Trade Finance 101

Sources of the law relating to demand guarantees and standby letters of credit.

An evolutionary excursus of the legal framework.

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Summary

1. Introduction.

The law of documentary credits has developed mainly through practice and customary uses; many of its operative rules, irrespective of geography or legal systems, have emerged from the customs of bankers dealing with importers and exporters, and with shipping and insurance companies. Since 1933, the International Chamber of Commerce ("ICC") has drafted and issued Uniform Customs and Practice for Documentary Credits ("UCP") i.e. a set of rules issued and regularly revised by the ICC, for the last time in 2007.
Besides this, the ICC has also introduced other uniform rules that can apply to demand guarantees and standby letters of credit, namely the Uniform Rules for Contract Guarantees ("URCG"), the Uniform Rules for Demand Guarantees ("URDG") and the International Standby Practices ("ISP98"). In addition to these rules, the United Nations Commission on International Trade Law ("UNCITRAL") adopted a universal legal framework for demand guarantees and standbys called the "United Nation's Convention on Independent Guarantees and Stand-by Letters of Credit", also known as "UNCITRAL Convention".
Due to their highly international nature, general sources of the law of commercial letters of credit, standbys and demand guarantees, are also often international banking practice and the usages in international trade. These are often set out in the rules issued by the ICC. In most countries, there are no explicit statutory rules for demand guarantees and standbys; as a result, disputes must primarily be addressed under explicit contractual provisions, unwritten rules, principles of contract and commercial law, and case law. Certain countries have individually introduced special legislation governing these instruments. In certain jurisdictions, another important source of law for demand guarantees and standbys is case law, also often supplementary to the law in this area are legal writings.

2. The International Chamber of Commerce and its rules.

In view of the highly international character of the market for demand guarantees and standbys, and the possibility of regulatory competition between different countries, there have only been a few initiatives at the domestic level to create regulations, mainly developed at international level where a distinction should be made between self-regulation and official regulation; as regards the former, one should concentrate on the uniform rules promulgated by the ICC.
In 1919 a few business leaders founded the ICC, an international, non-governmental organisation consisting of thousands of member companies and associations from over 130 countries. It operates through its numerous specialist commissions based in Paris and its national committees in all major capitals, and coordinates with their membership to address the concerns of the business community and to put across to their government the business views formulated. Its aim is to promote an open international trade and investment system, and the market economy worldwide. One of its most vital functions is to harmonise international trade practices through uniform rules and trade terms incorporated into contracts, and through the publication of guides devoted to specific fields of activity or specific problems areas. In other words, it represents the diverse interests of the world business community and makes rules that govern the conduct of business globally. The ICC is the international business organisation and it is the only representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. It also provides essential services, the most important among them being the International Court of Arbitration. Within a year of the creation of the United Nations, the ICC was granted consultative status at the highest level with the United Nations and its specialised agencies. To date, the ICC is the preferred partner of international and regional organisations whenever decisions have to be made on international issues of importance to business.

2.1. Uniform Customs and Practice for Documentary Credits

Owing to the characteristics of documentary credits, there have been various attempts in the past to create uniform rules governing documentary credits. Pioneering efforts were made on a national basis, from early 1920s, in the United States, Germany, France, Norway, Czechoslovakia, Italy, Sweden, Argentina, Denmark and in the Netherlands. The 1929 Congress of the ICC held in Amsterdam initiated the first real international attempt of standardising letters of credit. Such attempt proved to be unsuccessful as the ensuing regulations were adopted only by Belgium and France. In 1933, the ICC made another attempt in Vienna and issued the first version of the UCP, which was considered as the first important step towards achieving uniformity in the field of international letters of credit. This version of the UCP formed the basis for subsequent revisions and was adopted by bankers in some European countries and, on an individual basis, in the United States. Banks in the United Kingdom and most Commonwealth countries refused to adopt it. For the next few years there were no significant developments, until the 1933 version of the UCP was revised and a new version adopted in 1951 by bankers of various countries in Europe, Asia, Africa and the United States. The United Kingdom again rejected this version, although many Commonwealth banking communities toed the line.

