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REPORT OF THE WORKING GROUP ON INTERNATIONAL CONTRACT PRACTICES ON THE WORK OF ITS THIRTEENTH SESSION (New York, 8-18 January 1990)

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INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session, 1/ the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit. The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

2. The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and entrusted this task to the Working Group. The Secretariat was requested to prepare the necessary documentation. 2/

3. The Working Group, which was composed of all States members of the Commission, held its thirteenth session in New York from 8 to 18 January 1990. The session was attended by representatives of the following States members of the Working Group: Argentina, Bulgaria, Cameroon, Canada, Chile, China, Cuba, Czechoslovakia, Egypt, France, Germany, Federal Republic of, Hungary, India, Iran (Islamic Republic of), Japan, Kenya, Lesotho, Libyan Arab Jamahiriya, Mexico, Morocco, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America and Yugoslavia.

4. The session was attended by observers from the following States: Australia, Austria, Colombia, Ecuador, Finland, German Democratic Republic, Indonesia, Liberia, Malawi, Myanmar, Poland, Republic of Korea, Sweden, Switzerland, Thailand, Tunisia, Uganda and United Republic of Tanzania.

5. The session was attended by observers from the following international organizations: International Monetary Fund, International Chamber of Commerce, European Banking Federation.

6. The Working Group elected the following officers:

Chairman: Mr. R. Illescas Ortiz (Spain)

Rapporteur: Ms. R. M. Pinelo (Cuba)

7. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.64), and a note by the Secretariat containing the discussion of some issues of a uniform law: substantive scope of uniform law, party autonomy and its limits, and rules of interpretation (A/CN.9/WG.II/WP.65).

8. The Working Group adopted the following agenda:

1. Election of officers.

2. Adoption of the agenda.

3. Possible issues of a uniform law on guarantees and stand-by letters of credit.

4. Other business.

5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

9. The Working Group commenced its work entrusted to it by the Commission by considering the possible issues of a uniform law as discussed in the note by the Secretariat (A/CN.9/WG.II/WP.65). The deliberations and conclusions of the Working Group are set forth below in sections A to C of chapter II.

10. The Working Group engaged in a preliminary exchange of views on further possible issues to be covered by the uniform law, as set forth below in section D of chapter II.

II. POSSIBLE ISSUES OF A UNIFORM LAW ON GUARANTEES AND STAND-BY LETTERS OF CREDIT

A. Substantive scope of the uniform law

1. General discussion on the purpose and substantive scope of the uniform law

11. General remarks were made on the purpose of the future uniform law and on its substantive scope. As regards the purpose of the uniform law, it was suggested that the uniform law should serve a bridging function by overcoming essential disparities between different legal systems. Its scope should be modest and focus on essential issues such as validity and enforceability, time of effectiveness and expiry, liability of the parties and objections to payment. A view was expressed that the uniform law should not unduly restrict party autonomy and that the form of a model law was preferable to that of a convention. On the latter point, the Working Group was agreed that it was premature to take a decision at this early stage.

12. It was further stated that the uniform law should not adversely affect established and sound guarantee and letter-of-credit practice and its future development. In this connection, it was suggested that the uniform law should aim at coherence with pertinent uniform rules elaborated by the International Chamber of Commerce. With a view to avoiding inconsistency or conflicts, the uniform law should focus on those issues that could not effectively be dealt with by contractual rules. 3/

13. As regards the types of instrument to be covered by the uniform law, the prevailing view was that the uniform law should focus on independent guarantees and stand-by letters of credit and that it could be extended to traditional commercial letters of credit where that would be useful in view of their independent nature and the need to regulate equally relevant issues.

14. The view was expressed that the stand-by letter of credit should be dealt with clearly separately from the independent guarantee because of its different functional origin. The prevailing view, however, was in favour of a joint treatment in view of their common operational legal character and functional equivalence. The uniform law could adopt a common name for these two instruments such as the term "guaranty letter" suggested by the Secretariat. A view was expressed that a possible generic name embracing also the commercial letter of credit, i.e., all three types of independent instruments to be covered by the uniform law where that was possible and appropriate, could be, for example, "independent financial assurance".

2. Possible elements of a definition of "guaranty letter"

15. The Working Group discussed the possible elements of a definition of "guaranty letter" on the basis of the considerations and suggestions set forth in the above note (A/CN.9/WG.II/WP.65, paras. 21-47). It was understood that the discussion of such elements, while primarily concerning the definition of "guaranty letter", was often relevant also for later consideration in the drafting of operative provisions.

(a) Independent undertaking to pay

16. The Working Group was agreed that the definition of guaranty letter should contain the idea of an independent undertaking to pay. The term "undertaking", or possibly "promise", was preferred to expressions like "contract", "agreement" or "arrangement" in that it did not take a stand on the controversial question of the legal characterization as unilateral or bilateral. A view was expressed that the expression "to pay" might be too narrow and that a more appropriate expression might be "to honour" or "to credit". As regards the object of payment, it was stated that it should be understood to be of a financial nature.

17. As regards the qualification of the undertaking as "independent", the Working Group was agreed that this was an important element that should be included in the definition, in particular for the purpose of drawing a demarcation line to accessory guarantees, which were to be excluded from the uniform law. It was noted that the concept of independence of the guarantor's undertaking concerned primarily the so-called underlying transaction between the principal and the beneficiary but also other relationships such as that between the guarantor and the principal and that between the guarantor and a counter-guarantor.

