

AMERICAN BAR ASSOCIATION
SECTION OF BUSINESS LAW
REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED, that the American Bar Association recommends that the United States sign and ratify the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit

REPORT

BACKGROUND

The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (the “Convention” or the “UN Convention”) was drafted by the Working Group on International Contract Practices of the United Nations Commission on International Trade Law (UNCITRAL) from 1988 - 1995 and adopted by the Commission in May 1995. It was formally adopted by the General Assembly of the United Nations on 11 December 1995 and opened for signature. The Convention remains open for signature for two years.

The Letter of Credit Subcommittee, after receiving the advice of its Task Force, and that of other members of the Subcommittee, through the Uniform Commercial Code Committee, recommends that the Section of Business Law support signature and adoption of the Convention by the United States and send forward a draft resolution endorsing the Convention for ratification by the House of Delegates.

RECOMMENDATION AND SUMMARY

After study and analysis of the UN Convention on Independent Guarantees and Stand-by Letters of Credit, the Letter of Credit Subcommittee and the Task Force acting through the Uniform

Commercial Code Committee recommends that the American Bar Association urge the United States to sign and ratify the UN Convention.

The UN Convention on Independent Guarantees and Stand-by Letters of Credit clearly will be of assistance to United States parties doing business involving letters of credit and independent guarantees whether or not those countries have a developed body of law governing such transactions. The Convention fills the vacuum that exists in countries that have no modern letter of credit law and bridges the gap between standby and guarantee law and practice. It is compatible with Revised UCC Article 5, the current version of the Uniform Customs and Practices for Documentary Credits, UCP 500, and standby letter of credit practice now in the process of formulation. It reflects and encourages sound banking practice. The freedom of the parties to contract out of the Convention or modify its provisions allows parties to avoid application of all or part of the Convention should they so choose.

ANALYSIS

This report addresses the desirability of the Convention to determine whether its adoption by the United States would be in the best interests of parties located in the United States. Part of that determination was a review of provisions of the Convention to

determine their compatibility with letter of credit law and practice in the U.S. as well as in international trade. This process included considerations of issues raised by various commentators, including points raised by other delegations which are from the point of view of United States issuers, confirmers, advisers, paying or negotiating banks, applicants, or beneficiaries, and a decision as to whether any differences were insurmountable ones for the parties.¹ The Convention effects a scheme of law superior to the application of many current legal systems in such circumstances, especially because there is relatively little positive law in this field, and, in some respects, is an improvement over U.S. domestic law. As will be discussed more fully below, there are a few provisions which may not be as favorable to United States parties as are current provisions of domestic law. Nonetheless, the ability of parties to an international letter of credit transaction which is otherwise subject to the Convention to alter the provisions of the Convention, an ability expressly given by the Convention itself, allows United States parties uncomfortable with certain provisions to alter those provisions. *In addition, it must be recognized that U.S. domestic law in many cases is not always available as an option.* Moreover, although there may be differences in how certain provisions of the Convention would be applied by U.S. courts (as with any law), a review of the legislative history of the Convention sheds sufficient light on those provisions

to clarify their application. The process involved meetings of delegations from over 50 countries over a five year period and the deliberations involved in the revision of UCC Article 5 in meetings of both the Business Law Section and the Uniform Law Commissioners were carefully factored into U.S. positions at all stages.²

REVIEW OF THE CONVENTION

Attached to this report are: A) the UN Convention on Independent Guarantees and Stand-by Letters of Credit; B) the Explanatory note by the UN Commission on International Trade Law Secretariat. What follows are observations as to the primary problems addressed by the Convention, the main achievements of the Convention, and a discussion of the provisions of the Convention, including those which provoked questions or received negative comment, and the reasons such negative comments should not deter the United States from signing or ratifying the Convention.

A. Problems addressed by the Convention

The Convention “is designed to facilitate the use of independent guarantees and stand-by letters of credit, in particular, where only one or two of these instruments may be traditionally in use” and “also solidifies recognition of common basic principles and characters....”³ In most countries, use of the

1. The analysis was to ask for the following: Is the provision a departure from the prior developed law in the United States. If so, is that departure a desirable one? If not, can the provision nonetheless be justified on some other basis? Do the parties have the ability to contract around the issue presented? Are such provisions already standard in letter of credit transactions and practice?

