Trade Finance 101

The UNCITRAL Convention

A short survey on the aspects related to fraud and illegality in International undertakings.

Andrea Frosinini
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1. Introduction

In 1966, the United Nations created the 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 by a General Assembly resolution. Membership is structured so that a specified number of seats are allocated to each of the various geographic regions. This is an intergovernmental body of the General Assembly that prepares international commercial law instruments designed to assist the international community in modernising and harmonising laws dealing with international trade. From 1988 to 1995 the UNCITRAL worked on a Uniform Law on International Guaranty, which eventually resulted in the drafting of the UNCITRAL Convention, adopted and opened for signature by the General Assembly by its resolution 50/48 of 11 December 1995. States were given a two-year period to sign the Convention, after that they had to accede to it. The Convention could only come into effect after ratification 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, the Convention only came into effect on 1st January 2000.
It may at first sight appear to be strange that the UNCITRAL has invested such time and effort in producing its own Convention dealing with demand guarantees and standby letters of credit. The reason for this is historical; soon after the UNCITRAL first 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 URCG. 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, the UNCITRAL justifiably decided to proceed with its own proposals for a convention or uniform law. By the time the ICC got back on track with the URDG, the UNCITRAL project was considered too far advanced to be abandoned. 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.

2. Application and strength of the UNCITRAL Convention.

The UNCITRAL Convention applies to an international undertaking such as a demand guarantee or a standby letter of credit, where the place of business of the Guarantor/issuer at which the undertaking is issued is in a contracting state or the rules of private law lead to the application of the law of a contracting state, unless the undertaking closes out its application. The Convention can also apply to commercial letters of credit if the parties expressly state that their credit is subject to it (**article 1(2)**).
Article 2(1) 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*".

The independence of the undertaking is of basic importance for the applicability of the Convention and **article 3** describes the independence of the undertaking:

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

It is clear that ancillary undertakings, such as suretyships, are specifically excluded from the Convention. It was decided that the application of the UNCITRAL Convention should be limited to international undertakings, in particular, since it was felt that the inclusion of domestic instruments would adversely affect the global acceptability of the Convention.
Article 4 defines what is meant by "international character of the undertaking"; according to it, an undertaking is international if the places of business specified in the undertaking of any two of the following persons are in different countries: Guarantor/issuer, Beneficiary, Principal/Applicant, Instructing party or Confirmer.
The UNCITRAL Convention extents only to independent undertakings that are international in origin.
The Convention is shaped round both the UCP and the URDG, but it is distinctive in that both them are drafted by the ICC, a private organisation, as voluntary rules or self-regulation, whereas the Convention is drafted by the UNCITRAL, as a "uniform law" or official regulation for those countries who adopt it. 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. In addition to being essentially consistent with the solutions found in the rules of practice, the Convention 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; in other words, because the legal status of the Convention is distinctive from the ICC rules, the Convention includes provisions relating to the fraud rule. 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.
Since the adoption of the UNCITRAL Convention no major trading nation has acceded, although the ICC and World Bank have indicated their approval.

3. Prevention of unfair and fraudulent calls.

The UNCITRAL Convention is specifically designed to regulate demand guarantees and standbys, although users of commercial letter of credit may also opt for it if they wish to do so. The most important articles of the Convention are found in **Chapters IV** and **V**, concerning the bank's payment obligation and the exceptions to this obligation. Contrary to the ICC Rules, the UNCITRAL Convention made an attempt to address the issue of fraud, and to prevent fraudulent or unfair calling of standbys and demand guarantees. 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.
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 or standby. The bank is given a reasonable amount of time to examine the demand, i.e. a maximum of seven (7) working days (**article 16(2)**).
In **article 15**, the Convention first puts up a general requirement for the Beneficiary demanding payment. **Article 15(3)** provides that "*the Beneficiary, when demanding payment, is deemed to certify that the demand is not in bad faith and that none of the elements referred to in subparagraphs (a), (b) and (c) of paragraph (1) of article 19 are present*".; in other words, it 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**, the Guarantor/issuer must 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 or standby has the potential to be disrupted if the elements listed in **article 19 exist** in the demand/credit.
From the viewpoint of unfair calls and the principle of autonomy, the vital articles of the UNCITRAL Convention are **15(3)**, **19** and **20**, which work together to make it more difficult for an unfair call to succeed, by seeking a justification for the call in the underlying contract.