In 1962 the UCP were revised again, with the purpose of evolving a system that could be applied universally. To this end, it was necessary to adapt the UCP to the needs of Britain and Commonwealth countries. The 1962 revision accomplished this breakthrough and this version solved most of the specific problems that had been the cause for the rejection of the 1951 version by banks in the United Kingdom. The 1962 version was adopted by all the previous participants, as well as by the banks in the United Kingdom and the Commonwealth of Nations.
Technological advances, in particular the far-reaching container revolution, and the entry of new banks into the market led to a further revision of the UCP in 1974, assisted by The UNCITRAL. Banking organisations in socialist countries, which were not members of the ICC, made contributions through an *ad hoc* Working Party. The 1974 draft was a considerable improvement and was adopted by banking organisations and individual banks in nearly 170 countries, reaching out for a wide acclaim and undoubtedly becoming the cornerstone of the law pertaining to letters of credit.
In order to keep up with the changes in the law in the field of letters of credit and further developments in technology, it was necessary to revise the UCP again in 1983 ("UCP 400"). The UCP 400 widened the scope of their application and introduced changes necessitated by technological developments with a specifically extended scope to cover standbys. **Article 1** of the **UCP 400** provided that their articles would "*apply to all documentary credits, including, to the extent to which they may be applicable to standby letters of credit*". It was the first to indicate expressly that it applied to both commercial letters of credit and standbys. The UCP 400 were adopted by banking associations and individual banks in more than 160 countries.
In 1993, the ICC again revised UCP 400 in an attempt to address new developments in the transport industry and new technological applications. This revision was also intended to improve the functioning of the UCP, which, in the past, were a product of bankers. With the 1993 revision, it was the first time that law professors and lawyers also participated in the revision process. The ICC promulgated the revised version as UCP 500, that came into effect on 1st January 1994, applying to all documentary credits, including to the extent to which they may also be applicable to standbys, where they are incorporated into the text of the credit. If UCP 500 are incorporated into the text of the credit, they are binding on all parties thereto, unless otherwise expressly stipulated in the credit. Like their predecessor from 1983, UCP 500 also apply to standbys, provided that the UCP are at all applicable, usually incorporated by reference. Until 30th June 2007, the UCP 500 was the latest version that was in operation.
In May 2003, the ICC authorised the ICC Commission on Banking Technique and Practice, "the Banking Commission" to begin revising UCP 500. The general objective was to address developments in the banking, transport and insurance industries. The Banking Commission appointed a Drafting Group to carry out this revision. A second group, known as the "Consulting Group", was also established with the goal to review and advise on earlier drafts submitted by the Drafting Group. A draft version was sent out to all the national committees of the ICC during 2005 and their comments had to be submitted before 5th November 2005. A full draft was again sent out to the national committees in March 2006 and meeting was scheduled in Vienna during May the same year in to discuss the revised UCP. The final comments on the draft revision were due in June 2006 whereafter a final draft was compiled during July/August. On 25th October 2006, the Banking Commission by a unanimous vote approved a final version of the UCP. The 2007 version came into effect on 1st July 2007 is now commonly referred to as the "UCP 600". This revision is the work of bankers rather than of lawyers and is the result of more than three years of intensive work by the Banking Commission, incorporating a number of changes from the previous version, such as, for example, new sections on "definitions" and "interpretations" , which were added in order to clarify the meaning of ambiguous terms.
The UCP are a set of rules issued by the ICC in an attempt to create a uniform and standard set of conditions under which banks may issue documentary credits. Their further attempt to standardise the interpretation of documentary credit practice and govern most of their aspects, except for the relationship between the Applicant of a documentary credit and the issuing bank; more accurately, they are a compilation of internationally accepted banking customs and practice regarding documentary credits. To the extent that they apply to documentary credits themselves, they are also applicable to standbys and are the most successful harmonising measure in the history of international commerce so far, to the point that they have removed a large number of technical problems that could have undermined the smooth operation of letters of credit.
Like any other rules promulgated by the ICC, the UCP are primarily intended to guide banking practice relating to documentary credits, instead of providing a comprehensive treatment of legal rights and duties. In accordance with this, the UCP provide no more than a very generalised statement as to the compliance standard; also, they do not prescribe the exceptions to the principle of autonomy of the credit, leaving any related issues to be dealt with by the courts in the various jurisdictions.
Although widely accepted and used, due to the international good standing of the ICC, technically they are not laws, i.e. neither a statute nor a code. They are rather the work of the world banking community, under the auspices of the ICC, to unify banking customs in letter of credit law; they apply only if the operating banks, in particular the issuing ones, make the credit subject to them. Practically, all evidence indicates that these rules constitute a defined and reliable supranational code that is commonly given the force of law. Although they are technically only a set of standard terms, they have evolved to fulfil the function of law. They contain definitions,

the treatment of party liability and responsibility, and set norms usually expected of law. The UCP are considered to be "*de facto* law" and the cornerstone of the law pertaining to letters of credit. Over time they have gained universal acceptance in international trade and many domestic courts and legislatures recognise them because they reflect existing industry practice: they are in every sense the centrepiece of law and practice in the area of letters of credit.
In order to deal with the various concerns being raised regarding the wording and certain provisions of the UCP, the Banking Commission of the ICC often publishes their opinions and "Position Papers" in an attempt to address these issues without having to amend them. In the Banking Commission's published opinions they record particular problems that were put to them, the points made in the discussion of the problem and conclusions as to whether or not the problem does, in fact, lie within the ambit of the UCP and if so, the meaning and effect of the relevant UCP provision. Over the years the opinions of the Commission have been very helpful in clarifying points on which the UCP provisions have been unclear. These opinions have an independent value in helping to ensure that the UCP are applied in a consistent manner from one country to another. Although influential, these opinions do not bind courts or arbitrators, and merely provide a useful tool in the application and interpretation of the UCP.

