

International Measures to Prohibit Fraudulent Calls on Demand Guarantees and Standby Letters of Credit

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Introduction

It is common practice for many buyers, in particular foreign buyers, to demand that sellers, exporters or suppliers provide bank demand guarantees or standby letters of credit as security to ensure that the terms of their tender or contract (depending on the circumstances) are adhered to. Bank demand guarantees and standby letters of credit have become an established part of international trade, particularly in construction and engineering projects, and international sale of goods contracts.

Demand guarantees and standby letters of credit imply the danger that they may be abused. In fact, in the past few decades many cases in various countries have been brought before the courts where a party to, for example, an export transaction has complained that the other party has used the demand guarantee or standby letter of credit contrary to its purpose; in other words, tried to collect money under the guarantee or standby letter of credit in an unjustified or fraudulent way.¹ An abuse of a demand guarantee/standby letter of credit can be described as a case where the risk covered by that guarantee/standby letter of credit has not materialised and payment is demanded without justification.

The International Chamber of Commerce (ICC) and the United Nations Commission on International Trade Law (UNCITRAL) have both been active in seeking a solution to the problems caused by unfair or fraudulent calls on demand guarantees and standby letters of credit. Four instruments that are particularly relevant are (1) the ICC Uniform Rules for Contract Guarantees (URCG);² (2) the ICC Uniform Rules for Demand

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¹ See Ross P. Buckley & Gao Xiang, *The Development of the Fraud Rule in Letter of Credit Law; The Journey So Far and the Road Ahead*, 23 U. PA. J. INT'L ECON. L. 663, 688-99 (2002).

² *Uniform Rules for Contract Guarantees (URCG)*, International Chamber of Commerce [ICC] Publ'n No. 325 (1978) [hereinafter URCG].

Guarantees (URDG458);³ (3) the International Standby Practices (ISP98);⁴ and (4) the United Nations Convention on Independent Guarantees and the Stand-by Letters of Credit (the Convention).⁵ The first three instruments of the ICC are, in effect, standard-term contract rules available for incorporation into demand guarantees and standby letters of credit by the parties if they so choose. The adoption of the Convention by a state has the effect of making it law in that state.⁶

In this article particular attention will be paid to the international attempts made by the ICC and UNCITRAL to prevent unfair or fraudulent calls on demand guarantees and standby letters of credit. Attention will also be given the ICC's Uniform Customs and Practice for Documentary Credits (2007 version) (UCP600)⁷ and their predecessor, the Uniform Customs and Practice for Documentary Credits (1993 version) (UCP500)⁸ neither of which contain provisions attempting to prevent unfair or fraudulent demands being made on commercial or standby letters of credit. The article also examines which of the ICC instruments and the Convention departs the furthest from the principle of autonomy in the context of demand guarantees and standby letters of credit. Broadly speaking, the URDG and the

³ *Uniform Rules for Demand Guarantees (URDG458)*, ICC Publ'n No. 458 (1992) [hereinafter URDG458]. The URDG has recently undergone a dramatic revision, effective earlier this year. See *Uniform Rules for Demand Guarantees (URDG758)*, ICC Publ'n No. 758 (2010) [hereinafter URDG758].

⁴ *The International Standby Practices 1998 (ISP98)*, ICC Publ'n No. 590 (Jan. 1, 1999) [hereinafter ISP98].

⁵ 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).

⁶ The Convention, *supra* note 5, art. 1(1)(a) (stating that the Convention applies "if the place of business of the guarantor/issuer at which the undertaking is issued is a Contracting State."). See also *id.* art. 28(2).

⁷ *The Uniform Customs and Practice for Documentary Credits (UCP600)*, ICC Publ'n No. 600 (July 1, 2007) [hereinafter UCP600].

⁸ *The Uniform Customs and Practice for Documentary Credits (UCP500)*, ICC Publ'n No. 500 (January 1, 1994) [hereinafter UCP500].

Convention have both attempted to protect the principal of a demand guarantee against unfair calls in a manner that severely weakens the principle of autonomy, whereas the URDG have attempted to effect a compromise between the parties by effectively subjecting all calls on demand guarantees to documentary conditions.⁹

Uniform Customs and Practice for Documentary Credits

UCP600 contains no provisions that attempt to prevent unfair or fraudulent calls on commercial or standby letters of credit.¹⁰ Neither did its predecessor, UCP500. The UCP do not deal with the problems that arise where documents presented under a credit are forged or otherwise fraudulent.¹¹ Article 34 of UCP600 goes as far as stating that a “bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document.”¹² In fact, the UCP are completely silent on the issue of fraud and the fraud exception (i.e., fraud rule). The reason for this is that the UCP were primarily devised to provide a contractual framework for dealings between issuers and

⁹ See Charles Debattista, *Performance Bonds and Letters of Credit: A Cracked Mirror Image*, J. BUS. L. 289, 295 (1997).

¹⁰ The UCP applies to commercial letters of credit. In the 1980s, the ICC promulgated the first version of the UCP (UCP400) to provide that the UCP would also apply to standby letters of credit, to the extent to which they may be applicable to standby letters of credit. *The Uniform Customs and Practice for Documentary Credits (UCP400)*, ICC Publ'n No. 400 art. 1 (1983) [hereinafter UCP400]. In 1993, the ICC revised the 1983 version and promulgated the 1993 version (UCP500) with a similar scope provision. UCP500, *supra* note 8, art. 1. See also John F. Dolan, *The UN Convention on International Independent Undertakings: Do States with Mature Letter-of-Credit Regimes Need It?*, 13 BANKING & FIN. L. REV. 1, 2 (1998). The 1993 version was similarly revised and promulgated in 2006 (UCP600). See UCP600, *supra* note 7. Although the UCP apply to commercial letters of credit and standby letters of credit, by implication they also apply to demand guarantees, since demand guarantees, though not mentioned in the UCP, are the same from a legal viewpoint as standby letters of credit. See Roy Goode, *Abstract Payment Undertakings and the Rules of the International Chamber of Commerce*, 39 ST. LOUIS U. L.J. 725, 729 n.20 (1995) [hereinafter Goode, *Abstract Payment*]; and ROY GOODE, ICC PUBL'N NO. 510, *GUIDE TO THE ICC UNIFORM RULES FOR DEMAND GUARANTEES 8* (1992) [hereinafter the *GUIDE TO THE URDG*].

¹¹ Buckley, *supra* note 1, at 312-13.

¹² UCP600, *supra* note 7, art. 34. The UCP500 contained a similar provision. See UCP500, *supra* note 8, art. 15.

beneficiaries, and issuers and correspondent banks.¹³ The UCP do not deal with the rights and duties of parties to the underlying contract, nor is it the function of the UCP to regulate issues that are the proper province of national law and national courts.¹⁴ The content and the interpretation of the ICC uniform rules are equally influenced by the fact that their function is to serve as rules of best banking practice, not rules of law; and the issue of the fraud exception is commonly considered as the responsibility of the applicable national law and of the courts of the forum.¹⁵ Therefore, national laws should deal with any injunctive relief on the grounds of fraud by the beneficiary. The drafters of the UCP500 and UCP600 deliberately decided to leave out the fraud issue.¹⁶ Accordingly, the lack of a provision for fraud in the UCP demonstrates the intention of the drafters that the issue of fraud should be determined by the applicable national law.¹⁷ As Ross Buckley suggests, “The difficulty with leaving these issues to national law is that, except in the United States, such cases come so rarely before the courts that there are very limited opportunities to develop a coherent body of rules.”¹⁸

The view has been expressed that the decision of the drafters of the UCP500 not to address the issue of fraud “reflected either an unwillingness to tackle a difficult but necessary issue or an outdated view of the limited scope of the UCP as merely a codification of bankers’ practices rather than a dispositive regime of rules.”¹⁹ It has been said that one of the main weaknesses of the UCP500 was that it did not address the rights of an

¹³ Xiang Gao, *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 56 (Kluwer Law Int’l 2002).

¹⁴ *Id.*

¹⁵ Goode, *Abstract Payment*, *supra* note 12, at 727.

¹⁶ GAO, *supra* note 13.

¹⁷ For instance, in England, South Africa and Australia, the common law applies, but in the United States Revised Article 5, Section 5-109 of the Uniform Commercial Code (hereinafter the ‘UCC’) applies. *See also* John F. Dolan, *Commentary on Legislative Developments in Letter of Credit Law: An Interim Report*, 8 BANKING & FIN. L. REV. 53, 63 (1992); Katherine A. Barski, *Letters of Credit: A Comparison of Article 5 of the Uniform Commercial Code and the Uniform Customs and Practice for Documentary Credits*, 41 LOY. L. REV. 735, 751 (1996); GAO, *supra* note 15, at 56.

¹⁸ Ross P. Buckley, *The 1993 Revision of the Uniform Customs and Practice for Documentary Credits*, 28 GEO. WASH. J. INT’L L. & ECON. 265, 303 (1995).

¹⁹ *Id.* at 302.

applicant of a documentary credit against a bank that proposes to pay on documents that are forged or otherwise fraudulent.²⁰

Then again, several commentators have welcomed this inactive approach of the UCP as a remarkable success. It is their view that any attempt by the ICC to formulate a uniform fraud exception is unnecessary and bound to fail, since the fraud exception is rather sensitive to national laws and these rules vary among jurisdictions.²¹ They contend that the current position of the UCP may generate an incentive for the different jurisdictions to fashion fraud exceptions that do not interfere with the marketability of credits issued by the jurisdiction's banks.²²

Xiang Gao disagrees.²³ He is of the view that although it is correct that the UCP are technically not law, but a collection of accepted commercial practices, the truth is that the UCP are currently incorporated into substantially all cross-border commercial letters of credit (and also to a lesser extent into standby letters of credit), studied and observed by letter of credit bankers and users globally, and accordingly, treated as *quasi-law* of credit. Therefore, the UCP have basically become *de facto* law. He also says that a good commercial law is one that serves commerce best. A law that serves commerce best maximises certainty and predictability for the commercial world. To have such an effect, a law should provide the best answer it can give to problems that can be predicted. Furthermore, it is debatable whether the UCP satisfy this standard without dealing with the fraud issue. Although the drafters of the UCP knew of this problem and that it caused problems in documentary credit transactions, they still chose not to address it, leaving users of commercial and standby letters of credit without any guidance on how to deal with the fraud they might encounter.²⁴ Accordingly, this has left both the commercial and standby letter of credit community with a degree of uncertainty and unpredictability.²⁵

²⁰ *Id.* at 312–313.

²¹ Janet Ulph, *The UCP600: Documentary Credits in the Twenty-first Century*, J. BUS. L. 355, 371 (2007).

²² *See* Dolan, *supra* note 17, at 63; Barski, *supra* note 17, at 751; GAO, *supra* note 13, at 56.

²³ *See* GAO, *supra* note 13, at 56–57.

²⁴ *Id.*

²⁵ *Id.*

In Gao's view, what makes matters worse is the fact that national fraud exceptions are often diverse and lacking in clarity.²⁶ In such a situation, when a fraud case goes to court and a decision is made, the decision will most likely not be criticised by the letter of credit experts for not conforming with the practice of the letter of credit community and for being detrimental to the commercial utility of letters of credit. It is therefore ironic that in drafting the UCP, those same letter of credit specialists say that it is for the courts to make the relevant rules. According to Xiang Gao, this is neither logical nor fair to the courts.²⁷

It is true that the letter of credit is a specialised commercial creature and that the law governing it is complex. Even letter of credit specialists are at times perplexed by its complicated structure and the relationships between the parties. Although judges should be legal experts, it is not practical to expect each judge to be an expert in the law of letters of credit or to make good law within the short period of time that a case is before a court.²⁸ In reality, most trial judges have hardly had any experience with letter of credit matters.²⁹

I agree with Xiang Gao's opinion that it is desirable for the drafters of the UCP, who are well-known letter of credit experts, to provide guidance for issues commonly raised during practice, such as the issue of fraud. I also concur with his view that even if a detailed rule is not practical, guidance is better than nothing.³⁰ Schmitthoff had already submitted in 1982 that it would have been desirable for the 1983 version of the UCP³¹ to have dealt with the problem of fraud.³² It is regrettable that the 2007 version of the UCP has again remained silent on the issue of fraud.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.* See also The Report of the Task Force on the Study of the United States' Uniform Commercial Code Article 5 'An Examination of UCC Article 5 (Letters of Credit)', 45 BUS. LAW. 152, 161 (1990).