The UNCITRAL Convention also acknowledge exceptions to the absolute and independent nature of demand guarantees and standbys. Under the heading "Exception to Payment Obligation", **Article 19**, stipulates 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, has a right, as against the beneficiary, to withhold payment".*

Paragraph (2) of **article 19** explains what the term "no conceivable basis" referred to in subparagraph **(c)** of **paragraph (1)** means, providing 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;*
> *(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.*

For the first time, the Convention contains a codification of the different situations where fraud is present and it also requires strong evidence of this. A list that may not be exhaustive, although a remarkable and encouraging way in which defining 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. 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. 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*".
Article 19 deliberately avoids the terms "bad faith", "abuse" and "fraud", 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. 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. As far as the degree of proof is concerned, fraud must be "manifest and clear" and "immediately available". The Convention is mainly concerned with the nature of the documents presented, it does not mention, and is not even concerned with the identity of the fraudulent party. Therefore, the fraud exception applies under the Convention, if "*any document is not genuine of has been falsified*", regardless of the identity of the fraudster. 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.

From reading the provisions of the Convention, it seems that it focuses rather on the nature of misconduct than the fraudster's state of mind or the identity of the fraudster.

Article 19 does not place an express duty on the guarantor 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 also implies a certain duty on him to make a judgement whether the requirements are met or not; it 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.

The exception set out in **article 19(1)(b)** does include the so-called literal defences, i.e. the ones available stemming from the text of the guarantee and that the bank can use against the beneficiary. 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 or standby, i.e., fraud, abuse of rights, and manifestly unreasonable demand, the decision was made to use a general formulation of the fraud exception. The downside of this open formulation is that judges from various contracting states could interpret this provision in different ways; the risk has been reduced to some degree by the examples of the grounds for denying payment given in **article 19(2)**.

Two aspects of **article 19** depart quite clearly from the principle of autonomy: first, in determining whether a call is justified, **articles 19(1)(b)** and **(c)** and **19(2)(a)**, **(b)**, **(c)** and **(d)** all require the Guarantor/issuer 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 issuer of the guarantee on notice that payment needs to be justifiable by good cause.

Under the Convention, a demand is not in itself sufficient to trigger payment; a simple declaration that payment is due under the underlying contract is also not sufficient as 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, when it comes to examining the validity of a claim, the veil separating the guarantee from the underlying contract is well and truly discarded. This article describes an independent 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. The effect of this article is to describe the undertakings to which the Convention is to apply, not to establish the principle of autonomy in the context of demand guarantees.

Article 19 not only provides the Guarantor with some basis for refusing payment, but also enables the Principal to take court measures against a fraudulent Beneficiary. **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*". **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:*
>
> > *(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.*

Article 20 of the Convention makes provision both for measures similar to an injunctionpreventing payment and for attachment or freezing orders to be available to the court where there is a "high probability" shown by "immediately available strong evidence"; the court "*may issue a provisional order' or similar*". Although the exact meaning 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,

Article 19 of the Convention codifies the exception of fraud, in particular the cases in which the bank does not have to pay. 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**. Accordingly, both articles provide respectively for the definition and description of the fraud exception, and the measures available to the Principal in such case.

These provisions are clear and narrow in scope and provide an exceptional international standard. They undoubtedly provide good guidance for courts to enhance their application of the fraud exception and are generally in accordance with the current practice. They include most of the elements of the fraud rule that have been developed over the years by national courts and/or legislators, and provide a detailed and helpful guide to users of demand guarantees and the courts.