2.2. Application of the UCP to Standby Letters of Credit and Demand Guarantees

UCP 400 introduced an innovation by extending the UCP to standbys, the UCP 500 and the UCP 600 subsequently retained this approach, motivating it with a concern on the part of banks in the United States that their courts might confuse a standby with a suretyship guarantee, which most banks in America were legally prohibited from issuing. American banks, therefore, naturally pressed for standbys to be included in the UCP, so that they would be visibly equated with autonomous documentary credits, and not with suretyship guarantees to which the prohibition did not apply.
Despite the fact that the UCP did not address standbys until the 1983 version, this instrument had frequently been issued subject to both the 1962 and 1974 versions of the UCP; banks in the U.S. and other countries influenced their banking practices often referred to the UCP when issuing standbys long before they were incorporated into this set of rules. One of the reasons for this was that since the UCP were a set of "practice rules", their provisions relating to their scope could be varied and the rules incorporated into any undertaking. Another was that as most standby users regarded this instrument as a derivative of the commercial letter of credit, they saw no difficulty in issuing it subject to the UCP, maybe as a result of their desire to dismiss any doubt as to the independent and documentary nature of the standby letter of credit, and possibly by the fact that a suitable uniform set of rules other than the UCP did not exist until the International Standby Practices ("ISP98") came into operation on 1st January 1999.
The incorporation of standbys into the UCP did not result in specific rules for this form of letter of credit being included into the UCP. A large part of the UCP does not even apply to standbys or is inappropriate, while other vital issues in a standby context are not addressed at all in the UCP since they were drafted with traditional form documentary credits in mind, to apply primarily to international sale transactions, which included documentary credits as a method of payment under a contract of sale. Hence, there are a number of shortcomings in the application of the UCP to standbys, which are not a payment method under a contract of sale, but a "standby payment method" in case of default under some underlying transaction. The application of the UCP to standbys merely implies that the UCP's general letters of credit principles are expressly made applicable to standby letters of credit. It is also often necessary for the standby to exclude large parts of the UCP expressly, if the provisions of the UCP are not applicable to a specific kind of transaction. Many standbys exclude the UCP in their entirety.
Although the UCP apply to documentary credits and standbys, by implication they also apply to demand guarantees, since these undertakings, though not mentioned in the UCP, are the same from a legal viewpoint as standbys, although most of them are not subject to the UCP at all because their terms are not necessary, or sometimes even inappropriate, to the particular transaction.
The UCP have been for many years the only set of rules that could govern standbys. It was only until 1992, when the ICC published their Uniform Rules for Demand Guarantees ("URDG"), which applied to demand guarantees specifically and also to standbys. From a legal viewpoint, in the past standbys and demand guarantees were capable of falling within two sets of rules, the UCP and the URDG, and could be governed by whichever set of rules was incorporated into the documents. The banking sector was inclined to apply to standbys many of the practices in current use for documentary credits, including issuance for the Guarantor's own account, confirmation of the standby credit by a second bank and payment otherwise than at the counters of the issuing bank. The UCP were for this reason used for a long time in preference to the URDG and this was even signalled by the Introduction to the URDG. On 1st January 1999, a separate set of rules, the ISP98, came into operation, for the sole application to standbys. As of today, standbys can be governed by the UCP, URDG or the ISP98; in addition to these rules, it is also possible that the United Nation's Convention on Independent Guarantees and Stand-by

Letters of Credit can apply to standbys. Since the coming into effect of the ISP98, many standbys are no longer issued subject to the UCP.

2.3. Supplement to the UC Practice for Documentary Credits for Electronic Presentation.

At its meeting in May 2000, the Task Force of the ICC's Banking Commission indicated that it was going to focus more on the electronic trade. Later the need was identified to develop a bridge between the UCP 500 and the processing of the electronic equivalent of paper-based credits. The UCP 500 were unclear as to whether or not they allowed electronic presentations of credits and some of their provisions were incompatible with electronic presentations. With the current evolution from paper to electronic credits, the market was looking at the ICC to provide guidance in this transition. The ICC's Banking Commission established a Working Group consisting of the necessary experts to prepare the appropriate set of rules as a supplement to the UCP 500. In 2002 this resulted in the ICC publishing an electronic supplement to the UCP 500 called the "Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation, version 1.0'"("eUCP version 1.0") to be used for part or all-electronic presentations of documents tendered under letters of credit. The eUCP version 1.0 came into effect on 1st April 2002, but was later replaced with the Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation, version 1.1 ("eUCP version 1.1") when the UCP 600 came into operation on 1st July 2007. Both versions deal with the electronic presentation of documents under documentary credits and do not address any issues regarding the issuance or advice of credits electronically, because market practices and the UCP have allowed for electronic issuance and advice of documentary credits for a number of years and no specific problems have arisen in this regard; they are meant to deal with cases in which electronic records are presented, as well as cases in which electronic records are presented in combination with paper documents. The eUCP version 1.0 was a mere supplement to the UCP 500 which would have, when used together with them, provided the necessary rules for the presentation of the electronic equivalents of paper documents under letters of credit; similarly, the eUCP version 1.1 is a supplement to the UCP 600.
The eUCP version 1.0 applied as a supplement to the UCP 500 where the credit indicated that it was subject to them, though they did not automatically apply to a credit subject to the UCP 500. The eUCP version 1.1 also apply as a supplement to the UCP 600 though not automatically, unless the credit indicates that it is subject to them. A credit subject to either the eUCP version 1.0 or version 1.1, also called an "eUCP credit", would automatically be subject to either the UCP 500 or UCP 600, whichever version of the eUCP was referred to, without express incorporation of the UCP 500 or UCP 600.
Although the eUCP version 1.0 had the approval of the ICC, in practice it had not been generally accepted. Despite various workshops, conferences and professional literature attempting to explain and promote their use, these guidelines remained of theoretical value only. At the end of 2005, it had been said that the eUCP version 1.0 remained a futuristic voyage without any discernable practical landing whatsoever. While the UCP 500 were still being revised, the opinion was expressed that, if the eUCP version 1.0 were to be constituted as a new part of the latest version of the UCP, i.e., UCP 600, many banks would include in their standard forms a clause excluding the operation of the respective provisions, as they were allowed to do by virtue of **article 1** of the **UCP 500**. In the end, the drafting team of the UCP 600 decided not to incorporate the eUCP's treatment of electronic presentations, but rather to keep the eUCP as a supplement to them. The eUCP version 1.0 was therefore solely updated in order to reflect the changes made in the UCP 600 with regard to terminology and style of presentation. In terms of **article 1** of **UCP 600**, parties are still allowed to exclude the operation of certain provision of the UCP, including the provisions of the **eUCP version 1.1**.

