

Reimbursement under the Standby Letter of Credit Convention

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1. Possible Reimbursement Situations under the Standby Letter of Credit Convention

The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit¹ (the Convention) gives rise to a variety of interesting and commercially significant scenarios involving reimbursement. The Convention was approved by the UN General Assembly on 11 December 1995 and entered into force on 1 January 2000, making it the only international source of law for letters of credit and demand guarantees.² Reimbursement is a situation where a person obliged or entitled to pay the guarantee (or standby) amount to the beneficiary (i.e. a confirming bank, nominal bank, or the issuer or guarantor), pays it and subsequently demands repayment of the paid sum from another person. Ultimately, the person from whom reimbursement is sought is typically

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¹ United Nations Convention on Independent Guarantees and Stand-by Letters of Credit art. 5, Dec. 11, 1995, A/RES/50/48, *available at* <http://www.uncitral.org/pdf/english/texts/payments/guarantees/guarantees.pdf> [hereinafter The Convention]. As of 1 November 2010, eight nations have ratified or acceded to the Convention: Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia. The United States of America has signed the Convention but has not yet ratified it or acceded to it. United Nations Treaty Status Database ch. X § 15, <http://treaties.un.org/doc/Publication/MTDSG/Volume%20I/Chapter%20X/X-15.en.pdf> (last visited Nov. 1, 2010).

² Notably, but for the Convention there is no international law concerning letters of credit. There are a few instances of national law that may be highlighted. Within the United States, the law with regard to “standby letters of credit, the topic of the Convention, is Article 5 of the Uniform Commercial Code (UCC). Completely revised in 1995, Article 5 is up-to-date and consistent with commercial practices both in the United States and abroad.” James White, *Implementing the Standby Letter of Credit Convention with the Law of Wyoming*, 1 Geo. Mason J. Int'l Comm. L. 1, 5 (2010). The text of UCC Article 5 is available at <http://www.law.cornell.edu/ucc/5/>. Within the People's Republic of China (PRC), the People's Supreme Court has provided a set of judicial interpretations, referred to as the PRC letter of credit rules. The Institute of International Banking Law and Practice has published an unofficial, English translation of these rules. See INSTITUTE OF INTERNATIONAL BANKING LAW AND PRACTICE, LC RULES AND LAWS (4th ed. 2010).

within the circle of those persons who seek issuance of the standby or guarantee, either in conjunction with the guarantee or standby's issuance or the underlying transaction. They are known under practice rules as "applicants" and will be so named in this article although the UN LC Convention refers to this party as the "principal/applicant."³ The Convention does not expressly mention reimbursement; nor does the Convention expressly attribute to anyone the right to be reimbursed from any payment made pursuant the standby or guarantee. However, the Convention does describe events or situations in which reimbursement should be considered as a natural consequence of payment under the standby or independent guarantee.⁴

Although the UN LC Convention does not address questions of reimbursement, it does recognize the important role of rules of practice.⁵

³ At the time of the drafting of the UN LC Convention, demand guarantee practice was in the process of liberating itself conceptually from that of accessory or suretyship guarantees. As a result, the term "principal" was in common use for independent guarantees as is reflected in the Convention text, which provides "[t]he undertaking may be given: (a) At the request or on the instruction of the customer ('principal/applicant') of the guarantor/issuer" The Convention, *supra* note 1, art. 2(2)(a). Applicants are also known as "customers" or "account parties." The *Uniform Customs and Practices for Documentary Credits 600* (UCP600) states in Article 2 (Definitions) that "[a]pplicant means the party on whose request the credit is issued." *The Uniform Customs and Practice for Documentary Credits (UCP600)*, International Chamber of Commerce [ICC] Publ'n No. 600 art. 2 (July 1, 2007) [hereinafter UCP600]. The *International Standby Practices 98* (ISP98) states in Rule 1.09(a) (Definitions), "[a]pplicant' is a person who applies for issuance of a standby of for whose account it is issued, and includes (i) a person applying in its own name but for the account of another person or (ii) an issuer acting for its own account." *The International Standby Practices 1998* (ISP98), R. 1.09(a), ICC Publ'n No. 590 (Jan. 1, 1999) [hereinafter ISP98]. The *Uniform Rules for Demand Guarantees 458* (URDG458) alludes to issuance "at the request or on the instructions and under the liability of a party (hereinafter called the 'Principal')" *Uniform Rules for Demand Guarantees (URDG458)*, ICC Publ'n No. 458 art. 2(i) (1992) [hereinafter URDG458]. The 2010 revision to URDG458, *Uniform Rules for Demand Guarantees 758* (URDG758), abandons "principal" in favor of "applicant" and provides in Article 2 (Definitions) that "applicant means the party indicated in the guarantee as having its underlying obligation supported by the guarantee." *Uniform Rules for Demand Guarantees (URDG758)*, International Chamber of Commerce Publ'n No. 758 art. 2 (2010) [hereinafter URDG758].