³⁰ See GAO, *supra* note 13, at 57.

³¹ UCP400, *supra* note 10.

³² See Clive M. Schmitthoff, *Export Trade*, 44 J. BUS. L. 319, 321 (1982).

Uniform Rules for Contract Guarantees

The URCG are aimed at encouraging more equitable practices in the area of contract guarantees³³ particularly by limiting the problem of unfair calling of these guarantees. Therefore, unlike the UCP, the URCG have attempted to deal with the unfair calling of demand guarantees.³⁴ Of the rules of practice examined in this article the URCG went furthest in protecting the principal against unfair calls.³⁵ It was considered desirable that the URCG should not provide for first demand guarantees payable without any evidence of default. To prevent abuse by unscrupulous beneficiaries, the URCG therefore provide that “evidence” of default by the principal is required to justify the honouring of a claim under a contract guarantee.³⁶ It can be expected that in most cases the parties to such a guarantee will specify in it what form of evidence is required. Guarantors have been advised to require documentation prepared independently of the beneficiary and in a form capable of verification by the guarantor.³⁷ For example, a claim under a performance guarantee could be required to be supported by a certificate from specific engineers indicating the defect in the construction or performance of a particular structure.³⁸

³³ The term “contract guarantees” as used in the URCG refers to three types of contract guarantee: First, *tender guarantees*, whereby a party inviting tenders (the beneficiary) is assured of a specific sum if a party submitting a tender (the principal) fails to sign a contract if his tender is accepted, or fails to meet some other specified obligation arising from the submission of a tender. A second type is the *performance guarantee*, which gives the beneficiary recourse against the guarantor (i.e., payment of a specified amount or, if guarantee so provides, at the guarantor’s option, to arrange for performance of the contract) if the principal fails to perform a relevant contract between him and the beneficiary. The URCG therefore apply to a performance bond as a type of demand guarantee, as well as to a performance guarantee as a type of surety bond. A third type of contract guarantee is the *repayment guarantee*, which assures the beneficiary of the repayment of advances, or payments if the principal fails to fulfill a relevant contract. See Peter J. Parsons, *Commercial Law Note*, in 53 AUSTRALIAN L. J. 224, 225 (R. Baxt ed., 1979). See also URCG, *supra* note 2, art. 2(c)-(e); Lars A.E. Hjerner, *Contract Guarantees*, in INTERNATIONAL CONTRACTS AND PAYMENTS 69, 69-70 (P. Šarčević & P. Volken eds., Graham & Trotman Ltd. 1991).

³⁴ See GAO, *supra* note 13, at 57.

³⁵ Debattista, *supra* note 9, at 296.

³⁶ *Id.* (citing GUIDE TO THE URDG, *supra* note 10, at 6). See also 2 Documentary Credit Insight 9, part 1 (1996).

³⁷ Parsons, *supra* note 33, at 225.

³⁸ *Id.*

The ICC later created the URDG with the intention of replacing the URCG. However, since the URDG came into effect in 1992, the ICC has not yet withdrawn the URCG and they are therefore still available for incorporation into demand guarantees should parties choose to do so.³⁹ One of the main reasons why the URCG are not in general use—and the reason why a new set of rules was required in 1992—lies mainly in the two most important articles of the URCG, namely articles 8 and 9.⁴⁰

Article 8 deals with the submission of claims under a contract guarantee and the relevant paragraphs of this article provide as follows:

- (1) A claim under a guarantee shall be made in writing or by cable or telegram or telex to be received by the guarantor not later than on the expiry date specified in the guarantee or provided for by these Rules.
- (2) On receipt of a claim the guarantor shall notify the principal or the instructing party, as the case may be, without delay, of such claim and of any documentation received.
- (3) A claim shall not be honoured unless:
 - (a) it has been made and received as required by para. 1 of this Article; and
 - (b) it is supported by such documentation as is specified in the guarantee or in these Rules; and
 - (c) such documentation is presented within the period of time after the receipt of a claim specified in the guarantee, or, failing such a specification, as soon as practicable, or, in the case of documentation of the beneficiary himself, at the latest within six months from the receipt of a claim.

³⁹ GUIDE TO THE URDG, *supra* note 10, at 7.

⁴⁰ *See* Debattista, *supra* note 9, at 296.

In any event, a claim shall not be honoured if the guarantee has ceased to be valid in accordance with its own terms or with these Rules.⁴¹

As required by paragraph (1) of Article 8, the claim should be made in writing and received by the guarantor no later than the day of expiry. Once the guarantor receives a claim, he should notify the principal or the instructing party, as the case may be, not only of the claim itself, but also of any documentation received. However, problems may arise in relation to the requirement that documentation—preferably a court decision, arbitral award or approval of the principal—be presented by the beneficiary if he makes a claim. Since it may be difficult for the beneficiary to provide adequate documentation at the time of the claim or even before the expiry date of the guarantee, Article 8(3)(c) provides that such documentation may be presented after receipt of the claim within the time limit specified in the guarantee, or failing such specification, as soon as is practical. If a court decision or an arbitral award is required, this can clearly take a long time. However, if the claim has been made, this apparently excludes the guarantee from expiring before the required documentation can be presented. In cases where the beneficiary must provide the necessary documentation himself, for instance, an expert affidavit, a fixed time limit of six months is stipulated.⁴²

It has been indicated that the wording of Article 8(3) is ambiguous in that it provides that in any event a claim shall not be honoured if the guarantee “has ceased to be valid in accordance with its own terms or with these Rules.” It has been suggested that this implies that a claim would not be honoured if the necessary documentation, for example, a court decision or an arbitral award, cannot be presented before the expiry date of the guarantee. Moreover, it appears that the URCG intended to make a distinction between *the last day for a claim* and *the date on which the guarantee ceases to be valid* but failed to do so. In practice, if the claim is made in time, the guarantee does not cease to be valid because the case has not been settled before the expiry date.⁴³

⁴¹ URCG, *supra* note 2, art. 8.

⁴² See Parsons, *supra* note 33. See also URCG, *supra* note 2, art. 2(c)-(e). See also Hjermer, *supra* note 33, at 75-76.

⁴³ See Hjermer, *supra* note 33, at 76.

The most disputed article of the URCG is Article 9, which is concerned with the documentation required to support a claim. In the absence of an express stipulation in the guarantee stipulating the subject of the specific documentation required, Article 9 of the URCG provides as follows:

If a guarantee does not specify the documentation to be produced in support of a claim or merely specifies only a statement of claim by the beneficiary, the beneficiary must submit:

- (a) in the case of a tender guarantee, his declaration that the principal's tender has been accepted and that the principal has then either failed to sign the contract or has failed to submit a performance guarantee as provided for in the tender, and his declaration of agreement, addressed to the principal, to have any dispute on any claim by the principal for payment to him by the beneficiary of all or part of the amount paid under the guarantee settled by a judicial or arbitral tribunal as specified in the tender documents or, if not so specified or otherwise agreed upon, by arbitration in accordance with the Rules of the ICC Court of Arbitration or with the UNCITRAL Arbitration Rules, at the option of the principal;
- (b) in the case of a performance guarantee or of a repayment guarantee, either a court decision or an arbitral award justifying the claim, or the approval of the principal in writing to the claim and the amount to be paid.⁴⁴

Referring to party autonomy, the first part of Article 9 leaves it to the parties to decide which type of documentation will be required. If the parties fail to include such a specification, the beneficiary is required to submit the documents stipulated in subparagraphs (a) and (b) of Article 9. In a rather confusing way, Article 9 also refers to "on-demand guarantees" (those requiring "only a statement of claim by the beneficiary"). It follows that, if the URCG applies to an on-demand guarantee, in order to be effectively "on-demand" the guarantee must clearly exclude Article 9 or provide that the requirements for documentation under subparagraph (a) and

⁴⁴ URCG, *supra* note 2, art. 9.

(b) do not apply. It will not suffice to state that, although subject to the URCG, the guarantee is payable on first and simple demand.⁴⁵ By including on-demand guarantees in this article, the drafters of the URCG deliberately attempted to discourage their use. In this regard, it has been said that they may have gone too far.⁴⁶

The effect of URCG Articles 8(3)(b) and 9 was to make all demand guarantees conditional and, furthermore, to make the conditions to which calls were subject particularly onerous on the beneficiary.⁴⁷ If payment under the demand guarantee was subject to justification under the underlying contract or the agreement of the principal, then the guarantee was not truly independent of the underlying contract: for payment to be justified, the veil of the guarantee had to be lifted and justification found in the underlying contract.⁴⁸

In relation to tender guarantees, no court decision or arbitral award is necessary in support of a claim. This is not surprising, since at that stage no contract would have been concluded between the principal and the beneficiary.⁴⁹ Therefore, a *bona fide* statement by the beneficiary is adequate in which he acknowledges that the principal's tender was accepted, but thereafter the principal neglected to sign the contract or to provide the performance guarantee as indicated in the tender.⁵⁰ In addition to such statement, the beneficiary must offer to have any dispute arising between himself and the principal in connection with the repayment of the amount paid under the tender guarantee settled by arbitration.⁵¹

Proceeding to performance and repayment guarantees, subparagraph (b) of Article 9 stipulates that a claim must be supported by a court decision or an arbitral award justifying the claim, or the approval of the principal in

⁴⁵ See Hjerner, *supra* note 33, at 76.

⁴⁶ *See id.*

⁴⁷ Debattista, *supra* note 9, at 296.

⁴⁸ *See id.*

⁴⁹ Hjerner, *supra* note 33, at 76.

⁵⁰ *Id.* at 76-77.

⁵¹ *See id.*

writing to the claim and the sum to be paid.⁵² Even though this rule is less complicated than the one in subparagraph (a), it may nevertheless lead to complications. There is no suggestion as to whether the court decision should be final (i.e., no longer subject to appeal). Furthermore, even to obtain a decision in the first place may take considerable time. In the interim, the guarantee is of no use to the beneficiary, although he had probably thought that by using a demand guarantee he would quickly receive the money as compensation for the loss he had incurred due to the alleged breach of the underlying contract with the principal.⁵³ The situation may even be worse for the beneficiary if disputes between him and the principal have to be settled by arbitration. This is so, because it is well known that even “speedy” arbitration procedures last longer than one year; often two or more years. Such a solution is evidently unsatisfactory if the purpose of the guarantee was to make the money available to the beneficiary simply and speedily. However, it has been said that it has to be balanced against the risk that money had been paid and that in the end the claim could not be justified.⁵⁴

The question has been raised whether Article 9(b) was too severe, and it was even said that it was not clear what the URCG would achieve in this situation.⁵⁵ If the beneficiary had to justify his claim by arbitration or litigation, it would cause a delay in him receiving payment in terms of the guarantee. He would also have to incur unnecessary expenses in justifying his claim. However, if the beneficiary met the requirements of Article 9(b), he would be armed with documentation of its own force and effect requiring the honouring of the relevant guarantee.⁵⁶

Goode states that the URCG sought to deal with the problem of unfair calling of demand guarantees (performance guarantees/repayment guarantees) by requiring, as a condition of the beneficiary’s right to payment, the production of a judgment or arbitral award or the principal’s written approval of the claim and the amount.⁵⁷ Although the object of this

⁵² *Id.* at 76.

⁵³ *Id.*

⁵⁴ *See id.*

⁵⁵ Parsons, *supra* note 33, at 226.

