

Standby Letters of Credit and the ISP 98: A European Perspective

*Dr. Jens Nielsen & Nicolai Nielsen**

American and Canadian authors have welcomed the publication of the International Standby Practices (ISP 98), and have considered them a very usable and excellent regime for standby credits.¹ This optimism, however, is not entirely shared among authors in nations whose legal systems do not divide commercial and investment banking. In these countries, banks are allowed to issue straight guarantees without resorting to the concept of a standby. The following article analyzes the differences among the ISP 98, the Uniform Custom and Practices for Letters of Credit (ICC Publication No. 500), and established practices and jurisdiction for the issuance of guarantees. Furthermore, it alerts the reader to provisions in the ISP 98, which might be unenforceable under national laws outside the realm of Common Law.

Les auteurs américains et canadiens ont bien accueilli la publication des Règles et Pratiques Internationales relatives aux Standby (RPIS 98), jugeant que ces règles sont très utiles et constituent un excellent régime pour les crédits standby. Cet optimisme n'est cependant pas entièrement partagé par des auteurs en provenance de nations dont le système légal ne divise pas le secteur bancaire entre les banques commerciales et les banques d'investissement car dans ces pays, les banques ont le droit d'émettre des garanties directes sans avoir recours au crédit standby. L'article suivant analyse les différences entre les RPIS 98 et les Règles et Usances Uniformes relatives aux crédits documentaires (RUU) et les pratiques établies et les juridictions en matière d'émission de garanties bancaires. De plus, l'article met le lecteur en garde à propos de certaines clauses des RPIS 98 qui pourraient ne pas être exécutoires en vertu des lois nationales fondées sur les principes de common law.

* Dr. Jens Nielsen practices law in Hamburg, Germany, with the law firm of Westphal Voges Krohn. Nicolai Nielsen practices law with a Silicon Valley startup. This article was published in similar form last fall in the German legal magazine Wertpapiermitteilungen.

¹ See P.S. Turner, "New Rules for Standby Letters of Credit: The International Standby Practices," 14 B.F.L.R. 3, at 502.

1. RULES OF THE INTERNATIONAL STANDBY PRACTICES (ISP 98/ ICC PUBLICATION NO. 590)

(a) Reverence of the ICC to the “homeland of the standby”

(i) *Disputed adoption*

(A) More Abstention than approval: On January 1, 1999, the ISP 98 came into force as ICC publication no. 590. The groundwork for these Rules was a draft of the American Institute of International Banking Law & Practice, Inc. The new guidelines were passed against the vote of the German delegation, which was doubtful as to whether the enactment of new Rules applicable as well to guarantees and letters of credit was needed. The outcome of the vote is self-explanatory: 32 votes for, 9 against and 46 abstentions.² The enactment is a concession by the ICC to the United States, which is referred to in the Prologue as “homeland of the standby.”³ The new guidelines were drafted in accordance with Art. 5 UCC and with the “United Nations Convention on Independent Guarantees and Stand-by Letters of Credit” as adopted by the general assembly of the UN.^{3a} The UN convention — for which, according to this author’s opinion, no need exists — has not yet become effective since the necessary number of 5 signatory states has not been reached at this point.

Similarly it seems doubtful whether it was necessary or correct to validate the American standby practice with the stamp of approval of the ICC. Supporters of this idea emphasize the economic importance of the standby as “a product whose current outstanding value of USD\$750 billion dwarfs that of any other letter of credit-product,”⁴ and that the

² D. Taylor & W. Holzwarth, “Were the new ISP Rules on standbys fairly adopted and will they be useful? Winfried Holzwarth and Dan Taylor debate.” *INSight* 4:4 at 12

³ ICC-Pub. no. 590, Prolog at 12 “In addition to the concordance with revised Article 5, UCC (the letter-of-credit law of the homeland of the standby) and the similarly close contact (and personal overlap) with the 1993 UCP revision task force, I am referring in particular to UNCITRAL’s work which culminated in the adoption in 1995 by the General Assembly of the ‘Uniform Nations Convention on Independent Guarantees and Stand-by Letters of Credit’.”

^{3a} *United Nations Convention on Independent Guarantees and Standby Letters of Credit* (New York, 1995). The Convention was adopted by the General Assembly on 11 December 1995. Text is available online at: <<http://www.incitral.org/en-index.htm>>.

⁴ *Supra*, n. 2 at 14.

UCP 500, which is applicable for letters of credit, is not tailored for guarantees. Critics argue that the ISP 98 not only contains American legal practices but also legal parlance, and hence “excessive and unnecessary detail, legalistic style inappropriate to worldwide practice, and a failure to follow traditional ICC Rules drafting style.”⁵

(B) Necessity of an official commentary: Regardless of the justification of the criticism, there was some doubt among members of the working group who were charged with the drafting of the ISP 98. Members questioned whether the new Rules would be properly understood in parts of the world unfamiliar with American standby practices:

Not only was there a serious lack of understanding of standby practices in certain parts of the world, but many misidentifications with independent guarantee practice. ... In addition, it was also apparent that in some regions there was a need for an explanation of many aspects of standbys themselves since they were either unknown or known only in the form of performance or bid bonds.

Doubts as to whether others would properly understand the new Rules led the ICC to entrust the chairman of the working group, Professor Byrne, with writing an “official commentary.”⁶ It is well known that Art. 20, UCP 500 (“Ambiguity as to the Issuers of Documents”) considers terms such as “official,” “competent,” etc., too indefinite and thus immaterial to the inspection of documents. Hence, the official character of the new commentary cannot be an impediment to advocating a different interpretation of equal value. This outlook gains additional support from Holzwarth, who asserts in his article that many of the new Rules are void according to German law since they will be deemed “surprising” in the context of the AGBG.^{6a}

(ii) *Concept and applicability of standbys*

In accordance with the revised Art. 5, UCC, Rule 1.06, ISP 98 defines standbys as follows:

A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not state so.

⁵ Affaki, “How do the ISP standby Rules fit in with other uniform Rules?” *INSight* 5:1 at 3.

⁶ Prof. J.E. Byrne, Director, Institute of International Banking Law & Practices, *The Official Commentary on the International Standby Practices* (Montgomery Village MA: Institute of International Banking Law and Practices, 1988); James G. Barnes, ed., Baker & McKenzie.

^{6a} *Supra*, n. 1.

The broad formulation of this definition, which is consistent with Art. 2, UCP 500, allows the application of the ISP to Standby Letters of Credit and documentary credits or guarantees issued in compliance with European law.

The ISP uses the term “standby” in different ways. Rule 1.01(a) and (b), ISP 98, refer to the “Standby Letter of Credit” without defining it, an omission that is due to the difficult delimitation of “commercial letter of credit”:

This Rule uses the term “standby” in two distinct senses. SubRules (a) and (b) refer to a “standby letter of credit.” No definition of a standby is provided in these Rules. A precise definition has not been given because the distinction between commercial letters of credit and standby letters is not precise.”⁷ In distinction to a “Standby letter of Credit” a “Standby” according to Rule 1.01 (d), ISP 98 is: “any undertaking subject to these Rules. Thus, an independent guarantee issued subject to ISP 98 would be a “standby” for purposes of these Rules.”⁸

According to the understanding of the ISP 98, an international bank guarantee is not identical with a classical standby but can only be subject to the ISP 98 as an independent promise to pay *sui generis*. In the following the author uses the term standby uniformly avoiding the distinction made in Rule 1.01 ISP 98, a distinction whose practical value is hard to discern. Even the “official commentary” states:

A “standby letter of credit” is the type of letter of credit which is understood to be a letter of credit.⁹

(iii) *Documentary formulation of a standby according to former American banking laws*

Owing to the necessity of presenting a document in order to avail oneself of a standby (compare Rule 1.06, ISP 98), a standby is classified as a “documentary promise to pay.” This classification distinguishes the standby from an international guarantee, which is usually payable on first demand, and only in exceptional circumstances, when required by the guarantee itself, is it payable against documents. In order to demand payment under a standby, the beneficiary must present a document, even if the standby itself does not mention this requirement. Pursuant to Rule 4.08, ISP 98:

⁷ *Ibid.*, Rule 1.01, marginal note 3.

⁸ *Ibid.*

⁹ *Ibid.*

If a standby does not specify any required document, it will be deemed to require a documentary demand for payment.

The reasons for formalizing the demand for payment under a standby can be found in American banking legislation. The American banking system is characterized by the strict separation of investment and commercial banking, which was implemented by the *Glass-Steagall Act* of 1933.¹⁰ Hence, the majority of banks are not permitted to issue bank guarantees or suretyships.¹¹ Reputable authors have long disputed the validity of this prohibition.¹²

In 1996 the Office of the Comptroller of the Currency (OCC) liberated American banks from this prohibition:

On February 5, 1996, the OCC issued its final revised Interpretive Ruling Section 7.7016 (61 Fed. Reg. 4865)(Feb. 9, 1996), which authorizes national banks to issue and commit to issue letters of credit and “other independent undertakings” to pay against documents — such as bank guarantees — that are within the scope of applicable law or legally recognized rules of practice. The OCC has described the purpose of the change: “to reflect modern market standards and industry usage and replace the term ‘letters of credit’ with ‘independent undertakings’.”

Even with this change of legislation, the proven practice for standbys will probably not shift. A standby has basically the character of a bank

¹⁰ Zahn, Eberding & Ehrlich, *Zahlung und Zahlungssicherung im Außenhandel*, 6th edition, (1986) marginal note 1/6; Ebert, “Der Standby Letter of Credit im Recht der Vereinigten Staaten von Amerika,” (1981) *ZvglRWiss* 80, at 29 (31 f.); Vorpeil, “Einheitliche Richtlinien und Gebräuche für Dokumenten-Akkreditive - Revision 1993,” (1993) *IWB* 1125 at 1126; Nielsen, *Neue Richtlinien für Dokumenten-Akkreditive* (1994) marginal note 3; Schmitthoff, “The New Uniform Customs for Letter of Credit,” (1983) *Essay no. 29* at 449, 451; “Export Trade. The Law and Practice of International Trade,” (1990) 9 *Auf.* at 430.

¹¹ See Stapel, “Die Einheitlichen Richtlinien und Gebräuche für Dokumentenakkreditive der Internationalen Handelskammer in der Fassung von 1993,” (1998) [unpublished, Berlin] at 81: “Danach sind Rechtsgeschäfte, die eine Bank außerhalb der ihr ‘verliehenen’ Befugnisse (‘ultra vires’) tätigt, unwirksam. Nur die im Kredit- und Einlagengeschäft tätigen Institute sind berechtigt, Bankgarantien im kontinental-europäischen Sinne auszulegen.” [translation: Legal transactions a bank effectuates outside its authorities (‘ultra vires’) are void. Only banks operating in the deposit and credit business are authorized to issue bank guarantees as this term is understood in continental Europe]; J.F. Dolan, *The Law of Letters of Credit. Commercial and Standby Credits*, 2nd ed. (Boston: Warren Gorham & Lamont, Inc., 1991) at 12-25; J.F. Dolan, *The Law of Letters of Credit. Commercial and Standby Credits*, 2nd ed., supplement (Boston: Warren Gorham & Lamont, Inc., 1993), at 12-6; Schmitthoff, *Export-Trade. The Law and Practice of International Trade*, 9th ed. (1990) at 430.

¹² J.F. Dolan, *The Law of Letters of Credit* (Boston: Warren Gorham & Lamont, Inc.: 1984) 12.02(1)(a): “There are many clear exceptions to that general Rule.”

guarantee; however, much like a letter of credit, its demand depends on the presentation of a document however described. Letters of credit and other independent payment obligations can be subject to the Rule 1.01(d), ISP 98.¹³ Hence, the presentation of a document as the distinguishing criterion between a guarantee and a standby may come to be of dubious value.

(iv) *Function and economic importance*

Outside of the U.S., even though no legal impediments exist and the ICC guidelines do not provide for the contrary, it is nearly exclusively banks, and not other institutions, that issue letters of credit. Contrary to this practice, the circle of prospective issuers in the U.S. must be drawn larger. The ICC's objective is that the ISP 98, compared to the UCP 500, will be used by "a broader range of those actively involved in standby law and practice-rating agencies, corporate treasurers and credit managers, government officials, a wide variety of regulators, and a host of sophisticated users as well as their counsel."¹⁴ According to the ICC, the fact that the drafting of the standbys is apparently highly dependent on the acceptance of the beneficiaries and their counsels determines that the ISP 98 should guide lawyers and judges.

Even though exact statistical data are not available, the existing publications indicate that the use of documentary letters of credit is diminishing whereas the use of standbys is increasing:

Moreover, the outstanding amount of standbys, as reported in DCI, exceeds commercial letters of credit by five to one. Documentary Credit World reported that the value of standbys amounts of US\$755 billion worldwide.¹⁵

Should this development continue, even in countries outside the U.S., the question could arise as to which Rules should govern the

¹³ Del Busto, "ICC Guide to Documentary Credit Operations," Pub. no. 515 at 50: "The Standby Credit thus serves as a back-up or secondary means of payment, though it is recognized as a primary obligation of the Issuing Bank. ... The difference in application can be expressed by saying that the Commercial Documentary Credit is activated by the 'performance' of the Beneficiary. The Standby Credit, by contrast, supports the Beneficiary in the event of a 'default'."

¹⁴ International Chamber of Commerce and the Institute of International Banking Law & Practice, *ISP 98 -International Standby Practices* (ICC Pub. no. 590); characteristically, *ibid.*: "As a result, the ISP is also written to provide guidance to lawyers and judges in the interpretation of standby practice."

¹⁵ Affaki, *supra*, n. 5 at 3.

issuance of bank guarantees. Up to now, European, including British, banks preferred the issuance of first demand guarantees and letters of credit to the issuance of standbys.¹⁶ It is for this reason that no decisions regarding standbys exist under British common law.¹⁷ In Canada, however, the issuance of standby letters of credit has become rather standard in international trade with the U.S., the Middle East, and South America.¹⁸ It remains to be seen whether the new ISP 98 will serve as an initial impetus for the dissemination of standbys in other countries.

(b) Guidelines of the ICC regulating standbys, guarantees, and letters of credit

(i) Overview

The ICC expressly states in its introduction to the ISP 98 that the ISP, like the UCP 500 and the URDG, will apply to any independent undertaking issued subject to it.¹⁹ Hence, according to the ICC's own words in the introduction of its publication, the ISP competes with the existing ICC guidelines for guarantees and letters of credit, which are the "Uniform Rules for Contract Guarantees" (ICC publication No. 325), the "Uniform Rules for Demand Guarantees" (ICC publication No. 458/1), and the "ICC Uniform Customs and Practices for Documentary Credits" UCP 500.

In view of these extensions to the body of existing guidelines, the ICC entrusts the parties with the task of determining which body of rules they want to apply. One may well choose to use the ISP for certain types of standbys, the UCP 500 for others, and the URDG for still others.²⁰ The choice becomes considerably easier if one examines the suitability and acceptance of the existing Rules. The decision can be narrowed down to the issuance of guarantees according to either international standard practices or the new ISP 98, as a standby will be subject to the UCP 500 only in exceptional cases.

¹⁶ Schmitthoff, *supra*, n. 11 at 430.

¹⁷ Benjamin/Ellinger, marginal note 23-187.

¹⁸ Stapel, *supra*, n. 11 at 81.

¹⁹ ICC-Pub. no. 590, *supra*, n. 3 at 7.