18. As regards possible ways of expressing the concept of independence, it was suggested that the guarantor could be precluded from invoking against the beneficiary the defences that the principal could invoke against the beneficiary or that the principal could invoke against the guarantor, especially as arising out of a claimed inconsistency between the instructions of the principal and the guaranty letter as issued. This expression of independence was felt by some to be more appropriate than a more categorical one such as "the guarantee is independent of any underlying transaction or other relationship". It was feared that the latter expression might be construed as an absolute prohibition of referring to any instance relating to the underlying transaction and thus, for example, preclude possible recourse to such instance in case of fraud or abuse of right.

19. In a similar vein, it was felt that an expression of independence should not be too categorical and absolute so as to hinder the appropriate treatment of more specific issues such as the admissibility of pre-establishment conditions, non-documentary payment conditions or other agreed guarantee terms. It was concluded, therefore, that the definition should contain a statement of principle and that the concept of independence had to be refined and elaborated in various contexts of operative provisions.

(b) Compliance with terms and conditions

20. The Working Group was agreed that compliance with the terms and conditions set forth in the guaranty letter should be included as an element in the definition of guaranty letter, even though it may be regarded as a self-evident requirement. Its inclusion would help to characterize the undertaking and to clarify that the undertaking was shaped only by those terms set forth in the guaranty letter and not by any extraneous conditions. It was understood that any such reference to compliance did not take a stand on such questions as whether certain terms or conditions might be inadmissible or whether certain terms or conditions were required for the guaranty letter to be valid.

(c) Definite or determinable amount and currency of payment

21. It was observed that a reference to the payment of money or currency may be too narrow in that it would exclude, for example, an undertaking to pay in gold. It was, therefore, suggested that a wider wording such as "payment of anything that is stated in the guaranty letter" should be used. It was understood that any such reference in the definition merely expressed a principle and did not address specific questions such as the admissibility of a given object of payment or the possible need for providing a mechanism of conversion.

22. The Working Group was agreed that the amount payable should not be required to be definite but that it had to be at least determinable. It was noted that guaranty letters without a definite amount were being used in practice and, for example, provided for reductions according to the decrease in the guaranteed risk (e.g., progress of works covered by a performance guarantee). Concerns were expressed that the necessary determination in such cases might undermine the independent nature of the undertaking, unless the amount was specified to be available by definite instalments. In order to meet those concerns, it was suggested that the determination should be one that could be readily made by the guarantor, for example, on the basis of clearly specified documents.

(d) Claim within specified period of time

23. The Working Group was agreed that a demand for payment had to be made within any specified period of validity or effectiveness. For that purpose, it was necessary to provide certainty as to the exact point of time when the period commenced to run, that is, the date of establishment or effectiveness. It was equally important to determine the exact point of expiry, be it an expiry date or an expiry event, which should be determined on the basis of a document or, possibly, other ready means. Both issues had to be addressed in the operative rules of the uniform law.

24. It was noted that in practice guaranty letters were found that did not specify a period of validity or effectiveness. In view of that practice, the uniform law should not require guaranty letters to contain such a specification. However, various concerns were expressed with respect to such undertakings of indeterminate validity. Perpetual undertakings were regarded as unsettling and commercially undesirable owing to their lack of finality. They also raised regulatory concerns in view of their continuing liability and risk exposure. Moreover, they created uncertainty in that they might be affected by a statute of limitations of an applicable law which in itself might be difficult to determine. As to the latter point, it was felt that there was a need for further study of the possible impact of statutes of limitation on undertakings without a specified validity period.

25. In order to meet those concerns, it was suggested that the uniform law should provide a cut-off period of, say, 5 or 10 years for those guaranty letters that did not specify a period of validity. A concern was expressed that such a provision, if it prevented the issuance of guaranty letters that specified perpetual validity, might not be acceptable to all States. 4/

(e) Purpose for which guaranty letter is issued

26. The Working Group was agreed that the definition of guaranty letter should not include the requirement that the guaranty letter state the purpose for which it was issued.

(f) Undertaking in written form

27. The prevailing view was that the question of the form of the guaranty letter should be dealt with not in the definition of guaranty letter, which was relevant for the substantive scope of the uniform law, but in an operative provision concerning the valid establishment of the guaranty letter.

28. Divergent views were expressed as to whether written form should be required. Under one view, written form was necessary to confirm the seriousness of the undertaking and to provide a credible and enforceable record thereof. The form requirement could be broadly defined so as to include electronic message equivalents or other means that served the above purposes. Under another view, the uniform law should be liberal and not itself impose any such restriction as to form, even though oral undertakings were hardly found in practice. However, following the approach adopted in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), individual States could be given the option of including the requirement when implementing the uniform law. As to the latter suggestion, it was pointed out that the wording of that Convention might have to be adjusted in view of the difference between a sales contract and a guaranty letter and that the mechanism of a reservation could be used only if the uniform law were eventually adopted in the form of a convention. 5/

29. The Secretariat was requested to prepare alternative draft provisions reflecting the two views. In so doing, it should consider the question of distinguishing between the original establishment of a guaranty letter and any later amendments, in view of the fact that amendments were at times made orally. Moreover, the draft provisions should address the additional issue of authentication.

(g) Issued by a bank or other guarantor, at the request of a customer (principal, instructing or account party)

30. The Working Group was agreed that the uniform law should cover not only guaranty letters issued by banks but also those issued by other institutions or persons. It was understood that that wide coverage would not interfere with any regulation of a State that prohibited certain institutions or persons from issuing guaranty letters. It was further suggested that the inclusion of guarantors other than banks should not imply that their expected standard of conduct could be different from that required for sound guarantee and letter-of-credit practice.

31. As regards the possible element that the guaranty letter be issued at the request of another person, concerns were expressed that this might be too narrow in that it might not be appropriate for counter-guarantees and for those exceptional cases where a guaranty letter was issued by an entity on its own behalf. It was agreed that in formulating the element of the customer's request an attempt should be made to alleviate those concerns.