2. In 1988, the United Nations Commission on International Trade Law formally requested its Working Group on International Contract Practices to report on the desirability and feasibility of an international codification of the law of standby letters of credit and independent bank guarantees. At its XIIth Session (Nov. 1988), the Working Group reported affirmatively on both questions and in subsequent sessions (1990 to 1995) drafted the proposed law. For the final text of the Convention *see* United Nations: UN Convention on Independent Guarantees and Stand-by Letters of Credit, 35 I.L.M. 735 (1996). Notes of the Secretariat and Reports of the Working Group from the earlier sessions are available from UNCITRAL. *See* United Nations documents A/CN.9/330, 342, 345, 358, 361, 372, 374, 388, 391, 405 and 408; reproduced in UNCITRAL Yearbooks vol. XXI: 1990 to XXVI:1995). The deliberations of the Commission on the draft Convention are reflected in paragraphs 11 to 201 of the report of the United Nations Commission on International Trade Law on the work of its twenty-eighth session (1995), *Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17)* (reproduced in UNCITRAL Year Book vol. XXVI, 1995), which contains in its Annex I the draft Convention as submitted by the Commission to the General Assembly. The General Assembly adopted the Convention at the Fiftieth Session by its resolution A/RES/50/48 (containing citations to previous reports of the Working Group and the Secretariat).

3. Explanatory note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, at ¶3, A/CN.9/431 (1996).

instruments governed by the Convention is restricted to one of the two instruments covered. As a result, there is a lack of familiarity with the law and practice surrounding the other instrument. For example, in the U.S., there is relatively little understanding of the law and practice surrounding independent guarantees. In addition, outside the U.S., there is hardly any positive law which establishes the independence of the guarantee. Moreover, the only rules of practice applicable to the independent guarantee, the Uniform Rules for Demand Guarantees, have not achieved wide adherence. As to the standby, in many countries it is either unknown or understood only in the form of a simple demand or “clean” standby (one which only requires a statement of default). In fact, standby practice is far more complex. The misunderstanding of standbys is not remedied, as in the case of commercial letters of credit, by rules of practice. While the Uniform Customs and Practice for Documentary Credits are often incorporated by reference into standbys, they are designed specifically for the commercial letter of credit, and, while rules for standbys are now being formulated (the Draft International Standby Practices 1997), they have not as of the date of this Report been completed.

The Convention provides an international system of terminology and legal obligation which supplements and reinforces sound international practice and which harmonizes these two instruments at the level of fundamental legal principles. In so doing it emphasizes the independence, irrevocability and certainty of the undertakings. While U.S. domestic law resolves most of the problems encountered with standby letters of credit and, indirectly, independent guarantees, which are within its scope — as do the legal systems of some other countries — it may not be acceptable or applied to obligations arising under international letters of credit. In such situations, the Convention affords an attractive alternative to local laws which may be unsettled as to given issues, less clear regarding the independence of the undertaking, or adopt an approach which is inconsistent with the approach taken in the U.S.

B. Consistency with U.S. Domestic Law

U.S. domestic law is based upon Article 5 of the Uniform Commercial Code which has been enacted with some variation in all fifty states. This model statute was revised in 1995 and is in the process of adoption with 16 jurisdictions having adopted it as of February 1, 1997. Because of the speed with which the revision is being adopted and the wide-spread support it has justifiably attracted, this report considers the Convention in light of Revised UCC Article 5 which is likely to be in effect by the time that the UN Convention comes into effect.

The following points deserve attention regarding the consistency of the Convention and Revised Article 5.

1. No provision of domestic law has ever been so carefully coordinated with international law as the Convention and Revised UCC Article 5. Not only did the two efforts coincide chronologically but the process of developing U.S. positions involved continuous collaboration with the NCCUSL Drafting Group and the Section of Business Law (the members of the U.S. delegation to the UNCITRAL Working Group were active participants in the revision of UCC Article 5). A conscious effort was made to foster a consistent approach to similar problems. This effort required compromise on the part of the U.S. drafters and understanding on the part of the delegations to the UNCITRAL Working Group of the particular concerns of the U.S. and the issues posed by its legal system. As a result of a willingness to seek reasonable and acceptable solutions to these matters, the result was, on the whole, remarkably successful.