⁵⁶ *See id.*

⁵⁷ GUIDE TO THE URDG, *supra* note 10, at 6.

requirement was laudable, it did have the effect of limiting the acceptability of the URCG, for it resulted in the exclusion from their scope the simple on-demand guarantee that accounted for the great majority of documentary guarantees issued by banks.⁵⁸ Furthermore, although the requirement to produce a judgment or arbitral award was theoretically a documentary requirement, practically it meant that beneficiaries had to prove default by the principal by way of litigation or arbitration, and this tended to defeat the objective of the demand guarantee in providing the beneficiary with a speedy monetary remedy. This requirement was unacceptable to importers (buyers) and because of their strong negotiating position it resulted in the URCG seldom being incorporated.⁵⁹ This requirement also did not gain general acceptance because it proved to be too far removed from current banking and commercial practice.⁶⁰

The URCG, since their incorporation in 1978, have been used by parties with varying success. The major criticism voiced has been in relation to Article 9 and the fact that the URCG cannot be easily applied to on-demand guarantees. On-demand guarantees are probably the most common form of guarantees requested by certain groups of beneficiaries. However, by requiring documentation to support the claim, Article 9 directly contradicts the very character of on-demand guarantees, which are intended to assure the availability of the money on demand.⁶¹ It appears that the most severe criticism comes from the continental banking sectors. Conversely, other business sectors have confirmed that the URCG have been accepted in guarantees even with developing countries where government agencies often require submission to local rules and the use of on-demand guarantees. Even with their limited success, it appears that discontent still exists.⁶²

Although the purpose of the above-mentioned provisions of the URCG is to prevent fraud, they are strictly speaking not the same as the

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ See Roeland Bertrams, *Bank Guarantees in International Trade: The Law and Practice of Independent (First Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions* 28 (3d. ed., Kluwer Law Int'l 2004).

⁶¹ Hjerner, *supra* note 33, at 78.

⁶² See *id.* at 77-78.

traditional fraud exception as found in the English, American and South African jurisdictions.⁶³ In these jurisdictions the fraud exception is concerned with the circumstances under which payment under a demand guarantee may be disrupted, whereas Article 9 provides the conditions that trigger the payment of demand guarantees.⁶⁴

Uniform Rules for Demand Guarantees

Owing to the problems experienced as a result of using the URCG, the drafters of URDG458⁶⁵ decided to adopt an approach similar to the one taken in the UCP on the issue of fraud in relation to demand guarantees, by simply remaining silent and leaving it to the courts of the various jurisdictions to deal with.⁶⁶

During the formulation of URDG458, conflicting views reflecting the competing interests of the parties involved were expressed. At one end of the spectrum banks required a simple instrument whereby the issuer (guarantor) would have to pay without having to make difficult investigations or take complicated decisions based on doubtful evidence.⁶⁷

⁶³ For a full discussion of how the fraud exception is dealt with in England and the United States, see GAO, *supra* note 13; MICHELLE KELLY-LOUW, SELECTIVE LEGAL ASPECTS OF BANK DEMAND GUARANTEES: THE MAIN EXCEPTIONS TO THE AUTONOMY PRINCIPLE (Published LLD thesis, University of South Africa) 213-322 (VDM Verlag Dr. Müller Aktiengesellschaft & Co. KG 2009) and for a discussion of how the exception is dealt with in South Africa, see Kelly-Louw, *supra*, at 323-339.

⁶⁴ See GAO, *supra* note 13, at 58.

⁶⁵ The URDG are intended to apply worldwide to the use of demand guarantees, specifically guarantees, bonds or other payment undertakings, however named or described, under which the duty of the guarantor/issuer (i.e., a bank, insurance company or other body or person) to make payment arises on the presentation of a written demand and any other documents specified in the guarantee (e.g., a certificate by an engineer) and is not conditional on actual default by the principal in the underlying transaction. See URDG458, *supra* note 3, art. 2(a). Standby letters of credit unquestionably fall within the definition of "demand guarantee" as set out in article 2(a) of the URDG. Therefore, although the URDG apply to demand guarantees rather than to standby letters of credit, standby letters of credit may also be governed by the URDG if the parties elect to incorporate it. However, it was felt that the UCP were a more suitable set of rules for standby letters of credit than the URDG. *Id.* at 4; see also GUIDE TO THE URDG, *supra* note 10, at 7. This was the case, of course, until the ISP98 came into operation in 1999, which specifically deals with standby letters of credit. See *infra* at 94.

⁶⁶ See GAO, *supra* note 13, at 58.

⁶⁷ *Id.*

At another end, beneficiaries were claiming that they needed a device that would enable them to get paid against a simple demand or document without risking obscure objections. Then at a totally different end, principals were interested in having some kind of safety mechanism in the system so as to prevent unfair callings.⁶⁸

Therefore, URDG458 attempts to affect a compromise between the interests of the beneficiaries to obtain speedy payment and that of the principals to avoid the risk of unfair calling by the beneficiaries.⁶⁹ From all this, in order to prevent the beneficiary's outright unfair calling, a few fundamental articles, in particular Articles 9, 17, 20 and 21, were incorporated into URDG458. However, as will be seen below, Article 20 implicitly goes a small way towards restricting the beneficiary's right of payment.⁷⁰

Article 20(a) and (c) provides as follows:

- (a) Any demand for payment under the Guarantee shall be in writing and shall (in addition to such other documents as may be specified in the Guarantee) be supported by a written statement (whether in the demand itself or in a separate document or documents accompanying the demand and referred to in it) stating:
 - (i) that the Principal is in breach of his obligation(s) under the underlying contract(s) or, in the case of a tender guarantee, the tender conditions; and
 - (ii) the respect in which the Principal is in breach . . .
- (c) Paragraph (a) of this Article applies except to the extent that it is expressly excluded by the terms of the Guarantee . . .⁷¹

⁶⁸ *Id.*

⁶⁹ *See* Debattista, *supra* note 9, at 297.

⁷⁰ *See* GAO, *supra* note 13, at 58-59.

⁷¹ URDG458, *supra* note 3, art. 20(a), (c).

Furthermore, Article 9 provides that

[a]ll documents specified and presented under a Guarantee, including the demand, shall be examined by the Guarantor with reasonable care to ascertain whether or not they appear on their face to conform with the terms of the Guarantee. Where such documents do not appear so to conform or appear on their face to be inconsistent with one another, they shall be refused.⁷²

Interests of the beneficiary and the principal are built upon a compromise that has three characteristics.⁷³ First, although URDG458 clearly states in Article 2(b) that the demand guarantee is independent, they still seek to justify the call in terms of the underlying contract. Second, that connection is weakened in the sense that the requirement in the URDG of a court decision or arbitral award, or the agreement of the principal, is substituted by a detailed allegation—itsself contained in a document and at times accompanied by other specific documents—by the beneficiary of a breach by the principal. Third, the allegation and any accompanying documents are subjected to the scrutiny of strict compliance by the paying bank (guarantor), very much as if a call on a demand guarantee were the same as a demand for payment under a letter of credit. Therefore, URDG458 has retained the principle of autonomy, but has counter-balanced it by the doctrine of strict compliance.⁷⁴

Article 20 of URDG458 contains a very distinctive rule requiring the beneficiary to present with his demand a statement that the principal is in breach and the respect in which he is in breach.⁷⁵ The expression “the respect in which” as apposed to “respects” is intended to require only a general statement of the nature of the breach, for example, that the principal has been guilty of delay or defective workmanship, not a detailed specification.⁷⁶ Therefore, Article 20 requires the beneficiary, when demanding payment, to stipulate in writing both that there is some kind of breach of the underlying contract and what type of breach is involved,

⁷² *Id.* art. 9.

⁷³ Debattista, *supra* note 9, at 297.

⁷⁴ *Id.*

⁷⁵ GUIDE TO THE URDG, *supra* note 10, at 92.

⁷⁶ *See id.* at 93-94; Goode, *Abstract Payment*, *supra* note 10, at 725 n.47.

therefore giving the other party or parties some form of protection by providing a ground for a claim of fraud.⁷⁷ This places a certain obligation on the beneficiary to show his hand. The aim of this provision is to give some measure of protection against the unfair calling of the guarantee without interfering with the documentary character of the guarantee and the need of the beneficiary to have speedy recourse in the event of a perceived breach. It has been said that although the protection is rather limited in that it is the beneficiary himself, rather than an independent third party, who has to issue the statement of breach, the effect of this should not be too lightly dismissed.⁷⁸ Beneficiaries who may be quite ready to make an unjustified demand, if this is all that is required, may be more reluctant to commit themselves to a false statement of breach, particularly where the general nature of this has to be identified. This article does not affect the documentary character of the demand guarantee. The guarantor is not required to investigate the truth of the beneficiary's statement that the principal is in breach.⁷⁹ In its nature, Article 20 of URDG458 is similar to that of Article 9 of the URCG, in that it provides a kind of safety device against the triggering of the payment of the demand guarantee to prevent fraud. Article 20 (just as Article 9 of the URCG does) differs from the traditional fraud exception as found in the English, American and South African jurisdictions. The traditional fraud exception found in these jurisdictions, unlike Article 20 of the URDG458, specifically addresses what to do when fraud is found to have been committed.⁸⁰

Although the word "fraud" is not used in the URDG, the prevention of fraud is central to URDG458. The demand for payment must stipulate the reasons for calling on the guarantee in order to meet the URDG458's clear preference for reasoned demand guarantees. It is hoped that the requirement of providing reasons will prevent fraud. However, commentators have doubted the effectiveness of reasoned demand guarantees. It has been said

⁷⁷ There is a similar provision relating to counter-guarantees. In terms of Article 20(b), any demand under the counter-guarantee is to be supported by a written statement that the guarantor has received a demand for payment under the guarantee in accordance with its terms and with Article 20 itself. In other words, the guarantor, when claiming under the counter-guarantee, is required to certify that the beneficiary's demand was accompanied by the statement of breach required by Article 20. *See Goode, Abstract Payment*, *supra* note 10, at 739-740.

⁷⁸ *See GUIDE TO THE URDG*, *supra* note 10, at 92-93.

⁷⁹ *See Goode, Abstract Payment*, *supra* note 10, at 739-740.

⁸⁰ *See GAO*, *supra* note 13, *supra* note 13, at 59.

that in order to prevent fraud, it is imperative that the principal is informed about the demand for payment.⁸¹ Article 17 of URDG458 obliges banks to do so, but does not require a bank to hold payment until the principal has been made aware of the demand and its reasons. Therefore, banks may use their discretion to decide whether or not to wait with payment, or to proceed with payment as long as the principal is informed. In the event of fraud, the principal will then have the opportunity of requesting provisional and/or conservatory measures from a competent court.⁸² However, as no requirement for withholding payment is imposed, the fraud prevention provided in Article 17 is without much force if a bank decides to pay before the principal has been able to obtain interim relief. URDG458's purpose, however incomplete, is to achieve a more even distribution of risk between principal parties and beneficiary parties than was previously the case. It would appear that from the side of principals, the rules have been welcomed. However, it seems that beneficiaries will not frequently accept URDG458, since these rules worsen their position.⁸³

Furthermore, the ICC has incorporated Article 21 into the URDG in an attempt to prevent unfair calls.⁸⁴ Article 21 provides that "[t]he Guarantor shall without delay transmit the Beneficiary's demand and any related documents to the Principal or, where applicable, to the Instructing Party for transmission to the Principal."⁸⁵

The purpose of Article 21 is to give the principal the chance to challenge an unfair call before payment is made under it.⁸⁶ Article 21 obliges the bank to send the beneficiary's demand and any prescribed documents to the principal, but it does not require a bank to hold payment until the principal has received the demand and the documents. Therefore, as with Article 17 (discussed above), guarantors (banks) may again use their discretion to decide whether or not to wait with payment, or to proceed with

⁸¹ See Filip De Ly, *The UN Convention on Independent Guarantees and Stand-by Letters of Credit*, 33 INT'L LAW. 831, 835 (1999).