32. The Working Group was agreed that the terms to be used in the uniform law for the various parties involved in guaranty letter operations had to be carefully chosen, taking into account the current usages in different parts of the world and the need to establish corresponding versions in the six official languages of the United Nations.

(h) Payment to another party (beneficiary)

33. The Working Group was agreed that the definition of "guaranty letter" should contain the element of payment "to another party", to be called "beneficiary".

34. In that connection, a suggestion was made that there were a number of other terms that should be defined in the uniform law, e.g., negotiation, transfer, assignment, document, to pay, to honour, letter-of-credit custom. The Working Group was agreed that it would consider that suggestion at a later stage. 6/

3. Relationships to be dealt with in uniform law

(a) Relationship between guarantor and beneficiary

35. It was noted that the bulk of the operative provisions in the uniform law could be expected to deal with the rights and obligations of the guarantor and the beneficiary. It was stated, therefore, that the principle already enunciated that the uniform law should be restricted to only those elements that were strictly necessary to bridge the differences between legal systems was of particular relevance in this context. In respect of the relationship between the guarantor and the beneficiary, those elements would encompass such matters as the independence of the guarantor's obligation, irrevocability of the obligation, the time when the obligation was established, when it expired and a period of limitation within which claims could be brought under it.

36. Under another view, the uniform law might contain more detail than suggested above. It was pointed out that the purpose of the uniform law would be to unify the law. Whatever legal issues were not covered by the uniform law would be solved in practice by resort to other rules of national law that would not be uniform. It was suggested, therefore, that when the Secretariat prepared the first draft of the uniform law it should include more rather than fewer details. The Working Group might then decide to delete those provisions it did not believe were necessary.

37. The Working Group discussed the desirability of including in the uniform law a clear indication of the legal characterization of the guarantor's obligation. Under one view the uniform law should clearly indicate that the guarantor's obligation was of a contractual nature. One consequence of such a characterization would be that the guarantor would have no obligation until the beneficiary had accepted the terms of the guaranty letter.

38. Under another view, the uniform law should be drafted in such a way as to avoid the use of concepts. It was stated that a number of legal systems were currently not clear on the appropriate legal characterization to apply to the different relationships. As to the suggestion that the guarantor's obligation should be characterized as contractual in nature, it was said that such a characterization would cause problems in respect of the transfer to a third person of the beneficiary's rights under the guaranty letter.

39. Similarly, the Working Group decided that it was preferable not to attempt to determine the original source of the terms in a guaranty letter. It was noted that in many cases it was the beneficiary who determined the terms that it was willing to accept; it was the principal who instructed the guarantor as to what those terms would be, while it was the guarantor who issued the guaranty letter. If the original source of the terms was considered to be significant, it might be relevant to questions of interpretation of the guaranty letter as well as to the determination of the applicable law.

(b) Relationship between guarantor and principal

40. The Working Group noted that at its previous session the prevailing view had been that the guarantor's relationship with the principal should be kept clearly separate from that with the beneficiary and as such should fall outside the scope of the uniform law (A/CN.9/316, para. 136). However, consistent with the decision made in respect of the relationship between the guarantor and the beneficiary, it was decided that when the Secretariat prepared the first draft of the uniform law it should include more rather than fewer details and that the Working Group might later delete those it did not believe were necessary.

(c) Relationship between guarantor and counter-guarantor

41. The Working Group confirmed its decision at its prior session that it would be appropriate for the uniform law to apply to the relationship between the guarantor and the counter-guarantor in view of the fact that that relationship was itself a guarantee relationship (A/CN.9/316, para. 135).

42. Although most of the issues in respect of the counter-guarantee were the same as those in respect of the principal guarantee, i.e., independence of the guarantor's obligation, irrevocability of the obligation, the time when the obligation is established, when it expires and the period of limitation within which claims could be brought under it, the counter-guaranty letter raised the specific issues of the possible right of the counter-guarantor to be subrogated to the rights of the guarantor and of the independence of the counter-guaranty letter from the principal guaranty letter. It was said that two different types of independence were involved: first, the counter-guarantor was obligated to pay only under the terms of the counter-guaranty letter it had issued. The terms of that guaranty letter might be quite different from the terms of the principal guarantee. For example, the principal guarantee might be accessory while the counter-guarantee was abstract. Secondly, the counter-guarantor did not review the documents against which the guarantor was paid; the counter-guarantee served the function of reimbursement of the principal guarantor.

43. Doubt was expressed in the Working Group as to whether there was ever a confirming bank on a guarantee, and therefore whether reference to such a party would be appropriate in the uniform law. It was noted, however, that the uniform law might also apply to some aspects of documentary credits, in which case reference to a confirming bank would be expected.

44. As on a previous occasion (see above, para. 24), a concern was expressed about the length of the period during which a counter-guarantee might be considered to be enforceable. It was noted that under the laws of some countries the guarantee, and therefore the counter-guarantee, was enforceable until the document representing the guarantee had been returned to the guarantor, which might lead to perpetual liability. In other cases the period of enforceability might be for a finite, but exceedingly long, period of time even though the guaranty letter stated a shorter period of time. Enforceability of guaranty letters for such long periods of time was said to raise problems with the banking regulatory authorities in some countries where counter-guarantor banks were located. In addition, the capital adequacy rules under the Basel Agreement would increase the cost to counter-guarantor banks of remaining liable on the counter-guarantee.

45. It was suggested that those problems might be ameliorated if the uniform law were to contain a limit on the period that a guarantee, including a counter-guarantee, was enforceable. In reply it was stated that such an approach would not be effective; the uniform law could not be expected to be adopted by all States, or even all States of counter-guaranteeing banks. Therefore, those States that currently demanded guarantees that were enforceable for what was considered to be an excessively long period of time would always be able to require the principal who wished to secure the underlying contract to find a bank that would issue a counter-guarantee with the desired terms.