3. Uniform Rules for Contract Guarantees.

Guarantees for international projects have become over the years an important feature of world trade practice. The ICC's Commissions on Banking and on Commercial Practice has subsequently started creating uniform rules governing the issuing of such guarantees. On the one hand, the Banking Commission is concerned with bringing together world bankers for the purpose of harmonising and defining practices and terminology used in international banking, on the other hand, the Commission on Commercial Practice is generally concerned with standardising commercial usage. In an attempt to draft a set of uniform rules for these guarantees, the two Commissions of the ICC gathered in a Working Party whose members represented different interest groups in both industrialised and developing countries. In close cooperation with the intergovernmental and concerned international commercial organisations, the UNCITRAL in particular, the Working Party drafted the uniform rules. It took the ICC about 12 years to complete a set of standardised rules, and in 1978 the ICC approved and published the Uniform Rules for Contract Guarantees ("URCG") This was followed in 1982 by another publication namely the "Model Forms for Issuing Contract Guarantees".
The application of the URCG is voluntary and will only apply if parties incorporate them into a guarantee; if a party wishes that these rules should be applicable, the guarantee itself must contain a specific statement that it is

subject to the URCG. In such a case, the URCG are binding on all parties to the guarantee, unless otherwise expressly stated in the guarantee or any amendment thereto. The parties to the guarantee may agree on partial application of the URCG; hence, **article 1** provides that these rules apply to any guarantee, bond, indemnity, surety or similar undertaking, however named or described, which states that it is subject to the Uniform Rules for Tender, Performance and Repayment Guarantees ("Contract Guarantees") of the International Chamber of Commerce (**Publication No 325**) and are binding upon all parties thereto unless otherwise expressly stated in the guarantee or any amendment thereto.

The term "contract guarantees" as used in the URCG refers to three types of contract guarantees: first, *tender guarantees*, whereby a party inviting tenders, the Beneficiary, is assured of a specific sum if a party submitting a tender, the Principal, fails to sign a contract if his tender is accepted, or fails to meet some other specified obligation arising from the submission of a tender, a second type is the *performance guarantee* which gives the Beneficiary recourse against the Guarantor, i.e., payment of a specified amount or, if guarantee so provides, at the Guarantor's option, to arrange for performance of the contract, if the Principal fails to perform a relevant contract between him and the Beneficiary. The URCG therefore apply to a performance bond as a type of demand guarantee, as well as to a performance guarantee as a type of surety bond. A third type of contract guarantee is the *repayment guarantee* which assures the Beneficiary of the repayment of advances, or payments if the Principal fails to fulfil a relevant contract.

Although party autonomy is the main principle in the URCG, in some countries it may happen that there are mandatory rules of national law in the field of guarantees, requiring that claims under the guarantee be made within the limitation period prescribed by national law, irrespective of other limitation periods set out in the URCG or in the guarantee itself. **Article 1(2)** of the **URCG** provides that the mandatory rules must prevail.

The aim of the URCG was to create uniformity and to achieve a fair balance between the legitimate interests of three parties concerned, the Beneficiary, Principal and the Guarantor, and defining their rights and obligations with precision in order to avoid disputes, while observing the commercial purpose of the tender, performance and repayment guarantees, that is, to ensure the availability of funds with an independent third party in the event of the Beneficiary having a justified claim against the Principal.

Article 2 of the **URCG** defines various terms already mentioned above: "tender guarantee", "performance guarantee", 'repayment guarantee", "Principal", "Beneficiary", "Instructing party" and the "Guarantor under the guarantee". The URCG do not deal with the issue of the nature of a contract guarantee nor do they attempt to define its nature. In this regard, it does not stipulate whether the Guarantee is a primary and independent obligation or whether it is a secondary and accessory one; nor does it indicate the legal consequences of such characterisation. The link between performance of the Guarantor's undertaking and default by the Principal is established in the definitions. Instead, attention has been given to the prerequisites for payment under a contract guarantee, which goes to the Beneficiary–Guarantor relationship, and the objections and defences available to the Guarantor. Save for a few exceptions, the URCG do not specifically deal with the relationship between the Principal and the Guarantor and also aimed at encouraging more equitable practices in the area of demand guarantees, especially by limiting the problem of unfair calling of these guarantees. They attempted to protect the Principal from unjustified calls on the Guarantor by the Beneficiary by stipulating the need for appropriate documentation to support a claim in **article 9**. It was considered desirable that the URCG should not provide for on-demand guarantees, that is, payable on first demand without any evidence of default. All guarantees are payable only on demand; the term "on-demand guarantee" normally means that the only condition stipulated for payment is simple demand on the part of the Beneficiary. Such guarantees are sometimes referred to as "unconditional guarantees". This term is sometimes inadequate because there may be some restrictive conditions such as payment to be effected only if the claim is submitted before the expiry date of the guarantee. The parties may agree on partial application of the URCG which means that these rules may be applied also to simple or first demand guarantees, though this would require exclusion of those articles relating to documentation necessary to perfect a claim under a guarantee.