The regulation of the fraud exception in **article 19** is a success both politically and technically. Politically, a uniform and mandatory concept of fraud avoids regulatory competition between different legal systems, therefore between the banking industries of various countries, concentrating competition on the terms and prices of the banking products and not on regulatory issues. 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. 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. An open and uniform description has the disadvantage that judges in contracting states will interpret this concept differently. This often happens when one is dealing with 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. The UNCITRAL has developed a databank that contains court decisions on unifying texts and also regularly publishes summaries of recent decisions.

Many countries authorise the courts to grant an injunction enjoining the Guarantor from paying or the Beneficiary from receiving payment. Under **article 20**, the legal remedies are provided which Principals can make use of to prevent payment under a demand guarantee or a standby, as it suggests through its text that provisional rather than final measures are intended. Summary proceedings,such as injunctive relief, are interpreted as provisional measures and therefore it is doubtful that conserving attachment orders would fall under such article. It has been said in this respect that the text of **article 20**, the requirements of provisional measures and the cases in which provisional measures can be employed are arguments for keeping "attachment orders" and similar final measures outside of the Convention. 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 or standby is used for a criminal purpose. In terms of procedural law, provisional measures have been given extra guarantees to prevent them from being accepted too often. The Principal must most of all present the circumstances set out in **article 19** in a way in which "prima facie" evidence is not enough, 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. It therefore appears that **article 20** is not an open invitation for the judge to interfere. With regard to provisional measures, the Convention is strict enough with Principals while still being flexible enough to permit the application of provisional measures in exceptional cases.

The Convention does not provide the Principal with the highest degree of protection from fraud, while the URDG requires that a demand for payment states the reasons. Under **article 15(3)** 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. 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 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.

The Convention fraud rules are defensible from the viewpoint of banks and Beneficiaries; the Principal is left out in the cold if a demand for payment is made and the bank makes payment without notifying the Principal. No duty is placed 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.
The provisions relating to the fraud rule contained in the Convention mark a significant and encouraging development in this area of the law; the Convention is the first document to provide details of the fraud rule 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.
The codified fraud rule might be one of the reasons for countries being hesitant to adopt it and the fraud exception may possibly need further improvement. Viewed from a political point of view, it seems to be rather impossible to do as banks, in general, apparently also oppose the adoption of the Convention. Understandably, they want to keep their involvement as far as demand guarantees, commercial and 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 is regrettable that the UCP, which have become such an important universal set of rules are silent on the issue of unfair or fraudulent calling of letters of credit and standbys. What is even more regrettable is the fact that the UCP do not contain any provision on the Guarantor's right to refuse payment.
URDG does not go so far, as it has gone some small way in placing restrictions on the Beneficiary's right of payment and only required 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 he is in breach. The simple demand guarantee is thereby transformed into a documentary one, with a required minimum content of the document. 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. The URDG does not contain any provision on the Guarantor's right to refuse payment.; although it has attempted to prevent unfair calls on demand guarantees. In fact, not only has it failed to win the support of all groups but have also been strongly opposed by some. In the UNCITRAL Convention, thos approach was taken and the attempts made by way of **articles 19** and **20** are commendable, since it is the first real international attempt to prevent unfair calls and to codify the fraud rule.
The ISP98 take a similar approach to the UCP and expressly leave the issue of fraudulent or unfair calling of standbys to be determined by the applicable jurisdictional law; as with the UCP, it is also regretted that the ISP98 is silent on this issue.