46. As one possible solution to the problem it was suggested that the uniform law might provide a cut-off period for the presentation of claims under a guarantee. The cut-off period would be effective unless the guarantee, including a counter-guarantee, were to provide for a longer period of time.

4. Restriction to international guaranty letters

47. Under one view, the uniform law should be restricted to international guaranty letters. One reason given, which was not by itself determinative, was that the function of the Commission was to work towards the progressive unification and harmonization of international trade law. Of more immediate significance was that many legislators who might be prepared to adopt the uniform law if it was restricted to international transactions might not be prepared to adopt it if it was also applicable to domestic transactions. It was also pointed out that some of the eventual provisions might not be appropriate for domestic transactions, such as the definition of "money", which could be expected to refer to units of account.

48. It was suggested that in spite of those arguments it might be appropriate not to make a final decision on the requirement of internationality until the substantive provisions had been prepared. It was said that the essential elements of an independent guarantee were the same whether the guarantee transaction was domestic or whether it was international. Therefore, the substantive provisions when drafted might be acceptable by many States for domestic transactions. It was suggested that the substantive provisions might be more acceptable for domestic transactions if it was clear that the uniform law would not apply to consumer transactions.

49. In regard to the appropriateness for the Commission to prepare a uniform law that might be applied to domestic transactions, it was noted that the Commission's Working Group on the New International Economic Order had decided to prepare a model law on procurement that would apply to domestic as well as to international procurement. It had been the belief of that Working Group that that was the best method to harmonize the law governing international procurement.

50. It was suggested that the question whether the uniform law should be restricted to international guarantee transactions was of particular importance if the uniform law was eventually adopted in the form of a convention but that it would be of lesser importance if the uniform law was adopted in the form of a model law, since in that case any State would be free to adopt it for domestic guarantee transactions if it wished to.

51. When the Working Group turned to the possible criteria of internationality that might be applied if the sphere of application of the uniform law was so restricted, two sometimes conflicting policy considerations were stated. On the one hand, the application of the uniform law to a guaranty letter should be easily ascertainable to the banking and other personnel who would handle it. On the other hand, if at all possible the uniform law should be applicable to an entire guarantee relationship, including the principal guarantee and any counter-guarantees. The first of those policy considerations would call for the existence of the connecting criteria to be on the face of the guaranty letter itself. The policy would also be furthered if the recitals on the face of the guaranty letter were determinative of the application of the uniform law in respect of any party who had not participated in the placing of false recitals on the guaranty letter. The second of those policy considerations might call for investigation of facts that were not ascertainable from the face of the guaranty letter.

52. Support was given for the first three possible criteria set forth in paragraph 54 of the note by the Secretariat, i.e., (a) guarantor and beneficiary have their places of business in different States; (b) place of issue and place of business of requesting or instructing party (principal or counter-guarantor) are situated in different States; (c) place of issue and place of payment are situated in different States. It was also suggested that the three criteria might be set forth as alternative grounds for application of the uniform law.

53. It was pointed out that some possible criteria, such as the place of issue and the place of payment, might be irrelevant to the nature of the guarantee, and that in any case they could easily be manipulated. It was stated that in the typical four-party-guarantee relationship, e.g., a principal guarantee and a counter-guarantee, only the guarantor of the principal guarantee (beneficiary of the counter-guarantee) and the counter-guarantor would be from different States. As a result, if the criteria of internationality were restricted to the location or place of business of the guarantor and beneficiary, only the counter-guarantee would be subject to the uniform law.

54. Another suggestion was that a guaranty letter should be within the sphere of application of the uniform law if it was issued in connection with an international commercial transaction. In support it was stated that such internationality by reference was already known, especially in respect of international commercial arbitration where the internationality of the arbitration might be determined by the internationality of the relationship out of which the dispute arose. The question was raised as to how the personnel handling the guaranty letter could be expected to know whether the underlying transaction was international. It was also suggested that such a criterion for the sphere of application might raise doubts about the independence of the guarantee from the underlying transaction.

55. Under another approach the uniform law should contain a general reference to internationality, accompanied by the three above criteria as examples. The courts would be left to determine whether other fact situations would be sufficiently international to bring the guaranty letter under the uniform law. In support it was said that such an approach would extend the uniform law to the maximum number of international guaranty letters. In reply it was said that the formula was too uncertain to be useful to the personnel handling guaranty letters.

56. The suggestion was made that under a principle of party autonomy the parties should be able to choose the application of the uniform law to the guaranty letter. It was stated in support that such a facility would in practical terms lessen the importance of any objective criteria of internationality. In response it was stated that legislators in many States would not welcome such an approach. It was noted, however, that the suggestion made above that the recitals in the letter of guaranty should be determinative of the facts therein for the purpose of determining whether the guaranty letter was subject to the uniform law had somewhat the same effect as permitting the parties to choose the application of the uniform law.

57. The Working Group requested the Secretariat to prepare alternative draft versions of a test of internationality, taking into account the above views and suggestions.

B. Party autonomy and its limits

1. Express recognition of party autonomy

58. The question was raised whether it was necessary for the uniform law to state expressly that under the principle of party autonomy a guarantor could agree to give an independent guarantee. It was suggested that the existence of the principle and its application to the creation of an independent guarantee seemed to be self-evident. In reply it was said that an express statement to that effect in the uniform law would not be necessary today in many countries, especially in regard to independent guarantees given in connection with international transactions, but that that would not have been the case 10 years ago, when the idea of an independent guarantee was not well recognized. Even today there would undoubtedly be many States where the principle was not clearly recognized, and a clear statement in the uniform law would be useful.