²⁰ *Ibid.*

(ii) *Differing acceptance of the existing ICC guidelines for standby letters of credit, letters of credit, and guarantees*

(A) Lack of market conformity of ICC publication no. 325 —
Uniform Rules for Contract Guarantees

The Rules for contract guarantees, published by the ICC in 1978, attempted to solve the problem of fraudulent demand in case of dispute by requiring the beneficiary to present a verdict or an arbitral award. Payment obligations based on ICC publication no. 325 lack the decisive element of a guarantee: the liquidity function. They fail to reflect business needs since they regulate a type of guarantee, which in international business — a buyer's market — was never needed. Hence, these Rules were never accepted in the real world.²¹

(B) ICC publication no. 458/1 — Uniform Rules for Demand Guarantees (with invalid payment clause)

Since the Rules for contract guarantees (publication no. 325) were, as ascertained by the ICC itself, a misconception, the ICC adopted a new body of rules: its publication no. 458/1.²² This publication corresponds to a great degree with the proven standard practices for guarantees in foreign trade; however, the biggest defect is that the very important provision about calling of a guarantee is not suitable for guarantees.²³

According to Art. 20, Uniform Rules for Demand Guarantees ("URDG"), even if the payment provision stipulates that the guarantee be "payable on first demand," the beneficiary has to present a document stating that the applicant has violated his/her contractual duties and detailing the kind of violation that occurred. If applicable, the beneficiary must provide appropriate documentation. This provision is surprising and hence void.²⁴ Banks that issue guarantees subject to the ICC pub-

²¹ Schinnerer & Avancini, *Bankverträge*, Bd. III, 3rd ed. (1976) at 288.

²² ICC Pub. no. 458/1/ICC, "Einheitliche Richtlinien für auf Anfordern zahlbare Garantien," at 4: "Though Publication No. 325 was used, and continues to be used, to some extent, the requirements proved too removed from prevailing banking and commercial practice to gain general acceptance."

²³ V. Westphalen, "Ausgewählte Fragen zur Interpretation der Einheitlichen Richtlinien für auf Anfordern zahlbare Garantien," RIW/AWD 92 at 961 ff.

²⁴ V. Westphalen, "Die neuen Einheitlichen Richtlinien für "Demand Guarantees,"" (1992), DB at 2017 ff.; dissenting opinion: Schütze, *Internationale Wirtschaftspraxis* (1994) at 39.

lication no. 458/1 seek to avoid this element of surprise by inserting these additional provisions directly into the stipulations for payment in the text of the guarantee. The result of this clarification is that the beneficiary refutes this kind of guarantee if it does not correspond to the stipulations of the underlying transaction. According to a survey by the ICC, these Rules are rarely used in practice.

Hence, the result in regard to acceptance is no surprise. More than 60 per cent of those responding indicated that they rarely or never used the URDG.²⁵

(C) ICC publication No. 500 - ICC Uniform Customs and Practices for Documentary Credits (only partially applicable to guarantees with guarantee character)

The guidelines governing letters of credit, primarily intended for use as promises payable against presentation of documents representing the goods, can also be used for standby letters of credit. This result was first achieved in the 1983 revision and is stipulated in Article 1. The problem with this reference is that standbys do not regularly serve to pay the purchase price. Standbys are normally used to secure the fulfilment of contractual obligations.²⁶ The special character of a standby and its character as a guarantee are shown in the fact that according to Art. 1, UCP 500, the guidelines on letters of credit come into effect only **if applicable**. With this limitation, the drafters took into consideration that particular provisions might be inappropriate.²⁷ According to Affaki, the following provisions are incompatible with the practice for standbys and must be expressly excluded: Art. 17, force majeure; Art. 19, Reimbursement; Article 21, miscellaneous documents; Article 41, UCP 500 installment drawings.²⁸

²⁵ Affaki, *supra*, n. 5 at 6.

²⁶ Del Busto, *supra*, n. 13 at 50.

²⁷ Nielsen, *supra*, n. 10 at marginal note 4; ICC Pub. no. 469, Opinions of the ICC Banking Commission 1987-1988,: "The Commission decided that under a standby credit Art. 47(a) UCP does not apply, particularly where it is only a copy document which is, therefore, not a transport document."

²⁸ Affaki, *supra*, n. 5 at 3: "It follows that a number of UCP Articles are inappropriate for standby practices and, as a consequence, have to be excluded in the standby's text. These include Articles 23 to 38, dealing with transport documents, which are rarely required in standbys. Other inappropriate UCP Articles include 17 (force

(iii) *Uncertain forecast about acceptance of the ISP 98 in countries outside the U.S.*

It can be assumed that documentary credits will normally be subject to the UCP 500 and only in exceptional cases be subject to the ISP 98. This means that the question of a competition between the ISP 98 and the existing standard forms of guarantees and guidelines arises only for guarantee transactions. Since the ICC guidelines nos. 325 and/or 458/1 are completely irrelevant in practice, the following are the only remaining options:

- Issuance according to internationally recognized standard forms without reference to any guidelines.
- Issuance according to internationally recognized standard forms, stipulating the applicability of the UCP 500 according to Art. 1, UCP 500.
- Issuance according to American Standby practices stipulating the applicability of the ISP 98.

Even though a forecast is difficult, it can be expected that at least U.S. banks will tend to use the ISP 98 since the ISP 98 claim not only to be in concurrence with Art. 5 UCC but also with the UN adopted “United Nations Convention on Independent Guarantees and Standby Letters of Credit.”²⁹

Not without remarkable self-confidence, the drafters of the ISP 98 assume that the standby is an international product that should or could be accepted by non-U.S. banks.

While the standby is associated with the United States where it originated and where it is most widely used, it is truly an international product. Non-U.S. bank outstandings have exceeded those of U.S. banks in the United States alone. Moreover, the standby is used increasingly throughout the world.³⁰

In view of this development, it seems expedient to attempt — as a means of orientation for practical applications — to compare differences and similarities between usual standard practices and the relevant guidelines of the ICC (UCP 500/ISP 98).

majeure), 19 (reimbursement arrangements), 21 (content of documents), and 41 (instalment drawings).”

²⁹ *Supra*, n. 3 at 12.

³⁰ *Ibid.*, Preface, at 5.

2. STANDARD FORMS OF GUARANTEES: COMPARISON OF UCP 500 AND ISP 98

(a) Legal qualification of guidelines and standard forms

(i) *International standard of bank guarantees*

In the majority of cases, banks issue bank guarantees according to internationally developed and homogeneously interpreted standards without reference to any guidelines. A guarantee thus issued consists of the following elements:

- preamble which references the underlying transaction merely as a means of allocation;
- payment clause on first demand with documentary extension of the payment clause if applicable, if agreed upon in underlying transaction through presentation of formalized declarations about the occurrence of the guaranteed event or presentation of documentary proof;
- establishment of a maximum amount including or excluding interest and other costs;
- reduction clauses, if agreed upon in the underlying transaction, in order to automatically reduce the maximum amount; reduction is effectuated through presentation of documentary evidence (shipping documents) about the satisfaction of the transaction secured through the guarantee; and,
- expiration clause, unless a demand is made until a predetermined date.³¹

The characteristic trait of a bank guarantee is the payment clause “on first demand.” Basically this globally accepted clause is all that is needed.³² Its use possesses type-determining importance.³³ Non-German authors assume to this extent a “*unité de doctrine*.”³⁴ Even if one cannot

³¹ Nielsen, “How to construct a bank guarantee with typical guarantee provisions,” in: Schimansky, Bunte & Lwowski, *Bankrechts-Handbuch* (1997) at §120, marginal note 67ff.

³² Pleyer, “Die Bankgarantie im zwischenstaatlichen Handel,” 2 WM-Beilage 73 at 6.

³³ V. Westphalen, *Die Bankgarantie im internationalen Handelsverkehr*, 2nd ed. (1990) at 78.

³⁴ See the recent publication, Schweinfest, “Bankenhaftung im Internationalen Doku-

assume an international custom, one can discern a uniform interpretation.

This author advocates the recognition of the guarantee as a payment obligation *sui generis* in the meaning of international customary law. However this opinion is not shared by jurisdiction and literature, as evidenced by the *BGH* judgment dealing with the interpretation of documentary payment clauses in the context of the UN Convention on the International Sale of Goods.³⁵ Nevertheless, the following remains true: when banks issue guarantees according to international standard forms without reference to any guidelines, the parties involved assume an interpretation independent of any national laws. Schweinfest has confirmed this result.³⁶

(ii) *UCP 500*

Hitherto, the legal nature of the ICC guidelines has been controversial. On the one extreme, authors classify the guidelines as international customary law; on the other extreme, they are merely considered standard terms and conditions.

Between those extremes are the moderate positions that classify the ICC guidelines as *lex mercatoria*, *ordre sui generis*, a body of rules “of its own kind.”³⁷ The majority view considers the UCP 500, at least in regard to incorporation into contracts, as standard terms and conditions.³⁸ This classification, which does not exclude accepting individual clauses as commercial usage, does not truly reflect the characteristics of

mentengeschäft im deutschen, französischen und englischen Recht,” (thesis, Hamburg, 1999) at 122 ff.; also Kleiner, in regards to Swiss law, *Bankgarantie*, 4th ed. (1990) at R. 5.70 ; also Dohm, *Bankgarantien im internationalen Handel* (1983) at marginal note 80.

³⁵ BGH WM 1996, 1594 - WuB IH1-1.97 (Nielsen); Staudinger-Mangnus, Art. 53 CISG, marginal note 17.

³⁶ Schweinfest, *supra*, n. 34 at 113ff.

³⁷ See the overview given by Schütze, *Das Dokumentenakkreditiv im internationalen Handelsverkehr*, 4th ed. (1996) at marginal note 30ff.

³⁸ See, for example, Canaris, *Bankvertragsrecht*, 3rd ed. (1988) at marginal note 926: “Für die Annahme von Gewohnheitsrecht fehlt es insoweit aber schon an der erforderlichen *opinio juris*.” [free translation: According to German law one of the elements required to assume a “usage of trade” is the conviction of the parties that the usage is equitable and uniformly followed similar to a law. This element is missing since the parties know that the UCP 500 are not law like.]

the UCP 500. The purpose of the AGBG is the control and prevention of abuse of its superior negotiating power by a company using standard terms and conditions,³⁹ whereas the UCP 500 is a result of collaboration of all interest groups involved in foreign trade who drafted the Rules in ICC committees.⁴⁰ This problem, however, need not be discussed in this context; subjecting a bank guarantee to the UCP 500 is an exception, and under these circumstances there is no doubt that the *incorporation* of the UCP 500 has to comply with AGBG (Section 2, 24 AGBG). Up to now, banks have not referenced the UCP 500 when issuing guarantees, since they rely on the fact that a global consensus exists regarding issuance and interpretation, and that the principles of strict compliance will apply.

(iii) *ISP 98, ICC publication no. 590*

Owing to the fact that the ISP are a new publication there can be no doubt that they have to be classified as AGB.⁴¹ This does not prevent the recognition of individual stipulations as commercial usance. This applies in particular to the Rules about strict compliance. The preface of the ISP 98 hence states:

The International Standby Practices (ISP 98) reflects generally accepted practice, custom, and usage of standby letters of credit.

It needs to be mentioned, however, that the ISP 98 contains a multitude of detailed Rules which are, according to German law, void. The numerous formalistic Rules, which are unusual and surprising for European jurisprudence, foster fears that the new ISP 98 will become a “candy store for lawyers.”⁴² This fear cannot be refuted easily, as the ABA published an explanatory paper in which it commented on 38 articles. These comments were meant to clarify, but the majority contained suggestions to modify or exclude certain provisions.⁴³

³⁹ Wolf, Horn & Lindacher, *Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen*, 1976, 3rd ed. (1994), Einleitung, at marginal note 15.

⁴⁰ See, Nielsen, *supra*, n. 31 at marginal note 23.

⁴¹ See, Holzwarth, *supra*, n. 2 at 12, “standard contract terms.”

⁴² *Ibid.*, “I am afraid, that the ISP will become a candy store for lawyers.”

⁴³ Avidon, “Getting ready for ISP 98 - The International Standby,” (October, 1998) *Documentary Credit World* at 3ff.

(iv) *Regarding (i), (ii), and (iii): Necessity of precise incorporation*

In view of the rich offer of the ICC to regulate guarantees, it is adamant about clearly stating the applicable set of rules. In practice the reference is often made that this undertaking shall be governed by the ICC Rules. This is no longer sufficient and cannot be interpreted as a reference to the ISP 98.⁴⁴ Even if the ISP 98 stipulate in Rule 1.02 (“Relationship to Other Rules”) that:

These Rules supersede conflicting provisions in other Rules of practice to which a standby letter of credit is also made subject.

If the parties clearly consented to the applicability of the ISP 98, then the problem arises as to whether the BGH would accept this reference, since it would fall under the problem of incorporation of conflicting trade terms.

(b) Independence of guaranty undertaking

(i) *Standard forms*

The majority doctrine in Germany classifies the bank guarantee as an independent promise to pay in accordance with Section 780, BGB.⁴⁵ The term *independence* has to be distinguished from *accessoriness*, since the BGH accepted a payment clause “payable on first demand” in a suretyship,⁴⁶ and thus equates suretyships and guarantees in regard to the formal requirements for their respective demand. Recent literature distinguishes between accessoriness and independence, and further differentiates between external and textual independence. In particular, Hadding, Häuser & Welter, in their report on the reform of the law of obligations, criticize that the distinguishing criterion, “lack of independence,” often has been confused with the independence of the guarantee as a result of imprecise terminology.⁴⁷ Independence is solely the legal autonomy of one transaction from another. Accessoriness, on the other

⁴⁴ See, Affaki, *supra*, n. 5 at 5.

⁴⁵ V. Caemmerer, “Bankgarantien im Außenhandel,” in: Festschrift für O. Riese, (1964) at 295ff., 301; Liesecke, “Rechtsfragen der Bankgarantie,” (1968) WM at 21, 24; Pleyer, *supra*, n. 32 at 14; V. Westphalen, *Rechtsprobleme der Exportfinanzierung*, at 76; Zahn, *supra*, n. 10 at marginal note 8/9; LG Stuttgart, WM 1981, 633, 635.

⁴⁶ BGH, WM 1988, 44 = NJW 1984, 923; BGH, WM 1989, 1496, 1497; BGH, WM 1994, 106.

⁴⁷ Hadding, Häuser & Welter, *Bürgschaft und Garantie* (1983) at 709.

hand, means the dependence of an obligation in creation, continuation and existence on the obligation created in another obligation, as is the case in a suretyship.⁴⁸ Based on the additional distinction of external and textual independence, Hadding, et. al., qualify that the guarantee is only externally independent with the argument, and that the guarantee on first demand contains the purpose of securing another obligation.⁴⁹ This differentiation is immaterial for the jurisdiction. For the independence of a guarantee, it is irrelevant whether the cause for its creation is mentioned outside the document, as in the case of a draft, or is mentioned in the preamble of the document, as in the case of a guarantee. Also, the jurisdiction and academic literature in England and France consider the legally unregulated bank guarantee as an independent payment obligation, to the exclusion of any objections.⁵⁰

(ii) *Guarantee/standby according to UCP 500*

L/C, according to the uniform customs, is the general term for any kind of documentary promise to pay. Article 2, UCP 500, subsumes under L/C both the documentary letter of credit and the standby letter of credit. The broad definition of Art. 2, UCP 500, avoids any legal classification which could lead to a limitation of the applicability of the UCP.⁵¹ When a standby is governed by the UCP 500, the independence of the underlying transaction from the payment obligation is expressed by Art. 3(a), UCP 500, as follows:

Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or defenses by the Applicant resulting from his relationship with the Issuing Bank or the Beneficiary.

⁴⁸ See, V. Westphalen, *supra*, n. 45, 3rd ed. 1987, at 319; exemplary Palandt-Thomas, BGB, Before §765, marginal note I e ; c.f. also Kleiner, *supra*, n. 34 at 149 ff.; Pleyer, *supra*, n. 32 at 13.

⁴⁹ Hadding, *supra*, n. 47 at 709.

⁵⁰ Schweinfest, *supra*, n. 34 at 123 referencing Lesguillons in: Lamy Contrats internationaux, 9/157; Mattout, Nr. 228 ff., 232; Rives-Lange/Contamine-Raynaud, Nr. 793, 788

⁵¹ Eisemann & Schütze, *Das Dokumenten-Akkreditiv im internationalen Handelsverkehr*, 3rd ed. (1989) at 63.

(iii) *Standby according to ISP 98*

Rule 1.06 also defines the standby as an “irrevocable, independent, documentary, and binding undertaking when issued and need not so state.” Adding the provision of Rule 1.06(d) (“Because a standby is documentary, an issuer’s obligations depend on the presentation of documents and an examination of required documents on their face”), one can see that the UCP 500 and the ISP 98 nearly employ identical wording to define the independence of the payment and the underlying business transaction. Furthermore, Rule 1.07 emphasizes the “independence of the Issuer-Beneficiary Relationship.”