⁴ The Convention, *supra* note 1, arts. 2(2)(b), 6(c)-(e).

⁵ *See id.* art. 13 ("(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

Among these contractual or customary governing rules⁶—with optional or supplementary meaning—must be mentioned the International Standby Practices (ISP98),⁷ the Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR525),⁸ the Uniform Customs and Practice for Documentary Credits (UCP600)⁹ and Uniform Rules for Demand Guarantees (URDG), all having been endorsed by the International Chamber of Commerce (ICC).¹⁰ These rules are more explicit concerning reimbursements, although the UCP deals with commercial letters of credit, which are not the focus of the Convention.¹¹

to *generally accepted international rules and usages* of independent guarantee or stand-by letter of credit practice.”) (emphasis added); *id.* art. 14(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 stand-by letters of credit.”) (emphasis added); and *id.* art. 16(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 stand-by letter of credit practice.*”) (emphasis added).

⁶ These rules could be understood to be “contractual” in the sense that they are voluntary obligations. Technically, there is no “agreement”, since the undertaking unilaterally states that it is subject to them. However, though there is no obligation on the part of the beneficiary to act under the undertaking the beneficiary does so with awareness of the applicability of the rules as a condition of the undertaking, which is, in effect, incorporated by reference. Many of the rules also reflect standard international letter of credit practice and, as such, are customary and have been applied in the absence of a contrary provision in the undertaking even where it is not expressly subject to them.

⁷ See ISP98, *supra* note 3.

⁸ *Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR525)*, ICC Publ'n No. 525 (1996) [hereinafter URR525].

⁹ UCP600, *supra* note 3. This revision replaced *The Uniform Customs and Practice for Documentary Credits (UCP500)*, ICC Publ'n No. 500 (January 1, 1994), which was in effect at the time that the drafting of the Convention was completed.

¹⁰ URDG458, *supra* note 3, was in effect at the time that the Convention was completed. An early version of these rules was considered at a meeting of the Working Group in 1988. There is no reference to reimbursement in this version. URDG458 was revised effective 1 July 2010 and replaced with URDG758, which expressly contemplates reimbursement in Articles 21 and 22 and implies reimbursement situations in Articles 23, 24, 25, 26 and 33. See URDG758, *supra* note 3.

¹¹ *But cf.* The Convention, *supra* note 1, Article 1(2) (expressly permitting commercial letters of credit to incorporate the convention).

As will be explained in following paragraphs, the parties to a standby or demand guarantee can refer in the text of the standby or demand guarantee to a number of “rules, general conditions or usages” that are separate texts apart from the Convention.¹² Furthermore, the Convention provides that “regard shall be had to generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice.”¹³ That means that not only the Convention but also other rules of practice can govern directly or indirectly the standby or demand guarantee and any related reimbursements whether provided for therein or otherwise available.¹⁴

Though not expressly mentioned in its text, there are at minimum three reimbursement situations contemplated by the Convention:

- i) After payment to the beneficiary, the issuer asks for reimbursement from the instructing party or principal/applicant. Article 2 of the Convention describes this situation.¹⁵ The transfer of funds from the instructing party to the issuer before the issuance of the standby or demand guarantee or even after its issuance but before any payment to the beneficiary under the guarantee is *not* considered a reimbursement. However, such a transfer is very similar with only one particular difference, namely the moment in which the issuer or guarantor is funded is not after to payment to the beneficiary on the independent undertaking but prior to it. Though the moment of satisfaction is different, in both situations the issuer or guarantor is reimbursed for its payment, whether anticipated or actual.¹⁶

¹² *Id.* art. 13(1).

¹³ *Id.* art. 13(2).