59. It was noted that, although the principle of party autonomy would in general permit the creation of independent guarantees in international transactions, there may be hesitancy in some States to allow its full force in regard to some domestic transactions, and particularly in regard to some that were not commercial in nature. Furthermore, the principle of party autonomy as it might be set forth in the uniform law would not have the effect of overcoming regulatory provisions of national law that prohibited certain entities from issuing independent guarantees or contained other special rules in that regard.

60. The principle of party autonomy would have the further effect of permitting the parties to an independent guarantee to deviate from those provisions of the uniform law that were not indicated to be of a mandatory character. It would be necessary to indicate at a later time which of the provisions of the uniform law were of a mandatory character and from which it would not be possible to deviate. It was suggested that two limitations on party autonomy that could already be envisaged went to the scope of application, i.e., that the parties to a domestic transaction could not bring themselves within the provisions of the uniform law by indicating that the transaction was international and that they could not set forth the terms of an accessory guarantee and make it an independent guarantee simply by using those words. It was noted, however, that in some countries a guarantee might be considered to be accessory unless the guaranty letter specifically stated that it was independent.

2. Possible reference to uniform rules and usages or customs

61. The Working Group was in agreement that the uniform law should not refer explicitly either to the Uniform Customs and Practice for Documentary Credits (UCP) or to the Uniform Rules for Guarantees (URG). It was noted that URG had not yet been agreed upon by the International Chamber of Commerce (ICC) and neither the final text nor the extent to which they would be used could be known at the present time. As for UCP, ICC had announced its intention to revise the current text. It was said that it would be inappropriate to refer in a legislative text of the nature of the uniform law to another text that was itself subject to periodic revision. It was, however, suggested that there might be reference to one or both in a preamble to the uniform law.

62. The Working Group was also in agreement that UCP and, potentially, URG were important compilations of the customs and practice in the field of independent promises. Furthermore, it was suggested, the very fact that UCP and URG could be more easily revised and brought up to date with the evolving banking practice than could the uniform law, a fact that had contributed to the undesirability to mention them by name in the uniform law, meant that it would be wise to restrict the substantive coverage of the uniform law to those matters that could not easily be covered by such compilations of banking practice as UCP and URG.

63. In reply it was noted that, while the space between the mandatory provisions of the uniform law and the provisions of the guaranty letter itself might be filled by UCP or URG, it might also be filled by provisions of national law other than those in the uniform law. Whether that space would be filled by provisions of national law other than the uniform law would depend in part on the coverage of UCP or URG and on whether either of those texts was applicable to the particular guaranty letter. In that regard it was noted that, while there were a number of legal systems in which UCP would be applied by the courts as a matter of customary law, there were other legal systems in which it would be applied as a matter of contract and only if the parties incorporated it into the guaranty letter by reference. It was suggested by some that as a result it might be desirable for the uniform law to cover at least some of the same subject areas that were currently covered by UCP. The view was expressed that it would be desirable for there to be a high degree of co-ordination between UNCITRAL in its preparation of the uniform law and ICC in its revision of UCP and work intended to bring URG to completion.

64. The suggestion was made that, even if UCP and URG were not mentioned by name in the uniform law, the uniform law might make a reference to usages or custom, perhaps by the use of a formula modelled on article 9 (2) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), which reads as follows:

> "The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to the particular trade concerned."

65. It was stated in reply that the formula used in the Sales Convention made sense in the context of the law of sales where the parties were completely free to draft their contract as they wished, but that it was not appropriate for use in the context of independent guarantees where many of the provisions of the uniform law would have an imperative nature.

3. Possible limits to party autonomy

(a) Limits set in mandatory provisions

66. The Working Group was agreed that party autonomy would be recognized in the uniform law within certain limits that should be clearly described by the law. As had been suggested at the twelfth session, the uniform law could establish certain standards of accountability and set forth the requirement of good faith. Such standards of accountability could be cast as limits to exemption clauses and, for example, impose liability on guarantors for failure to act in good faith or with reasonable care, as provided for in article 15 of the current draft URG.

67. In this connection, concerns were expressed that the uniform law might overlap or conflict with uniform rules prepared by ICC, in particular with UCP articles 15 and 16 on the issue of bank responsibility. In order to avoid undesirable inconsistencies, close co-operation between the two organizations was necessary. The Observer of ICC explained the need and the organizational steps planned for a revision of UCP and expressed the expectation that the Commission would assist in those efforts, as it had done in connection with previous revisions.

(b) Exclusion of non-documentary conditions of payment

68. The Working Group considered the problem of non-documentary conditions of payment on the basis of the discussion set forth in the note by the Secretariat (A/CN.9/WG.II/WP.65, paras. 28-29 and 74-82). Various statements were made with a view to clarifying the scope of the problem.

69. It was pointed out that the problem under discussion concerned only conditions of payment and not any pre-existing conditions of effectiveness of the guaranty letter, and that it concerned only conditions in the strict sense of the word, that is, those that made payment dependent on an uncertain future act or event. It was noted that a demand or claim for payment could be considered to be documentary if made in written form, since the term "document" included any "writing". In that connection, it was noted that different categories of "documentary guarantees" could be distinguished, depending on how many of the following payment conditions were stipulated: written demand, statement by beneficiary about principal's default, specification by beneficiary of obligations not performed by principal, supporting documents by third party.

70. Finally, it was noted that the problem under discussion was different from that posed by a possible condition not set forth in the guaranty letter. Such an extraneous condition that might be agreed upon by the parties at a later stage raised different issues, such as the formal validity of amendments to the guaranty letter.