(iv) *Regarding i), ii), and iii): Uniform concept of independence*

Equivalent liquidity function: The qualification of a bank guarantee without reference to any guidelines as an independent promise to pay in the meaning of para. 780 BGB is equivalent to the definition of the UCP 500/ISP 98 in regard to independence of guarantee or L/C. The attempt made in the recent literature to differentiate between external and textual independence is not recognized in legal systems outside Germany, and this author does not believe that it is an appropriate criterion. It is due to chance or pure formalities whether the purpose of the security is mentioned within the document evidencing the obligation to pay or outside this payment document. Even a draft has a “causa.” If the underlying transaction is not mentioned in the draft it is not due to a higher degree of independence, but rather is based on the formal legal requirements for drafts.⁵² For this reason it is objectionable to mention the L/C number in the left upper corner of a draft issued in connection with the L/C.⁵³ It is wrong however to create a “scale of independence” depending on whether the underlying transaction is mentioned in the document or not.⁵⁴ The decisive element is the independent promise to pay. This is

⁵² Baumbach & Hefermehl, “Wechselgesetz und Scheckgesetz,” Art. 1, marginal note 4.

⁵³ Zahn, *supra*, n. 10 at marginal note 5/16; c.f. furthermore BGH, WM 1960, 374; c.f. dazu Reinicke, “Treu und Glauben im Wechselrecht,” DB 60, 344; see also the provision for prime acceptances used in the financing of import/export etc., transactions; these require a reference on the front page of the bill to the financed transaction: Baumbach & Hefermehl, *supra*, n. 52 at Art. 1, marginal note 71; BGH, WM 1957, 1334.

⁵⁴ V. Mettenheim, “Die mißbräuchliche Inanspruchnahme bedingungsloser Bankgarantien,” (1981) *RIW/AWD* at 581, 582.

also the opinion of authors in jurisdictions outside Germany who consider the guarantee a payment instrument *sui generis*.⁵⁵

Superfluous emphasis of waiver of objections: A guarantee need not mention that the issuer waives any objections emanating from the underlying transaction. Hence, wording such as “without any objections,” “without any contestation,” etc., is superfluous.⁵⁶ In concurrence with this principle Rule 1.10(i), (ii), and (iii), ISP 98 states that:

A standby should not or need not state that it is:

- i. **unconditional** or **abstract** (if it does, it signifies merely that payment under it is conditioned solely on presentation of specified documents);
- ii. **absolute** (if it does, it signifies merely that it is irrevocable);
- iii. **primary** (if it does, it signifies merely that it is the independent obligation of the issuer.

(c) Piercing the independence in cases of fraud

(i) *Disputed harmful intention as an element of a prima facie case*

The possibility of fraudulent demand is not particular to the bank guarantee or the standby, but is the typical risk of abstract promises to pay, independent of whether the obligation is based on acknowledgement of indebtedness, draft, acceptance of the statement of account, or guarantee.⁵⁷ The common element is that the eligibility of the presenter

⁵⁵ Dohm, *Bankgarantien im internationalen Handel*, (1985), marginal note 67 (Vielmehr ist festzustellen, da die Wesensmerkmale der Bankgarantie im technischen Sinne in keinem der in der Schweiz gesetzlich geregelten Vertragstypen vorkommen. Folglich handelt es sich um einen Innominatsvertrag, genauer: **um einen Vertrag sui generis** [translation: The typical elements of a bank guarantee do not resemble any type of contract statutorily regulated in Switzerland]. Hence the bank guarantee has to be classified as a contract *sui generis*.). Dissenting: Canaris, *Bankvertragsrecht*, 3rd ed. (1988) at marginal note 1004, 1134, who expresses reservations in regards to the possibility of creating independent international legal constructs based on law merchant.

⁵⁶ c.f. Nielsen, *supra*, n. 31 at para. 121, marginal note 65 with further references.

⁵⁷ Nielsen, “Rechtsmißbrauch bei der Inanspruchnahme von Bankgarantien als typisches Problem der Liquiditätsfunktion abstrakter Zahlungsverprechen,” (1982) ZIP at 253.

will be examined only after payment.⁵⁸ The piercing of the independence will only be allowed if the immediate payment contradicts material and non-optional legal rules of a legal system regarding dealings in good faith in such a way that the limitation of the obligor to sue after payment does not seem acceptable. According to German law, the objection of unfair dealing is considered a violation of the principle of good faith dealing as stipulated in para. 242 BGB.⁵⁹ As the analysis by Coing shows, legal systems outside Germany usually prohibit fraudulent demands in the same way.⁶⁰ Article 2 of the Swiss civil code, for example, uses the same elements as the BGB: everyone has to exercise his or her rights and fulfil his or her obligations in good faith. Even though the wording might be identical, the requirements according to the jurisdiction are different. The distinguishing element is whether demand by an unauthorized person is sufficient or, and this is the doctrine advocated by American courts — additionally a harmful intent has to be obvious.

The ISP 98 does not regulate the requirements for objections based on fraudulent demands, thus distinguishing itself in this respect from the UN Convention. The ISP however factor out only offences, which contain an element of intent.⁶¹ Rule 1.05(c), ISP 98, states: “These Rules do not define or otherwise provide for : (...) c. defenses to honor based on fraud, abuse, or similar matters.” Byrne, in “The Official Commentary on the International Standby Practices,” at Rule 1.05(a) states: “Generally: The presence and consequences of fraud, abuse, illegality, or similar matters are left to applicable law such as Rev. UCC, Art. 5 Section 5-109 or the UN Convention, Art. 19 as indicated by Sub-Rule (c) of this

⁵⁸ Kübler, *Feststellung und Garantie*, at 189.

⁵⁹ C.f. Staudinger & Weber, *BGB*, 11th ed. (1961) at §242, comment D 766 subsequent; clearer than in subsequent editions the authors state that the most important field of application of §242 BGB is the correction of abuses in the field of abstract payment obligations.

⁶⁰ Coing, “Probleme in der Internationalen Bankgarantie,” (1983) ZHR 147 at 125 (139)

⁶¹ Byrne, *supra*, n. 7 at Rule 1.05(a):

Generally: The presence and consequences of fraud, abuse, illegality, or similar matters are left to applicable law such as Rev. UCC Art. 5 Section 5-109 or the UN Convention Art. 19 as indicated by Subrule (c) of this Rule. The UN Convention states that the issuer has a right to withhold payment if ‘[a]ny document is not genuine or has been falsified’ or if ‘the demand has no conceivable basis’ judging by its type and purpose.

Rule. The UN Convention states that the issuer has a right to withhold payment if ‘[a]ny document is not genuine or has been falsified’ or if ‘the demand has no conceivable basis’ judging by its type and purpose.”

The reason for this wording is probably that according to U.S. law an objectively illicit demand without actual malice is not considered abuse of law.

Unfortunately, the ISP is not consistent in its approach to avoiding regulation of abuse of demand. Rule 8.01, ISP 98, obligates the applicant to reimburse the bank even if the bank was victim of a fraud. According to this author, this can only apply if the bank could not detect the fraud. Contrary to this, Rule 1.06(c)(iv), ISP 98, stipulates that

Because a standby is independent, the enforceability of an issuer’s obligations under a standby does not depend on:

- i. The issuer’s knowledge of performance or breach of any reimbursement agreement or underlying transaction.

The official commentary advocates that even if the fraud is obvious or can easily be proven a right to refuse payment does not exist. Byrne comments on the ISP 98 in this regard as follows:

Issuer’s Knowledge: Issuers are not in a position to detect or judge the accuracy of claims or accusations against the beneficiary. They do not have the power to compel the production of evidence or testimony nor the authority to sit in judgment upon it. Therefore, knowledge of breach or performance of transactions other than the obligation to present documents under the standby does not affect the issuer’s obligation.⁶²

The consequence of this is that Rule 1.06(c)(iv), ISP 98, is void when a standby is subject to German law. This is the case when the contract defining performance is subject to German law. This clause will also be considered void in other European legal systems that require the bank to refuse payment in obvious cases of fraud.

(ii) *Jurisdiction of the BGH regarding fraud (no unambiguous distinction between objective and subjective abuse)*

According to the consistent jurisprudence and academic commentary, a guarantee bank is not only justified but also obligated to refuse payment if fraud is apparent and obviously can be proven. The jurisdiction of the BGH is graphically mirrored in the following head note:

⁶² *Ibid.*, at Rule 1.06.

If it is obvious or easily provable that despite the formal correctness of a presentation the guaranteed event has not occurred, the payment claim based on the guarantee fails due to the defense of fraud. This defense is limited to those cases where the abuse of a position, which constitutes only color of title, is obvious to everyone. Any dispute, factually or legally, which cannot be resolved by itself will be adjudicated after payment in an action for repayment.⁶³

This wording indicates an objective standard of fraud, which is conditioned upon the fact that the fraud can be proven with obvious evidence. Consequently, it would be sufficient if the objective inadmissibility of the demand were established. Proof of culpable conduct would not be needed.⁶⁴ Contrary to this interpretation, a strong opinion supported by the literature and jurisdiction requires as an element of fraud obvious willfulness, fraud, or malice.⁶⁵ Despite the head note quoted above, the BGH seems to tend to condition fraud on a subjectively reproachable attitude of the defendant. This is the only explanation of the following verdict: a bank refused to pay the beneficiary since it was clear that the beneficiary had delivered pirated goods, which were of no value to the applicant.⁶⁶ The BGH accepted that the secondary beneficiary acted in good faith and hence affirmed his claim against the bank. This decision seems problematic. If the buyer receives goods that are not saleable owing to a violation of paragraph 25, GWB, it is irrelevant for the assumption of fraud according to the objective fraud standard advocated by the author whether the seller acted in good faith.⁶⁷

This author would like to point out that the BGH's tendency to subjectify the elements of fraud contradicts the court's jurisdiction in regard to banking security arrangements. For this kind of contract the BGH suddenly changed practice and requirements and labelled certain practices as non-equitable. The parties, following a longstanding practice, lacked any notion that these acts were illicit.⁶⁸

⁶³ BGH, NJW 1988, 2610; ebenso BGHZ 90, 287, 297 = ZIP 1984, 685 (687); gleiche Grundsätze wendet der BGH auch für die Bürgschaft auf erstes Anfordern an (BGH WM 1988, 934), "the BGH has applied similar principles for a suretyship payable on first demand." c.f. auch Nielsen, WuB 8.88 IK3-4.88.

⁶⁴ Westphalen, *supra*, n. 33 at 191.

⁶⁵ Caemmerer, *supra*, n. 45 at 303.

⁶⁶ BGH, (1996) WM 995 at 996.

⁶⁷ Nielsen, *supra*, n. 32 at marginal note 414.

⁶⁸ c.f. resolution of the BGH, WM 1998, 227 answering inquiries of the IX. and XI. civil divisions of the Supreme Court regarding required margins of cover.

(iii) *English/French jurisprudence*

French and English courts tend to find fraud when the objective criterion of inadmissibility is paired with a subjective intent to harm.⁶⁹ French law, based on the general tort provision of Article 1382, Code Civil, requires that a certain behaviour be paired with an intent to harm in order to classify the behaviour as “inequitable.” Consistent with this position, the French cour de cassation refused the payment claim of a beneficiary against a bank with the defence of “fraude.”⁷⁰

English jurisdiction requires established fraud, and grants preliminary injunctions only in these cases.⁷¹ Representative in this regard is the reasoning of Lord Denning in the Court of Appeal’s *Edward Owen Engineering Ltd. v. Barclay’s Bank International Ltd.* (1977), 3 W.L.R. 764 at 733:

All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit ... The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.

Similarly, Kerr in *Harbottle Ltd. v. National Westminster Bank Ltd.* (1977), 3 W.L.R. 752 at 761, elaborates on the distinction between guarantee and provision of services:

In that event the injunctions would be inappropriate because they might cause greater damage to the bank than the plaintiffs could pay on their undertaking as to damages, and because the plaintiffs would then have an adequate remedy in damages. The balance of convenience would in that event be hopelessly weighted against the plaintiffs.

⁶⁹ Coing, *supra*, n. 60 at 141, referencing Merz, “Vom Schikaneverbot zum Rechtsmißbrauch,” (1977) ZfRV 165 at 173.

⁷⁰ c.f. Juris Classeur Commercial Annexes, Banque-Bourse Fascicule 32 - Crédit documentaire no. 108/109.

⁷¹ Williams, “On Demand and Conditional Performance Bonds,” (1981) 1 Journal of Business Law 8 at 10ff.; Horn, *Securing International Commercial Transactions*, (1982), at 275, 291 subsequent; and Stockmayer, “Zur unzulässigen Rechtsausübung bei Zahlung auf eine mißbräuchlich angeforderte Bankgarantie,” (1980) AG 326 at 331; also Riesenfeld, “Recent developments in the law relating to letters of credit,” in: Festschrift für Ernst v. Caemmerer, 1978, at 997, 1005, footnote 28; Westphalen, *supra*, n. 33 at 175.

(iv) *U.S. - jurisdiction*

American courts are already bound by paragraph 5-114(2), UCC, to consider the beneficiary's subjective intention to harm as a requirement for fraud:

Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document . . . is forged or fraudulent or there is fraud in the transaction: (a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course . . . (b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.⁷²

Hence, courts can only prohibit the guarantee/L/C bank to pay in cases of fraud.⁷³

American courts always apply Art. 5, UCC, on standby letters of credit regardless of whether the standby has the character of a guarantee or of an L/C. This jurisdiction originated from *Sztejn v. J. Henry Schroder Banking Corp.*:

Where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment ... the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller.⁷⁴

This author believes that it is problematic if the courts require not only an objectively provable fraud but also a subjective intent to harm. The decision of the *House of Lords United City Merchants (Investments) Ltd. v. Royal Bank of Canada* may serve as an example: a loading broker falsified bills of lading by backdating them. The evidence showed that

⁷² Compare U.C.C. (1990 Official Text) §5-114(2).

⁷³ Stapel, *supra*, n. 11 at 95 referencing *Pringle-Associated Mortgage Corporation v. Southern National Bank of Hattiesburg*, 571 F.2d 871 at 871, 874 (1978); *Werner Lehara International, Inc. v. Harris Trust & Savings Bank*, 484 F.Supp. 65 at 66 & 73 (1980); *Harris Corp. v. National Iranian Radio & Television*, 691 F.2d 1344 at 1345 & 1354 (1982); *Andy Marine, Inc. v. Zidell, Inc.*, 812 F.2d 534 at 535 & 536 (1987); Hillmann, "An Introductory Lecture on Letters of Credit," in: *Letters of Credit: Current Thinking in America*, 1987, at 13; Schmitthoff, *supra*, n. 11 at 404, 441-445

⁷⁴ 177 Misc. 719, (1941), 31 NYS(2d) 631: "Transea filled the fifty crates with cow hair, other worthless material and rubbish with intent to simulate genuine merchandise and defraud."

when the beneficiary presented the bills, he did not know they were false. The law lords ruled that such fraud on the part of the broker could not prevent the beneficiary from obtaining payment under the credit.⁷⁵ Similarly, in *Offshore Trading Co. v. Citizens National Bank*, the court affirmed an obligation of the bank to pay the beneficiary who presented a fraudulent certificate, since it had not been proven that the beneficiary knew of the falsification.⁷⁶

3. CLASSIFICATION OF GUARANTEES

(a) Types and security purpose

(i) Standard forms

(A) Tender/participation guarantee

Governmental and semi-governmental organizations in particular demand the issuance of tender guarantees in requests for proposals. These are issued to ensure that the tenderor who is awarded the bid really concludes a contract with the offeree consistent with the tenderor's offer. The guarantee amount is between 1 per cent and 5 per cent of the contract value, but can reach up to 10 per cent. The guarantee amount is liquidated damages for examination of the proposals and the impossibility to sign up a co-bidder for the project.⁷⁷

(B) Advance payment guarantee

Down payments are agreed upon when an exporter manufactures high-tech and specialized equipment which cannot be sold otherwise if the buyer does not comply with his duty to take possession of the goods.