¹⁴ UNCITRAL, Explanatory note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit cmt. 5, U.N. Doc. A/CN.9/431 (July 4, 1996), *available at*, <http://daccess-ods.un.org/TMP/9645256.html>.

¹⁵ The Convention, *supra* note 1, art. 2 (“[t]he undertaking may be given (a) at the request or instruction of the ... “principal/applicant” ... [or] (b) on the instruction of [an] ... “instructing party” that acts at the request of the customer ...”).

¹⁶ *Id.* art. 6(c).

- ii) After payment to the guarantor-issuer or issuer of the counter-standby of a local guarantee or counter-standby in favor of a local beneficiary by the counter-guarantor, the latter can claim reimbursement for the amount paid from its instructing party or applicant. Article 6(c) of the Convention contemplates this type of reimbursement.¹⁷
- iii) After payment to the Beneficiary by the Confirmer, the latter can claim for reimbursement of the paid amount from the issuer under the definition contained in Art. 6(e) of the Convention.¹⁸ It is not clear in practice whether the confirmer has a right to claim reimbursement directly from the applicant in the event that the issuer is insolvent. The issue is more readily resolved under commercial letters of credit where the documents typically represent commercial goods that are of value to the applicant although the location of the documents is important. Where they are tied up in the liquidation of the issuer, the applicant will not readily agree to reimburse the confirmer. With respect to standby letters of credit, it is rare that the documents have any inherent value. This issue is interstitial under the Convention and would probably be resolved under local law. However, UCP600 Art. 7(c) refers to reimbursement without reference to the given value. This provision is fully consistent with the independence of standbys and guarantees with respect to the underlying transaction.¹⁹

Reimbursement situations expressly contemplated under the above-mentioned additional non-convention texts—particularly under ISP98—are the following:

- i) With regard to the ISP98, there is an initial reimbursement provision concordant with the situation described in Article 2 of the Convention: “[w]here a payment is made against a complying presentation, reimbursement must be made by ... an applicant to an issuer requested to issue a standby”²⁰

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* art. 7(c).

²⁰ ISP98, *supra* note 3, R. 8.01(a)i.

- ii) Reimbursement must also be made by “an issuer to a person nominated (in the standby) to honour or otherwise give value.”²¹ ISP98 Rule 8.02(a), which is formulated to take into account other purposes, establishes a list of nominated persons: “persons nominated with the applicant’s consent to advise, confirm, honour, negotiate, transfer, or to issuer a separate undertaking.”²² In the case of issuance of a transferable standby, a transfer of drawing rights can be made by the beneficiary to a third party. If this occurs, the issuer or other nominated person must honor the drawing by this another person as if that person were the beneficiary as provided in ISP98 Rule 6.01.²³ In this case, pursuant to ISP98 Rule 6.05, the issuer or nominated person that has paid against a regular transfer of the standby is entitled to reimbursement as if it had made payment to the beneficiary.²⁴ As usually is the case when transfer of rights is made, this situation is very complex and nuance is necessary. It should be noted that the transfer is made not with regard to a property right or a credit but with regard to the right to draw against the issuer of the transferred standby.
- iii) Any issuer or nominated person paying under acknowledged assignment of proceeds under a standby pursuant to ISP98 Rule 6.08 is “entitled to reimbursement as if it has made payment to the beneficiary.”²⁵ ISP98 clearly states that the right to claim and the conditions for acknowledgement of assignment of proceeds is a situation completely different than the transfer or negotiation of the standby.²⁶ In fact, an assignment relates solely to the proceeds and not to the rights under the standby. For a continental jurist, it

²¹ *Id.* R. 8.01(a)ii.

²² *Id.* R. 8.02.

²³ *Id.* R. 6.01 (“Where a beneficiary requests that an issuer or nominated person honour a drawing from another person as if that person were the beneficiary, these Rules on transfer of drawing rights (“*transfer*”) apply.”).

²⁴ *Id.* R. 6.05 (“An issuer or nominated person paying under a transfer pursuant to Rule 6.03(a), (b)(i), and (b)(ii) is entitled to reimbursement as if it had made payment to the beneficiary.”).

²⁵ *Id.* R. 6.10.

²⁶ *Id.*

represents a situation similar in concept to differentiating between legitimacy and tularity.