71. The crux of the problem under discussion was seen in the fact that non-documentary conditions of payment called for the determination or verification of facts and that such conditions might undermine the independent character of the undertaking to pay. While even the handling of documents was not always without difficulties, the need for factual determinations, which could be time-consuming, create difficulties or get the guarantor entangled in disputes between other parties, placed an undesirable burden on the guarantor and hindered the prompt payment under the guaranty letter. As expressed in the maxim "banks deal in documents and not in goods", the documentary or representational character of the payment conditions was closely linked with the concept of independence.

72. It was noted that non-documentary conditions relating to the underlying transaction often cast doubt on the independent character of the undertaking and that it was a question of interpretation whether a given undertaking was in fact independent or accessory. While the uniform law could provide guidance by a rule of interpretation on that crucial issue, it was clear that an accessory guarantee would not be covered by the uniform law. Accordingly, the problem under discussion was, for the purposes of the uniform law, limited to those non-documentary conditions of payment that accompanied independent undertakings.

73. Various views were expressed as to the treatment of non-documentary conditions by the uniform law. Under one view, the uniform law should not address the problem, let alone disallow such conditions or transform them into documentary conditions. It was stated, in support, that the agreement of the parties should be fully recognized and that strict compliance with agreed conditions was necessary for the sake of certainty. Moreover, the question of whether a non-documentary condition constituted an undesirable or unacceptable burden on the guarantor was a matter that should be left to the business judgement of the guarantor when assuming such an undertaking.

74. Under another view, the problem should not be addressed by a specific rule concerning non-documentary conditions but within the realm of a general rule that would provide sufficient discretion to deal in a practical way with the possible variety of cases. Such a rule could be one relating to strict compliance or one that defined the standard of care of a reasonable document checker in a bank.

75. The prevailing view, however, was that the uniform law should provide that non-documentary payment conditions be read as documentary conditions, unless, of course, the undertaking was not independent and thus fell outside the scope of the uniform law. While such conversion might be contrary to the expectation of one or more of the parties, that concern was expected to diminish over time with the parties' increasing familiarity with the relevant provision on conversion. As regards the mode of conversion, that is, which kind of document should be required, it was suggested that a statement by the beneficiary certifying the fact or event in question or, at his option, a certificate by an appropriate third person should suffice.

C. Possible rules of interpretation

76. On the basis of the discussion set forth in the note by the Secretariat (paras. 83-99), the Working Group considered the ways in which the uniform law might provide guidance in the interpretation of the terms used in the uniform law and of the wording of guaranty letters.

1. Definitions

77. The Working Group was agreed that the uniform law should define the essential terms used within the law. In formulating the definitions, due regard should be had to the terminology used in international guarantee and letter-of-credit practice and possible future changes. Thus, one should aim at establishing a clear common understanding without being excessively detailed or formalistic. In particular as regards UCP, it was suggested that definitional disparities between two internationally elaborated texts covering the same subject-matter should be avoided.

78. It was noted that the question as to which individual terms should be defined was difficult to answer at this early stage of the project. A final answer could be given only when it was clear which issues were covered and which operative rules were contained in the uniform law. Similarly, one could decide only at a later stage whether the definitions should be lumped together in provisions placed in the first part of the uniform law or whether at least some definitions should be placed in the context of the substantive operative rules to which they primarily related.

79. A more far-reaching proposal was that the uniform law should contain a comprehensive compilation of terms that provided an authentic description of the practices in different regions and legal systems, based on national practice reports to be forwarded to the Secretariat. The purpose of the proposal was to ensure the national treatment of foreign guarantees and letters of credit by facilitating the comparative understanding of the characteristics of a foreign instrument and the essential rights and obligations of the parties (e.g., a financial stand-by letter of credit issued in the United States of America to be recognized and enforced in France, or a French guarantee to be confirmed by a bank in the United States). At a later stage, such compilation of terms might also provide a basis for developing abbreviated terms or symbols for electronic usage.

80. It was stated in reply that the proposal was too ambitious and could not appropriately be accommodated within the envisaged scope and purpose of the uniform law. Based on the experience gained by ICC in similar efforts, it was felt that insurmountable difficulties would be encountered in the implementation of the proposal.

81. The Working Group did not adopt the proposal. It was understood, however, that any national reports containing descriptive terms and practices that the Secretariat might obtain would be useful in preparing common and acceptable definitions of the terms to be used in the uniform law.

2. General rules of interpretation

82. The Working Group considered possible general rules of interpretation that would apply to the whole uniform law, as suggested in paragraphs 84 to 86 of the note by the Secretariat.

83. The Working Group was agreed that the uniform law should contain a general rule, along the lines of article 3 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg), that would, for example, read: "In the interpretation and application of the provisions of this law regard shall be had to its international character and to the need to promote uniformity." Such a rule would help to eliminate or at least reduce reliance on traditional national concepts and thus to foster the aim of harmonization. It was stated that the incorporation of such a rule raised special considerations if the uniform law were adopted in the form of a model law rather than a convention.

84. The Working Group was agreed that the requirement of good faith should be included as a further general element of interpretation and that it could be combined with the above rule, as done in article 7 (1) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980): "In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade." It was noted in support that such a rule was also included in other texts elaborated by the Commission, such as the United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988) which, however, referred to "international transactions" rather than "international trade". On the latter point, it was agreed that the Working Group would select appropriate wording for the uniform law at a later stage, on the basis of alternative draft provisions to be prepared by the Secretariat.

85. It was further stated that the requirement of good faith as an element of interpretation was of particular importance in the subject-matter governed by the uniform law in that it could foster the observance of good faith by principals, beneficiaries and other parties involved in guarantee and letter-of-credit operations. It was pointed out that the inclusion of the element of good faith might have implications for the treatment of certain issues, such as manifestly abusive or unfair callings, and that those implications should be taken into account in the formulation of the operative provisions.

