanying documents, in which to:*

*(a) Examine the demand and any accompanying documents;*

*(b) Decide whether or not to pay;*

*(c) If the decision is not to pay, issue notice thereof to the beneficiary.*

*The notice referred to in subparagraph (c) above shall, unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, be made by teletransmission or, if that is not possible, by other expeditious means and indicate the reason for the decision not to pay.*

Whether documents are consistent with one another has to be judged by the applicable international practice. For example, UCP600 Article 14d requires that documents not “conflict;” ISP Rule 4.03 provides that one must “examine” for “inconsistency” only to the extent that the undertaking requires. Article 5 of the UCC has no analogous requirement.

Article 16 does not specify the consequences of an issuer’s failure to give notice or to give its reasons for dishonor in the notice. Where an undertaking under the Convention is not subject to other law or rules of practice that provide for timely and adequate notice of refusal and where such law or practice does not spell out the consequence of failure to give such notice, a court may apply Section 5-108(c) of the UCC or rules of practice such as UCP600 Article 16 or ISP Rule 5.03 and so preclude the issuer from using any unstated reasons to justify its dishonor.

#### *Article 17. Payment*

*(1) Subject to article 19, the guarantor/issuer shall pay against a demand made in accordance with the provisions of article 15. Following a determination that a demand for payment so conforms, payment shall be made promptly, unless the undertaking stipulates payment on a deferred basis, in which case payment shall be made at the stipulated time.*

*(2) Any payment against a demand that is not in accordance with the provisions of article 15 does not prejudice the rights of the principal/applicant.*

Article 17(2) does not establish or address any rights that the principal or applicant may have after a payment that is not permitted or required by the Convention. Those rights must be found in the agreements of the parties, in rules of practice or in applicable law (See e.g. Section 5-108(i) (1) of the UCC).

#### *Article 18. Set-off*

*Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, the guarantor/issuer may discharge the payment obligation under the undertaking by availing itself of a right of set-off, except with any claim assigned to it by the principal/applicant or the instructing party.*

The work of this Article is as much to state where set-off is prohibited (by use of the applicant’s claims) as where it is not (by use of the issuer’s claims against the beneficiary).

#### *Article 19. Exception to Payment Obligation*

*(1) If it is manifest and clear that:*

*(a) Any document is not genuine or has been falsified;*

*(b) No payment is due on the basis asserted in the demand and the supporting documents;  
or*

*(c) Judging by the type and purpose of the undertaking, the demand has no conceivable basis, the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment.*

*(2) For the purposes of subparagraph (c) of paragraph (1) of this article, the following are types of situations in which a demand has no conceivable basis:*

*(a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized;*

*(b) The underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking;*

*(c) The underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;*

*(d) Fulfillment of the underlying obligation has clearly been prevented by willful misconduct of the beneficiary;*

*(e) In the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter-guarantee relates.*

*(3) In the circumstances set out in subparagraphs (a), (b) and (c) of paragraph (1) of this article, the principal/applicant is entitled to provisional court measures in accordance with article 20.*

The effect of Article 19 against the beneficiary is substantially the same as the fraud rule stated in Section 5-109(a) of the UCC. Paragraph 46 of the Secretariat's Note states that the purpose of Article 19 is to provide an "internationally agreed general definition of the types of situations in which an exception to the obligation to pay against a facially compliant demand would be justified," and that the "definition encompasses fact patterns covered in different legal systems by notions such as 'fraud' or 'abuse of right.'"

Since Article 19 is silent as to the rights of the issuer against other parties, e.g. holders in due course, a court must apply other law such as Section 5-109 of the UCC where there are claims by or against such persons.

#### *Article 20. Provisional Court Measures*

*(1) Where, on an application by the principal/applicant or the instructing party, it is shown that there is a high probability that, with regard to a demand made, or expected to be made, by the beneficiary, one of the circumstances referred to in subparagraphs (a), (b), (c) or paragraph (1) of article 19 is present, the court, on the basis of immediately available strong evidence, may:*

*(a) Issue a provisional order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the undertaking, or*

*(b) Issue a provisional order to the effect that the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm.*

*(2) The court, when issuing a provisional order referred to in paragraph (1) of this article,*

*may require the person applying therefor to furnish such form of security as the court deems appropriate.*

*(3) The court may not issue a provisional order of the kind referred to in paragraph (1) of this article based on any objection to payment other than those referred to in subparagraphs (a), (b), (c) of paragraph (1) of article 19, or use of the undertaking for a criminal purpose.*

Because the Convention does not include a full range of procedural rules, courts that deal with extraordinary remedies should use local procedural rules and may invoke local rights and remedies to supplement those in Article 20.

Consistent with the independence principle in letter of credit law, the United States Understanding concerning Article 20 concludes that the phrase “use...for a criminal purpose” applies only to cases where payment on the undertaking itself would violate criminal law, and not to cases where payment of the underlying obligation would violate criminal law. *See* United States Understanding on Article 20.

#### *Article 21 Choice of Applicable Law*

*The undertaking is governed by the law the choice of which is:*

- (a) Stipulated in the undertaking or demonstrated by the terms and conditions of the undertaking; or*
- (b) Agreed elsewhere by the guarantor/issuer and the beneficiary.*

Both UCC 5-116 and Article 21 give full effect to any choice of law clause in the undertaking and are consistent with one another.

A choice of law clause such as “This undertaking is issued subject to ISP98 and is governed by the New York UCC and, as to matters outside the scope of ISP98 and the UCC, by New York State and United States federal laws,” or a simpler clause that merely stated that “this undertaking is governed by the New York UCC,” would limit application of the Convention's substantive provisions to those not displaced by the chosen UCC. Because the UCC is more comprehensive than the Convention in its codification of the law of independent undertakings, the practical effect of choosing the UCC is to displace all of the Convention except for a small number of cases (as in Article 18 on setoff) where the Convention states a rule but the UCC does not. Incorporation of ISP alone has the practical effect, under Article 13 of the Convention, of displacing much if not most of the Convention. Since the Convention, the UCC, and ISP were all drafted in the 1990s with a view to harmonizing the law and practice applicable to independent undertakings, each yields nearly the same result in most disputes. *See* the United States Understanding on Article 21.

#### *Article 22. Determination of Applicable Law*

*Failing a choice of law in accordance with article 21, the undertaking is governed by the law of the State where the guarantor/issuer has that place of business at which the undertaking was issued.*

Article 22 of the Convention and Section 5-116(b) of the UCC state equivalent choice-of-law

rules. Both focus on the obligor's location. Because Section 5-116(b) deals with advising and nominated banks as well as issuing and confirming banks, it is more elaborate. *See* the United States Understanding on Article 22.