⁷⁵ Dolan, *supra*, n. 12 at 7.04 (4a): "In *United City Merchants (Investments) Ltd. v. Royal Bank of Canada* (1982), [1983] 1 A.C. 168, [1982] 2 W.L.R. 1039, [1982] 2 All E.R. 720 (U.K. H.L.), a lading broker falsified bills of lading by backdating them. The evidence showed that when the beneficiary presented the bills, it did not know they were false. The law lords ruled that such fraud on the part of the broker could not prevent the beneficiary from obtaining payment under the credit."

⁷⁶ 650 F.Supp. 1487 (D. Kann. 1987): "The court held that it was insufficient for the issuer to show that the certificate was untrue; it also was necessary for the issuer to show that the beneficiary knew that it was untrue."

⁷⁷ Dohm, *supra*, n. 34, marginal note 18; Zahn, *supra*, n. 10 at marginal note 9/43 subsequent.

The down payment is intended to prevent the illicit rescission of the contract by the buyer and at the same time facilitate the financing of the project for the seller.⁷⁸ In these instances, it is customary to have the seller issue a tender guarantee (advance payment guarantee/bank refund guarantee/garantie d'acompte/garantia de pago anticipado) which secures the claim of the buyer for repayment of the down payment in the event that the seller violates his delivery duties. The amount is a matter of negotiation and no international customary rates have been established. The down payment can amount to 30 per cent of the contract value.⁷⁹ The guarantee covers non-delivery or non-performance, but does not cover the delivery of defective equipment. If a seller has to issue a warranty guarantee the seller should pay attention to the fact that the warranty guarantee only becomes effective after return of the advance payment guarantee.

(C) Guarantee for proper performance under the contract

(I) *Performance guarantee*

“Performance guarantee” is a collective term used to designate all guarantees that secure the risk of non-performance of contractual duties. If the purpose of the guarantee is not limited in the preamble, the beneficiary can avail himself of the guarantee not only in cases of non-performance but also for consequential damages due to delays, penalties, etc.⁸⁰ In practice, such a broad purpose is not always wanted. Rather the parties stipulate in the preamble whether only specific claims or all contractual claims shall be secured by the guarantee. Which kind of guarantee is intended can normally not be deduced from the denotation of the guarantee but only from its content (preamble, payment clause, and reduction clause). The text of the guarantee determines whether the bank issued an all-purpose guarantee or only a specific purpose guarantee for example a delivery, or warranty guarantee.

⁷⁸ Zahn, *ibid.*, marginal note 9/46; Scheuermann, AWD 1959, 194, 195; Brüggemann, Die Banktechnik des Auslandsgeschäfts, at 166.

⁷⁹ Zahn, *supra*, n. 10 at marginal note 9/47.

⁸⁰ BGH WM 1988, 212; WuB IK3-4.98 (Nielsen).

(II) *Delivery guarantee*

The delivery guarantee (delivery guarantee/garantie de livraison/garantia desuministro) is a guarantee with a limited security purpose. In contracts involving the sale of goods it covers the simple fact of non-delivery: in all other contracts (performance guarantee/garantie d'exécution), it covers the non-performance of a contractual obligation, for example, installation or construction of sites or equipment. The guarantee amount normally amounts to 5 per cent to 10 per cent of the contract value. According to its security purpose, the guarantee is extinguished with performance of the obligation. Not covered are additional claims for warranty, etc.⁸¹

(III) *Guarantee for warranty obligations*

Similar to the delivery guarantee, the guarantee for warranty obligations has a limited security purpose, since it only covers the buyer against the risk of breach of contract when the seller performs (or fails to perform) warranty services after delivery or installation. The guarantee normally amounts to 5 per cent to 10 per cent of the contract value, and a demand only becomes relevant after delivery or installation.⁸²

(IV) *Performance bond*

It is possible to issue a guarantee covering any breach of contract. Often delivery/performance/warranty/and down payment guarantees are merged in an all-encompassing performance bond (Erfüllungsgarantie/garantie de bonne exécution du contrat). The amount fluctuates between 5 per cent and 20 per cent of the contract value; in the majority of cases the parties generally agree on 10 per cent.⁸³

(ii) *Standby according to UCP 500*

According to Art. 2, UCP 500, the expressions

Documentary Credits(s) and Standby Letter(s) of Credit mean any arrangement, however named or described, whereby a bank (the "Issuing Bank") acting at the request and on the instructions of a customer (the "Applicant") or on its own behalf,

⁸¹ Zahn, *supra*, n. 10 at marginal note 9/51.

⁸² Nielsen, *Die Bankgarantien bei Außenhandelsgeschäften*, at 19.

⁸³ Dohm, *supra*, n. 34 at 37; Westphalen, *supra*, n. 33 at 39; Zahn, *supra*, n. 10 at marginal note 9/55.

- i. is to make payment to or to the order of a third party (the “Beneficiary”), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary; or,
- ii. authorizes another bank to effect such payment, or to accept and pay such bills of exchange (Draft(s)); or,
- iii. authorizes another bank to negotiate,

against stipulated documents(s), provided that the terms and conditions of the Credit are complied with. For the purposes of these Articles, branches of a bank in different countries are considered another bank.

The revised version of Art. 2, UCP 500, deliberately does not require the presentation of documents representing goods, but rather, in very general terms, the presentation of “stipulated documents.” Hence, a letter of credit can be used not only in sales and/or services contracts, but also to protect the beneficiary against non-performance of specific obligations. The UCP 500, however, abstain from defining certain types of L/Cs, leaving the proper wording of standbys to the parties.

(iii) Types of standby according to the ISP 98

(A) Mostly default undertaking, exceptionally financial, and direct pay standbys

The American Standby Practice, and hence the ISP 98, are particular insofar as they — following a tendency in American jurisdiction to differentiate legal instruments solely on the basis of formal criteria — distinguish in comparatively great detail between standbys based on the respective security purpose. The Preface to Publication 590 lists the most common types of standbys as follows:

- A “Performance Standby” supports an obligation to perform other than to pay money including for the purpose of covering losses arising from a default of the applicant in completion of the underlying transactions.
- An “Advance Payment Standby” supports an obligation to account for an advance payment made by the beneficiary to the applicant.
- A “Bid Bond/Tender Bond Standby” supports an obligation of the applicant to execute a contract if the applicant is awarded a bid.

- A “Counter Standby” supports the issuance of a separate standby or other undertaking by the beneficiary of the counter standby.
- A “Financial Standby” supports an obligation to pay money, including any instrument evidencing an obligation to repay borrowed money.
- A “Direct Pay Standby” supports payment when due of an underlying payment obligation typically in connection with a financial standby without regard to a default.
- An “Insurance Standby” supports an insurance or reinsurance obligation of the applicant.
- A “Commercial Standby” supports the obligations of an applicant to pay for goods or services in the event of non-payment by other methods.

The preceding types of standbys basically have the character of a guarantee. A “commercial standby” in this regard is closest to an L/C, even though its call — contrary to that of an L/C — is conditioned upon non-payment. Nevertheless, it is inaccurate to generally describe standbys as “default undertakings. This definition in particular does not apply for “direct pay standbys.” Moreover, standbys have often been casually defined as ‘default undertakings’ because they are commonly used in the event of default. While this explanation is partially correct as a functional description, it is incomplete and incorrect as a definition because it fails to encompass direct pay standbys.⁸⁴ This kind of obligation provides for the payment of principal and interest at maturity, and the default of the debtor need not be established.

(B) Irrelevancy of description

In concurrence with the rules for international bank guarantees a document need not be described in a particular way to be qualified as a standby. Hence, Rule 1.01(b), ISP 98, stipulates that it is irrelevant how the standby is named or described. In practice the descriptions for documentary payment obligations — be it an L/C or a standby — overlap to a great extent. Hence the official commentary avoids the term “documentary letter of credit”:

⁸⁴ Byrne, *supra*, n. 7 at Rule 1.01, marginal note 6.

Documentary Letter of Credit: In this Official Commentary and the preface to ISP 98, the phrase “Documentary Letter of Credit” is avoided. Because it applies equally to standbys which are both “documentary” and “letters of credit” and to which the Uniform Customs and Practice for Documentary Credits also applies, it is ambiguous. For clarity and precision the term “commercial letter of credit” is used in the Official Commentary drawing upon the original title of the UCP 500, the “Uniform Customs and Practice for Commercial Documentary Credits” in effect since 1933 and which was only shortened in the 1962 revision. Where both a commercial credit and as standby are intended, the term “letter of credit” or “LC” is used.⁸⁵

The extent to which the definitions suggested by the official commentary contribute to the clarification of terms shall not be decided at this point. In view of the inconsistent use of the terms in practice, it is important to clearly stipulate in contracts whether the parties want to have the UCP 500 or the ISP 98 applied.

(b) Conclusion of the guarantee contract

(i) Standard forms

A guarantee even though it establishes only a one-sided obligation of the guarantor, is still subject to the rules of offer and acceptance.⁸⁶ No statute provides that the guarantee contract be concluded in writing, and paragraph 650 HGB stipulates that merchants, within the ambit of their business, can conclude contracts without being subject to special form. However, in practice, a compulsion to use writing exists, and this obligation is based on commercial use.⁸⁷ In addition to writings nowadays, the transmission of guarantee texts via telex, telefax, or other modern means of telecommunication is accepted. According to German law and most other European legal systems, the guarantee becomes effective with receipt by the beneficiary and not, as in the U.S., with placement into the mailbox.

The offer to conclude a guarantee contract is normally accepted by implication, that is, the beneficiary need not expressly state his accep-

⁸⁵ Byrne, *ibid.*, at marginal note 9.

⁸⁶ Kleiner, *Bankgarantie*, 4th ed. (1990) at marginal note 16.01, reporting that due to the unilateral obligation of the guarantor practitioners use the term “Garantieerklärung” [statement of guarantee] and not “Garantievertrag” [guarantee contract]; c.f. furthermore Hadding, Häuser & Welter, *Bürgschaft und Garantie* (1983) at 687; Westphalen, *supra*, n. 33 at 109.

⁸⁷ Nielsen, *supra*, n. 31 at §121, marginal note 94.

tance. This principle is also valid in legal systems outside Germany.⁸⁸ Insofar as the guarantee text contains a clause which postpones the effectiveness of the guarantee — e.g., in a delivery guarantee until presentation of an import license — this clause has to be considered a condition precedent, which does not impinge on the bank's obligation to pay or on the issuer's obligation to provide sufficient funds to the issuing bank.⁸⁹

(ii) *UCP 500 (implied acceptance according to International Private Law)*

The uniform customs and uses for documentary credits do not contain regulations in regard to conclusion of the L/C or standby contract. Hence, the same principles apply as in the issuance of guarantees, which are not subject to any regulation. The implied acceptance of a bank's promise to pay can be assumed if the beneficiary does not object within three days.⁹⁰ An objection is particularly necessary when the text of the guarantee does not match the text of the underlying transaction; otherwise the risk exists that the acceptance of the guarantee text also constitutes an amendment of the modification of the underlying transaction.⁹¹

(iii) *ISP 98 (Mailbox)*

According to Rule 2.03, ISP 98, "a standby is issued when it leaves an issuer's control unless it clearly specifies that it is not 'issued' or 'enforceable'." Statements like, "the standby is not 'available', 'operative', 'effective,' or the like do not affect its irrevocable and binding nature at the time it leaves the issuer's control." The terms listed in Rule 2.03, ISP 98, are considered immaterial, non-documentary payment conditions if they cannot be referred to a document as a prerequisite for demand. This does not apply to expressions limiting the call of the standby, which are based on dates or documents available to the bank.

Often these terms are based on dates (e.g., 'drawing not available until 31 December 19XX') or facts determinable from the issuer's own records (e.g., 'drawing

⁸⁸ Dohm, *supra*, n. 34 at marginal note 165; Käser, "Garantieversprechen als Sicherheit im Handelsverkehr," *RabelsZ* 354 at 601; Kleiner, *supra*, n. 86 at marginal note 16.01 with further references; v. Westphalen, *supra*, n. 33 at 110.

⁸⁹ Dohm, *supra*, n. 34 at marginal note 168; ebenso v. Westphalen, *supra*, n. 33 at 111.

⁹⁰ Schütze, *supra*, n. 37 at marginal note 107.

⁹¹ Nielsen, *supra*, n. 31 at marginal note 108.

not available until advance payment of US\$ XXX is made to applicant's account no. XXX with us').⁹²

The second quoted alternative corresponds with standard practice to condition the call of the guarantee, upon the receipt of funds on a precisely designated account of the guarantee bank.

Rule 2.03, ISP 98, provides for the case that a standby is not "issued" or "enforceable" at all. This should not have any meaning in practice, even though it corresponds to a preadvise according to Art. 11(c), UCP 500. A specific preadvise Rule is missing in the ISP 98.

(iv) Regarding (i), (ii), and (iii): Conclusion and modifications of the guarantee contract

In regard to the conclusion of a contract, the ISP 98 differs from the international practice for guarantees and the UCP 500 insofar as a standby already binds the issuer when it leaves his control. The same applies to a subsequent modification of payment terms. Rule 2.06(b), ISP 98, even provides for an automatic amendment, which is effective without any further notification or consent.

If there is no provision for automatic amendments, an amendment binds:

- (i) the issuer when it leaves the issuer's control

compare Rule 2.06(c):

If there is no provision for automatic amendment:

- (i) the beneficiary must consent to the amendment for it to be binding.

As is stipulated in Art. 9(d)(iii), UCP 500, for L/Cs, silence of the beneficiary after receipt of notification does not constitute approval. If the beneficiary does not expressly agree in advance to a modification, all parties involved are subject to an abeyance. Until the beneficiary demands payment, he need not decide whether he wants to comply with the standby in its original version or in its modified version (Rule 2.06(c)(ii), ISP 98).

⁹² Byrne, *supra*, n. 7 at Rule 2.03, marginal note 2.

(c) Transaction and appointment of third parties*(i) Guarantee*

A guarantee issued by a bank outside the U.S. normally provides for sight payment and sometimes for deferred payment with clearly defined installments — the reason being that the beneficiary wants immediate payment in case of occurrence of the guaranteed event. The use of another bank only serves the purpose of advice, since the issuing bank is usually unwilling to let someone else decide whether the demand of the beneficiary was compliant.⁹³

This has to be distinguished from the issuance of an indirect guarantee which the beneficiary demands, based on the national law of the importing country, in more than 50 per cent of all international contracts. In these instances, the role of the domestic bank is solely to authorize a bank domiciled in the country of the beneficiary to issue a direct guarantee, which is subject to the law of the domicile of the secondary bank. This leads to a complete shift of risk and laws to a foreign country with the following consequences:

- The guarantee will be subject to the law of the foreign bank and the jurisdiction of the country of its domicile excluding the jurisdiction of the first bank.
- Independence of the obligation of the secondary bank from any currency/boycott or other trade restricting laws in the country of the first bank.

Owing to this shift of risk and law, Canaris labels this type of transaction a “suicide guarantee.”⁹⁴ Canaris does not, however, take into consideration that the issuance of this type of guarantee is based on regulations of the importing countries or can be enforced as a result of the market position of the foreign buyers.

⁹³ See Avancini, Iro & Koziol, *Österreichisches Bankvertragsrecht*, Bnd II, marginal note 3/131, 133.

⁹⁴ Canaris, *supra*, n. 38 at marginal note 1115; c.f. regarding the reasons for the proliferation of indirect guarantees Bark, “Rechtsfragen und Praxis der indirekten Garantien im Außenwirtschaftsverkehr,” (1982) ZIP at 405ff.

(ii) *UCP 500*

According to Art. 9(a)(i) to (iv), and (b)(i) to (iv), UCP 500, an L/C can provide not only for sight payment, but also for deferred payment, acceptance or negotiation. It is customary to sue a secondary bank not only for purposes of advice but also as a nominated bank. The use of secondary banks for the processing of an L/C can be explained by the fact that the primary bank is more willing to transfer the payment obligation to third parties since the availment requires presentation of exactly prescribed documents. The detailed description of the documents, which minimizes the risk of fraudulent availment, is the distinguishing criterion between a letter of credit and a guarantee. The key provision here is Art. 10(b)(i), UCP 500, which states that unless the credit stipulates that it is available only with the issuing bank, all credits must nominate the bank which is authorized to pay, to incur a deferred payment undertaking, to accept draft(s) or to negotiate. In a freely negotiable credit, any bank is a nominated bank.