⁸² *Id.*

⁸³ *See id.* at 835–836.

⁸⁴ GUIDE TO THE URDG, *supra* note 10, at 92.

⁸⁵ URDG458, *supra* note 3, art. 21.

⁸⁶ *See* GUIDE TO THE URDG, *supra* note 10, at 92.

payment as long as the demand and relevant documents have been transmitted to the principal.⁸⁷ Article 21 also does not contain a provision that payment will be withheld until the principal has obtained interim court relief. Therefore, the fraud prevention provided in Article 21 is also without much force if a bank decides to pay before the principal has been able to obtain interim relief.⁸⁸

It was intended that URDG458 would replace the URCG, which had proved a failure in consequence of the complex payment procedure that they introduced. In contrast, URDG458 provides a simple mechanism, based on the guarantor's unconditional duty to meet a demand or call on the facility as set out in Article 20.⁸⁹ However, in spite of this, URDG458 initially did not gain wide acceptance and was, until recently,⁹⁰ rarely

⁸⁷ *Id.* at 101.

⁸⁸ *See* De Ly, *supra* note 81, at 835-836.

⁸⁹ *See* E. P. Ellinger, *British Business Law: Banking Law*, J. BUS. L. 704, 704 (2005).

⁹⁰ During the first couple of years of their existence, it seemed that the URDG were not widely accepted. At the end of 2005, the URDG still had not gained wide acceptance and were not frequently used in practice. The exact reason for this limited acceptance is not clear. *See* Paul S. Turner, *New Rules for Standby Letters of Credit: The International Standby Practices*, 14 BANKING & FIN. L. REV. 457, 485 n. 3 (1999). For a discussion of possible reasons, *see* Ellinger, *supra* note 89, at 705. During recent years, however, it seems that the URDG have grown in popularity and are currently being used by banks worldwide. For example, Chinese Banks generally issue their demand guarantees subject to the URDG. *See* D. A. Laprès & J. Mo, *L/Cs, Collections, Guarantees and Other Instruments in the PRC*, 13 DCINSIGHT 21 (Oct.-Dec. 2007), and in 2004, the Central Bank of Iran (Bank Markazi Jomhuri Islami Iran) issued a circular indicating that Iranian banks could use the URDG. DCI Interview with Farideh Tazhibi, *The URDG and Demand Guarantees in Iran*, 14 DCINSIGHT 11 (Jan.-Mar. 2008) [hereinafter 'Tazhibi Interview']. *See also*, DCI Interview with Andrea Hauptmann, *Insights on the URDG Revision*, 13 DCINSIGHT 5, 5 (Oct.-Dec. 2007) [hereinafter 'Hauptmann Interview']. However, in a fairly recent survey conducted by SITPRO (formerly, the Simpler Trade Procedure Board: a non-departmental public body for which the United Kingdom's Department of Trade and Industry has responsibility) it was shown that in the United Kingdom the URDG were not often used and the respondents (i.e., exporters and banks) to the survey indicated that they preferred to issue demand guarantees subject to UCP500. Banks that took part in the survey indicated that the URDG did not reflect United Kingdom or international banking practices. SITPRO, *Report on the Use of Demand Guarantees in the UK* 8, 10 (July 2003), <http://www.sitpro.org.uk>. The URDG were adopted in 1999 by the International Federation of Consulting Engineers in their model guarantee forms and later in 2002 also by the World Bank. *See* DCI Interview with Georges Affaki, *On Revising the Uniform Rules for Demand Guarantees (URDG)*, 13 DCINSIGHT 18, 18 (Jan.-Mar. 2007). A few national lawmakers have even taken the URDG as a model for independent guarantee statutes. *See, e.g.*, the Uniform Act Organizing Securities (adopted on 17 April 1997 and enforced by

incorporated in first-demand guarantees or in performance guarantees.⁹¹ One of the reasons for this limited acceptance was apparently due to certain banks' objection that Article 20(a), which provides that the payment condition is a written demand for payment supported by a specific statement of default, is contrary to the on-demand guarantees (i.e., guarantees payable on simple or first demand) which do not require such a statement.⁹² Banks objected to this payment condition, despite the fact that Article 20(c) allows parties to exclude the requirement of a statement of default.

The Drafting Group appointed to revise and redraft URDG458⁹³ indicated that special attention was given to Article 20 during the drafting process. At this point, it seems that the crux of the contentious Article 20 will be kept, but that some of the misunderstanding surrounding it will be clarified in the revised version.⁹⁴ Whether better success will be achieved by taking a new approach in a revised article remains to be seen.

derogation on 1 January 1998) as adopted by the 16 African states belonging to OHADA (i.e., the French acronym for the Organization for the Harmonization of Business Law in Africa and includes the following states: Benin, Burkina Faso, Cameroon, Central African Republic, Comoros, Congo, Côte d'Ivoire, Gabon, Guinea, Guinea Bissau, Equatorial Guinea, Mali, Niger, Senegal, Tchad and Togo) provides that the demand for payment under a demand guarantee must not only state that the principal has defaulted, but also in what respect the principal has defaulted on his contractual obligations towards the beneficiary, a provision based on Article 20 of the URDG. Pradeep Taneja, *The URDG Revision and Islamic Banking*, 14 DCINSIGHT 14, 14 (Apr.-June 2008). Seminars worldwide on the rules have also started to attract enthusiastic audiences. See *ICC to Revise its Uniform Rules for Demand Guarantees*, <http://www.iccwbo.org/iccbdfie/index.html> (last accessed Nov. 16, 2009). It has taken more than a decade for the URDG to achieve its objective of being accepted internationally, but it is not nearly as widely used as the UCP. The impact of the recent revision (URDG758, *supra* note 3) on international acceptance remains to be seen.

⁹¹ Ellinger, *supra* note 89, at 704-705.

⁹² See *id.* at 704.

⁹³ The revision to the URDG has just completed and is embodied within URDG758, *supra* note 3. The process began in 2007, when the ICC Banking Commission gave the go-ahead to begin a revision of the URDG. The revision was entrusted to a Drafting Group consisting of guarantee experts from a wide range of countries. See *ICC to Revise its Uniform Rules for Demand Guarantees*, *supra* note 91. For a brief discussion on which issues were looked at during the drafting process, see the Hauptmann Interview, *supra* note 91, at 5-6; see also Tazhibi Interview, *supra* note 91, at 11-12.

⁹⁴ See Hauptmann Interview, *supra* note 93, at 6; Tazhibi Interview, *supra* note 93, at 12.

International Standby Practices (ISP98)

ISP98 does not attempt to regulate fraud or abusive drawing, taking a similar approach to the UCP.⁹⁵ In Rule 1.05(c), ISP98 expressly leave the issue of fraudulent or abusive demands for payment (drawings) or “defenses to honour based on fraud, abuse or similar matters” to be determined by the applicable jurisdictional law, for instance Revised UCC Article 5-109 (in the case of the United States) or Articles 19 and 20 of the Convention (where a state/country has adopted the Convention).⁹⁶

Professor Byrne states that although ISP98 provides no systematic rule with regard to fraud or abuse, it does contain rules based on principles that would provide important guidance in determining whether and what

⁹⁵ See ISP98, *supra* note 4. The Institute of International Banking Law and Practice created ISP98 with the support of the United States Council on International Banking, Incorporated (“USCIB,” is now known as the International Financial Services Association or “IFSA”). The IFSA adopted ISP98, after which it was also submitted to the ICC for approval. During 1998, the ICC Banking Commission endorsed the rules, where after they came into operation on January 1, 1999. ISP98 is intended to apply to domestic and international standby letters of credit, providing separate rules for standby letters of credit in the same sense that the UCP do for commercial letters of credit and the URDG do for demand guarantees. ISP98, *supra* note 4, at *Preface*. Rule 1.01 outlines the scope and application of the ISP98, and indicates the types of undertaking for which the rules are intended. Though the intended use of the ISP98 is for international and domestic standby letters of credit, it is not limited to standby letters of credit. Theoretically, any international or domestic undertaking, however far removed from a standby letter of credit, can be issued subject to ISP98. ISP98, *supra* note 4, R. 1.01(b). The use of ISP98 for dependent undertakings (such as suretyship guarantees) and *quasi*-independent undertakings (such as commercial paper or negotiable instruments) is not intended or suitable and will lead to confusion. However, it may be used for independent undertakings, such as demand guarantees, although the URDG have been specifically drafted for this type of undertaking. See James E. Byrne, *The Official Commentary on the International Standby Practices*, Rule 1.01 cmt. 2 (James G. Barnes ed., Inst. of Int'l Banking Law & Practice, Inc. 1998) [hereinafter *The Official Commentary on the ISP98*]. By their terms, the rules apply to a letter of credit or independent undertaking that incorporates them by express reference, such as “this letter of credit is subject to ISP98” or “subject to ISP98.” See Turner, *supra* note 90, at 458; Byrne, *The Official Commentary on the ISP98, supra*, at R. 1.01 cmt. 10. Therefore, like the UCP and the URDG, ISP98 also applies to any independent undertaking, such as demand guarantee, issued subject to it. ISP98, *supra* note 4, R. 101(b). So therefore, parties themselves are allowed to choose the applicable set of rules. In other words, a party may choose to use ISP98 for certain types of standby letters of credit, the UCP for others and the URDG for still others. See GAO, *supra* note 13, at 20–21; see also ISP98, *supra* note 4, at *Preface*.

⁹⁶ See GAO, *supra* note 13, at 59. For a full discussion of Articles 19 and 20 of the Convention, see *infra* at 99.

remedy might be appropriate in the event of fraud.⁹⁷ These principles include the documentary character of the undertaking; the absence of any duty to investigate the transaction beyond the face of the complying document; the right to reimbursement for payments made in good faith, notwithstanding the fraudulent or forged character of the documents; the independence of transferee beneficiaries from the consequences of any fraudulent or abusive conduct on the part of the first beneficiary; and the right of nominated persons who have acted within the scope of their nomination to obtain reimbursement, notwithstanding the presence of fraudulent or abusive drawings. ISP98 is also based on the assumption that an exception to the obligation to pay and the independence principle arise only in the case of material fraud or clear, manifest abuse.⁹⁸

The omission of the fraud exception from ISP98 has, nonetheless, been commended by some commentators as an act that is “especially welcome,” because fraud has been addressed in different ways in different countries.⁹⁹ It has been said that if provisions on fraud were to be included in ISP98, it would probably have created needless complications in countries such as the United States, where the issue of fraud has been dealt with by the courts and legislators in detail over a long period of time.¹⁰⁰ Dolan states that it was a wise decision of the drafters of ISP98 to leave questions regarding the troublesome subject of fraud in the transaction to local law.¹⁰¹ He further indicates that a major failing of the Convention lies in UNCITRAL’s attempt to codify rules dealing with that subject. According to him, fraud exceptions are best left to local law, because questions of fraud are inextricably entwined with matters of local procedural law and because the notion of fraud itself varies from jurisdiction to jurisdiction. It is the market that will sort out the problem. Jurisdictions that do not fashion efficient rules, procedurally and otherwise, for resolving questions of fraud, will find credits issued by their banks

⁹⁷ See Byrne, *The Official Commentary on the ISP98*, *supra* note 95, at R. 1.05(c) cmt. 5(c).

⁹⁸ *Id.*

⁹⁹ Turner, *supra* note 90, at 463.