The URCG therefore sought to deal with the problem of unfair calling of contract guarantees by requiring in **article 9**, as a condition of the Beneficiary's right to payment, the production of a judgment or arbitral award or the Principal's written approval of the claim and its amount. Although the object of this requirement was commendable, it did have the effect of limiting the acceptability of the URCG, for it resulted in the exclusion from their scope the simple on-demand guarantee that accounted for the great majority of documentary guarantees issued by banks. Although the requirement to produce a judgment or arbitral award was theoretically a documentary requirement, practically it meant that Beneficiaries had to prove default by the Principal by way of litigation or arbitration, and this tended to defeat the objective of the demand guarantee in providing the Beneficiary with a speedy monetary remedy. This requirement was unacceptable to importers and because of their strong bargaining position, it resulted in the URCG being seldom incorporated. This requirement also did not gain general acceptance, because it proved to be too far removed from the current banking and commercial practice. Another reason why the URCG failed to gain general acceptance in the market is because the rules are rather general, vague, fragmentary and conceptually fragile. The ill-fated URCG were in theory intended to cover

tender, performance and repayment guarantees; their requirements for a judgment or arbitral award as a condition of entitlement to pay were too far removed from international practice to be acceptable, coming close to crossing the line between a documentary guarantee and a suretyship guarantee.

4. Uniform Rules for Demand Guarantees.

In the light of the dissatisfaction with the 1978 URCG, the Committee of London and Scottish Bankers ("CLSB"), subsequently merged into the British Bankers' Association ("BBA"), submitted a draft Code of Practice for Contract Guarantees or Bonds to the ICC for consideration in 1985. This was followed in 1987 by a new edition of the draft. The ICC was therefore prompted to work on a new set of uniform rules due to the limited acceptance of the 1978 URCG. The idea was that the inclusion of first demand guarantees, in addition to a more comprehensive and detailed set of rules, would encourage a wider adoption in practice.
The ICC's Commission on Banking Technique and Practice joined forces with the Commission on International Commercial Practice to create a Joint Working Party to draft the new uniform rules. The Working Party carried out extensive work in this regard and a smaller Drafting Group eventually completed the rules. The UNCITRAL Working Group on International Contract Practices also contributed by reviewing the draft rules and making several recommendations for changes and improvements. A major difficulty experienced in formulating the uniform rules was the balancing of the interests of banks, exporters and industrialised countries, which tended to be at the Principal's end of guarantee deals, with the rights of importers and developing countries, which were usually at the Beneficiary's end. This was one of the reasons why the project took longer than was initially anticipated. The uniform rules were eventually approved by the two commissions and endorsed by the ICC in December 1991. In the end the rules embodied the collective knowledge and experience of the ICC's two commissions, professional and commercial associations and individual specialists across the world. In April 1992 the URDG were officially published, followed in 1994 by another publication, namely the 'Model Forms for Issuing Demand Guarantees". The URDG were created to be more in line with established international bank guarantee practice, under which the great majority of documentary guarantees are payable on first written demand, with or without supporting documents. They also aim at providing some safeguards against unfair calling of the demand guarantees and appear effectively to have superseded the 1978 URCG.
The URDG are intended to apply worldwide to the use of demand guarantees, specifically guarantees, bonds or other payment undertakings, however named or described, under which the duty of the Guarantor/Issuer, i.e. a bank, insurance company or other body or person, to make payment arises on the presentation of a written demand and any other documents specified in the guarantee and is not conditional on actual default by the Principal in the underlying transaction. Although the URDG apply to demand guarantees rather than to standbys, the latter may also be governed by the URDG. It was felt that the UCP were a more suitable set of rules for standbys than the URDG, of course, until the ISP98 came into operation in 1999, dealing specifically with standbys.
URDG confirm the independence of the guarantees to which they apply, since guarantees are by their nature separate transactions from the contract or tender conditions on which they may be based. They do not apply to suretyship or conditional bonds or guarantees, or other accessory undertakings under which the Guarantor's duty to pay arises only on actual default by the Principal. Although these instruments are widely used, they fall outside the scope and purpose of the URDG, because they are different in character from demand guarantees.
The URDG apply to a demand guarantee solely by way of their explicit incorporation into the guarantee by the parties; as they operate solely by way of contract, the parties are free to exclude or alter any of these rules to the extent permissible by the law applicable to their agreement.
The main purpose of the URDG is to codify rules of good practice to which parties subscribe by expressly incorporating these rules into their contracts. They provide a contractual framework for dealings between Guarantor and Beneficiary, between Instructing party and Guarantor, and in a few respects only, between Principal and Guarantor or Instructing party. Not only do they cover the relations between Guarantor and Beneficiary, but also those arising under counter-guarantees. The URDG do not deal with the rights and duties of the parties to the underlying contract, namely the Principal and the Beneficiary, nor do they regulate the internal mandate given by the Principal to the Guarantor or to the Instructing party.
The URDG also do not deal with issues that are the proper preserve of national laws and national courts, such as the circumstances in which the Principal may obtain injunctive relief against payment of a demand suspected to be fraudulent or otherwise abusive. These are issues of positive law, not of contract, and the URDG, like other ICC rules, deal only with issues that can properly be regulated by agreement between the parties. In the end, their success of depends on the extent to which the international business society is willing to adopt them in practice. During the early years of their existence, it seemed that they were not widely accepted; at the end of 2005 the URDG still had not gained wide acceptance and were not frequently used in practice, probably due to the fear that they might conflict with the standard guarantee texts that banks employ or the particular provisions that banks and Beneficiaries wish to include or exclude. This fear is unfounded, since the URDG themselves do not