2. The Convention is also consistent with standard international banking practice which underlies U.S. domestic law and Revised UCC Article 5, in particular. This practice is manifested in the Uniform Customs and Practice for Documentary Credits (ICC Publication No. 500) which articulates the practices of the international letter of credit community. While much of the UCP is not specific as to standbys, its general principles are an important

source of letter of credit law. In addition, the effort now underway in the U.S. and throughout the world to formulate standby practice in rules specifically designed for standbys (the International Standby Practices). The ISP was inspired by efforts in the drafting of the UN Convention and have received whole-hearted support from the U.S. letter of credit community. As was the case in the revision of UCC Article 5, the drafters of the UN Convention began with a consideration of the rule of practice and, on the whole, deferred to it. As a result, the two statutes taken together with internationally accepted practice produce virtually universal harmonization of law and practice in this field throughout the world.

3. In addition, the Convention is consistent with the progressive approach taken by U.S. regulators. In its revised Interpretative Ruling, 12 C.F.R. § 7.7016, the Office of the Comptroller of the Currency has specifically addressed safety and soundness considerations raised by developments in Revised UCC Article 5 and the UN Convention. Of special interest is the recognition that the UN Convention was an example of a law under which it was permissible for a national bank to issue letters of credit and whose incorporation made the independence of the undertaking apparent on its face.

4. Where the two statutes differ is with regard to language and coverage. Being international in character and applicable to a wide variety of legal systems and languages, the UN Convention necessarily used terminology and concepts which differed from those familiar to U.S. commercial lawyers. In addition, the scope of Revised UCC Article 5 is broader than that of the UN Convention. These differences and some additional issues are discussed in the Report of the Letter of Credit Subcommittee Task Force and in this Report. As is clear from the legislative history of the two projects, however, there is no significant difference in the approach taken between the Convention and Revised UCC Article 5.

C. Main Achievements of the Convention

1. Emphasis Upon Party Autonomy

The Convention, as is Revised UCC Article 5, is founded on the principle of party autonomy. In the field of letters of credit, such a provision is important because of the international significance of rules of practice. Article 13 specifically provides that the rights and obligations under the Convention “are to be determined by the terms and conditions set forth in the undertaking...” Most of the provisions of the Convention may be derogated from (are non mandatory) with the exception of (a) the scope provisions in Article 2 (an undertaking which does not meet these terms is not necessarily invalid but is not governed by the Convention); (b) the formality requirements of Article 7(2) (which require any form “which preserves a complete record...and provides authentication...by generally accepted means...”); (c) the minimum standard of conduct of Article 14(a) (No exemption from failure to act in good faith or for grossly negligent conduct); (d) Article 11(2) regarding the retention of the operative instrument after the expiration of the undertaking; and (e) Articles 19 and 20 regarding exceptions to the payment obligation for fraud or abusive drawing and provisional court measures. These exceptions are, on the whole, consistent with the approach taken in U.S. commercial law and Revised UCC Article 5 in particular.

2. Premier Role of Standard International Banking Practice

As indicated, the Convention defers to standard international banking practice. Where provisions may be derogated from or varied, the incorporation of rules of standard practice in the undertaking (a common practice) constitutes such a variation and these rules would control over the default rules of the Convention. In addition, specific articles of the Convention refer to standard international banking practice. Article 13(1) indicates that the rights and obligations of the parties are to be determined by reference to the terms and conditions of the undertaking “including any rules, general conditions or usages specifically referred to

therein....” Article 13(2) also looks to such rules for the interpretation of the terms and conditions of the undertaking and settling questions not addressed by the undertaking or the Convention. Article 14(1) indicates that the standard of conduct must be understood with regard to “generally accepted standards of international practice....” With respect to the examination of documents, Article 16 provides that in determining compliance, regard shall be had to “the applicable international standard of independent guarantee or stand-by letter of credit practice.” In this respect, the Convention is progressive, directing parties, their lawyers, and courts to the mercantile rules which are the source of this area of the law.