3. Special rules of interpretation

86. The Working Group considered possible special rules geared to the subject-matter governed by the uniform law. A first such rule would call for the strict construction of the terms and conditions of the guaranty letter. While there was agreement on the principle and the usefulness of such a rule, the discussion revealed various differences concerning its scope and meaning.

87. As regards the term "strict", linguistic differences were found to exist in that, for example, in civil law countries of the Romanistic tradition the term "literal" was commonly used, without necessarily being the precise equivalent of what in other jurisdictions was called "strict". Another source of uncertainty appeared to be the fact that the notion of "strictness" or "literality" related to various issues and accordingly conveyed different connotations.

88. A primary issue was the determination of the rights and obligations of the parties that had to be made solely on the basis of the terms and conditions set forth in the guaranty letter. The preclusion of reliance on any extraneous facts or intentions was of particular importance in the subject-matter governed by the uniform law since the need for verifying factors concerning the underlying relationship or the principal-guarantor relationship would undermine the independent character of the undertaking.

89. The commonly agreed restriction to what was within the four corners of the guaranty letter became especially relevant at the stage of performance or enforcement of the parties' obligations. In addition to the exclusion of extraneous facts or intentions, the strictness of the construction of individual terms found in the guaranty letter became particularly crucial. As exemplified by the doctrine of strict compliance of documents, the question arose as to how strictly or literally individual requirements had to be met.

90. In this context, a terminological imprecision arose from the fact that "strict compliance", as distinguished from "substantial compliance", could be understood as meaning true strictness down to the comma or as allowing a marginal latitude to correct typographical errors or similar minimal deviations. As indicated by that example, the term "strict" or any equivalent single word seemed to be insufficient to describe precisely the standard of construction or compliance.

91. As regards the standard of construction to be generally applied, a suggestion was made that the understanding of bankers, based on their established practices, should be determinant. They were in the best position to judge the practical requirements of the day-to-day handling of many payment instruments and of maintaining smoothly functioning correspondent relationships in international transactions despite the current disparity of legal rules in different jurisdictions. In response, a concern was expressed

that such a standard might accord a privileged status to one category of persons involved in guarantee and letter-of-credit transactions. That would be inappropriate if it went beyond the setting of a standard of reasonable conduct that, like any other standard of care, would be geared to the relevant group of persons (e.g., document checkers) and take into account the requirements of their practice.

92. As regards the strict or literal construction of an individual term in the guaranty letter, a concern was expressed that it would be inappropriate and too formalistic where other terms in that guaranty letter would suggest a different construction. For example, the use of the term "cautionnement" in a French guarantee should not preclude the characterization of the undertaking as independent based on terms and conditions set forth in the guarantee. It was noted, in response, that the principle of strict construction could not be understood as according more weight to one term than to another term used in the same text. In such cases of inconsistency or ambiguity, the principle of strict construction would be of no assistance and might have to be supplemented by more specific rules of interpretation.

93. As suggested in the note by the Secretariat (para. 94), one such rule that would address the problem of the above example would be to accord priority to the terms and conditions over any inconsistent label or legal characterization used in the same text. In support of such a rule, it was stated that it would help to disregard a legal characterization expressed by the parties in a label that was incorrect in that it was inconsistent with the terms and conditions that compelled a different characterization. Certainty about the legal characterization was needed not only for the determination of the substantive scope of application of the uniform law but also in a variety of practical contexts (e.g., a bank asked to issue a counter-guarantee needed to know the legal nature of the principal guarantee).

94. However, concerns were expressed that such a rule might be too rigid and too mechanical to give sufficient leeway to the courts to decide the issue in the light of all the circumstances. It was also doubted whether such a special rule was appropriate in view of the fact that national laws tended to have general rules of interpretation that might provide for nullity or envisage other solutions for cases of ambiguity or inconsistency.

95. As regards the characterization of an undertaking as either independent or accessory, it was suggested that, if the legal nature could not be determined by any other general or special rule of interpretation included in the uniform law, the undertaking would in such case of doubt be regarded as independent. It was pointed out in support that the resolution of such doubt would be useful in view of the fact that the legal nature of the undertaking determined the substantive application of the uniform law and that uncertainty about the legal nature was a problem often encountered in practice. In support of a presumption in favour of independence, it was noted that that would accord with the needs and actual practice at the international level.

96. The suggestion was opposed on the ground that such a rule would be a novelty in an international legal text in that it would apply to instruments where doubts existed as to their legal nature and thus to their being covered by the uniform law, and that it would bring such instruments under the law's coverage by a rule of presumption in its favour. It was further pointed out that not all international guarantee undertakings were independent. Moreover, such a rule would be inappropriate in that it would favour the beneficiary to the detriment of the guarantor. On the latter point, it was stated in reply

that the rule would serve the interest of the guarantor in that it provided certainty and spared him from having to ascertain or verify any facts relating to the underlying transaction. The Working Group agreed to reconsider and decide on the suggestion on the basis of a draft to be prepared by the Secretariat.

97. The Working Group considered the related suggestion of a general rule on solving ambiguities or inconsistencies, as set forth in the note by the Secretariat (paras. 90-92). Such a rule could either call for the construction of the text against the actual drafter or, if a clear-cut rule were preferred, construe the text against one of the parties, in which case a choice would have to be made between the guarantor and the beneficiary.