- iv) Under a standby issued pursuant to ISP98, any issuer or nominated person paying under a transfer by operation of law is entitled to reimbursement as if it has made payment to the beneficiary.²⁷ While Rule 6.14 clearly states the right to claim, ISP98 Rule 6.12 sets out various conditions to be fulfilled in order to made the claim: presentation of an additional document which appears to be issued by a public official and indicates that the claimant is a successor of the initial beneficiary as consequence of a structural modification of a corporation, an insolvency proceeding, or the death or incapacity of a natural person.²⁸

Additional reimbursement situations expressly contemplated under the above mentioned non-conventional texts—particularly under UCP600—are the following:

- i) Pursuant to UCP600, a reimbursement situation occurs when “an issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation of a documentary credit and forwarded the documents to the issuing bank.”²⁹ The same article indicates other circumstances—for instance, time and independency of undertakings—concerning the reimbursement.³⁰ Furthermore, it is necessary to recall UCP600 Article 12(a) concerning the circumstances under which the nominated bank is entitled to reimbursement under the credit.³¹
- ii) Pursuant to UCP600, “a confirming bank undertakes to reimburse another nominated bank that has honoured or negotiated a complying presentation of a documentary credit and forwarded the documents to the issuing bank.”³² The article indicates other

²⁷ *Id.* R. 6.14.

²⁸ *Id.* R. 6.12.

²⁹ UCP600, *supra* note 3, art. 7(c).

³⁰ *Id.*

³¹ *Id.* art. 12(a).

³² *Id.* art. 8(c).

additional circumstances—time and independence of the undertaking—concerning the reimbursement, in a manner similar to UCP600 Article 7(c).³³

In fact, the rules governing reimbursements under UCP600 complement the provisions of the Convention concerning the relationship between the parties to a standby. The Convention's text, as stated above, does not contain specific provisions on reimbursement; it merely describes situations in which the natural consequence would be a reimbursement. In short, the Convention is silent as it pertains to the particularities of a reimbursement. Accordingly, UCP600 Articles 7 and 8 complement the Convention in that they expressly mention the right of the paying bank under a documentary credit—or a standby as is demonstrated *infra*—to be reimbursed by the issuer or confirming banks.³⁴

2. Applicable Law

As indicated *supra*, the Convention was designed to be the applicable law with respect to reimbursements under a standby or demand guarantee. The fact, however, that the Convention makes no mention of reimbursement forces one to search for additional and express rules of practice governing the issue. In performing that task, the Articles 13 and 14 of the Convention are especially helpful in finding additional norms to the Convention provisions. The extent of their relevance is as follows:

- i) Article 13(1) makes reference to “rules, general conditions or usages specifically referred to therein (the stand-by)” in order to determine the rights and obligations arising from the undertaking.³⁵
- ii) Article 13(2) states that regard shall be had to “generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice” in interpreting terms and conditions of the undertaking and in settling questions that are not addressed by the conditions of the undertaking or the provisions of the Convention.³⁶

³³ *Id.* arts. 7(c), 8(c).

³⁴ *Id.* arts. 7-8.

³⁵ The Convention, *supra* note 1, art. 13(1).

³⁶ *Id.* art. 13(2).

- iii) Article 14(1) makes a third express reference to customary rules and practices that are globally accepted. However, the reference is made with a more limited scope: only to supplementary customary rules governing the discharge of the issuer or guarantor's obligations under the undertaking and the Convention by the guarantor/issuer. This person "shall act in good faith and exercise reasonable care having due regard to *generally accepted standards of international practice of independent guarantees or stand-by letters of credit*" (emphasis added).³⁷

Thus, the Convention is not alone in determining rights and obligations of the parties to a standby at the moment of their exercise or discharge. The Convention text is complemented by rules, general conditions or usages specifically referred to by the standby and also by generally accepted international standards, rules and usages of independent guarantee or standby letter of credit practice, irrespective of specific facial mention in the standby itself. Accordingly, the mandates formulated by Articles 13 and 14 of the Convention open the door to the qualification as applicable law to the reimbursement regime under a standby to ISP98, UCP600, and also, *mutatis mutandis*, URR 525. It is my opinion that these three rules of practice serve an interpretation function for the Convention regardless of their own discrete internal provisions and requirements. For example, the incorporation into the text of the Reimbursement Authorization in the case of the URR 525³⁸ is not necessary when the rules are used solely to aid in the interpretation of the Convention according to Articles 13(2) and 14(1).