3. Internationally Recognized Standard of Examination of Documents

The undertaking to pay embodied in a letter of credit is conditioned upon compliance with its terms and conditions. A large percentage of the disputes which arise in this area are caused by differences over whether the documents conform. In addressing the cases which were litigated on this issue, courts tended to articulate principles founded on a geometrical model of mirror image, on the one hand, or the bilateral contractual rule of substantial compliance, on the other. Neither of these approaches, however, yield satisfactory results nor meet the reasonable commercial expectations of the parties. While the standard typically followed by US courts is that of “strict compliance”, it varies considerably in its application from case to case and is rarely what letter of credit practitioners understand when they use that term. In an effort to clarify this area and focus upon foundational principles, the 1994 revision of the Uniform Customs and Practice provided that the standard of compliance shall be determined in accordance with “international standard banking practice....” UCP 500 Article 13(a). Article 16 of the Convention follows this approach, as does Revised UCC Section 5-108(a) and (e). This formulation directs courts to the standard practice of those institutions who regularly issue and act upon letters of credit in order to determine compliance, thereby contributing toward international uniformity.

4. Standard Applied to Extraordinary Relief

After the problems with the non-conformity of documents, the issues related to the standards to be applied in granting extraordinary relief have caused the greatest disruption. This problem, moreover, is one which can only be addressed by a legislative enactment and not by rules of practice. The question is when should a court enjoin payment under a letter of credit. In a typical situation, the applicant claims that the presentation is forged or fraudulent. The issuer or other bank has no independent means of determining the fraudulent character of the documents presented and typically is prepared to make payment if the documents conform on their face. The issue is then brought before the appellate courts by the applicant which frequently seeks an ex parte order. In the U.S., it has taken decades for the courts to formulate standards which provided that such relief was only available in situations where the fraud was unmistakable and serious and for the trial courts to apply them consistently. The problem is compounded with respect to international transactions where the court of one country may order a bank to refrain from payment but that of another country where the bank has assets may order payment. As a result, the adoption of an international standard is a vital step toward the harmonization of this area of law and may be the single most important contribution of the Convention. If the Convention achieved nothing else, the formulation of an international standard which discouraged award of such relief while permitting it in the extreme situations where it is warranted argues for its adoption.

5. Linkage to Commercial Letters of Credit

While the subject of the Convention is international standby letters of credit and independent guarantees, it can be made applicable to international commercial letters of credit. Although there are some differences between standby letters of credit and commercial letters of credit at the level of practice, these differences disappear at the abstract level of law. In particular, in the U.S., the standby is linked to

the commercial letter of credit and, for purposes of the application of law, is identical. While the Working Group did not accept the U.S. suggestion that the Convention include commercial letters of credit within its scope, it did adopt the provision in Article 1(2) which permits a commercial letter of credit to expressly provide that it is subject to the Convention. While this provision, strictly speaking, is not necessary in the U.S. and some other legal systems -- since the parties could do so and achieve the same effect unless such incorporation was expressly prohibited under the principle of party autonomy -- the provision removes any doubt on this point. It, therefore, expressly extends the benefits of the Convention to those parties to commercial letters of credit who wish to take advantage of it.

6. Linkage Between Standby Letters of Credit and Independent Guarantees

Because of the tendency of guarantee practice and standby practice to concentrate in geographical regions, there is a relative lack of understanding in each region about the other instrument. This ignorance is compounded by the possibility of legal differences between the two undertakings. The result of this misunderstanding and confusion makes it difficult and risky for the two undertakings to be linked as is illustrated in *Banque Paribas v. Hamilton Industries International, Inc.*, 767 F.2d 380 (7th Cir. 1985), a case in which the majority opinion thoroughly confuses the character of the two undertakings and their inter-relationship. By providing a uniform regime of law, the Convention removes the risk of linking the two undertakings and facilitates a practice whereby standbys back independent guarantees and vice versa, and opens the possibility of the confirmation of an independent guarantee. As a result of the Convention and its harmonization of this area of law, the Office of the Comptroller of the Currency in its Revised Interpretative Ruling permitted national banks to issue "independent undertakings" including independent guarantees, a matter which was in some doubt under the prior ruling. In the explanation of the ruling, the Official Notice states that "[t]he term 'independent undertakings' is used by the United Nations

Commission on International Trade Law (UNCITRAL) to cover a broader array of transactions in this area." 61 C.F.R. 4849 (9 February 1996).