contain guarantee texts or specific provisions, and any of these rules can be excluded or altered by contractual clauses in the guarantee as agreed by the parties.
During recent years, however, URDG have grown in popularity and are currently being used by banks worldwide. They were adopted in 1999 by the International Federation of Consulting Engineers ("FIDIC") in their model guarantee forms and later in 2002 also by the World Bank. A few national lawmakers have even taken the URDG as a model for independent guarantee statutes.
URDG 458 came into force by 1992, based on a model which was applied by British bankers. Despite the fact that they were strongly influenced by UCP: still worldwide acceptance of the Rules was a little disappointing. URDG 758, the revisd versionof URDG 458, came into force on 1st July 2010, trying to address problems of the previous version and set out functions and obligations of parties to demand guarantees by reflecting the best practices in business of guarantees.

5. International Standby Practices.

As mentioned above, standby letters of credit were brought within the scope of the 1983, 1993 and 2007 versions of the UCP. Approximately half of all standbys were initially governed by the UCP, but could also later be governed by the URDG. It was felt that the UCP were a more suitable set of rules for standbys than the URDG, a point that was also stressed in the Introduction to the URDG. In the past, standbys were capable of falling within two sets of rules, either the UCP or the URDG, and could be governed by whichever set of rules was incorporated into the credit. In 1996, the UNCITRAL published their "Convention on Independent Guarantees and Stand-by Letters of Credit'" applicable to international standbys and demand guarantees. During negotiations regarding the Convention the United States expressed concerns about the application of the Convention to the American standbys and suggested that specific rules should be included; a proposal that was rejected. The developments, in addition to the fact that there was no effort under way to formulate standby rules and the decision of the ICC Banking Commission not to make any of the adjustments for standbys requested by the United States letter of credit community in the UCP 500 revisions, the United States Department of State require the letter of credit community to take the lead in formulating standby rules in consultation with letter of credit communities throughout the world. This effort was coordinated by the International Financial Services Association ("IFSA"), formerly the United States Council on International Banking, Incorporated ("USCIB"), the trade association representing the major banks in the United States in this field, and the Institute of International Banking Law and Practice, Inc. Eventually, this resulted in the Institute of International Banking Law and Practice Incorporated, based in the United States, with the support of the IFSA, embarking on a project to formulate self-regulatory rules for the American standby letter of credit market. The International Standby Practices Project ("ISP Project") was started in the United States with the goal to provide self-regulatory rules that were more appropriate than the UCP to address problems related to standbys. The Institute of International Banking Law and Practice Incorporated interacted with hundreds of people over a five-year period, and looked at various comments received from individuals, banks, and national and international associations. The ICC's Commission on Banking Technique and Practice also formed an a*d hoc* Working Group that also provided their assistance with the ISP Project. Various sponsorships and support were received from banks, a firm of attorneys and the National Law Centre for Inter-American Free Trade. The Secretariat of the UNCITRAL also played an active role in this project.
Eventually, it resulted in the creation of a separate set of rules, namely the "ISP98". The IFSA adopted the ISP98, after which they were also submitted to the ICC for approval. Although the ICC Banking Commission did not initiate this ISP Project, it did endorse the rules on 6th April 1998, which came into operation on 1st January 1999. The ISP98 have gained considerable acceptance as they have been adopted by major banks in the United States. To address inevitable questions, to provide for official interpretation of the rules of the ISP98 and to assure their proper evolution, the Institute of International Banking Law and Practice Incorporated created a Council on International Standby Practices, which is representative of the various constituencies that have contributed to the ISP98, and has charged it with the task of maintaining the integrity of the ISP98 in co-operation with the Institute, the ICC Banking Commission, the IFSA and various supporting organisations. The council is charged with the duty of explaining the intentions of the drafters and providing official interpretations of the ISP98. It also has to monitor the ISP98 and assure its application, interpretation and revision in a manner consistent with sound standby practice.
As there were no specific rules for standbys in the past, most credits were issued subject to various versions of the UCP. Since it was commonly accepted that the UCP were not appropriate for standby letters of credit, because the they were originally written for use only in commercial letters of credit and therefore did not contain any specific provisions relating to standbys. Many of the provisions were either not applicable or inappropriate in a standby. Contrary to this, the ISP98 were specifically and exclusively drafted for standbys and were intended to be complementary to the UNCITRAL Convention in order to address the concerns on the part of the United States. The ISP98 are intended as a replacement for the UCP for standbys. Seen from this perspective, the ISP98

are welcomed, because they were written explicitly for standbys and are generally better suited to govern these instruments than the UCP. Notwithstanding the coming into effect of the ISP98, the UCP 600 are still available for incorporation into a standby. It was expected that with the publication of the ISP98, standbys would no longer be made subject to the UCP 600. Since ISP98 turned out to be successful, one might even consider excluding standbys from future revisions of the UCP all together as, by doing so, the UCP could then solely apply to commercial letters of credit and the ISP98 to standbys.
Standbys may also still be issued subject to the URDG that govern the demand guarantees. Although standbys and demand guarantees are different in form, they are functionally equivalent; in fact, courts have applied standby letter of credit law to the bank demand guarantee and the general agreement is that the same law should apply to them. At present the UCP 600, ISP98 and the URDG are all available for incorporation into a standby. It would appear that widespread use of ISP98 continues in sophisticated financial standbys and independent undertakings.
The ISP98 reflect generally accepted practice, custom and usage of standbys that can either be accepted or modified. To the extent that these rules may be unclear, incomplete or become outdated, they should be interpreted and supplemented by reference to standard standby practice, because they do not perfectly and completely state all practices for all times. The ISP98 are intended to apply to domestic and international standbys and not to commercial letters of credit. The ISP98 provide separate rules for standbys in the same sense the UCP do for commercial letters of credit and the URDG do for demand guarantees.
Rule 1.01 outlines the scope and application of the ISP98, and indicates the types of undertaking for which the rules are intended, providing that:

> *a. These Rules are intended to be applied to standby letters of credit (including performance, financial, and direct pay standby letters of credit).*
> *b. A standby letter of credit or other similar undertaking, however named or described, whether for domestic or international use, may be made subject to these Rules by express reference to them.*
> *c. An undertaking subject to these Rules may expressly modify or exclude their application.*
> *d. An undertaking subject to these Rules is hereinafter referred to as a "standby".*

Theoretically, any international or domestic undertaking, however far removed from a standby, can be issued subject to ISP98, whose use for dependent undertakings, such as suretyship guarantees, and *quasi*-independent undertakings, such as commercial negotiable instruments, is not suitable and will lead to confusion. It may be used for independent undertakings, such as demand guarantees, although the URDG, have been specifically drafted for this type of undertaking. By their terms, the ISP98 rules apply to an independent undertaking that incorporates them by express reference, such as "*this letter of credit is subject to ISP98*" or "*subject to ISP98*". Like the UCP and the URDG, the ISP98 also apply to any independent undertaking, such as demand guarantee, issued subject to it. Parties themselves are allowed to choose the applicable set of rules; in other words, a party may choose to use the ISP98 for certain types of standbys, the UCP for others and the URDG for others again.
They use the term "standby" in two distinct senses. **Subrules (a)** and **(b)** of **rule 1.0**1, refer to a "*standby letter of credit*". No definition of standby letter of credit is provided in the ISP98. This approach avoids the impractical and often impossible task of identifying and distinguishing standbys from commercial letters of credit. It was decided not to provide a technical definition, and to leave it to the market to decide which undertakings should be governed by the ISP98.
The ISP98 were designed to be compatible with the UNCITRAL Convention and also with local law, whether statutory or judicial, and to embody standby letter of credit practice under that law. If the rules of the ISP98 conflict with the mandatory law on an issue, the applicable law will prevail.
Rule 1.05 of **ISP98** provides that questions of capacity, e.g., who may issue a standby credit, formal requirements and the issue of fraud are left to the applicable jurisdictional law. In other words, these questions are beyond the scope of the ISP98. Many other issues regarding standby credits, such as the choice of law, the legal remedies and the recovery of damages, are also excluded from the scope of the ISP98 and are left to the applicable jurisdictional law.

6. Uniform Rules for Contract Bonds.

While the URDG were being drafted, a few representatives, especially those of Scandinavian countries and Japan, voiced their concern about the desirability of simple first demand guarantees requiring no evidence of the principal debtor's default and the associated risk of abuse by the Beneficiary. It was felt that there was some need for a security device in terms of which the Guarantor's liability was accessory to that of the Principal debtor, based upon established fraud. The ICC Commission on Insurance, in co-operation with representatives of

the construction industry, was requested to draft rules in this regard. In April 1993 the Uniform Rules for Contract Bonds ("URCB") was adopted and they came into operation on 1st January 1994.
The URCB only apply to bonds to which they are stated as applying and deal with suretyship guarantees, to be precise, guarantees that are secondary both in intent and in form, and are thus triggered only by established default, as opposed to the presentation of documents. The main provisions are **articles 3(b)** and **(d)**, which stipulate that the Guarantor's liability under the bond is accessory and arises upon default, and that all defences of the principal debtor against the Beneficiary under the underlying contract are also available to the Guarantor. In the event of a dispute, **article 7(j)** provides that default is deemed to be established upon a certificate issued by the Guarantor, or, if the bond so provides, upon a certificate of default being issued by a third party or upon final judgment or arbitral award. Contrary to the URCG, the URCB allow the Guarantor of the bond to elect to make good the Principal's default by performing the obligations under the underlying contract instead of paying the demand. Owing to the different nature of this type of security, the URCB are not a source of law for the demand guarantee or the standby letter of credit.