(iii) *ISP 98*

According to Rule 2.01(b), ISP 98, a standby is payable at sight unless provided for otherwise. The standby can however — like an L/C — be used by acceptance, deferred payment or negotiation (Rule 2.01(b)(i) to (iii), ISP 98). The admissibility of additional payment methods, particularly deferred payment and acceptance with the result of deferred payment shows, once again, that a standby normally but not necessarily has the character of a guarantee, since the beneficiary will demand immediate payment and not agree to deferred payment. The official commentary explains the admissibility of other payment methods as follows: “Given the fact that the standby is the issuer’s undertaking and not that of a defaulting applicant, and that a standby is not necessarily a default instrument, there is no reason why it cannot be payable after a period of time.”⁹⁵

Consistent with the UCP 500, Rule 2.04, ISP 98, provides for the use of nominated persons as follows: “A Standby may nominate a person to advise, receive a presentation, effect a transfer, confirm, pay, negotiate, incur a deferred payment obligation, or accept a draft.” The mere

⁹⁵ Byrne, *supra*, n. 7 at Rule 2.01, marginal note 5.

nomination does not establish an obligation of the nominated person towards the beneficiary. This is in concurrence with Art. 10(c), UCP 500.

Should the nominated bank decide to advise the standby, it must, similarly to the advising bank according to Art. 7, UCP 500, check the apparent authority (Rule 2.05(a)(i), ISP 98). Furthermore, the advice has to accurately reflect what has been received (Rule 2.05(a)(ii), ISP 98). The responsibility of the advising bank is limited if it only forwards a printout of the received text. However, Byrne points out that “where the advice is re-typed, the advisor assumes responsibility for errors introduced by the re-keying or re-typing.”⁹⁶

The confirmation of a standby establishes an independent payment obligation for the confirming bank, which is — as with the confirmation under an L/C according to Art. 9(c), UCP 500 — independent of the obligation of the issuer. Standbys typically permit presentation to the confirmer, and the presentation typically is made first to the confirmer.⁹⁷

Under these Rules, a presenter is permitted to present to either the issuer or the confirmer unless the obligation of the issuer or the confirmer is conditioned on its receipt of documents. Therefore, where the confirmation does not expressly condition the confirmer’s obligation on prior presentation only to the confirmer, the confirmer is obligated when the issuer wrongfully dishonors presentation even if the confirmer has not first received the documents.⁹⁸

In the case that a standby is confirmed, the confirming bank has to take care that the standby is payable at the confirming bank to avoid bypassing.

(d) Transferability

(i) Guarantee

With all documentary and non-documentary payment promises, the distinction has to be made between assignment of proceeds and assignment of the instrument itself. The distinction is relevant when

⁹⁶ Byrne, *ibid.*, at Rule 2.05, marginal note 3.

⁹⁷ Byrne, *ibid.*, at Rule 2, marginal note 9(a).

⁹⁸ Byrne, *ibid.*, at Rule 2, marginal note 9(b).

bank guarantees are used as collateral or will be transferred in the context of forfeitures. The BGH has not decided whether a guarantee payable on first demand is assignable.⁹⁹ The tendency in the literature and in the ICC guidelines is to negate such a right to assignment if it is not expressly agreed upon in the instrument. This opinion is correctly based on the consideration that by a complete change of creditors the risk of fraudulent demands will be unduly increased. The applicant relies, if at all, on his contractual partner, the original beneficiary, not to fraudulently draw down on the guarantee.¹⁰⁰

(ii) *UCP 500*

Art. 48(b), UCP 500, stipulates that a credit can be transferred only if it is expressly designated as “transferable” by the issuing bank; the applicant is generally not willing to have the L/C be used by a complete stranger. According to Art. 48(c), a bank shall be under no obligation to effect such a transfer except to the extent and in the manner expressly consented to by such bank. The author believes however, that a bank issuing a transferable L/C can refuse consent only due to important reasons (“wichtiger Grund”),¹⁰¹ for example, due to lack of seriousness of the assignee.

(iii) *ISP 98*

Rule 6.02, ISP 98, allows for assignment as follows: “A standby is transferable unless it so states.” Contrary to the UCP 500, the ISP 98 regulates the requirements for an assignment in great detail:

An issuer of a transferable standby or a nominated person need not effect a transfer unless:

⁹⁹ BGH, WM 1999, 72, 73 referencing BGH, WM 1990, 287, 291 both judgments confirming that the transferability can be provided for in the guarantee contract.

¹⁰⁰ LG Frankfurt, WM 1978, 422; ebenso Canaris, *supra*, n. 38 at marginal note 1130; Dohm, *supra*, n. 34 at marginal note 184 subsequent; Schütze, *Bankgarantien unter Berücksichtigung der Einheitlichen Richtlinien für “auf erstes Anfordern” zahlbare Garantien der Internationalen Handelskammer*, Internationale Wirtschaftspraxis, (1994), at 60; Zahn, *supra*, n. 10 at marginal note 9/126; dissenting Hadding, *supra*, n. 86 at 715, who consider a transfer of the guarantee admissible, since the risk of the guarantor would not be increased substantially; similarly Zeller, “Probleme der Abtretung einer Garantie “auf erstes Anfordern,”” (1990) BB at 363 ff.

¹⁰¹ Nielsen, *supra*, n. 31 at marginal note 353; also Eisemann & Schütze, *supra*, n. 50 at marginal note 343 m.w.N.

- a. it is satisfied as to the existence and authenticity of the original standby; and,
- b. the beneficiary submits or fulfils:
 - i. a request in a form acceptable to the issuer or nominated person including the effective date of the transfer and the name and address of the transferee;
 - ii. the original standby;
 - iii. verification of the signature of the person signing for the beneficiary;
 - iv. verification of the authority of the person signing for the beneficiary;
 - v. payment of the transfer fee; and,
 - vi. any other reasonable requirements.

As the text quoted from Rule 6.03, ISP 98, shows, the issuing bank or a nominated person has to effect the transfer after the beneficiary fulfils certain requirements one of which is the presentation of the original of the standby. Unclear and uncommented upon is Art. 6.03(b)(vi), ISP 98, according to which the issuer can demand “any other reasonable requirements.” It is imaginable that in cases of substantiated doubt this includes proof of the seriousness of the assignee so that as a result (and also according to the ISP 98) the transfer could be refused on the round of “serious reasons” (“wichtiger Grund”).

(e) Assignment of proceeds

(i) Guarantee

Proceeds due under a bank guarantee are always assignable unless international private law designating the national law of the guarantee bank requires the satisfaction of certain formalities (notification).

(ii) UCP 500

According to Art. 49, UCP 500, the assignment of the beneficiary’s conditional claim to pay is admissible, even if the L/C itself is not transferable. The substantive law designated by international private law, normally the domicile of the guarantee bank, determines form and procedure of the assignment.¹⁰² Generally, a silent assignment is valid;

¹⁰² Nielsen, *supra*, n. 31 at marginal note 369.

however, to avoid payment to the assignor, the assignee should notify the bank. Inasmuch as national law does not provide otherwise, the acknowledgement of an assignment lies at the discretion of the issuer of the standby or its nominated person.

(iii) *ISP 98 (“Acknowledgment of Assignment of Proceeds” (Rule 6.06))*

As the heading of Rule 6.06, ISP, shows, the ISP requires the acknowledgement of the bank for assignment to be valid. Without such an acknowledgement the bank is not obligated to heed such an assignment. The requirement of an acknowledgement serves to clarify the legal situation, since it is disputed whether a secondary bank being solely used as a payment place is subject to the laws of the issuing bank,¹⁰³ or the law of its domicile.¹⁰⁴ This relation is clarified by subRule 6.04 b. ISP 98 as follows:

- a. Unless applicable law otherwise requires, an issuer or nominated person:
 - (i) is not obligated to give effect to an assignment of proceeds which it has not acknowledged; and
 - (ii) is not obligated to acknowledge the assignment.
- b. If an assignment is acknowledged:
 - (i) the acknowledgment confers no rights with respect to the standby to the assignee who is only entitled to the proceeds assigned, if any, and whose rights may be affected by amendment or cancellation; and,
 - (ii) the rights of the assignee are subject to:
 - (a) the existence of any net proceeds payable to the beneficiary by the person making the acknowledgment;
 - (b) rights of nominated persons and transferee beneficiaries;
 - (c) rights of other acknowledged assignees; and,
 - (d) any other rights or interests that may have priority under applicable law.”

¹⁰³ *Ibid.*, marginal note 389 m.w.N.; c.f. also Schütze, “Rechtsfragen der Avisierung von Dokumentenakkreditiven,” (1987) DB at 2189 ff.

¹⁰⁴ C.f. regarding the status of the differing opinions Schütze, “Revisionsrechtliche Probleme des Dokumentenakkreditivs,” (1982) WM at 226.

4. DOCUMENTARY DEMAND OF GUARANTEE AND STANDBY

(a) Timely and due demand for payment

(i) *Timely receipt and risk of delay*

(A) Bank guarantee

The standard texts for guarantees contain an expiry clause, which stipulates that the receipt of documents is necessary for a timely presentation under the guarantee. Also, for suretyships payable on first demand, the BGH accepted that contrary to paragraph 777, paragraph 1, sentence 2, BGB, the beneficiary must present his request for payment before the expiry date, and considered it not sufficient that the bank was informed only after expiry that the guaranteed event had occurred.¹⁰⁵ The risk of timely demand lies exclusively with the beneficiary. Even delays due to force majeure (strike, riots, etc.) do not give rise to a claim for an extension. Hence the superior courts in *Stuttgart* and *Karlsruhe*, applying the rules for L/Cs as an analogy, refused to grant an extension because of riots in Lebanon.¹⁰⁶

(B) UCP 500

According to Art. 42(b), UCP 500 documents must be presented on or before the expiry date. The beneficiary bears the responsibility of timely presentation. He cannot claim accident, force majeure, strike including postal strike, or other circumstances mentioned in Art. 17, UCP 500.¹⁰⁷ American courts have confirmed the expiration of an L/C during interruption of business due to force majeure or strikes.¹⁰⁸

(C) ISP 98

According to Rule 3.05, a presentation is timely if made at any time after issuance and before expiry on the expiration date. An express

¹⁰⁵ BGHZ 99, 288 (290) WM 1987, 227 WuB IK3-5.87 (Nielsen); ferner BGH, WM 1989, 96 WuB IK3-1.90 (Horn).

¹⁰⁶ LG Stuttgart, WM 1979, 733, 735; LG Stuttgart, WM 1978, 1056, 1057ff.

¹⁰⁷ Canaris, *supra*, n. 38 at marginal note 992.

¹⁰⁸ See Art. 17 Satz 2 UCP500; Benjamin, *supra*, n. 17 at marginal note 23-092; *Consolidated Aluminum Corporation v. Bank of Virginia*, 544 F.Supp. 386 at 387 & 401 (1982).

provision that the beneficiary bears the risk of delay for documents in transit was not included since the drafters probably considered this as self-evident. Deviating in this sense from Art. 17, UCP 500, Rule 3.14(a), provides that if, on the last business day for presentation, the place for presentation stated in a standby is for any reason closed and presentation is not made in a timely manner because of the closure, then the last day for presentation is automatically extended to the day occurring 30-days after the place for presentation reopens for business, unless the standby provides otherwise.

(ii) *Banking hours/ holidays*

(A) Guarantee

No Rule states whether the demand has to be made during banking hours. Even though some support this idea,¹⁰⁹ it seems unlikely that the courts would follow this opinion owing to the continuous changes of banking hours, during which, in any event, bank employees may not be present. It can be assumed however, that the expiration date is automatically extended if it falls on a holiday (compare paragraph 196, BGB).

(B) UCP 500

According to Art. 42(b), all documents must be presented on or before the expiry date. The provision of Art. 45 that banks are under no obligation to accept presentation of documents outside their banking hours is relevant only for courier services, but not for mailings which are deposited on the expiry date in containers or other devices intended for receipt of mail. According to Art. 44(a), UCP 500, if the expiry date falls on a day on which the bank to which presentation has to be made is closed because it is a Sunday, a holiday, a free Saturday, etc., the expiry date shall be extended to the first day following, on which that bank is open.

(C) ISP 98

According to Rule 3.13, ISP 98, if the last day for presentation stated in a standby is not a business day of the issuer, then presentation made there on the first business day following shall be deemed timely.

¹⁰⁹ Westphalen, *supra*, n. 33 at 142.

The additional Rule of 3.05(b), wherein a presentation made after the close of business is deemed to have been made on the next business day, might be considered surprising and hence void under German law.¹¹⁰ ISP 98 Rule 3.11(a)(iv) (Issuer Waiver and Applicant Consent to Waiver of Presentation Rules) provides, however, that the issuer in its discretion may permit presentation after the close of business without affecting its right to reimbursement.¹¹¹ The difference between a business and a banking day is as follows:

... [Business Day] means a day on which the place of business at which the relevant act is to be performed is regularly open; and "Banking Day" means a day on which the relevant bank is regularly open at the place at which the relevant act is to be performed.

(iii) *Complying medium of presentation*

(A) International bank guarantee (acknowledgement of modern means of communication)

Guarantees contain their own provisions regarding the medium in which a demand has to be presented; normally guarantees require a writing. Therefore, a demand for payment over the phone or orally does not suffice. However the use of modern means of communications is recognized (telegraph, fax, etc.) and a demand made by these means will be considered a timely demand.¹¹² The picture changes, however, if and when the presentation of additional documents is required under the L/C.¹¹³

(B) UCP 500

For an L/C, electronic presentation is not relevant since shipping documents etc., normally have to be presented as originals (Art. 20(b), UCP 500, which only deals with the creation of originals by means of modern machinery). Furthermore, electronic signatures are recognized if national laws do not provide otherwise.¹¹⁴ "L/C's should acknowledge that any symbol executed or adopted by a party with the present intention

¹¹⁰ Holzwarth, *supra*, n. 2 at 12ff., 14.

¹¹¹ See Rule 1.09(a), ISP 98.

¹¹² Nielsen, *supra*, n. 31 at 121, marginal note 146 m.w.N.

¹¹³ Westphalen, *supra*, n. 33 at 162.

¹¹⁴ See Nielsen, *supra*, n. 31 at marginal note 188 referencing the recommendations of the ICC in ICC Pub. no. 511 at 59.

to authenticate a writing should be accepted as a valid signature.”¹¹⁵ Since according to Art. 1 the UCP 500 are only relevant if applicable, the need to present original documents only arises in case of documents representing goods or shipping documents. All other documents without legal significance, according to the author, need not be presented in original versions.

(C) ISP 98

Rule 3.06(b)(i), ISP 98 stipulates:

Where no medium is indicated, to comply a document must be presented as a paper document, unless only a demand is required, in which case:

- i. demand that is presented via S.W.I.F.T., tested telex, or other similar authenticated means by a beneficiary that is a S.W.I.F.T. participant or a bank complies.[emphasis added]

This Rule takes into account that according to U.S. practice the simple demand for payment is considered a document, even though such a statement does not have documentary character. In all other cases however, the documents required under the standby have to be presented in paper form. Sub-Rule 3.06(c), ISP 98, clarifies that a document is not presented as a paper document if it is communicated by electronic means. The official commentary supports this notion:” Sub-Rule 3.06(c) indicates that it does not include communications capable of being generated in a paper form after receipt (e.g., telex, fax, or e-mail).”¹¹⁶ However, the ISP 98 wants to encourage the use of electronic communication, which has to be provided for in the standby: is this indicated in the standby to comply, a document must be presented as an electronic record capable of being authenticated by the issuer or nominated person to whom it is presented (Rule 3.06(d)). According to Rule 3.06(b)(ii), a demand that is not presented as the issuer in its sole discretion can accept a paper document. This creates an uncertainty for the beneficiary, who cannot rely on the issuer to exercise its discretion.

¹¹⁵ ICC Pub. no. 511 at 59.