7. Anticipates Developments of Electronic Commerce

The relative informality of letter of credit law and the absence of the operation of the doctrine of merger whereby the obligations of the undertaking are merged with a unique piece of paper have made letter of credit practice progressive with regard to the movement toward paperless commerce in the issuance of letters of credit. On the other hand, the need for presentation of paper documents of title have made the field resistant to these trends with respect to documentary presentations. Rather than forcing practice, the Convention wisely allows for the current paper system but is drafted in such a manner as to permit future movement toward paperless commerce. The definition of "document" in Article 6(g) only requires a "form that provides a complete record". The formality requirements of Article 7(2) call for an undertaking "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"

8. Expiration and Possession of the Operative Instrument

One of the issues which has bedeviled international practice in this field has been the desire of certain beneficiaries, in particular those affiliated with nation-states, to hold the issuer to its undertaking perpetually. This can occur by the express terms of the undertaking, the absence of an expiry date, or by virtue of the significance attached to the possession of the operative instrument. Articles 11 and 12 address these issues and provide that possession of the operative instrument has no significance after the expiry of the undertaking. By this provision, the Convention, if adopted, would clarify and resolve serious problems present in international law and practice in this area.

9. Definitions

The formulation of definitions in Article 6 and, in particular, the definition of the undertaking in Article 2 usefully establish international uniformity of usage in this area.

10. Effectiveness of the Obligation

Article 7 provides for the effectiveness of the obligation upon issuance in a manner consistent with standard international banking practice and Revised UCC Section 5-106.

11. Transfer and Assignment of Proceeds

Articles 9 and 10 provide a legal framework for standard international banking practice as it relates to transfer and assignment of proceeds. These provisions open the possibility of more flexible utilization of the undertakings in finance. They are, on the whole, consistent with Revised UCC Sections 5-112 and 5-114.

D. Provisions Which May Need Further Interpretation

1. Differences in the Language and Concepts Used in the UN Convention and Revised UCC Article 5

There are, of course, instances where the UN Convention uses language or concepts which differ from those in use under domestic law. It was not to be expected in a Convention which was international, intended to be used in legal systems other than the common law system, and translated into multiple languages other than American English, that terms and concepts familiar to U.S. law would or could have been used throughout the Convention. In some instances, this difference may raise questions regarding the interpretation of the UN Convention as to whether the scope and coverage of the particular provisions are similar. Unless there is a demonstrated difference, it is likely that U.S. courts will interpret the provisions in accord with the interpretation given the

similar provision and language under U.S. law. Because the legislative history of the Convention is set out in detail in UN documents, its intent explained in the Secretariat's Explanatory Note, and UNCITRAL maintains a case summary service to promote international harmony of interpretation, such an approach is unlikely to produce international disharmony in interpretation of the Convention. As a result, the minor inconvenience of different formulations is outweighed by the advantages of uniformity internationally in this field.

An example is the standard of care set forth in Articles 13, 14, and 16 and that referred to in UCC Section 5-108. The UN Convention refers to "standard international practice" whereas Revised UCC Article 5 omits the term "international" in referring to the "standard practice of financial institutions that regularly issue letters of credit". While this difference may be dismissed as a result of the differing venues of the two formulations, such a conclusion would be only partially correct. It may explain the reason for the omission of the term "international" in the revision of US law but it does not provide the further assurance that the omission does not produce a different result. The standard followed by financial institutions that regularly issue letters of credit in the U.S. and elsewhere is an international standard even with respect to the few issues which are domestic because the system is predicated upon international correspondent banking relationships. As a result, any domestic interpretation of a domestic issue must be consistent with the approach which would be taken to similar issues elsewhere. As a result, this difference in language would not yield a different result between domestic law and the Convention.

Another instance worthy of note is the standard by which exceptions to the obligation to pay are to be measured. Article 19 of the UN Convention eschews the formulation preferred by US law which revolves around the notion of fraud. This term was deemed unacceptable in civil systems where fraud connoted criminal fraud and, consequently, a burden of proof that could rarely be met in a non criminal case.

On the other hand, the civil notion of abusive drawing (*abus de droit*) was sufficiently alien to common law notions and sufficiently clouded among the various civil jurisdictions (in a manner similar to the US fraud cases in the 1970s) that it was not acceptable. As a result, the approach undertaken in Article 19 was to identify the situations in which extraordinary relief was warranted. New approaches in terminology which are unavailable can, of course, require further interpretations. As is clear from the record of the proceedings of the Working Group, the intent in adopting these provisions was to produce a standard which made extraordinary relief restrictive and which created a difficult burden of proof for proponents of such relief. In this respect, if not in the terms used, it resembles the approach taken in Revised UCC Section 5-109 which turns upon the notion of “material fraud”. The result, therefore, was intended to be similar.