4. The UNCITRAL Convention dealing with Illegality.

The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit ('UNCITRAL Convention') specifically provides for an illegality exception. **Article 19(2)(b)** clearly provides for an exception to the autonomy principle if the underlying contract is illegal by specifically stating that such exception will only be accepted where the underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal.
Article 20 makes specific provision both for measures similar to an injunction preventing payment and for attachment or freezing orders to be available to the court where there is a "high probability" shown by "immediately available strong evidence"; the court "may issue a provisional order" or similar. **Article 20(3)** specifically provides that where 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, or where the undertaking is used for a criminal purpose, the court may issue an injunction preventing payment. The only problem with this is that the impression is gained that before the court may issue an injunction or payment may be withheld, the underlying contract must first have been declared invalid by a court or arbitral tribunal. Both of these might take a long time to achieve and in the meantime the bank might still pay as there is no injunction preventing it from paying; after receiving payment, the Beneficiary might also utilise and spend the money obtained. Also if the bank pays in the meantime, it will be entitled to be reimbursed by its customer, i.e. Principal of the demand guarantee. If this happens, there will clearly be no need to apply for these types of injunctions and the Principal's / Applicant's best option would be to try and claim damages, if that is allowed in the specific jurisdiction's law of contract, especially when it relates to a contract that has been found to be illegal. It is also not certain whether this declaration of invalidity by a court should be an order dealing specifically with the underlying contract, be final or from a court having jurisdiction over the underlying contract.

It seems that if the demand guarantee or standby is used for a criminal purpose, a court may immediately issue an injunction preventing payment or issue a*n* injunction, without a prior court or arbitral tribunal having made a declaration on the matter. It is not clear whether the phrase "use of the undertaking for a criminal purpose" relates to a case where the payment on the undertaking itself or where the payment of the underlying obligation would violate criminal law.
The exact interpretation of the illegality exception as provided for in the UNCITRAL Convention is problematic and consists of mere speculation.
It seems to be settled law nowadays that a contract that is contrary to the law, good morals or public policy is illegal, and consequently, void in terms of the general principles of the law of contract in each separate jurisdiction. If it is the commercial or standby letter of credit or demand guarantee itself that is contrary to the law, good morals or public policy, i.e. the law of the country which applies to the guarantee/credit or the law of the country where the guarantee/credit is to be performed, it will likewise not be enforceable. Where the demand guarantee/letter of credit itself is illegal and the underlying contract legal, the principle of autonomy does not come into play and no difficulty arises as a result of that principle.
Recent cases are in favour of accepting illegality in the underlying contract as an exception to the principle of autonomy of letters of credit and demand guarantees. Fraud as a possible exception to the autonomy principle already received attention during the 1920s and has been in development for nearly a century and still it has not been authoritatively settled in all respects. Illegality as a possible exception received its first real consideration as a possibility during the 1990s, but it was not until 2004 that it was really acknowledged as an exception. Illegality as an accepted exception is still in its infancy stage and there are still too many uncertainties regarding its exact application, the specific types of illegality that would be considered to be sufficient to constitute an exception, i.e. illegality as a concept, and the exact standard of proof that is required.
At this stage, it is possible to identify only a few requirements that will need to be satisfied before the illegality exception will be applicable under the law; at first, the alleged illegality will have to be established clearly, secondly, the illegality will also have to be sufficiently serious, thirdly, the Beneficiary must have been involved in the illegality. Lastly, the letter of credit or demand guarantee must be sufficiently connected to the illegality in the underlying transaction.
For the fraud exception to the autonomy principle to succeed, earlier cases have consistently required that banks had to have clear evidence of the fraud at the time of presentation of the documents. Whereas later cases take the view that the earlier cases did not intend restricting the time by which the evidence of fraud had to be available to the extent of ignoring evidence of fraud that came to light after presentation of the documents, but before hearing the case. The point is rather that the bank should reach a decision on whether or not to pay, soon after presentation of the documents. Usually it will only refuse payment in the light of compelling evidence available to it at that stage. If the bank refuses to pay on a suspicion of fraud, and is sued, and prior to the hearing of the case acquires evidence, this evidence should be admissible. Therefore, as to the time when the bank should have the evidence on which it relies to establish illegality, the view of the later English cases is to be preferred.
In the instance where the bank is actually aware of the illegality of the underlying contract, e.g., when it is evident from the information supplied by the Applicant/Principal in the application form for the letter of credit/demand guarantee that certain foreign-exchange regulations will be contravened by the bank if it complies with its payment instruction, the bank should refuse to honour it. Likewise, when the bank may obtain knowledge of the illegality of the transaction by exercising reasonable care, it should similarly be under an obligation not to pay out. When the bank is neither actually aware of the illegality of the underlying contract, nor able to become aware by exercising reasonable care, its payment under the letter of credit/demand guarantee cannot be faulted.
Placing such a duty, i.e. obtaining knowledge of the illegality of the transaction by exercising reasonable care, e.g. by looking at the information applied on the application form on a bank makes sense and will not, as already mentioned above, necessarily place an additional duty on the bank. Therefore, if a reasonable examination by the bank does not disclose evidence of illegality, the bank should be entitled to pay and to be reimbursed by the Principal/Applicant. If the bank fails to fulfil such a duty, the bank should not be allowed to be reimbursed by its customer.
The "illegality defence" will be potentially more problematic than the "fraud defence". It will often be very difficult to determine whether a specific underlying contract is indeed illegal, especially if it is against the public policy or good morals of a rather unfamiliar country and if illegality is proven, whether that illegality is serious enough to justify the infringement of the autonomy principle. It will not be an easy task for a court always to establish whether or not the illegality is serious enough.
Going in depth into the UNCITRAL Convention, we can notice that it specifically provides for an illegality exception. **Article 19(2)(b)** clearly provides for an exception to the autonomy principle of demand guarantees and standby letters of credit if the underlying contract is illegal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking.. It specifically states that the illegality exception will only be accepted where the underlying obligation of the Principal/Applicant has been declared