3. Legal Requirements for Reimbursement

It is useful to identify a comprehensive list of legal requirements to be satisfied by the claimant in order to obtain reimbursement of its payment to the beneficiary made under a standby. Some common requirements can be identified taking into account the Convention provisions and all the supplementary applicable rules arising from the international practice. They are common in that the applicable law requires their fulfillment in all the cases of reimbursement previously mentioned. These common requisites are prior payment and the conformity of the demand.

³⁷ *Id.* art. 14(1) (emphasis added).

³⁸ URR525, *supra* note 8, art. 1.

Prior payment is the first condition in order to claim reimbursement from the issuer or any other person. The payment should be made in accordance with the Convention: payment when the presentation is made, deferred payment if so provided in the standby or as a result of set-off.³⁹ What appears impossible under the Convention is to claim reimbursement without having made previous payment. Where the bank that claims reimbursement, for example, charged the issuer or confirmer's account without having made payment, the issuer can ask for a provisional measure or injunction to impede any payment under the standby, thus excluding reimbursement.⁴⁰ Where the issuer or guarantor charges the applicant or instructing party's account without having become obligated, it remedies must be in the reimbursement agreement. Where a nominated bank has not honored, it is not entitled to reimbursement either. In addition, the issuer or guarantor can also assert a defence that the demand for reimbursement has been made without prior payment. With regard to reimbursement by the issuer, the prior payment condition is crystal clear in ISP98 Rule 8.01.⁴¹ This clarity appears also in other applicable rules in the International Standby Practices.⁴²

Payment must be made at the appropriate moment. That means that if the standby provides for a deferred payment, the reimbursement claim should be made after the exhaustion of the deferred period for payment.⁴³

³⁹ The Convention, *supra* note 1, arts. 17 (“(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.”); and *id.* art 18 (“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.”).

⁴⁰ *Id.* art. 20.

⁴¹ ISP98, *supra* note 3, R. 8.01 (stating “where payment is made against a complying presentation in accordance with these Rules” as a precondition to any reimbursement).

⁴² See *supra* notes 23-31 and accompanying text.

⁴³ The Convention, *supra* note 1, art. 17(a) (“payment shall be made promptly, unless the undertaking stipulates payment on a deferred basis ...”).

The second condition for reimbursement involves the necessity of a conforming demand prior to payment. The demand and accompanying documents, if any, should comply with the facial requirements stated in the standby unless the rule of preclusion operates. As Article 15 of the Convention provides, any demand for payment under the undertaking shall be made "... in conformity with the terms and conditions of the undertaking."⁴⁴

The conformity of the demand with respect to the claim for reimbursement is also required by Article 17(1) of the Convention⁴⁵ and is also reflected in ISP98.⁴⁶ The legal consequences of a non-complying presentation are fatal with respect to the reimbursement (except where the preclusion rule operates). As established in Article 17(2) of the Convention "any payment against a demand that is not in accordance with the provision of Article 15 does not prejudice the rights of the principal/applicant."⁴⁷ This implies that any subsequent reimbursement claim made by the paying person against the instructing party will not succeed in view of the lacking conformity of the presentation.

A standby can nominate persons who are entitled, typically with the applicant's consent, to confirm, honor, pay, negotiate, transfer or issue a separate undertaking (for instance, a counter-guarantee or counter-standby). Notably, a claim for reimbursement made subsequent to payment by a nominated person will only succeed if the nomination of the paying person was made by the issuer as indicated by ISP98 Rule 8.02(a).⁴⁸

⁴⁴ *Id.* art. 15.

⁴⁵ *Id.* art. 17(1) ("Following a determination that a demand for payment so conforms (to Article 15), payment shall be made ...").

⁴⁶ See ISP98, *supra* note 3, R. 8.02, 6.05, 6.10, 6.14 (the conformity in general is less explicit than the specific conformity and documental demonstration of the concerned transfer, assignment of proceeds or transfer by operation of law).

⁴⁷ The Convention, *supra* note 1, art. 17(2).

⁴⁸ ISP98, *supra* note 3, Rule 8.02(a) ("An applicant must pay the issuer's charges and reimburse the issuer for any charges that the issuer is obligated to pay to persons nominated with the applicant consent to advise, confirm, honour, negotiate, transfer, or to issue a separate undertaking").