Other differences in approach:

(a) Article 2(4) which uses “when acting in favour of another person” in lieu of common law notions of trust or representative capacity.

(b) Article 4(b) which uses “habitual residence”, a term employed in a number of conventions, as a default rule for determining the internationality of an undertaking where the undertaking specifies it instead of a place of business.

2. Terminology Which is Unclear or Untested

As is the case with any new effort at the formulation of positive law, the possibility exists that terms may need a further track record of interpretation. In such situations, one must rely on the legislative history, the reporting decisions, oversight review by the Secretariat and Commission, and of Commentators to note non-uniform interpretations which deviate from the purpose of the drafters. On the whole, the instances where such interpretations could arise are relatively small and, even in such situations, the value of a uniform international law outweighs the disadvantages.

Specifically, the texts which may need interpretation are:

(a) Article 2(1): “in conformity with the terms and any documentary conditions of the undertaking”. The question has been raised whether the omission of the adjective “documentary” from the word “terms” in this phrase will be taken to imply that non-documentary terms are acceptable. Such a result is, of course, unlikely in the US where, whatever the jurisprudence regarding “terms”, there is clarity regarding what constitutes a “condition” (an event whose occurrence is uncertain). As long as “conditions” cannot be non-documentary, it makes no difference whether “terms” are non-documentary because the only terms which can impact the undertaking will also be conditions and must, therefore, be documentary in any event (e.g. the expiry date is a non-documentary condition but certainly it is within the purview of a bank operation). Beyond this highly technical interpretation lies the unmistakable intent of the Working Group to adopt the approach taken in UCP 500 Article 13 toward non-documentary conditions. This interpretation is reinforced by the language of Article 3(b) which does not distinguish between a term and condition in that regard. As a result, there should be little doubt that an undertaking within the scope provisions of the Convention could not be one which was fundamentally non-documentary. This interpretation is not only supported by the legislative history of the Convention but also by the literature and dynamic of progressive thought in the field for more than a decade. As a result, the possibility of this interpretation causing difficulties is remote.

(b) Article 5: “the observance of good faith”. Good faith is understood throughout the world as a basis of commercial dealings and jurisprudence. In the U.S., however, this term has been overlaid with a certain degree of controversy stemming from theoretical questions regarding whether the question is subjective or objective, and practical difficulties regarding the scope of the issue to be set before a jury. The objection on the part of many commercial lawyers is that the use of increasingly vague terms to

describe concepts which do not, in any event, admit a scientific definition invites a jury to base its decision on an emotional basis not linked to the merits of the relative legal rights and obligations of the parties. In their defense, it must be noted that fields such as letters of credit are particularly vulnerable to these difficulties since the relative undertakings are based on highly specific allocations of risk and responsibility and are not intended to be “fair” or “reasonable” in any ordinary sense. Outside the US, there is little possibility that such issues could give rise to difficulties in the interpretation of the Convention. Within the US, one must rely on the international character of the Convention, the interpretation given elsewhere, and the limitation of the concept of “good faith” in Revised UCC Section 5-102(a)(7) to the narrow notion of “honesty in fact in the conduct or transaction concerned”.

(b.1.) A similar difficulty may arise in connection with the term “reasonable care” in Article 14. Under US commercial law, obligations of reasonableness may not be varied by agreement, although standards which are not unreasonable may be enforced.⁴ While this regime does not obtain under the UN Convention where Article 14(2) clearly sets forth the limitations to any exculpatory provisions, interpretive rulings may be needed to explain this difference.

(c) Article 12 appears to allow expiry to turn upon an event not embodied in the presentation of a document. Such an approach would create a non-documentary condition and constitute a departure from US law and practice. While the Convention does envision expiry events not linked to documents, it becomes clear that such an undertaking is subject to two important limitations: 1) Article 12(b) indicates that, even if a document is not specified for the purpose of indicating that the event has occurred, the undertaking expires on “certification by the beneficiary of the occurrence of the act or event”; 2.

in any event, it expires six years after the date of issuance where no expiry date is indicated. As a result, the result is not inconsistent with that under US law and practice.