¹¹⁶ Byrne, *supra*, n. 5 at Rule 3.06, marginal note 2.

(iv) *Examination of signature and signature authority*

(A) International bank guarantee

Included in the duty to examine the formal and timely demand of the guarantee is the ascertainment that the documents stem from the issuer. Contrary to Westphalen's, opinion the issuing bank does not need to ascertain whether representatives acting on behalf of the principal are validly authorized.¹¹⁷ To ascertain beyond any doubt who can legally bind the principal requires a legal examination effort for which there is no time in the fast-paced environment of guarantee transactions.¹¹⁸ It is sufficient that the demand appears on its face to come from the beneficiary; this means it must be discernible from the requirements of the guarantee that the beneficiary is availing himself of the guarantee. A demand for payment lacking the signature line, therefore, is void according to the correct opinion of the BGH.¹¹⁹ In practice, the degree of examination is of little relevance since according to German law the issuing bank is obligated to notify the applicant. At time of notification the applicant will recognize immediately whether the beneficiary effected the demand.

(B) UCP

According to Art. 13(a), UCP 500, the bank need only examine whether the presented documents "appeared on their face" to comply with the L/C requirements. According to Art. 15, UCP 500 ("Disclaimer on Effectiveness of Documents"), banks assume no liability for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s). The authenticity of documents cannot be ascertained, since in order to do this a bank would have to consult foreign registers which would lead to expense in time, money, and labour which is not intended by any party involved in the transaction. The L/C amount will not be funnelled to the wrong channels since — even in case of fraudulent presentation — a bank will transfer the money to the beneficiary as evidenced in its files.

¹¹⁷ See Westphalen, *supra*, n. 33 at 162.

¹¹⁸ Nielsen, *supra*, n. 31 at §121, marginal note 147.

¹¹⁹ BGH, EWiR, §765 BGB, 99; 74H-3.11 (Nielsen).

(C) ISP 98

Rule 4.13(a), ISP 98, delusively entitled “No Responsibility to Identify Beneficiary,” stipulates that “a person honoring a presentation has no obligation to the applicant to ascertain the identity of any person making a presentation or any assignee of proceeds.” Regarded on its own this clause probably is void according to German law, since according to the BGH it is the bank’s duty to ascertain that the real beneficiary avails himself of the guarantee.¹²⁰

The author questions whether this stipulation contradicts Rule 4.13(b), ISP 98: “Payment to a named beneficiary, transferee, an acknowledged assignee, successor by operation of law, to an account or account number stated in the standby ... fulfils the obligation under the standby to effect payment.”

(v) *Language of proper demand*

(A) International bank guarantee

The standard texts for bank guarantees normally do not contain any provisions stipulating the language to be used in the documents. For first demand guarantees it is sufficient to use a recognized world trading language. Identity with the language of the guarantee is not required. This Rule does not apply, according to the author, when dealing with a guarantee with a payment clause requiring the presentation of formalized documents evidencing the occurrence of the guaranteed event: for example, “that the principal is in breach of his obligation(s) under the underlying contract(s)” or “that the principal is in default.” The beneficiary does not have to copy the wording; it is sufficient to convey the meaning of the guarantee provision.¹²¹ However, it is advisable to use the language of the guarantee to avoid mistakes during translation of additional documents.

¹²⁰ BGH, ZIP 1998, 136 EWiR, 765 BGB, 1999, at 29 (Nielsen); dissenting Byrne, *supra*, n. 5 at Rule 4.13, Rn. 2: “If payment is made to a person other than the true beneficiary, the applicant must reimburse twice should the true beneficiary make a complying drawing.”

¹²¹ Dohm, *supra*, n. 34 marginal note 198; Nielsen, *supra*, n. 31 at §121, Marginal note 156; Westphalen, *supra*, n. 33 at 151

(B) UCP 500 (no provision, no obligation to translate foreign language terms)

The UCP 500 does not stipulate that the documents presented under an L/C have to use the same national language as the text in the L/C. Art. 37(c), UCP 500 is an exception to this Rule, stipulating that “the description of the goods in the commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit.” It is no duty of the bank to compare foreign language designations with their German equivalents.¹²² Only in case of absolute clarity can foreign language terms be acceptable. This should be the case if, for example, in an L/C issued in English for a quantity of steel, the French commercial invoice translates this term correctly as “acier.”¹²³ The presentation of an invoice in an L/C should remain the exception but might be appropriate if the beneficiary wants to prove his claim under a purchase price guarantee. Since the jurisdiction does not assume an obligation of the bank to translate documents it seems advisable, in standbys subject to the UCP 500, not to translate *termini tecnici* into languages other than the language of the guarantee text.

(C) ISP 98 (demand only in the language of the standby)

As shown above, the beneficiary of an L/C or a standby subject to the UCP 500 must only in exceptional cases use the language of the guarantee when presenting additional documents containing special technical or legal terms. Rule 4.04, ISP 98, on the other hand, stipulates that: “Language of the documents: the language of the documents issued by the beneficiary is to be that of the standby.” This general requirement violates the principle that all world trade languages are equal. Furthermore, it is a surprise for the beneficiary and will hence be considered void under the terms of the German law on trade terms.¹²⁴ The author urgently advises to waive Rule 4.04, ISP 98, when issuer and beneficiary are domiciled in different countries. This is even more important if the documents are created by third parties. By waiving Rule 4.04, ISP 98,

¹²² Brüggemann, *Die Banktechnik des Auslandsgeschäfts*, 5th ed. (1977) at 154.

¹²³ Epechlein & Bontoux, *Sécurités et Précariétés du Crédit documentaire*, 1964 at 10.

¹²⁴ Holzwarth, *supra*, n. 2 at 13.

the beneficiary ensures that he can present documents in the language of his home country.

(b) Demand according to form

(i) Strict compliance with instructions from applicant

(A) International bank guarantee (examination by analogy to Art. 13, UCP 500)

For the examination of documents presented under an international bank guarantee, the globally accepted principle of strict compliance applies.¹²⁵ The reason to narrowly bind the bank to the instructions of the applicant is based in the fact that, as with L/Cs, the bank has no view of the relation between buyer and seller, and owing to lack of industry experience cannot foresee what result a deviation to the order will have.¹²⁶ Kleiner ascertains appropriately that Art. 2, UCP 500, which extends the applicability of the UCP 500 to standby letters of credits, is not an exception but the expression of an already existing use.¹²⁷

(B) UCP 500 (standard of consistency on its face: Art. 13, UCP 500)

The L/C business is the source of the principle of strict compliance, which is stated in Art. 13(a), UCP 500, as follows: “Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit.” As is the case in international

¹²⁵ Canaris, *supra*, n. 38 at marginal note 1109, 1132 f.; Westphalen, *supra*, n. 33 at 165; Zahn, *supra*, n. 10 at marginal note 9/108.

¹²⁶ BGH, WM 1958, 291 (292 unter II) LM Nr. 1 zu § 780 BGB; BGH, WM 1958, 587, 588 LM Nr. 2 zu § 780 BGB; BGGH, WM 1960, 38, 39 LM Nr. 3 zu § 665 BGB; BGH, WM 1964, 476 LM Nr. 3 zu § 373 HGB; BGH, WM 1970, 552, 554 f.; BGH, WM 1971, 158, 159f.; c.f. Nielsen, *Neue Richtlinien für Dokumentenakkreditive* (1994), at marginal note 86.

¹²⁷ Kleiner, *supra*, n. 86 at marginal note 192; Canaris, *supra*, n. 38 at marginal note 1107, 1109 and 1132; Hadding, Häuser & Welter, *Bürgschaft und Garantie*, 1983, at 695f.; Liesecke, “Rechtsfragen der Bankgarantie,” (1968) *WM* 26; Mülbart, “Neueste Entwicklungen materiellen Rechts der Garantie “auf erstes Anfordern,”” (1985) *ZIP* at 1104; Nielsen, “Ausgestaltung internationaler Bankgarantien unter dem Gesichtspunkt etwaigen Rechtsmißbrauchs,” *ZHR* 147 at 146, Nielsen, *Bankgarantien bei Außenhandelsgeschäften*, 1986, at 71f. Notwithstanding, the author recommends for purposes of clarification to reference the UCP 500.

guarantees, the banks, owing to lack of industry experience, cannot judge what result even minor deviations might have. The consequence is that small insignificant deviations can have far-reaching consequences, and this is not only the case if the applicant himself has to present the documents under a back-to-back L/C since he resold the goods to an end-customer. In consequence, documents compliant on their face with the requirements will be honoured even though they might be inappropriate for the effectuation of the underlying transaction. Non-compliant documents will not be honoured even though their material adequacy for the purposes of the underlying transaction can be proven through evidence outside the documents.¹²⁸ Lord Sumner has appropriately summarized the essence of examination in a nearly classic sentence; “there is no room for documents which are almost the same, or which will do as well.”¹²⁹

(C) ISP 98 (analogy to Art. 13, UCP 500)

According to Rule 4.01, ISP 98 (Examination for Compliance), the following applies:

Whether a presentation appears to comply is determined by examining the presentation on its face against the terms and conditions stated in the standby as interpreted and supplemented by these Rules which are to be read in the context of standard standby practice.

However, the standards for examination are quite different to those of the UCP 500.

(ii) *Standards for examination of documents*

(A) International bank guarantee (complete satisfaction of guarantee provisions/exclusion of contradictions)

For the examination of a demand for payment under a guarantee, the principle of strict compliance applies. The form of the demand has to correspond to the provisions of the payment clause. Given that the beneficiary has to present additional documents, according to which the applicant has violated his contractual duties, a word-by-word compli-

¹²⁸ Zahn, *supra*, n. 10 at marginal note 2/216.

¹²⁹ Lord Sumner, *Equitabel Trust Company of New York v. Dawson Partners Ltd.* (1927), 27 L.L. Rep. 49.

ance is necessary only if expressly stipulated in the guarantee.¹³⁰ If the guarantee stipulates the presentation of documents, the beneficiary has to submit them before expiration of the guarantee as a complete set; only by presenting a complete set of documents does he trigger the obligation of the bank to examine the documents. Furthermore, the presented documents cannot contradict each other.

(B) Standby according to UCP 500

The criteria for demand under a standby subject to the UCP 500 are formal compliance of the documents with the L/C stipulations, completeness of the documents, and no contradictions among documents.¹³¹

(C) ISP 98

(I) *No examination for inconsistency*

According to Article 13(a), UCP 500, banks have to examine documents to determine whether they appear on their face to be inconsistent with one another. Rule 4.03, ISP 98, in a hefty deviation from this practice, stipulates that an “issuer or nominated person is required to examine documents for inconsistency with each other only to the extent provided in the standby.” The official commentary gives the following reason for this clause: “Under Rule 4.03, the test is whether each document relates to the standby. Each document under a standby must comply with the terms and conditions of the standby. Examination of the documents against one another is not required because there is not necessarily any one underlying obligation from which the examiner can determine what constitutes consistency.”¹³² However, this argument does not apply to standbys with commercial character. In these cases the inconsistency examination should be expressly stipulated.

(II) *Admissibility of presentation of individual documents:*

Rule 3.02, ISP 98, stipulates that the receipt of a document required by and presented under a standby constitutes a presentation requiring

¹³⁰ BGH, WM 1984, 44, 45; c.f. ferner Nielsen, *supra*, n. 31 at 121, marginal note 150ff.

¹³¹ Nielsen, *supra*, n. 31 at marginal note 145ff.; Eisemann & Schütze, *supra*, n. 50 at marginal note 380.

¹³² Byrne, *supra*, n. 5 at Rule 4.03, marginal note 3.

examination for compliance with the terms and conditions of the standby even if not all of the required documents have been presented. According to Rule 3.11(a)(i), ISP 98, issuer and applicant can agree to waive this discretionary clause and stipulate that the examination should be postponed until presentation of a complete set of documents. However, this procedure seems unnecessary complicated, so that it is advisable to specify whether and how to extend the examination to inconsistencies and to exclude the presentation of documents in installments.

(iii) *Interpretation of documentary promises to pay (strict compliance versus substantial compliance)*

(A) International bank guarantee

Even though all parties in guarantee transactions agree that for the demand under a guarantee the formal conformity of the presented documents with the guarantee is determinative, the limits of admissible interpretation are disputed every now and then. The following two approaches are equally inadequate: (1) mindless acceptance of the guarantee text; (2) interpretation of the purpose of the underlying transaction. The BGH summarized the limits and admissibility of interpretation as follows: “It is admissible to interpret L/Cs and standby letters of credit. The interpretation does not only have to take into account the wording but also the meaning of the provisions contained in the document.”¹³³ The importance of this statement is that the document itself has to provide all the elements of its interpretation. On the other hand, this verdict contains the clear statement that a refusal to pay cannot solely be based on purely formalistic deviations (typographical errors, incorrect punctuation) unless these deviations change the meaning of the document.

(B) UCP 500 (formal conformance, no mindless imitation)

The jurisprudence has confirmed that the principle of strict compliance applies. An interpretation based on the guarantee document is admissible, but no deviation is admissible. The BGH has adjudicated that “minor deviations” (“geringfügige Abweichungen”) should be admissible when a reasonable examination of the presented documents

¹³³ BGH, WM 1994, 1063; Nielsen, EWiR Heft 7/94, 635 subsequent.

yield the certain result that the purpose of the L/C conditions has been met.¹³⁴ This should be considered an exception that has not been repeated since. A deviation from an unambiguous text of the L/C cannot be justified either with arguments of reasonable examination, or with considerations of expediency.¹³⁵ This is the reason to side with Eisemann & Schütze and reject the decision by the Cour de Paris.¹³⁶ In its decision, the court decided that an L/C which required a health certificate and a certificate of inspection came within the limits of admissible interpretation, as did the following BGH decision. The L/C required a certificate of inspection issued by an officially recognized control company. The BGH considered it sufficient that the certificate had been issued by a legally recognized control company since in the country of the supplier no company existed which through official grant had been awarded the right to inspect goods.¹³⁷ The decision of the BGH concurs with the jurisprudence under Canadian and the British common law. These countries demand that the documents also comply exactly with the stipulations of the L/C.¹³⁸

A slavish imitation of the L/C stipulations, however, is not necessary. This applies particularly to typographical errors or misspellings and the proper reproduction of names in foreign languages. The following deviations are harmless: small letters instead of capital letters; “VöLKERS” instead of “VOELKERS;” incorrect reproduction of difficult street names; use of foreign language expressions such as “Genf” instead of “Genève.”¹³⁹ Also harmless are deviations in additional information in a document that is not necessary for its verification or

¹³⁴ BGH, WM 1960, 38, 39.

¹³⁵ Zahn, *supra*, n. 10 at marginal note 2/217.

¹³⁶ Eisemann & Schütze, *Zahlung und Zahlungssicherung im Außenhandel*, 3rd ed. (1989) at 180, “unter Bezugnahme auf Cour de Paris,” (1942) 1943 *Revue Générale de Droit Commercial* at 72 (quoted at Stoufflet, *Le Crédit Documentaire* (1957) at 214).

¹³⁷ BGH, WM 1958, 1542, 1543.

¹³⁸ C.f. dazu neuerdings Stapel, *supra*, n. 11 at 148 referencing *Gian Singh & Co. v. Banque de l'Indochine*, [1974] 1 W.W.R. 1234, [1974] 2 All E.R. 754, [1974] 2 Lloyd's Rep. 1 (Singapore P.C.) at 5 [Lloyd's Rep.]; *Seaconsar Far East Ltd. v. Bank Markazi Jomhuri Islami Iran*, [1993] 4 All E.R. 456 (U.K. H.L.), 1 Lloyd's Rep. (C.A.) 236 at 249; *Angelica-Whitewear Ltd. v. Bank of Nova Scotia* (1987), 36 D.L.R. (4th) 161, 36 B.L.R. 140 (S.C.C) at 184 [D.L.R.].