¹⁰⁰ *Id.*

¹⁰¹ John F. Dolan, *Analyzing Bank Drafted Standby Letter of Credit Rules, the International Standby Practices (ISP98)*, 14 WAYNE L. REV. 1865, 1901 (2000) [hereinafter Dolan, *Analyzing*]. For criticism of the Convention’s attempt to legislate fraud, see Dolan, *supra* note 10, at 1. For further discussion of this subject, see *infra* at 105.

unacceptable in world markets. Dolan is of the view that ISP98, like the UCP, correctly eschews the question of fraud.¹⁰² However, Xiang Gao rightly disagrees with this, and states that avoiding problems might not be the best way to resolve them.¹⁰³

Although there is no rule dealing with fraudulent or abusive demands, there are a few rules that are relevant for purposes of this article and should therefore be considered in more detail. For instance, ISP98 Rule 4.08 provides that even if a standby letter of credit does not specify any required document, it will still be deemed to require a documentary demand for payment.¹⁰⁴ Therefore, when a standby letter of credit does not call for a demand explicitly, the standby is not properly called on by the beneficiary unless it includes a demand in the package of documents presented to the issuer.¹⁰⁵ The effect of this rule is that if the issuer leaves out the requirement for the demand, the beneficiary who does not present one will have made a non-complying presentation and may lose the entire benefit of the standby.¹⁰⁶

ISP98 has created certain rules setting out certain data that must be included in a demand made under a standby letter of credit. For instance, Rule 3.03 stipulates that the demand identifies the standby.¹⁰⁷ Such a requirement is important to a bank issuer that may have thousands of outstanding standby credits in favour of the beneficiary that is making the demand. This rule renders any draft or demand that does not identify the credit non-compliant, even when the credit does not contain that requirement, although the issuer may, on its own motion, waive this

¹⁰² See Dolan, *Analysing*, supra note 101.

¹⁰³ See GAO, supra note 13, at 60.

¹⁰⁴ ISP98, supra note 4, R. 4.08 (“If a standby does not specify any required document, it will still be deemed to require a documentary demand for payment.”). For criticism of ISP98 Rule 4.08, see Dolan, *Analysing*, supra note 101, at 1893.

¹⁰⁵ Dolan, *Analysing*, supra note 101, at 1893.

¹⁰⁶ *Id.*

¹⁰⁷ ISP98, supra note 4, R. 3.03 (“A presentation must identify the standby under which the presentation is made.”).

requirement under rule 3.11(a)(ii).¹⁰⁸ Furthermore, ISP98 Rule 14.16, under the heading “Demand for Payment,” provides as follows:

- (a) A demand for payment need not be separate from the beneficiary’s statement or other required document.
- (b) If a separate demand is required, it must contain:
 - i. a demand for payment from the beneficiary directed to the issuer or nominated person;
 - ii. a date indicating when the demand was issued;
 - iii. the amount demanded; and
 - iv. the beneficiary’s signature.
- (c) A demand may be in form of a draft or other instruction, order, or request to pay. If a standby requires presentation of a “draft” or “bill of exchange”, that draft or bill of exchange need not be in negotiable form unless the standby so states.¹⁰⁹

In addition to this rule, ISP98 also stipulates the content of a certificate of default. Most standby letters of credit call for two documents: (1) a demand or draft and (2) a certificate indicating that the drawing event (e.g., default) has occurred or that payment is due; commonly a certificate of default.¹¹⁰ In this regard, ISP98 Rule 14.17, under the heading “Statement of Default or Other Drawing Event,” provides as follows:

If a standby requires a statement, certificate, or other recital of a default or other drawing event and does not specify content, the document complies if it contains:

¹⁰⁸ *Id.* R. 3.11.a.ii (“In addition to other discretionary provisions in a standby or these Rules, an issuer may, in its sole discretion, without notice to or consent of the applicant and without effect on the applicant’s obligations to the issuer, waive (a.) the following Rules and any similar terms stated in the standby which are primarily for the issuer’s benefit or operational convenience ... (ii.) identification of a presentation to the standby under which it is presented ...”).

¹⁰⁹ *Id.* R. 14.16. For a discussion of this rule, see Byrne, *The Official Commentary on the ISP98*, *supra* note 95, at R. 4.16 cmts. 1-7.

¹¹⁰ Dolan, *Analysing*, *supra* note 101, at 1893.

- (a) a representation to the effect that payment is due because a drawing event described in the standby has occurred;
- (b) a date indicating when it was issued; and
- (c) the beneficiary's signature.¹¹¹

It follows that under Rules 3.03, 4.08, 4.16 and 4.17 of ISP98, a demand for payment under a standby letter of credit is not required to indicate a default or other event in the underlying contract, if that is not required under the terms and conditions of the standby letter of credit. This is a step back from the position of the URDG, where the beneficiary is required to state that there is a breach of the underlying contract and what type of breach is involved.¹¹²

Furthermore, the issuer under Rule 3.10 of the ISP98, unlike Article 17 of the URDG, is not required to notify the applicant (the principal in the case of a demand guarantee) of receipt of a demand for payment under the standby letter of credit.¹¹³ Article 17 of the URDG requires "in the event of a demand" that the guarantor "shall without delay" notify the principal or his instructing party.¹¹⁴ Rule 3.10 is consistent with the standby letter of credit practice that rejects the notion embodied in Article 17 that the issuer has a duty to notify the applicant upon receipt of a demand under a standby.¹¹⁵

Byrne has explained the rationale behind Rule 3.10.¹¹⁶ Apparently, the concern raised is that by giving notice to the applicant before payment is

¹¹¹ ISP98, *supra* note 4, R. 14.17. For a discussion of this rule, *see* Byrne, *The Official Commentary on the ISP98*, *supra* note 95, at R. 4.17 cmts. 1-3; *but cf.* Dolan, *Analysing*, *supra* note 101, at 1894.

¹¹² For a discussion of Article 20(a) of the URDG, *see supra* 88; GAO, *supra* note 13, at 60.

¹¹³ ISP98, *supra* note 4, R. 3.10 ("An issuer is not required to notify the applicant of receipt of a presentation under the standby."). *See* De Ly, *supra* note 81, at 836.

¹¹⁴ *See* URDG458, *supra* note 3, art. 17.

¹¹⁵ De Ly, *supra* note 81, at 837.

¹¹⁶ Byrne, *The Official Commentary on the ISP98*, *supra* note 95, at R. 3.10.

made might have the effect that the applicant might seek to prevent payment by trying to obtain a judicial order restraining payment.¹¹⁷ While it is agreed that such relief may be appropriate in the case of an abusive or fraudulent drawing, it is not appropriate in the event of a contractual dispute between the applicant and beneficiary. It is stated that, in fact, many standbys are meant to be drawn upon in just such a situation. It has been said that to propose a duty to give notice calls into question the neutrality of the issuer; a concept that is at the heart of the standby's commercial value.¹¹⁸ It is agreed that there may, of course, be valid commercial reasons for contacting the applicant prior to honour, for example, in order to notify the applicant that he is being called upon to fund the drawing. The abuse of such notice, however, may not only compromise the reputation of the issuer, but may expose it to legal liability as well.¹¹⁹

This rationale behind Rule 3.10 of the ISP98 is not convincing and the approach taken in Article 17 of the URDG is to be preferred. Merely informing the applicant that a presentation has been made does not prevent the issuer from paying the standby. Placing such a duty on the issuer will merely allow the applicant to approach a court for the appropriate relief (i.e., application for an injunction (or interdict as it is known in the South African law) sooner, thereby enabling the applicant, for instance, to attach (by way of a *Mareva*-type injunction (or anti-dissipation interdict under the South African law)) the money before it is used by the beneficiary. Including such a duty in ISP98 would help in preventing fraudulent or abusive calls on standbys.

The Convention

From 1988 to 1995 UNCITRAL¹²⁰ worked on a Uniform Law on International Guaranty. This eventually resulted in the drafting of the

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ In 1966, the United Nations created UNCITRAL because it desired to play a more active role in reducing and removing legal obstacles to the flow of international trade. UNCITRAL's aim is to further the progressive harmonisation and unification of the law of international trade and its mandate is to be the main legal body in the field of international trade law within the United Nations system. UNCITRAL was initially composed of 29 states, but was expanded in 1973 to 36 states by a General Assembly resolution. Membership is structured so that a specified number of seats are allocated to each of the various geographic regions. Therefore, UNCITRAL is an intergovernmental body of the

Convention.¹²¹ UNCITRAL adopted this Convention and opened it for signature by the General Assembly by its resolution 50/48 of 11 December 1995.¹²² States were given a two-year period to sign the Convention, whereafter they had to accede to it. The Convention could only come into effect after it had been ratified by five states. Furthermore, in terms of Article 28 of the Convention, it could also only enter into force on the first day of the month following the expiration of one year from the deposit of the fifth instrument of ratification. As a result of this, the Convention only came into effect on 1 January 2000.¹²³

General Assembly that prepares international commercial law instruments designed to assist the international community in modernising and harmonising laws dealing with international trade. Various legal instruments have since been prepared by UNCITRAL. See UNCITRAL, Explanatory note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, cmt. 1, n.2 U.N. Doc. A/CN.9/431 (July 4, 1996), available at <http://daccessods.un.org/TMP/9645256.html> [hereinafter Explanatory Note]; but cf. Mara E. Trager, *Towards a Predictable Law on International Receivables Financing: The UNCITRAL Convention*, 31 N.Y.U.J. INT'L. L. & POL. 611, 614-615 (1999).

¹²¹ For a discussion of the background to the Convention and a discussion of a previous draft of this Convention, see E. E. Bergsten, *A New Regime for International Independent Guarantees and Stand-by Letters of Credit: The UNCITRAL Draft Convention on Guaranty Letters*, 27 INT'L LAW. 859 (1993). For a further legislative history of the UNCITRAL Convention, see James E. Byrne, *The International Standby Practices (ISP98): New Rules for Standby Letters of Credit*, 32 UCC L. J. 149, 150-151 (Fall 1999) (focusing on the authorities cited in note 2); Norbert Horn, *The U.N. Convention on Independent Guarantees and the Lex Mercatoria*, in GERMAN BANKING L. & PRAC. IN INT'L PERSPECTIVE 189 n.2 (Walter de Gruyter ed., GmbH & Co. 1999).

¹²² See The UNCITRAL Explanatory Note, *supra* note 120, cmt 1. For a full discussion of the Convention, see Lars Gorton, *Draft UNCITRAL Convention on Independent Guarantees*, J. BUS. L. 240 (May 1997); Dolan, *supra* note 10, at 1; De Ly, *supra* note 81; Horn, *supra* note 121, at 189.

¹²³ 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). In order for the US to ratify the Convention, it will require the advice and consent of the US Senate. After many years of inaction, there are now signs that the US might possibly ratify the Convention soon. Recently a delegation from the Uniform Law Conference of Canada met with a delegation from Mexico and delegates invited by the National Conference of Commissioners on Uniform State Laws (NCCUSL), the organisation that oversaw the drafting of the Article 5 of the American UCC, to discuss the implementation of the Convention in North America. NCCUSL, Mexico and Canada all expressed interest in adopting the Convention. See *2008 Annual Survey of Letter of Credit Law and Practice*, Publ'n No. 967 13 (J. E. Byrne & C. S. Byrnes, eds. 2008). For a discussion on what the

In view of the URDG, it may at first sight appear to be strange that UNCITRAL has invested such time and effort in producing its own Convention dealing with demand guarantees and standby letters of credit.¹²⁴ The reason for this is historical. Soon after UNCITRAL began to look at demand guarantees, the ICC embarked on its project to formulate a set of demand rules, the URDG, intended to be more accommodating of prevailing practice than the URDG. Thereupon, UNCITRAL agreed to stop further work and to abide by the ICC project. Unfortunately, this proceeded slower than had been anticipated and when, after the lapse of a number of years, it showed no signs of reaching finality, UNCITRAL justifiably decided to proceed with its own proposals for a convention or uniform law.¹²⁵ By the time the ICC got back on track with the URDG, the UNCITRAL project was considered too far advanced to be abandoned. Furthermore, being a work designed to lead either to a convention or to a uniform law capable of adoption in national legislation, it was able to deal with matters that could not properly be the subject of contractually incorporated rules, particularly the effect of fraud and the granting of interim injunctive relief.¹²⁶

Application and Force of the Convention

The Convention applies to an international undertaking such as a demand guarantee or a standby letter of credit, (1) where the place of business of the guarantor/issuer at which the undertaking is issued is in a contracting state¹²⁷ or (2) the rules of private law lead to the application of

position under the letter of credit law will be in the United States if the Convention is adopted by the United States, *see* Paul S. Turner, *The United Nations Convention on International Standby Letters of Credit: How Would It Change Existing Letter of Credit Law in the United States?*, 114 *BANKING L.J.* 790 (1997). The Secretariat for UNCITRAL has explained the main objectives of the Convention. *See generally*, Explanatory Note, *supra* note 120.