(d) Article 15(3) provides that the beneficiary “when demanding payment, is deemed to certify that the demand is not in bad faith” and that the demand is not fraudulent or abusive. The question arises whether this provision would be understood to give rise to a warranty which survives honor and give rise to a cause of action predicated on the underlying transaction and not the letter of credit. It is clear from the legislative history that no warranty in the sense understood at common law was intended. Nonetheless, as to the presence of fraud, the existence of a basis for relief alternate to that available by injunction can do no harm and is paralleled (allowing for the difference in causes of action) in Revised UCC Section 5-110(a)(1), although it is unclear from the Convention whether this remedy is available to the applicant. As to a certification that the demand is not in bad faith, the result may be duplicative of other remedies but such overlapping remedial provisions can do no harm. There is no possibility from this language of resurrecting the discredited theory that the beneficiary gives a warranty that the statements contained in documents are truthful independent of the certification that there is no fraud.

3. Possible Differences Between the Convention and US Law or Practice

There are several instances where the approach taken in the Convention either differs from or goes beyond the approach taken under US law or practice. None of these instances are fundamental and, because the parties can opt out of the Convention, they are provided with a choice as to which regime they wish to govern. Moreover, the advantages of the Convention outweigh any problems which may be created by these provisions.

4. UCC Section 1-201.

(a) Article 8(3) seems to suggest that the beneficiary cannot consent to an amendment orally or by presenting documents which undoubtedly conform to the amendment but must do so expressly in “any form which provides a complete record”. Since it is consistent with practice for consent to an amendment to be expressed orally or by conduct, this provision establishes a more rigorous standard with respect to consent to amendments than is presently followed in the US. Two ameliorating considerations may soften this conclusion somewhat. In the first place, where the undertaking is subject to standard rules of banking practice such as the UCP or ISP, its provisions provide for consent by conduct. It was thought by the Working Group that issuance of the undertaking subject to these rules would operate to create a permissible variation of the text. In the second place, it is common for telephonic conversations in which consent is given orally to be recorded or confirmed in writing. Such a practice would appear to meet the requirements of Article 8(3).

(b) Article 9(2) provides that the issuer/guarantor is not required to effect a transfer even if it issues a transferable undertaking. This rule apparently differs from Revised Section 5-112(b) which assumes that issuance of a transferable credit obliges the issuer to effect a transfer. In actuality, the differences may not be significant because the UCC provision contains the significant qualification that the issuer may refuse to effect the transfer where it would violate applicable law or for failure to comply with requirements imposed by the issuer in accordance with standard practice or which are otherwise reasonable. As a result, the issuer of a transferable credit under the Revised UCC may not arbitrarily and unreasonably refuse to recognize a request to effect a transfer whereas it may arguably do so under the UN Convention. Since the parties can expressly provide for transfer and opt out of the UN Convention, these differences are not impediments to the adoption of the Convention.

(c) Article 10 recognizes a broad right of the beneficiary to assign the proceeds of any payment under a letter of credit and protects an issuer or

guarantor which makes payment according to such an assignment. While not requiring acknowledgment of an assignment by the issuer, the provision may create an impression among lawyers and courts unfamiliar with letter of credit practice that an acknowledgment by the issuer is required. Under Revised Section 5-114(d), there is no general obligation to acknowledge; where the assignee has possession of the operative instrument and exhibits it under a credit which requires presentation of the operative instrument as a required document, however, acknowledgment may not be unreasonably withheld. The Convention is closer to standard international banking practice (see, e.g. Draft ISP 1997 Rule 6.12). Strictly speaking, there is no conflict but one arguably could arise. Such a conflict could be avoided under rules such as the ISP which would control if added by the parties or otherwise applied.

(d) Article 12(c) provides a default expiration date of six years whereas the expiration date in Revised Section 5-115 is one year. Although these provisions are different, the difference should cause no problems because the undertaking can avoid their operation merely by stipulating an expiration date. If it does not do so, the undertaking can opt out of the UN Convention should the six year default provision be troublesome.

(e) Article 14(2) provides an outer limitation to the ability to exculpate liability, namely in those situations where there is a failure to act in good faith or for grossly negligent conduct. This provision is different from U.S. law which requires that exclusion of liability must be specific and may not be general.

(f) Article 18 provides for set-off, permitting an issuer or guarantor to assert set-off to any obligation arising under the undertaking. This provision is not reflected in Revised UCC Article 5, but at the same time does not conflict with general provisions of US law. Nor does it affect the independence principle. Under general rules of civil procedure, a collateral claim raised in a timely fashion can be asserted and will impact the ultimate recovery.