¹³⁹ Nielsen, *supra*, n. 31 at 152; see also ICC Banking Commission, 1984 to 1986, Pub. no. 434 at 33, relation to the so-called “typing errors.”

authentication. Accordingly, the ICC considered it immaterial that an invoice did not contain the zip code.¹⁴⁰

Without exception, the principle of strict compliance applies according to Art. 37(c), UCP 500, for the description of the goods in a commercial invoice.¹⁴¹

(C) ISP 98 (strict compliance versus substantial compliance)

Understandably, no court decisions dealing with the interpretation of the ISP 98 exist at this point. However, we can fall back on past U.S. jurisdiction dealing with standbys. The numerous decisions do not present a homogeneous approach. In the U.S. the issue of the limits of acceptance of deviant documents is being discussed under the headings of “strict compliance”/“substantial compliance,” according to which courts allow “insignificant” variations and “a reasonable compliance standard.”¹⁴² The results differ widely.

In *Beyene v. Irving Trust Co.*, a Mr. Sofan had to be informed about the arrival of a ship. The presented document addressing Mr. Soran was rejected as non-compliant.¹⁴³ Similarly, in *Texpor Traders v. Trust Company Bank*,¹⁴⁴ the court considered the following deviation as not “trivial or microscopic”: “Oxford Industries, Inc., Robert Stock Division, Dept. OA5, P.O. Box 510, Lyons, GA 30436, attn: Sue Turner” instead of “Oxford Industries, Inc., P.O. Box 1618, Atlanta, Georgia 30310.”

The other extreme to these decisions applying a standard of substantial compliance is *Exotic Traders Far East Buying Office v. Exotic Trading U.S.A., Inc.*¹⁴⁵ The invoice requested detailed “FOB Seoul,” the invoice presented showed “FOB Korea.” The court argued that a noti-

¹⁴⁰ Collier, “Opinions of the ICC Banking Commission, 1995 - 1996,” ICC Pub. no. 565(E):

Invoice shows the postal district code under beneficiary’s address as ‘0256’ instead of ‘2056.’

The analyses of the ICC was as follows:

A postal district code, being for postal use only, under these conditions (reference as to who has issued the invoice) should not be a reason for rejection of the invoice.

¹⁴¹ C.f. in this regard Nielsen, *supra*, n. 31 marginal note 295 with further references.

¹⁴² *Burton v. McCullough*, in Dolan, *Letters of Credit* (1992), at §4.051, at 4-33.

¹⁴³ 762 F.2d 4, 40 U.C.C. Rep. Serv. (2d) (Callaghan) 1811 (2d Cir. 1985).

¹⁴⁴ 720 F.Supp. 1100, 10 U.C.C. Rep. Serv. (2d) (Callaghan) 1227 (S.D.N.Y. 1989).

¹⁴⁵ 9 U.C.C. Rep. Serv. (2d) (Callaghan) 698 (D.Mass. 1989).

fication via telex had arrived two days previously and had hence fulfilled the purpose of avoiding unnecessary warehouse charges.

(D) Summary: (A) to (C)

Even though a profound comparison of the jurisprudence in several countries in regard to the interpretation of bank guarantees demands more thorough research, the following seems to be true: European courts apply a standard which follows the wording of the guarantee, while American courts vacillate between an extreme fidelity to the wording and a free interpretation based on reasonableness. However, a trend to disregard minor deviations that do not challenge the correctness of a document is discernible.

If the beneficiary's documents contain discrepancies, but the discrepancies are so minor that they 'could not possibly mislead' a reasonable document examiner, the discrepancies should be considered harmless and disregarded as a matter of law. This 'could not possibly mislead' approach should be considered a part of the strict compliance and not an exception to the Rule.¹⁴⁶

In this regard, a U.S. court considered immaterial the presentation of drafts bearing the wrong reference number.¹⁴⁷

(iv) *Special problem of exact or logical declaration*

(A) International banking guarantee

It is generally agreed that the beneficiary to a guarantee of a suretyship "payable on first demand" does not have to prove the occurrence of the guaranteed event.¹⁴⁸ If the guarantee requires presentation of additional documents in regard to the occurrence of the guaranteed case, the beneficiary has to present those "exactly with the content prescribed by the guarantee document."¹⁴⁹ In this context the following differentiation has to be noted: As reflected in Art. 20 (a)(i), "Uniform Rules for Demand Guarantees," ICC publication no. 458/1, if not stipulated oth-

¹⁴⁶ *Supra*, n. 142 at 4-40.

¹⁴⁷ *New Braunfels National Bank v. Odiorne*, 780 S.V.(2d) 313, 10 U.C.C. Rep. Serv. (2d) (Callaghan) 1352 (Tex. Ct. App. 1989).

¹⁴⁸ BGH, WM 1994, 106; Nielsen, BuB IK3-1.94; confirming Dohm, *supra*, n. 55 at marginal note 199; Mülbart, *Mißbrauch von Bankgarantien und einstweiliger Rechtsschutz* (1985) at 39; Brändel, in: *Festschrift für Werner*, 1984, at 48ff.; Westphalen, *supra*, n. 33 at 165; Zahn, *supra*, n. 10 at marginal note 9/20.

¹⁴⁹ Canaris, *supra*, n. 38 at marginal note 1133.

erwise the beneficiary has to present documents which substantially comply with the requirements of the guarantee (sinngemaesse Erklärung).¹⁵⁰ The exact imitation of the requirements, down to the spelling and spacing in the document, is necessary only when the guarantee document uses quotation marks to designate the additional certification.¹⁵¹ The BGH demands however that the distinction between payment clause and additional declaration should be “obvious to everyone.”¹⁵²

(B) UCP

The above-mentioned problem is not relevant in the context of L/Cs since the demand is effectuated by presenting documents. If a standby is subject to the UCP 500, the Rules outlined for bank guarantees apply.

(C) ISP 98

Rule 4.09, ISP 98, entitled “Identical Wording and Quotation Marks,” is only partially identical to the existing guarantee practice. The identical portion is contained in Rule 4.09(a), ISP 98, which states: “If a standby requires: (a) a statement without specifying precise wording, then the wording in the document presented must appear to convey the same meaning as that required by the standby.”

The picture is different with Rule 4.09(b), ISP 98, which provides for cases in which the guarantee document uses “specified wording” as indicated by the use of quotation marks, blocked wording, or an attached exhibit of form. In this case, the wording has to be repeated word by word; however, typographical errors, spacing, and punctuation are not required to be duplicated. The official commentary gives easily understandable examples. It is considered harmless deviation if the guarantee requires a certificate that “default has occurred” and the beneficiary presents the misspelled document as “default has occurred.”¹⁵³

However, Rule 4.09(c), ISP 98, leads to completely absurd results. The Rule states: “If a standby requires: (c) specified wording by the use

¹⁵⁰ Westphalen, *supra*, n. 33 at 151; Dohm, *supra*, n. 55 at marginal note 198; Pleyer, *supra*, n. 32 at 9.

¹⁵¹ Nielsen, *supra*, n. 127 at 82.

¹⁵² BGH, WM 1984, at 44, 45.

¹⁵³ Byrne, *supra*, n. 5 at Rule 4.09, marginal note 5.

of quotation marks, blocked wording, or an attached exhibit or form, and also provides that the specified wording be “exact” or identical,” then the wording in the documents presented, including typographical errors in spelling, punctuation, spacing and the like, as well as blank lines and spaces for data, must be exactly reproduced.”

A standby subject to this Rule hence demands a slavish imitation of errors and spacing. Turner graphically points out that the following declaration:

_____, 1999
Ajax Loan Corporation hereby certifies that Joseph Glutz is in default under the Loan Agreement dated January 8, 1999 between Ajax Loan Corporation and Joseph Glutz.
Ajax Loan Corporation
By _____
[Signature, Printed Name, and Title of
Officer of Ajax Loan Corporation]

is not identical with the wording of the following certificate:

March 15, 1999
Ajax Loan Corporation hereby certifies that Joseph Glutz is in default under the Loan Agreement dated January 8, 1999 between Ajax Loan Corporation and Joseph Glutz.
Ajax Loan Corporation
By Jeremy Harris
Vice President
Ajax Loan Corporation

The presented document is discrepant under Rule 4.09(c) in three respects. First, it fails to reproduce the blank line at the top of the certificate as it appears in the attachment to the credit. Filling in the date violates the Rule because “blank lines” must be “exactly reproduced.” Second, the presented document fails to reproduce the blank line for the signature as it appears in the attachment. Substituting the actual name violates the Rule that the blank line must be “exactly reproduced.” Third, the presented document fails to reproduce the words “[Signature, Printed Name, and Title of Officer of Ajax Loan Corporation]”¹⁵⁴ in the attachment. Filling in the actual data violates the Rule.¹⁵⁵

¹⁵⁴ Turner, claims that ISP Rule 5.09(c) (among others) is unfavorable to users of credit, in: 5 *INSIGHT* 2 at 15.

¹⁵⁵ This view is shared by Turner, *supra*, n. 1 at 457, 478 subsequent.

**(c) Notification of the applicant before payment under standby/
L/C***(i) International bank guarantee*

The notification of the applicant before payment to the beneficiary has been longstanding practice. To the extent that Art. 17 of the practically irrelevant “ICC Uniform Rules for Demand Guarantees” (ICC publication No. 458/1), reflects an international use. According to the BGH adjudicating a suretyship payable on first demand, the notification serves to give the applicant the opportunity to present facts that would release the bank from payment.¹⁵⁶ This, however, is only an inevitable side effect. The main purpose of the notification is for the bank to inform the applicant that the claim for reimbursement of the guarantee amount has now become due. The applicant thus has the opportunity to make provisions for the imminent debit to his account, or to advise the bank which funds to use to honour the guarantee. The bank however, does not have to insist or wait for a response from the applicant. Rather it decides independently about the payment under the guarantee after the customary processing time of one to three days.

(ii) Standby according to UCP 500 (usual/mandatory notification of demand)

In L/C transactions, the notification of the applicant before payment is customary. Since the 1993 revision of the L/C provisions in the UCP 500, the issuing bank has had the opportunity to contact the applicant to check whether he wants to waive the discrepancies (Article 14(c), UCP 500).¹⁵⁷ The preceding regulation does not change the fact that the decision whether the presented documents are in proper form lies with the bank and not the applicant without any regard for the applicant’s opinion. However, in processing the underlying transaction, the applicant’s opinion is helpful, particularly in cases of minuscule discrepancies.¹⁵⁸

¹⁵⁶ BGH, NJW 1986, 310.

¹⁵⁷ Vorpeil, Einheitliche Richtlinien und Gebräuche für Dokumenten-Akkreditive - Revision 1993, (1993) IWB 1125 at 1131; Ellinger, The Uniform Customs and Practice for Documentary Credits - the 1993 Revision, (1994) L.M.C.L.Q. 377 at 392; Dolan, *supra*, n. 11, Cumulative Supplement No. 2 at S.SA-15.

¹⁵⁸ Stapel, *supra*, n. 11 at 173, with additional references to national and international publications.

(iii) *Standby according to ISP 98 (no notification of the beneficiary)*

Contrary to the use in the UCP 500, international guarantees, and Rule 3.10, ISP 98, stipulates the following: “An issuer is not required to notify the applicant of receipt of a presentation under the standby.” According to the author, the notification of the applicant before payment is a principal duty, which cannot be excluded through standard terms and conditions.

According to Holzwarth, Rule 3.10, ISP 98, will be considered void: “In a number of jurisdictions, established case law requires the issuer of a guarantee to notify the applicant of receipt of a presentation under the guarantee. In such cases, Rule 3.10 will be rendered null and void if the standby is revealed to be what it truly is — namely a guarantee-type instrument adopting the guise of a letter of credit.”¹⁵⁹

5. TREATMENT OF NON-COMPLIANT DEMANDS

(a) Process of appeal

(i) *International bank guarantee*

Normally, it takes two to three banking days to examine the documents submitted under a guarantee.¹⁶⁰ Exceeding this time limit does not trigger any penalties.¹⁶¹ In particular, the bank is not automatically in default since a fixed date for payment does not exist. The lack of any sanction when exceeding the standard examination time does not entitle the bank to postpone a refusal until the day of expiration; on the contrary, the bank has to notify the beneficiary immediately.¹⁶² It is disputed, however, whether, in case of refusal, a bank is obligated in concurrence with Art. 14(d)(ii), UCP 500, to list all non-compliances. The alternative would be to generally refuse payment and leave it to the beneficiary to find out what mistakes he made when presenting documents for payment. Dach appropriately remarks in his discussion on a judgment of the Karlsruhe Superior Court that the guarantee bank is not obligated to help the beneficiary potentially to enjoy the benefits of the guarantee

¹⁵⁹ Holzwarth, *supra*, n. 2 at 13.

¹⁶⁰ Westphalen, *supra*, n. 33 at 171; Zahn, *supra*, n. 10 at marginal note 9/112.

¹⁶¹ Nielsen, *supra*, n. 31 at 121, marginal note 159.

¹⁶² Dohm, *supra*, n. 55 at marginal note 213.

amount.¹⁶³ This already follows from the bank's contractual relation to the applicant. This view has to be somewhat modified, taking into account the jurisdiction of the BGH. An obligation to tutor the beneficiary exists only in those cases where the beneficiary knows about the lack of conformance of the presented documents.¹⁶⁴

(ii) *Standby according to UCP 500 (maximum time seven days)*

In contradistinction to guarantees, Art. 14(d)(i), UCP 500, obligates the bank to give notice to the beneficiary within seven days of any non-conformance of the presented documents and precisely and in detail specify the non-conformance. The beneficiary has the opportunity to remedy any defects in the documents until expiration of the credit. The bank receiving the documents is deemed to have accepted the documents if it does not give notice of non-compliance within seven banking days.¹⁶⁵ It seems questionable whether these Rules intended for L/Cs can be equally applied to standbys, which have the character of a guarantee. This author advocates, in accordance with Art. 1, UCP 500, not to apply Art. 14, UCP 500, to standbys. However, a complete lack of jurisdiction and literature on this point makes it advisable to comply with Art. 14(g)(ii), UCP 500, and detail all non-compliances in case of rejection of the documents.

(iii) *Standby according to ISP 98 (three days reasonable, seven days unreasonable)*

In contradistinction to the UCP 500 stipulation, Rule 5.01, ISP 98 limits the time for examination of the documents to three days ("Timely Notice of Dishonor: Notice given within three business days is deemed to be not unreasonable and beyond seven business days is deemed to be unreasonable").¹⁶⁶ Much more important in this context are Rules 5.02 and 5.03, ISP 98. Rule 5.02, ISP 98 states: "Statement of Grounds of Dishonour: A notice of dishonour shall state all discrepancies upon which dishonour is based." Rule 5.03, ISP 98 states: "Failure to Give Timely Notice of Dishonour: (a) Failure to give notice of a discrepancy in a notice of dishonour within the time and by the means specified in

¹⁶³ OLG Karlsruhe, WM 1992, 2095 - WuB IK3-1.93 (Dach).

¹⁶⁴ BGH, WM 1996, 393ff. - EWIR 133 BGB 1/96, at 341ff. (Nielsen).

¹⁶⁵ C.f. Nielsen, *supra*, n. 31 at 120, Das Reklamationsverfahren, marginal note 301ff.

¹⁶⁶ Turner, *supra*, n. 1 at 486, considers this rule as "The Jewel in the Crown."

the standby or these rules precludes assertion of that discrepancy in any document containing the discrepancy”

Whilst the preceding Rules are in concurrence with Art. 14(e), UCP 500, the authors believe that Rule 5.03 b., ISP 98 has to be interpreted such that the issuer of a deferred payment standby is unconditionally obligated to effect payment if he has failed to give notice of any discrepancy at the time of presentation of the documents. This limiting interpretation results from the fact that banks — according to European viewpoints — are obligated to refuse payment if after presentation and before payment they become cognizant of a fact which constitutes fraud.¹⁶⁷

(iv) *Regarding (i), (ii) and (iii)*

The result is that a demand for payment supported by non-compliant documents has to be refuted within “reasonable time.” This applies to UCP 500 and ISP 98. Even though the ISP attempts to reduce the processing time to three days, this attempt is rather futile, owing to the fact that it will be difficult to prove undue delay. Contrary to the practice for guarantees, a general rejection is not sufficient under UCP 500 or ISP 98. According to both guidelines, the rejection has to list all non-compliances to avoid a loss of the right to appeal.