98. No support was expressed for a clear-cut rule that would favour either the guarantor or the beneficiary. It was felt that such a rule would be unfair in that it could operate to the detriment of a party who had not been involved in the drafting of the ambiguous language. If a rule were to be adopted, it should place the risk of ambiguity on the actual drafter of the text. It was stated in support that such a rule ("contra preferentem") was known in various national and international legal texts and that its operation, including the need for establishing the actual draftsmanship, appeared to function well. However, the rule was objected to on the ground that it required investigations of fact that were inappropriate in the context of independent undertakings. Moreover, the idea of construing an ambiguous text against its drafter, while reasonable as a general idea, should not be cast in terms of a rigid, mechanical rule.

99. The Working Group considered the suggestion set forth in paragraph 95 of the note by the Secretariat (and illustrated by three examples in paras. 96 to 98). The suggestion was to consider the advisability of including in the uniform law a rule of interpretation that would accord priority to a special, individual clause that was in conflict with a clause contained in standard clauses, general conditions or, possibly, uniform rules referred to in the same guaranty letter.

100. The Working Group was agreed that the principle underlying the suggestion was a sound one and that it was recognized in most national laws. However, it was felt that a strict and mechanical rule adopting that principle would be inappropriate for the uniform law.

101. In that context, a suggestion was made that the uniform law, assuming that it would cover commercial letters of credit, should accord priority to UCP, as referred to in almost every letter of credit, over any inconsistent provision of the uniform law. Such a rule of priority could refer to party autonomy or to universal customary law, if an express mention of UCP appeared undesirable. It was noted in reply that the suggestion related to issues that had been discussed earlier, namely, the possible limits to party autonomy and the advisability of avoiding conflicts between the uniform law and UCP (see, in particular, above, paras. 60, 66-67). It was stated that both issues were of continuing importance throughout the preparation of the uniform law and that the suggestion of according general priority to UCP could thus not appropriately be decided upon at the current stage of the preparatory work.

102. The Working Group adopted the proposal set forth in paragraph 99 of the note by the Secretariat that the uniform law should provide for the irrevocability of all undertakings covered by it unless otherwise stated in the guaranty letter. Such a provision would accord with the realities and needs of the international practice of guarantees and stand-by letters of credit and was preferable to current article 7 (c) of UCP which, in case of silence, treated letters of credit as revocable. A suggestion was made that in that connection consideration should be given to the problem of possible conditions of establishment or effectiveness.

D. Form and time of establishment of guaranty letter

103. The Working Group engaged in a preliminary exchange of views on issues relating to the form and time of establishment or effectiveness of a guaranty letter. It was pointed out that it was of utmost importance to guarantors and other parties to know exactly when a binding and irrevocable undertaking had been established. At the same time, it was realized that it would be difficult to find precise and uniformly acceptable solutions in view of the variety of means of communication and the diversity of current practices.

104. A suggestion was made that the search for acceptable solutions should be based on extensive empirical research and gathering of standard forms and actual guarantee texts from the various parts of the world. Such materials, to be forwarded to the Secretariat, would help to identify the essential formal requisites of guarantees and stand-by letters of credit on the basis of current international practices. In response, doubts were expressed as to the feasibility and actual benefit of such an extensive endeavour. While any information on current practices would be useful to the Secretariat, it was feared that the collection of information would be hampered by reasons of confidentiality. Above all, the information collected could be expected to reflect a large diversity of practices that were still in the process of development and that would change in the years to come. It was felt that any such compilation of current practices would thus not lead directly to solutions for the uniform law, especially when taking into account the possibility that some of the current practices might be regarded as unfair or unacceptable for other reasons.

105. As regards the required form of a guaranty letter, wide support was expressed for requiring some tangible or material form, to the exclusion of purely oral undertakings. In searching for an acceptable formula, regard should be had to the various means of communication that were currently used and to the rapid developments in the field.

106. As regards possible later amendments or modifications of the terms and conditions, it was suggested that the required form should be the same as that for the original establishment of the guaranty letter. It was stated in reply that there existed a practice under which an amendment of a written guaranty letter might be made orally and authenticated in that form. While the amendment would then be confirmed by a message in a form that provided a record of the amendment, the oral communication was in practice regarded as determining the point of time of effectiveness of the amendment.

107. As regards the question of the decisive point of time of the establishment of a guaranty letter, one view was that the guaranty letter should become binding and effective when it was issued or released by the guarantor. Under another view, the guaranty letter should become effective when it was communicated to the beneficiary or accepted by it. It was stated that the decisive point of time depended on whether the undertaking was

characterized as unilateral or contractual. While there was considerable support for the characterization as contractual, it was pointed out that some legal systems regarded the guaranty letter as a speciality of mercantile law, like the commercial letter of credit, where acceptance was usually implied from the silence of the beneficiary or effected by stipulations in advance.

III. FUTURE WORK

108. The Working Group took note of the decision of the Commission at its twenty-second session that the fourteenth session of the Working Group would be held from 3 to 14 September 1990 at Vienna. 7/

109. The Working Group requested the Secretariat to submit to its next session a first draft set of articles, with possible variants, on the issues considered during the current session.

110. The Working Group further requested the Secretariat to submit to its next session a note discussing other possible issues to be covered by the uniform law. It was agreed that, of a number of detailed issues mentioned at the previous session, 8/ the following issues should not be retained: preventing adverse effects of the submission of documents not called for under the terms of the guarantee; the risk of payment to an imposter, as regards both the right of reimbursement from the principal and any future claim by the true beneficiary; the beneficiary's warranty as to genuineness of documents; and measure of damages.

Notes

1/ Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 18.

2/ Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

3/ See also discussion below, paras. 62-63, 66-67.

4/ See also discussion below, paras. 44-46.

5/ See also discussion below, paras. 103-106.

6/ See also discussion below, paras. 77-81.

7/ Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 297.

8/ A/CN.9/316, para. 173.