7. International Standard Banking Practice for the Examination of Documents Under Documentary Credits.

Another ICC publication relating to documentary credits is the "International Standard Banking Practice for the Examination of Documents Under Documentary Credits" ("ISBP"), which was drafted by a Task Force of the Banking Commission and approved on 30th October 2002. The detailed provisions of ISBP aimed at stipulating the requirements of the documents normally called for in documentary credit transactions. It was originally created to help reducing the large percentage of documents refused for discrepancies on first presentation. It was aimed at all parties involved in a documentary credit transaction. Furthermore, it also aimed to fill in many voids and uncertainties left unanswered by the UCP 500, by providing an insightful checklist of items that document checkers could refer to in determining how the UCP 500 applied in daily practice.
Since the publication of the UCP 500 in 1993, it has been said that various articles were open to ambiguity and the high level of rejections of documentary presentations had done little to comfort exporters concerned about the likelihood of prompt payment when letters of credit were used. One of the main problems voiced was that banks did not have a common standard covering the checking of the various documents that could be presented under a letter of credit. **Article 13(a)** of the UCP 500 provided that "*compliance of the stipulated documents on their face with the terms and conditions of the credit shall be determined by international standard banking practice as*" reflected in the UCP 500. The lack of such a published international practice has resulted in a situation where various banks have different rules on acceptability, or otherwise, of documents.
The ICC then attempted to address this problem by publishing the ISBP. Contrary to the UCP 500 and the eUCP version 1.0, it was not designed to be incorporated into a documentary credit, instead, it was created in an attempt to define the international banking practice regarding the examination of documents tendered under documentary credits. In view of that, the ISBP could not be regarded as comprising standard terms governing the contractual relationships created in documentary credit transactions. The ISBP's effect was bound to depend on its being accepted as a declaration, or an authoritative statement, of the international practice developed by banks and referred to in **article 13(a)** of the **UCP 500**.
The drafting of the ISBP was not based on an extensive study of the existing practice, its purpose being rather to explain how practices set out in the UCP 500 were to be applied by documentary practitioners. The drafters of the ISBP even recognised that the law in certain countries might compel a practice different from that stated in the ISBP, which, moreover, even recognised that it was impossible to deal with all the documents that might be called for in documentary credits. It did attempt to cover terms commonly seen on a daily basis and the documents most often presented under documentary credits.
The ISBP recognised that it did not provide a complete guide to the banking practice concerned and also accepted the existence of local variants of international banking practice. Up to a certain point, these are dictated by the prevailing local laws with which the ISBP might have been inconsistent. If a certain practice described by the ISBP was in conflict with the local laws, the latter would have prevailed.
A weakness in the ISBP is the express reference to determinations of the Banking Commission. Although the influence of these decisions was acknowledged, it should have been remembered that banking practice changes itself to, and develops in accordance with, the changes seen in international business. It is a common fact that banking practice is not static and therefore determinations of the Banking Commission will serve only as a guideline as long as the point of practice remains the same. This also applies to the ISBP generally; if it were not amended regularly, in future courts may be inclined to wonder if its specific statements are current.
The ISBP could not be viewed as an ultimate statement of banking practice universally applicable to documentary credits. Their publication has understandably attracted conflicting opinions on the effectiveness of the publication. Some commentators have proclaimed that it was a solution to all the problems experienced with the presentation of purportedly discrepant documents, while others have stated that this publication could only

intensify and enhance the confusion surrounding the UCP 500 and the ICC's subsequent policy statements, position papers and decision papers. The majority of countries and banks appeared to have been encompassing the ISBP and a concern was even expressed that it might also possibly have turned out to be yet another unsuccessful effort on the part of the ICC. The ISBP has apparently evolved into an essential companion to the UCP 500 for determining compliance of documents presented with the terms of letters of credit.

7.1. The Revised International Standard Banking Practice for the Examination of Documents Under Documentary Credits

As the UCP 500 were replaced with the UCP 600, it also became necessary to update the ISBP to bring it in line with the new UCP rules. The same Drafting Group that created the final version of UCP 600 was tasked with the development of the new update, after the UCP 600 had been approved in October 2006. The Drafting Group entertained comments from various countries of the ICC Banking Commission during the drafting process. During the ICC Banking Commission's April 2007 meeting held in Singapore, the International Standard Banking Practice for the Examination of Documents Under Documentary Credits, 2007 Revision for UCP 600 ("ISBP (2007 revision)") was adopted.

The ISBP (2007 revision) is viewed merely as being an updated version of the original ISBP published in 2002, rather than a revision thereof. Although much of the ISBP (2007 revision) remains unchanged from the first version, certain minor alterations had to be made to bring the wording in line with UCP 600. Certain paragraphs also had to be removed from the original version, where they had been incorporated into UCP 600.

In the introduction to the ISBP (2007 revision) it is mentioned that the international standard banking practices that are documented in this publication are consistent with the UCP 600 and the Opinions and Decisions of the ICC Banking Commission. It also clearly stated that the ISBP (2007 revision) does not amend UCP 600. It is merely explained how the practices articulated in the UCP 600 are applied by documentary practitioners. Therefore, it is suggested that the ISBP (2007 revision) and the UCP 600 should be read in their entirety and not in isolation. The ISBP (2007 revision), just like its predecessor, also recognises that the law in some countries may compel results different from those set out in this publication. The term "standard banking practice" as incorporated in the UCP 600 encompasses more than can be found in the ISBP and ISBP (2007 revision); this is also made clear by the introduction to the ISBP (2007 revision). In the introduction it was stated that no single publication can anticipate all the terms or the documents that may be used in connection with documentary credits or their interpretation under UCP 600, and the standard practice they reflect. The Task Force that had prepared the original version of the ISBP, endeavoured to cover terms commonly seen on a daily basis and the documents most often presented under documentary credits.

The ISBP was originally created to help reducing the large percentage of documents refused for discrepancies on first presentation. Anecdotal evidence suggested that this objective had partially been achieved. Participants in ICC seminars and workshops have also indicated that rejection rates have dropped due to the application of the practices that were detailed in ISBP, which apparently evolved into an essential companion to the UCP 500 for determining compliance of documents generally presented with the terms of letters of credit.

The ISBP and the ISBP (2007 revision) are both sources of law of the commercial letter of credit and, to the extent to which they may be applicable, the standby letter of credit and also by implication the demand guarantee.