¹²⁴ See Roy Goode, *Abstract Payment Undertakings in International Transactions*, XXII *BROOK. J. INT'L L.* 1, 19 (1996) [hereinafter *International Transactions*].

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ The Convention, *supra* note 5, art. 1(1)(a). As of Nov. 15, 2010 the Convention will apply to international undertakings (demand guarantees or standby letters of credit) issued by banks in Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia.

the law of a contracting state,¹²⁸ unless the undertaking excludes its application. The Convention can also apply to commercial letters of credit if the parties expressly state that their credit is subject to it.¹²⁹

Article 2(1) of the Convention describes the type of undertaking regulated by it in the following terms:

For the purposes of this Convention, an undertaking is an independent commitment, known in international practice as an independent guarantee or as a stand-by 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.¹³⁰

Article 2 of the Convention concerns an undertaking that “is an independent commitment.” The independence (autonomy) of the undertaking is of basic importance for the applicability of the Convention and Article 3 describes the independence of the undertaking as follows:

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 stand-by 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

¹²⁸ *Id.* art. 1(1)(b). For instance, the Convention will apply to international undertakings (demand guarantees or standby letters of credit) if a court determines the law of Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia is the applicable law.

¹²⁹ *Id.* art. 1(2).

¹³⁰ *Id.* art. 2(1).

event except presentation of documents or another such act or event within a guarantor/issuer's sphere of operations.¹³¹

From the above, it is clear that ancillary undertakings, such as suretyships, are specifically excluded from the Convention.

It was decided that the application of the Convention should be limited to international undertakings (demand guarantees/standby letters of credit), in particular, since it was felt that the inclusion of domestic instruments would adversely affect the global acceptability of the Convention.¹³² Article 4 defines what is meant by "international character of the undertaking."¹³³ According to Article 4(1), an undertaking is international if the places of business (or residence) specified in the undertaking of any two of the following persons are in different states (countries): guarantor/issuer, beneficiary, principal/applicant, instructing party or confirmer. Therefore, the Convention extends only to independent undertakings that are international in origin.¹³⁴

The Convention is shaped round both the UCP and the URDG, but it is distinctive in that both the UCP and the URDG are drafted by the ICC, a private organisation, as voluntary rules or self-regulation, whereas the Convention is drafted by UNCITRAL, as a uniform law or official regulation for those countries who adopt it. Therefore, a state's adoption of the Convention has the effect of making it law in that state, in contrast to the URDG and other ICC rules, which take their force from incorporation into the contract of the parties.¹³⁵ The Convention, in addition to being essentially consistent with the solutions found in the rules of practice, supplements their operation by dealing with issues beyond the scope of such rules. It does so especially regarding the question of fraudulent or unfair demands for payment and judicial remedies available in such instances.¹³⁶

¹³¹ *Id.* art. 3.

¹³² Bergsten, *supra* note 121, at 863; *see also* De Ly, *supra* note 81, at 838.

¹³³ The Convention, *supra* note 5, art. 4; *see also* De Ly, *supra* note 81, at 838.

¹³⁴ Dolan, *supra* note 10, at 9.

¹³⁵ GUIDE TO THE URDG, *supra* note 10, at 7.

¹³⁶ Explanatory Note, *supra* note 120, cmt. 5.

In other words, because the legal status of the Convention is distinctive from the ICC rules, the Convention includes provisions relating to the fraud exception.¹³⁷ In its treatment of contractual relations between the parties, the Convention follows the URDG rather closely in scope and effect, although its drafting is fairly different and the Convention does not contain any equivalent of article 20 of the URDG.¹³⁸

Since the adoption of the Convention no major trading nation has acceded, although the ICC has indicated its approval.¹³⁹ To date, South Africa has neither signed nor acceded to the Convention. It also seems that South Africa has no immediate plans to do so.

As mentioned above, the Convention is specifically designed to regulate demand guarantees and standby letters of credit, although commercial letter of credit users may also choose to use it if they so wish.¹⁴⁰ The most important articles of the Convention are found in Chapters IV and V, which concern the bank's payment obligation and the exceptions to this obligation. Contrary to the ICC rules of practice, the Convention made an attempt to address the issue of fraud and to prevent fraudulent or unfair calling of standby letters of credit and demand guarantees.¹⁴¹ However, the terms "fraud" and "abuse of right" have not been used in the Convention in order to avoid possible confusion resulting from different (and inconsistent) interpretations already developed in various jurisdictions about the meaning of these terms. This was done especially since criminal law notions often influence the concept of fraud.¹⁴²

In relation to the payment obligation, Articles 13 to 17 of the Convention determine that the bank must honour a payment demand if it meets the requirements in the demand guarantee/standby letter of credit.¹⁴³

¹³⁷ GAO, *supra* note 13, at 21.

¹³⁸ International Transactions, *supra* note 124, at 19.

¹³⁹ The ICC endorsed the UNCITRAL Convention on June 21, 1999. See ICC Publ'n No. 500/2 (2002) at 69.

¹⁴⁰ The Convention, *supra* note 5, art. 1(2).

¹⁴¹ GAO, *supra* note 13, at 60.

¹⁴² *Id.* at 60-61; Bergsten, *supra* note 121, at 872, 872 n.61; BERTRAMS, *supra* note 60, at 356.

¹⁴³ The Convention, *supra* note 5, arts. 13-17.

The bank is given a reasonable amount of time to examine the demand (a maximum of seven working days).¹⁴⁴

In Article 15, the Convention first puts up a general requirement for the beneficiary demanding payment under a demand guarantee/standby letter of credit.¹⁴⁵ Article 15(3) of the Convention provides that “[t]he 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.”¹⁴⁶ In other words, Article 15(3) states that a beneficiary “is deemed to certify that the demand is not in bad faith” and that the demand is not fraudulent.

In terms of Article 17 of the Convention, the guarantor/issuer must, subject to Article 19, pay against a demand made in accordance with the provisions of Article 15. Article 18 spells out an exception due to the right of set-off and Article 19 contains certain exceptions in which cases the bank does not have to pay. In other words, payment under a demand guarantee/standby letter of credit has the potential to be disrupted if the elements listed in Article 19 exist in the demand/credit.¹⁴⁷

From the viewpoint of unfair calls and the principle of autonomy, the vital articles of the Convention are Articles 15(3), 19 and 20. These articles work together to make it more difficult for an unfair call to succeed and they do so by seeking a justification for the call in the underlying contract.¹⁴⁸

Fraud and the Convention

The Convention also recognises exceptions to the absolute and independent nature of demand guarantees and standby letters of credit. Article 19, under the heading “Exception to Payment Obligation” stipulates

¹⁴⁴ *See Id.* art. 16(2).

¹⁴⁵ *See id.* art. 15.

¹⁴⁶ *Id.*

¹⁴⁷ GAO, *supra* note 13, at 61.

¹⁴⁸ Debattista, *supra* note 9, at 297.

the circumstances under which the issuer/guarantor may dishonour the beneficiary's demand for payment. Article 19(1) reads as follows:

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,¹⁴⁹ has a right, as against the beneficiary, to withhold payment.¹⁵⁰

Paragraph (2) of Article 19 explains what the term "no conceivable basis" referred to in subparagraph (c) of paragraph (1) means. It provides that 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) Fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary;

¹⁴⁹ See The Convention, *supra* note 5, art. 14(1) (imposing on the guarantor/issuer a duty to act in good faith and exercise reasonable care having due regard to generally accepted standards of international practice of standby letters of credit/demand guarantees in discharging its obligations under the undertaking and under the Convention.).

¹⁵⁰ *Id.* art. 19(1).

- (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.¹⁵¹

For the first time the Convention contains a codification of the different situations where fraud is present and it too requires strong evidence of this.¹⁵² This list may not be exhaustive, but it is a remarkable and encouraging way in which to define the kind of misconduct that may provoke the fraud exception. It unquestionably stands as the most detailed provision so far to clarify the misconduct that may bring the fraud exception into operation.¹⁵³ This definition of unfair calling and the acknowledgment of a legal defence are embedded in a more general codification of exceptions to the payment obligation in Article 19 of the Convention. This situation of unfair calling is generally described in Article 19(1)(c) as “judging by the type and purpose of the undertaking, the demand has no conceivable basis.” Accordingly, this is then more specifically described by five cases set out in Article 19(2).¹⁵⁴

Article 19 deliberately avoids the terms “bad faith,” “abuse,” and “fraud,”¹⁵⁵ since they have confusing and inconsistent meanings in the different legal systems and are often influenced by criminal law notions of malicious intent, which are not suitable in relation to guarantees.¹⁵⁶

¹⁵¹ *Id.* art. 19(2).

¹⁵² *Id.* art. 20(1) (implying that the courts may issue provisional measures on the basis of “strong evidence” of the presence of fraud); Horn, *supra* note 121, at 200-201.

¹⁵³ GAO, *supra* note 13, at 97.

¹⁵⁴ Horn, *supra* note 121, at 200–201.

¹⁵⁵ Bergsten, *supra* note 121, at 872.

¹⁵⁶ *Id.* at 872, n.61. See also Jean Stoufflet, *10th Biennial Conference of The International Academy of Consumer and Commercial Law: International Banking Developments: Fraud in Documentary Credit, Letter of Credit and Demand Guaranty*, 160 DICK. L. REV. 21, 25 (2001) (“Practitioners within the industry know that some letters of credit or guaranties are fraudulent, having been issued either by swindlers, claiming to be first-class banks, or by insolvent issuers. Such behavior is unseemly and blameworthy, however, it is not really characteristic. More typical is a fraudulent demand for payment by the beneficiary of a letter of credit or demand guaranty . . . [t]here are strong reasons for courts to look objectively at fraud in transactions involving documentary credits, stand-by letters of credit

Therefore, Article 19(1) of the Convention has instead employed the general formula of a demand for payment that “has no conceivable basis,” while paragraph (2) of Article 19 also shows that the impropriety of the demand may relate, or could be determined by reference to, the underlying transaction.¹⁵⁷ As far as the degree of proof is concerned, fraud must be “manifest and clear” and “immediately available.”¹⁵⁸ The Convention is mainly concerned with the nature of the documents presented. It does not mention, and is not concerned with, the identity of the fraudulent party. Therefore, the fraud exception applies under the Convention if “any document is not genuine or has been falsified” regardless of the identity of the fraudster.¹⁵⁹ Furthermore, although the Convention requires “manifest and clear” evidence to invoke the fraud exception, it does not mention that the wrongdoer’s intention should be proven.¹⁶⁰ From reading the provisions of the Convention, it seems that the Convention, like Revised UCC Article 5-109, focuses rather on the nature of misconduct than the fraudster’s state of mind or the identity of the fraudster.¹⁶¹

The Convention does not place an express duty on the guarantor to refuse payment under certain circumstances, but only a right to do so.¹⁶² Article 19 seems to allow the guarantor/issuer certain discretion when payment is demanded, but it also implies a certain duty on him to make a judgement whether the requirements are met or not. The article therefore allows for certain objections of payment under certain circumstances and they seem to go further than the limits that have developed in case law. The most significant part is perhaps that there now appears to be a certain duty on the guarantor to make a judgement call as to whether payment should be made.¹⁶³ Whether the enumerated causes giving right to a refusal to pay are

and demand guaranties. It should not be necessary to prove that the beneficiary had malicious intent or that the beneficiary acted in bad faith.”).