invalid by a court or arbitral tribunal. **Article 20(3)** then specifically provides that where the underlying obligation of the Principal/Applicant has been declared invalid by a court or arbitral tribunal, or where the undertaking is used for a criminal purpose, the court may issue an injunction preventing payment. These provisions are problematic as they create the impression that before the court may issue an injunction or payment may be withheld, the underlying contract must first have been declared invalid by a court or arbitral tribunal. Both of these provisions might take a long time to achieve and in the meantime the bank might still pay as there is no injunction preventing it from paying; the Beneficiary might also after receiving payment utilise and spend the money obtained. Furthermore, if the bank pays in the meantime, it will be entitled to be reimbursed by the Principal of the demand guarantee. If this happens, there will clearly be no need to apply for these types of injunctions and the Principal's/Applicant's best option would be to try and claim damages, if that is allowed in the specific jurisdiction's law of contract, especially when it relates to a contract that has been found to be illegal. If the demand guarantee or standby is used for a criminal purpose, the court may immediately issue an injunction preventing payment, without a prior court or arbitral tribunal having made a declaration on the matter. It is though not clear whether he sentence "use of the undertaking for a criminal purpose" relates to a case where the payment on the undertaking itself would violate criminal law, or where the payment of the underlying obligation would violate criminal law. If the undertaking is itself is contrary to the law of the country that applies to the guarantee or credit or the law of the country where the guarantee or credit is to be performed, it will likewise not be enforceable. Where the undertaking itself is illegal and the underlying contract legal, the principle of autonomy does not come into play and no difficulty arises as a result of such principle. The aforementioned sentence in the Convention might thus refer to the situation where the payment of the underlying obligation would violate criminal law; if it relates to a case where the payment on the undertaking itself would violate criminal law, no injunction would be necessary as the undertaking would merely be unenforceable. The illegality exception is not adequately dealt with in the UNCITRAL Convention since it does not provide for a workable illegality exception and the exact interpretation of the illegality exception is fraught with uncertainties and its application seems to be problematic.

The UNCITRAL Convention is aimed at providing a harmonised set of rules for demand guarantees and standbys, not to forget about a greater legal certainty in their use for daily commercial transactions. In addition to being consistent with the UCP and the URDG and working "in tandem" with them, the Convention supplements their operation by dealing with issues beyond the scope of those rules, in particular regarding the question of fraudulent or abusive demands for payment and judicial remedies in such circumstances. The ICC rules will apply only if expressly stated in the undertaking, whereas the Convention automatically applies to such documents issued from a country that has adopted the Convention, unless expressly excluded from the document. There is also a need for more information to be made generally available about the UNCITRAL Convention so that interested parties can consider it in detail.