(g) Article 20(3) expressly provides an exception to the requirement to pay in a situation where there is illegality with regard to a payment under a letter of credit. This provision is not inconsistent with general commercial law but is not expressly contained in Revised UCC Article 5 and is an area where U.S. letter of credit law is not well developed. In all likelihood, US courts would reach a similar result in such a situation. In this respect, the Convention may arguably be an improvement on U.S. law.

(h) Articles 21, 22, and 1(3) create a system of conflict of law rules which govern situations where the Convention is applicable, even where the undertaking opts out of or otherwise is not covered by the Convention. Thus, the Convention's conflicts rules might apply to a class of undertakings even where a particular undertaking was not otherwise subject to the Convention's substantive rules. For example, should the undertaking not stipulate a choice of law, the default rule is the place of business where the issuer or guarantor issued the undertaking. While this rule does not contain the nuances of Revised Section 5-116(b) for nominated parties, it states the current conflicts rule followed by most U.S. courts regarding the issuer (and presumably the confirmer). Since the parties have the autonomy to choose their own rules, the only dislocation which would result is in a situation where the Convention would apply, the undertaking opted out but did not choose an applicable law, and any litigation involved a nominated person. Even in such a situation, it is possible that the court would analogize the situation of the nominated person to that of the issuer or guarantor and apply its law.

IMPLEMENTATION ISSUES

The Convention is self-executing, and no state or federal legislation would be necessary for the United States to fulfill its obligations or desirable in order to facilitate compliance.

Execution and Implementation of the Convention

Further, the Convention would have no federal or state budgetary implications, nor any other resource implications.

Other Affected Groups

The US Council on International Banking, Inc., the trade association representing the 320 major US and foreign banks engaged in letter of credit practice is expected shortly to give an unqualified endorsement of the Convention. The Secretary of State's Advisory Committee on Private International Law, which includes representatives from 11 nationally based law organizations, the Departments of Justice and Commerce, and other participants, has recommended that the U.S. sign the Convention.

CONCLUSION

The ratification of the Convention by the United States would, on the whole, further the issuance and payment of obligations under letters of credit and independent guarantees, and the interchange of these instruments. Although the Convention necessarily contains a few provisions and language choices different from those US drafters would have used, these provisions do not represent unfavorable deviations from the status quo and, in most cases, may be adequately addressed in the undertaking itself, as is the current practice in the trade. It is the conclusion of the Subcommittee acting through the Uniform Commercial Code Committee that the advantages of the Convention far outweigh any possible problems and its recommendation that the Business Law Section should act to assure its prompt signature and endorsement by the U.S.

U.S. ratification of the Convention is crucial for its acceptance by other nations which regard the position of the U.S., as the place of origin of the standby letter of credit, as a bell weather of the viability of the compromise it embodies. It is in the interest of the U.S. to have the certainty provided by the Convention in situations where U.S. domestic letter of credit law does not apply and where,

otherwise, a legal regime often unknown and unpredictable, would obtain.

Respectfully submitted,

Professor James E. Byrne
Chair
Letter of Credit Subcommittee
of the
Uniform Commercial Code Committee

May 1997

EXECUTIVE SUMMARY

1. Summary of the Recommendation

The Letter of Credit Subcommittee acting through the Uniform Commercial Code Committee recommends that the Business Law Section of the American Bar Association seek the support of the American Bar Association to the signing and ratification of the UN Convention on Independent Guarantees and Stand-by Letters of Credit by the United States.

2. Summary of the Supporting Report

On 11 December 1995, the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (the "Convention") was formally adopted by the General Assembly, and is now being presented to individual states for signature and ratification. The Convention remains open for signature until December 13, 1997.

The UN Convention on Independent Guarantees and Stand-by Letters of Credit will be of assistance to United States parties doing business in those countries which do not have a developed body of law governing letters of credit, and in those countries (such as the U.S.) in which practice is concentrated in one or the other of the instruments governed by the Convention, and thus would further international trade. The freedom of the parties to contract out of the Convention or alter its application allows parties to contractually change provisions of the Convention which might be objectionable. Taken as a whole, the UN Convention is not in conflict with domestic law, will be compatible with current international trade practices, and will be of aid to United States parties to international letter of credit or independent guarantee undertakings.