¹⁵⁷ Explanatory Note, *supra* note 120, cmts. 46-47.

¹⁵⁸ The Convention, *supra* note 5, arts. 19-20. *See also* BERTRAMS, *supra* note 60, at 356.

¹⁵⁹ The Convention, *supra* note 5, art. 19(1)(a). *See also* GAO, *supra* note 13, at 117.

¹⁶⁰ The Convention, *supra* note 5, art. 19(1).

¹⁶¹ GAO, *supra* note 13, at 97, 117.

¹⁶² The Convention, *supra* note 5, art. 19(1) (stating that if the presence of fraud is “manifest and clear ... the guarantor/issuer, acting in good faith, *has a right*, as against the beneficiary, to withhold payment ...”) (emphasis added).

precise and clear enough is something that will have to be resolved in future case law, but the ground is certainly laid for a narrowing down of the independence of the demand guarantee.¹⁶⁴

The exception set out in Article 19(1)(b) includes the so-called literal defences—the defences available that stem from the text of the demand guarantee/standby letter of credit and that the bank can use against the beneficiary.¹⁶⁵ With the exception stipulated in Article 19(1)(c), the Convention has formulated a general definition of the fraud exception. In view of the fact that in different countries various descriptions are given of the circumstances under which it is possible to reject payment under a demand guarantee/standby letter of credit (i.e., fraud, abuse of rights, and manifestly unreasonable demand), the decision was made to use a general formulation of the fraud exception.¹⁶⁶ The downside of this open formulation is that judges from various contracting states could interpret this provision in different ways. However, the risk has been reduced to some degree by the examples of the grounds for denying payment given in Article 19(2).¹⁶⁷

However, two aspects of Article 19 depart quite clearly from the principle of autonomy.¹⁶⁸ First, in determining whether a call is justified, Article 19(1)(b) and (c) and 19(2)(a), (b), (c) and (d) all require the guarantor/issuer of the demand guarantee/standby letter of credit to look to the underlying contract for good cause to pay. Second, by constantly insisting on the exercise of good faith, Article 15(3), the tailpiece of Article 19(1) and Article 19(2)(e) put both the beneficiary and the guarantor/issuer of the guarantee/letter of credit on notice that payment needs to be justifiable by good cause.¹⁶⁹

¹⁶³ Explanatory Note, *supra* note 120, cmt. 48 (“entit[les] but not impos[es] a duty on the guarantor/issuer, as against the beneficiary, to refuse payment when confronted with fraud or abuse ... allowing discretion to guarantor/issuer acting in good faith”).

¹⁶⁴ Gorton, *supra* note 122, at 249.

¹⁶⁵ De Ly, *supra* note 81, at 842.

¹⁶⁶ Explanatory Note, *supra* note 120, cmt. 46.

¹⁶⁷ De Ly, *supra* note 81, at 842-843.

¹⁶⁸ *Id.* at 842.

¹⁶⁹ Debattista, *supra* note 9, at 298.

Viewed in context of ICC rules, it is clear that the Convention represents a step back from the URDG and towards the URCG. Under the Convention, a demand is not in itself sufficient to trigger payment.¹⁷⁰ A simple declaration that payment is due under the underlying contract is also not sufficient: the demand needs to be justified in good faith within the context of the underlying contract. Despite the declaration of the principle of independence in Article 3 of the Convention,¹⁷¹ when it comes to examining the validity of a claim (call), the veil separating the guarantee (or standby letter of credit) from the underlying contract is well and truly discarded.¹⁷²

Article 19 not only provides the guarantor/issuer with some basis for refusing payment, but also enables the principal to take court measures against a fraudulent beneficiary.¹⁷³ Paragraph (3) of Article 19 states that “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.”¹⁷⁴ Article 20 of the Convention, under the heading “Provisional Court Measures,” then stipulates the measures a court can take by providing:

- (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) and (c) of paragraph (1) of article 19 is present, the court, on the basis of immediately available strong evidence, may:

¹⁷⁰ *Id.*

¹⁷¹ The Convention, *supra* note 5, art. 3 (describing an independent guarantee (demand guarantee) to which the Convention applies as one that is not dependent on the underlying contract or subject to any term not appearing in the undertaking itself). However, it has been said that the effect of this article is to describe the demand guarantees/standby letters of credit (undertakings) to which the Convention is to apply, not to establish the principle of autonomy in the context of demand guarantees. *See* Debattista, *supra* note 9, at 298.

¹⁷² *Id.*

¹⁷³ Explanatory Note, *supra* note 120, cmt. 49.

¹⁷⁴ The Convention, *supra* note 5, art. 19(3).

- (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 therefore 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) and (c) of paragraph (1) of article 19, or use of the undertaking for a criminal purpose.¹⁷⁵

Article 20 of the Convention makes provision both for measures similar to an injunction (i.e., an interdict under the South African law) preventing payment and for attachment or *Mareva*-type injunctions (freezing orders or anti-dissipation interdicts as they are known in the South African law)¹⁷⁶ to be available to the court where there is a “high probability” shown by “immediately available strong evidence”;¹⁷⁷ the court “may issue a provisional order” or similar.¹⁷⁸ Although the exact meaning

¹⁷⁵ The Convention, *supra* note 5, art. 20.

¹⁷⁶ For a brief discussion of the South African anti-dissipation interdict, *see* Kelly-Louw, *supra* note 63, at 426-428.

¹⁷⁷ Charles F. Hugo, *The Law Relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks* 309 (University of Stellenbosch Printers 1997).

¹⁷⁸ In *BC Ltd. v. KPMG Inc.* [2004] 238 D.L.R. 13 (Can.), a Canadian court concluded that a drawing on a letter of credit where there was no breach of the underlying contract would be abusive and within the concept of fraud. *See* James E. Byrne, *Case Summary of BC Ltd. v. KPMG Inc.*, in 2005 ANNUAL SURVEY OF LETTER OF CREDIT LAW AND PRACTICE 260-62 (James Byrne, ed. 2005). The view has been expressed that this case is on the edge of what is fraud and it was decided correctly. (This view was expressed by one of the panellists (it

of the two crucial phrases, namely, “high probability” and “immediately available strong evidence” will have to be determined by the courts in the different jurisdictions, Hugo has indicated that it appears that one may conclude that the position of the bank’s customer would in most jurisdictions be significantly better under the Convention than under the prevailing law.¹⁷⁹

Notably, neither the UCP nor the URDG contain any provisions on court procedure. This is rather obvious taking into consideration the contractual/custom status of the UCP and the URDG. In recent years various national courts and/or legislators have established provisional court measures (such as injunctions in Anglo-American law), allowing the applicant to request provisional court interference to prevent the payment to the beneficiary under a letter of credit/demand guarantee under certain circumstances.¹⁸⁰

Article 19 of the Convention codifies the exception of fraud, in particular the cases in which the bank does not have to pay (however, payment is permitted).¹⁸¹ This article is immediately attached to the right of the principal to petition the court in the case of fraud and to invoke his rights, which are set out in Article 20.¹⁸² Accordingly, Articles 19 and 20 provide respectively for the definition and description of the fraud exception, and the measures available to the principal in such case.¹⁸³

Xiang Gao indicates that these provisions of the Convention are clear and narrow in scope, and provide an exceptional international

is uncertain from which jurisdiction he or she was) during the 2005 Annual Survey of Letter of Credit Law & Practice, held by the Institute of International Banking Law and Practice in Miami, Florida on 17-18 March 2005. Boris Kozolchyk, adding to this, indicated that that case clearly demonstrated the value of the Convention in helping to protect against abusive drawings.) See James Byrne, Annual Survey of Letter of Credit Law & Practice Supplemental Materials 50 (March 2005) (unpublished manuscript, on file with the Institute of International Banking Law and Practice).

¹⁷⁹ HUGO, *supra* note 177, at 309.

¹⁸⁰ Gorton, *supra* note 122, at 251.

¹⁸¹ Explanatory Note, *supra* note 120, cmt. 46.

¹⁸² The Convention, *supra* note 5, art. 19(3).

¹⁸³ See De Ly, *supra* note 81, at 842.

standard.¹⁸⁴ He points out that these provisions will undoubtedly provide good guidance for courts to enhance their application of the fraud exception.¹⁸⁵ He is also of the view that these provisions are generally in accordance with the current practice. They include most of the elements of the fraud exception that have been developed over the years by national courts (e.g., American and English courts) and/or legislators, and provide a detailed and helpful guide to users of demand guarantees and the courts. Furthermore, he states that like the United States Revised UCC Article 5-109(b), the Convention¹⁸⁶

- (1) has clearly indicated what kind of actions victims of fraud may take when fraud is “manifest and clear” in a transaction of demand guarantees/standby letters of credit, namely the guarantor’s/issuer’s dishonour of a presentation or withholding payment,¹⁸⁷ and the principal’s/applicant’s entitlement to a court injunction preventing the honouring of a presentation by the guarantor/issuer;
- (2) has listed what kind of misconduct may invoke the fraud exception;¹⁸⁸
- (3) has specified that either fraud in the documents or fraud in the underlying contract may invoke the fraud exception;¹⁸⁹ and
- (4) has provided necessary guidelines for courts considering the application of the fraud exception.¹⁹⁰

¹⁸⁴ Buckley & Gao, *supra* note 1, at 333 (citing *Litigation Digest: Agritrade Int’l Pte. Ltd v. Industrial & Commercial Bank of China*, [1998] 3 S.L.R. (Singapore), 4(3) DOCUMENTARY CREDIT WORLD 8, 12 cmt. 1 (2000)).

¹⁸⁵ See GAO, *supra* note 13, at 97 (citing *Litigation Digest: Agritrade Int’l Pte. Ltd v. Industrial & Commercial Bank of China*, [1998] 3 S.L.R. (Singapore), 4(3) DOCUMENTARY CREDIT WORLD 8, 13 (2000)).

¹⁸⁶ See GAO, *supra* note 13, at 62-63.

¹⁸⁷ See The Convention, *supra* note 5, art. 19(1)(c).

¹⁸⁸ See *Id.* art. 19.

¹⁸⁹ See *Id.* art.19(1)(a), (c).

¹⁹⁰ See *Id.* art. 20.

It has been said that the regulation of the fraud exception in Article 19 is a success both politically and technically.¹⁹¹ Politically, a uniform and mandatory concept of fraud avoids regulatory competition between different legal systems and therefore between the banking industries of various countries, concentrating competition on the terms and prices of the banking products and not on regulatory issues.¹⁹² Technically, the somewhat open-ended formulation of the fraud exception has avoided the exercise of reaching an agreement on the concept of fraud in various national legal systems. Moreover, the description of fraud is strong enough so that payment as a rule remains, while refusal to pay is an exception. Apparently, the examples in Article 19(2) make the rule sufficiently clear. However, an open and uniform description has the disadvantage that judges in contracting states will interpret this concept differently.¹⁹³ This often happens when one is dealing with a uniformed text (e.g., a convention) that does not provide for an international court to decide in a binding way how uniform law is to be interpreted. It is possible though to control this risk, if there is sufficient information available in other countries regarding the interpretation of the unifying text. As already mentioned, UNCITRAL has developed a databank that contains court decisions on unifying texts. It also publishes summaries of recent decisions.¹⁹⁴

Many countries—including South Africa, England and the United States—authorise the courts to grant an order (i.e., an interdict or injunction) enjoining the guarantor/issuer from paying or enjoining the beneficiary from receiving payment under a demand guarantee/standby letter of credit. In Article 20 of the Convention legal remedies are provided that a principal/applicant can make use of to prevent payment under a demand guarantee/standby letter of credit. It seems that the text of Article 20 suggests that provisional rather than final measures are intended. In various countries summary proceedings (such as injunctive relief) are interpreted as provisional measures and therefore it is doubtful that (conserving) attachment orders would fall under Article 20. In this regard it has been said that the text of Article 20, the requirements of provisional measures and the

¹⁹¹ De Ly, *supra* note 81, at 843-44.

¹⁹² For a contrary view, *see* Dolan, *supra* note 10, at 16-21 (arguing that fraud should be left to be governed by the domestic law of mature letter of credit and bank demand guarantee jurisdictions).

¹⁹³ De Ly, *supra* note 81, at 842.

¹⁹⁴ *Id.* at 843.

cases in which provisional measures can be employed are arguments for keeping “attachment orders” and similar (final) measures outside of the Convention.¹⁹⁵ In terms of the Convention, the principal can request provisional measures under which the beneficiary will not receive payment (including the bank putting the funds into an escrow account) or in which the beneficiary’s funds are blocked. This is only possible under the exceptions listed in Article 19 and if the demand guarantee/standby letter of credit is used for a criminal purpose.¹⁹⁶ In terms of procedural law, provisional measures have been given extra guarantees to prevent them from being accepted too often. Most of all, the principal must present the circumstances set out in Article 19 in a manner in which *prima facie* evidence is insufficient, as “immediately available strong evidence” is required. The judge may only allow provisional measures if there is a “high probability” that the circumstances set out in Article 19 exist and it may be taken into account that the account party is “likely to suffer serious harm” if no provisional measure is taken.¹⁹⁷ Therefore, it appears that Article 20 is not an open invitation for the judge to interfere. The view has been expressed that with regard to provisional measures, the Convention is strict enough with principals/applicant while still being flexible enough to permit the application of provisional measures in exceptional cases.¹⁹⁸

However, the Convention does not provide the principal/applicant with the highest degree of protection from fraud. In the URCG the principal is protected by the requirement, set out in Article 9, that a document is provided that proves default, while Article 20 of the URDG requires that a demand for payment state the reasons.¹⁹⁹ Under Article 15(3) of the Convention none of this is required, and the Convention limits itself to the statement that the beneficiary is considered to have judged whether or not the demand is made in good faith and whether the exceptions set out in article 19(1) apply.²⁰⁰ It has been said that the weakness contained in the article regarding the beneficiary’s examination of his own conscience will in practice in cases of fraud prove to be meaningless and ineffective in

¹⁹⁵ See *id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ See *id.* at 843-844.

¹⁹⁹ *Id.* at 844-845; GAO, *supra* note 15, at 57-58.

²⁰⁰ De Ly, *supra* note 81, at 845.

countering fraud. Furthermore, the practical difference between the URDG and the Convention in this perspective is not to be exaggerated; also the reasoned demand of payment by the beneficiary in many cases will not prevent fraud.²⁰¹

It has also been stated that the Convention fraud rules are defensible from the viewpoint of banks and beneficiaries. However, the principal is left out in the cold if a demand for payment is made and the bank makes payment without notifying the principal.²⁰² The Convention does not place a duty on the bank to provide information and to wait a few days before payment is made so that in cases of fraud the principal is not in a legal position to take immediate action. Furthermore, the Convention would have achieved a better balance by including an obligation to provide information and to delay payment.²⁰³ Only then would market participants have been able to choose between strong protection against fraud under the URDG, moderate protection under the Convention and minimal protection under the UCP. Moreover, in this regard the Convention is not inventive, is too closely aligned with the self-regulation of the URDG and UCP, and an important chance to correct the current situation was missed.²⁰⁴

It is true that the provisions relating to the fraud exception contained in the Convention signal a significant and encouraging development in this area of the law.²⁰⁵ Furthermore, the Convention is the first document to provide details of the fraud exception at an international level. Another important issue is that, unlike the ICC rules, which have to be incorporated into the demand guarantee as contractual terms to be effective, the Convention becomes law in a country that signs and/or ratifies it.²⁰⁶

²⁰¹ *Id.* at 844-845.

²⁰² *Id.* at 845.

²⁰³ *Id.* at 845-846.

²⁰⁴ *See id.*

²⁰⁵ However, Dolan has criticised the inclusion of the provision of the Convention aimed at the prevention of fraudulent calls. He suggests that like the UCP, the UNCITRAL Convention should have left the question of fraud out of the Convention and should rather have left it to the domestic law of the different jurisdictions. In fact, according to him it would have been better if the Convention were never created. See Dolan, *supra* note 10, at 19-21, 23.

²⁰⁶ GAO, *supra* note 15, at 61.

Conclusion

Opinion on whether or not the UCP should deal with the fraud issue is divided. In my view, it is regrettable that the UCP, which have become such an important universal set of rules (source of law) are silent on the issue of unfair or fraudulent calling of letters of credit and standby letters of credit. What is even more regrettable is the fact that the UCP do not contain any provision on the guarantor's right to refuse payment.

ISP98 takes a similar approach to the UCP and expressly leave the issue of fraudulent or unfair calling of standby letters of credit to be determined by the applicable jurisdictional law. As with the UCP, it is also regrettable that the ISP98 is silent on this issue.

One of the objectives of the URCG was to limit the possibilities of unfair demands of guarantees issued under it. In terms of Article 9 of the URCG, if the guarantee did not specify the documentation to be produced in support of a claim or merely specified the submission of a statement of claim, the beneficiary was required to submit (1) in the case of a tender guarantee, the beneficiary's declaration that the guarantee was due and an agreement to have any dispute with the principal submitted to litigation or arbitration, and (2) in the case of a performance guarantee or of a repayment guarantee, either a court decision or an arbitral award justifying the claim, or the approval of the principal in writing to the claim and to the amount to be paid. However, in addition to limiting the possibility of improper demand, the requirements of Article 8(3)(b) read with Article 9 effectively eliminate the simple demand guarantee. Therefore, one of the major problems with respect to the URCG is that they did not take into consideration the increasing use and importance of on-demand (simple or first demand) guarantees.

Article 20 of the URDG458 does not go as far as Article 9 of the URCG. The article has gone some small way in placing restrictions on the beneficiary's right of payment. This article only requires that the demand be in writing and supported by a written statement that the principal is in breach of the underlying contract and in what respect the principal is in breach. The simple demand guarantee is thereby transformed into a documentary guarantee, with a required minimum content of the document. However, the wording used here is not a very effective safety device, but at least it places on the beneficiary a certain obligation to show his hand. The requirement that the beneficiary has to state in writing both that there is

some kind of breach of the underlying contract and the type of breach that is involved gives the principal limited protection. However, URDG458 does not contain any provision on the guarantor's right to refuse payment.

Therefore, although the URCG and URDG458 have both attempted to prevent unfair calls on demand guarantees, in conclusion, it can be said that neither set of rules seems quite sufficient. In fact, URDG458 has not only failed to win the support of all groups but have also been strongly opposed by some.

In the Convention, neither the approach of the URCG nor that of the URDG458 was taken. Contrary to the UCP and ISP98, the Convention made an attempt to address the issue of fraud and to prevent fraudulent or unfair calling of standby letters of credit and demand guarantees. From the viewpoint of unfair calls and the principle of autonomy, the vital articles of the UNCITRAL Convention are Articles 15(3), 19 and 20. These articles work together to make it more difficult for an unfair call to succeed and they do so by seeking a justification for the call in the underlying contract. The Convention specifically recognises exceptions to the absolute and independent nature of demand guarantees and standby letters of credit. Article 19 with the heading "Exception to Payment Obligation" stipulates the circumstances under which the issuer/guarantor may dishonour the beneficiary's demand for payment. Article 19(1) provides that if it is manifest and clear that (1) any document is not genuine or has been falsified; (2) no payment is due on the basis asserted in the demand and the supporting documents; or (3) 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. Article 19(2) then proceeds to listing the circumstances in which it will be considered that the demand has no conceivable basis. In addition to this, Article 20 recognises the possibility of restraining orders against the beneficiary and/or bank on the basis of immediately available strong evidence that the beneficiary's demand for payment has no conceivable basis, as described in Article 19(2).

The Convention for the first time contains a codification of the different situations where fraud is present, and it too requires strong evidence as to this situation. This list may not be exhaustive, but it is a remarkable and encouraging way in which to define the kind of misconduct that may provoke the fraud exception. Article 19 provides that as far as the degree of proof is concerned, the fraud must be "manifest and clear" and "immediately available." It clearly provides that appropriate fraud in the

narrow sense (e.g., fraud committed by the beneficiary on the documents) as well as broad sense (e.g., fraud committed by the beneficiary that does not relate to documents) will be sufficient to constitute an exception to the autonomy principle. In my view, it defines the concept of fraud a little too widely in Article 19(2). However, it unquestionably stands as the most thorough provision so far with regard to the clarification of the type of misconduct that may bring the fraud exception into operation.

However, it does seem that Article 19 departs quite clearly from the principle of autonomy. For instance, in determining whether a call is justified, most of the sub-articles of Article 19²⁰⁷ require the guarantor/issuer of the demand guarantee/standby letter of credit to look to the underlying contract for good cause to pay. Article 19 does not place an express duty on the guarantor/issuer to refuse payment under certain circumstances, but only a right to do so. The article seems to allow the guarantor/issuer certain discretion when payment is demanded, but it also implies a certain duty on him to make a judgment whether the requirements are met or not. Therefore, there now appears to be a certain duty on the guarantor to make a judgment whether payment should be made. Banks understandably want to keep their involvement to a minimum when dealing with the question of whether or not to pay under a demand guarantee/letter of credit, particularly when there are allegations of fraud. It has been said that banks are objecting to the ratification of the Convention, because of their perception that Articles 15(3) and 19 will bring about their greater involvement.²⁰⁸

Articles 19 and 20 provide respectively for the definition and description of the fraud exception, and the measures available to the principal/applicant in such a case. However, the attempts made by the Convention by way of Articles 19 and 20 are commendable, especially since it is the first real international attempt to prevent unfair calls and to codify the fraud exception. However, the effectiveness of the Convention in this regard is seriously doubted.

Although the Convention already came into effect on 1 January 2000, it has so far been ratified (acceded to) by only a few countries. The

²⁰⁷ See The Convention, *supra* note 5, art. 19(1)(b)-(c), 19(2)(a)-(d).

²⁰⁸ See Roger Fayers, *Developments Concerning the "Accounting Principle"*, 12 DCINSIGHT 18, 20 (Oct.-Dec. 2006).

United States signed the Convention on 11 December 1997, but has yet to accede to it. Therefore, no major trading country has thus far ratified it. It would also appear that South Africa has no immediate future plans to adopt it either. From this it appears that the success of the Convention has been rather limited. The reasons for this could be numerous. However, from a critical point of view, it is possible that the codified fraud exception might be one of the reasons for countries being hesitant to adopt it. Therefore, the fraud exception may possibly need further improvement. However, viewed politically, it seems to be rather impossible to do. Banks, in general, apparently also oppose the adoption of the Convention. They justifiably want to keep their involvement as far as demand guarantees/standby letters of credit are concerned to a minimum, and it is their opinion that the Convention, particularly Articles 15(3) and 19, would bring about their greater involvement.

It follows that if market participants want strong protection against fraud, they should incorporate the URCCG; if they desire moderate protection, they should incorporate the Convention; and if they only want minimal protection, they should incorporate the URDG.

It is also clear that none of the rules of practice or the Convention has really succeeded in preventing fraudulent and unfair calls being made. Banks need a simple device in terms of which they will have to pay without having to make difficult considerations and to take hard decisions based on unclear evidence. Beneficiaries need a device in terms of which they get paid against a simple demand or against a simple document without risking various obscure objections. Principals/applicant, however, are interested in having some safety mechanism in the system so as to prevent unfair callings. Although the international initiatives, discussed above, are praiseworthy, they are unlikely to bring about a clear and practical solution to the problem of unfair calls, given the opposing nature of commercial and political interests and motives. The problem with all of these international initiatives, is that their effectiveness is limited to the extent to which the international community is prepared to adopt them in practice.