A considerable difference between ISP 98 and UCP 500 consists in the fact that according to Art. 14 (d)(ii), UCP 500, a bank must hold the documents at the disposal of the presenter or send the documents in order to maintain its right to complain. Rule 5.07, ISP 98, differs from the UCP 500, Art. 14(d) in that the preclusion Rule does not apply if the examiner fails to state in the notice that documents are being held at the disposal of the beneficiary or other presenter.¹⁶⁸ “Because the documents presented under standby typically are not inherently valuable and are considered the property of the presenter in the event of dishonor, a recital of the willingness of the examiner to act at the presenter’s instructions is unimportant and unnecessary.”¹⁶⁹

¹⁶⁷ Canaris, *supra*, n. 38 at marginal note 955; c.f. OLG Frankfurt, WM 1981, 445; BGH, WM 1987, 977

¹⁶⁸ Byrne, *supra*, n. 5 at Rule 5.07, marginal note 1.

¹⁶⁹ *Ibid.*

(b) Problematic contacts with the applicant in case of presentation of discrepant documents

(i) International bank guarantee

In concurrence with the jurisdiction of the BGH, this author advocates that the issuing bank has to inform the applicant of the demand for payment. This notification provides the informal opportunity to ask the applicant whether he wants to waive any documentary defects discovered by the issuing bank. This approach, even though not reflected in any rules, is, however, standard practice.

(ii) UCP 500

Since the 1993 revision of the UCP 500, the issuing bank may, in its sole discretion, approach the applicant for a waiver of discrepancies (Art. 14(c), UCP 500). This contacting does not extend the time to process the L/C (seven days), nor does it bear upon the right of the issuer to accept or refuse documents.¹⁷⁰

(iii) ISP 98

Rule 3.10, ISP 98, stipulates that the applicant not be informed of a demand for payment made under the guarantee, hence, no rule exists which governs contacts between applicant and issuer. The lack of any such provision imposes upon the applicant a duty to reject a demand considered to be *fraudulent*.

The ISP approaches the issue of contacts among the parties in case of presentation of defective documents from the beneficiary's side. The beneficiary can demand that the issuer contact the applicant regarding a waiver of the defective documents. If the beneficiary avails himself of this opportunity he can no longer dispute the correctness of the assertion of the defects (Rule 5.06(c)(I), ISP 98). Correctly, Turner considers this Rule as "unfavorable to users of credits."¹⁷¹

¹⁷⁰ Nielsen, *Neue Richtlinien für Dokumenten-Akkreditive* (1994) Art. 14 at marginal note 105; c.f. also ICC Pub. no. 511 at 46: "Therefore, the contact with the Applicant is not justifiable if it is designed to allow the Issuing Bank and the Applicant to make a joint decision on the discrepant documents."

¹⁷¹ Turner, *supra*, n. 154 at 14, claims that ISP Rule 5.09(c) (among others) is unfavorable to users of credit.

However, the issuer may contact the applicant without any request from the beneficiary (cf. Rule 5.05, ISP 98, “Issuer Request for Applicant Waiver without Request by Presenter”). The official commentary states in this regard the following:

Presenter’s Instruction Not to Seek Waiver. In some situations, the beneficiary or presenter may prefer to have discrepant documents returned without seeking waiver from the applicant. It can give such instructions in a cover letter or a separate communication. In such a situation, the option of seeking waiver would not be available under this Rule.¹⁷²

(c) Non-documentary payment terms, superficial documents

(i) International bank guarantee

Problems arise when demand for payment is made under a guarantee that stipulates the presentation of documents if:

- the beneficiary presents documents or declarations which are not necessary according to the payment clause and hence are superfluous; or,
- the guarantee contains provisions that need not be proven through presentation of documents.

This problem is not relevant to international banking guarantees. At most, it is imaginable that the beneficiary states additional inconsistent facts, which raise doubts in regard to the legality of the demand for payment. For example: A bank issues a delivery guarantee in connection with shipment FOB port of origin. The beneficiary demands payment with the explanation that the ship has sunk. Since the risk of loss in a FOB transaction passes to the buyer with the loading of goods on the deck of the vessel, the seller has satisfied his delivery obligations. The superfluous acknowledgement that the goods were destroyed while in transit makes the demand for payment inconsistent and hence illegal.

(ii) UCP 500

If the beneficiary presents documents not stipulated in the L/C, the bank, in accordance with Art. 13(a), UCP 500, either will not examine these documents or will forward them to the applicant without obligo. This provision, first introduced into the guidelines in the 1993 revision,

¹⁷² Byrne, *supra*, n. 5 at Rule 5.05, marginal note 4.

ordered banks to disregard those L/C provisions which are not needed for the demand under the L/C. The ICC justified this revision stating that “the problem of ‘non-documentary’ requirements continues to plague the Documentary Credit Business.”¹⁷³ The following stipulations clarify this point:

- “Shipment on a seaworthy vessel not more than 15 years old.”
- “Details of shipment to be advised by the beneficiary after shipment directly to the insurers.”
- “Copies of documents to be sent by beneficiary immediately after shipment to the applicant.”

These conditions are not in relation to a documentary credit.¹⁷⁴ This revision of Art. 13(c), UCP 400, is questionable, since some courts believe that non-documentary payment provisions are specifically negotiated and supersede the general terms of the UCP. The general uncertainty in this regard led the ICC to publish a so-called paper addressing this issue.¹⁷⁵ This paper contributes to the general uneasiness, since it specially recognizes payment provisions that can be connected to another document:

Sometimes, however, a condition appears in a documentary credit which can be clearly linked to a document stipulated in that documentary credit. Such a condition is not then deemed to be a non-documentary condition. For example, if a condition in the documentary credit states that the goods are to be of German origin and no Certificate of Origin is called for, the reference to “German origin” would be deemed to be a non-documentary condition and disregarded in accordance with UCP 500 sub-Article 13(c). If, however the same documentary credit stipulated a Certificate of Origin, then there would not be a non-documentary condition as the Certificate of Origin would have to evidence the German origin.

(See also ICC publication no. 511, “UCP 500 and 400 Compare,” at 42.)

(iii) *ISP 98*

Generally, the ISP contains the same regulations as the UCP; both distinguish between superfluous ancillary documents and non-documentary payment provisions. Rule 4.02, ISP 98, entitled “Non-Exami-

¹⁷³ ICC Pub. no. 511 at 42: “The problem of the ‘non-documentary’ requirement continues to plague the Documentary Credit business.”

¹⁷⁴ Art. 13(c), UCP 500, only deals with “conditions,” not “terms,” c.f. Nielsen, *supra*, n. 179 at marginal note 99.

¹⁷⁵ C.f. del Busto, “Case Studies,” ICC Pub. no. 535(E) at 157.

nation of Extraneous Documents,” provides that documents not required by the guarantee are not to be examined in any event or be forwarded with the other documents to the applicant. This rigid rule raises concerns in those instances where inconsistencies with the main documents are discernible in these ancillary documents. Nevertheless, parallel to the treatment under the UCP, the majority view in the legal literature approves of the return of documents not required by the guarantee if the documents are returned to the beneficiary. The forwarding of documents to the applicant without obligo, on the other hand, is considered void.¹⁷⁶ This author believes that the forwarding of ancillary documents to the applicant is not a problem that can be solved by the German law on trade terms. The problem is rather to deliver additional documents to the applicant, which he might use to prove the falsity of the documents presented under the guarantee. To this extent, it seems doubtful that the issuer of a letter of credit of a standby can argue with the forwarding without obligo.

Rule 4.11(a) treats the non-observance of non-documentary payment provisions as follows: “A standby term or condition which is non-documentary must be disregarded whether or not it affects the issuer’s obligation to treat a presentation as complying or to treat the standby as issued, amended, or terminated.” However, Rule 4.11(b) contains the limitation that non-documentary payment obligations have to be examined, if their fulfilment can be ascertained through documents the bank has in its possession: “... in which they are to be evidenced and if their fulfilment cannot be determined by the issuer from the issuer’s own records or within the issuer’s normal operations.” The vaguely worded exception is exemplified in Art. 4.11(c), ISP 98, which is tailored to American practices. The guarantee bank can see the following:

- i. when, where, and how documents are presented or otherwise delivered to the issuer;
- ii. when, where, and how communications affecting the standby are sent or received by the issuer, beneficiary, or any nominated person;
- iii. amounts transferred into or out of accounts with the issuer; and

¹⁷⁶ Stapel, *supra*, n. 11 at 65; v. Westphalen, RIW 1994 at 453 (456).

- iv. amounts determinable from a published index (e.g., if standby provides for determining amounts of interest accruing according to published interest rates).

These exceptions, which lead to recognizing conditions not included in the payment provision of the guarantee, are foreign to the European understanding of guarantees. The official commentary exemplifies certain facts within the issuer's operational purview.

For example, the requirement that the standby be presented before a certain time at the issuer's location is one which is not documentary and yet is able to be verified by the issuer from its own internal operational procedures. Similarly, the transfer of amounts to or from accounts held by the issuer is within its own purview.¹⁷⁷

In view of this difficult determination, in the author's opinion, of what can be subsumed under the term "operational purview" of the standby issuer, it is comforting that the issuer at least does not have to verify the calculations of the presenter at presentation. Rule 4.11(d), ISP 98, states: "An issuer need not re-compute a beneficiary's computations under a formula stated or referenced in a standby except to the extent that the standby so provides."

6. PAPER OF THE AMERICAN BAR ASSOCIATION

(a) Choice of law and arbitration

A subcommittee of the ABA analyzed the consequences of the ISP 98 on standby practices.¹⁷⁸ The ABA lists in its paper the different Rules for standbys:

UCC Revised Article 5. See Section 5-116 (a) and (c) (choice of law and effect of Rules of custom or practice, respectively).

United Nations Convention on Independent Guaranties and Stand-by Letters of Credit. See Article 1 (opt-out).

New York law. Per current New York UCC — Section 5-102 (4), New York UCC, Article 5, does not apply to a standby if by its terms or by agreement, course of dealing or usage of trade it is subject in whole or in part to the UCP. There is no such automatic exclusion for ISP 98. New

¹⁷⁷ Byrne, *supra*, n. 5 at Rule 4.11, marginal note 5.

¹⁷⁸ Avidon, *The International Standby Practices*, (October 1998) *Documentary Credit World* at 33ff.

York UCC Section 1-102 (3) permits variation by agreement (with certain exceptions).

New York law contains a provision according to which it is not applicable if a standby is subject to the UCP. For the ISP 98 a similar exclusion does not yet exist.¹⁷⁹

The ABA further mentions the possibility of subjecting the standbys to arbitration (dispute resolution mechanism):

- ICLOCA - International Center for Letter of Credit Arbitration, Inc.
- UNCITRAL - United Nations Commission on International Trade Law
- ICC - International Chamber of Commerce
- AAA - American Arbitration Association
- DOCDES - ICC Rules for Documentary Credit Dispute Resolution Expertise

The preceding considerations of the ABA in regard to choice of law and arbitration show that the standby, contrary to the international bank guarantee, is a payment instrument whose provisions are mostly determined by lawyers; in consequence, people unskilled in the art of law cannot always follow easily. Even though the issuance of bank guarantees requires special knowledge, and the administration of L/Cs requires familiarity with the UCP 500 and logical thinking, hitherto specialists without legal education have handled these tasks. Until now, there has been no reason to make foreign trade the domain of lawyers, as the ISP 98 does. Specialists with and without legal education, whom the author has consulted, consider the new rules to be the most complicated guidelines ever published by the ICC. This is also the only explanation for why the publication of an “official commentary” seemed to be necessary.

(b) Recommendations of the American Bar Association

The ABA mentions that the ISP differs in various points from the hitherto existing practice of American banks, “that may lead to changes in forms of standby letters of credit and reimbursement agreements that

¹⁷⁹ *Ibid.*, at 34.

may lead to changes in standby practices; that may alert parties to issues they had not previously focused upon; or, that parties may wish to limit or vary.”¹⁸⁰ The ABA concludes that applicants should see to it that certain Rules are excluded. Several recommendations have already been mentioned. Additionally, the following should be borne in mind:

(i) *Liability for third parties*

According to Rule 1.08(c), ISP 98, the issuer is not responsible for “actions or omissions of others if the other person or chosen by the issuer or [a] nominated person.” Even though this Rule is in conformity with Art. 18(a), UCP 500, Rule 1.08(c), ISP 98, extends the application of this rule to branches, agencies or other offices, since these are treated as third parties. The applicant can exclude this limitation of liability for branches of the issuer, and the bank should advise the applicant of this possibility.

(ii) *Payability of confirmed standbys*

In regard to Rule 2.01(d)(ii), ISP 98, the ABA appropriately advises that in case of confirmation of the standby, the standby should be made payable only at the confirming bank and not at the issuing bank. This advice is equally applicable to documentary credits where the confirming bank will not know about its obligations if the beneficiary presents them at the issuing bank.¹⁸¹ The ABA mentions that in the event the issuer wrongfully dishonours the documents presented, the confirmer is obligated to pay as if the presentation had been made at its counters.

(iii) *Forwarding of modifications/cancellations*

According to Rule 2.07, ISP 98, the original obligation of the issuing bank continues to exist when the nominated person has acted prior to receipt of a modification or cancellation. This corresponds with Art. 8(b), UCP 500, in regard to the cancellation of revocable letters of credit. The ABA therefore recommends avoiding freely negotiable standbys: “The Rule may thus lead to discourage the use of freely negotiable standby letters of credit.” It is a typical quality of a freely

¹⁸⁰ *Ibid.*, at 33.

¹⁸¹ Nielsen, *supra*, n. 179 at Art. 9, marginal note 55.

negotiable L/C that the issuing bank does not know at which bank the beneficiary presents his documents for negotiation.

(iv) *Admissibility of partial drawings:*

Article 41, UCP 500, stipulates:

If drawings and/or shipments by installments within given periods are stipulated in the Credit and any installment is not drawn and/or shipped within the period allowed for that installment, the Credit ceases to be available for that and any subsequent installments, unless otherwise stipulated in the Credit.

Contrary to this Rule, Rule 3.07(a), ISP 98, "Separateness of Each Presentation," permits additional drawings.

(v) *Substitution for stolen or lost standbys*

According to Rule 3.12(a), ISP 98, the issuer is not obligated to replace a lost or stolen standby, or to waive any requirement that the original be presented under the standby. The ABA recommends modifying this clause, since in case of transfer of the standby, or in case of acknowledgement of assignment of proceeds (Rule 6.08(a), ISP 98), the issuer can demand presentation of the original standby (Rule 6.03(b)(ii), ISP 98).

(vi) *Identical wording*

Unless the contrary is specifically stipulated, typographical errors in spelling, punctuation, spacing or the like that are apparent when read in context are not required to be duplicated. Blank lines or spaces for data may be completed in any manner not inconsistent with the standby (Rule 4.09(b), ISP 98). However, this no longer applies if the standby uses words such as "exact" or "identical." In this case the wording in the documents presented, including typographical errors in spelling, punctuation, spacing and the like, as well as blank lines and spaces for data, must be exactly reproduced (Rule 4.09(c), ISP 98). This nearly sophistic clause should absolutely be excluded since practically only a photocopy would yield the required identity. When issuing a newly prepared document, however, minor deviations can never be entirely avoided.

(vii) Original, copy and multiple copies

The stipulation of Rule 4.15(c)(ii), ISP 98, that a document “... is deemed to be an original if the signature or authentication appears to be original” is more or less identical with Art. 20(b), UCP 500. Art. 20(b), UCP 500, details that a document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or by any other mechanical or electronic method or authentication. Rule 4.07(c)(ii), ISP 98 simply states that, “any signature or authentication will be regarded as a complying signature.” In this author’s opinion, both wordings are identical with the limitation that national laws, which require handwritten signatures for drafts, cheques, or suretyships, supersede this Rule.¹⁸² Independently of this, it is advisable to stamp any document that has not been signed by hand as an “original.”

Art. 20(c) (i) provides that banks will accept as a copy a document either labelled “copy” or not marked as an original. Even though Rule 4.15(d) contains the same Rule, the ABA recommends as a precautionary measure to expressly label copies as “copy.”

(c) Summary

The preceding comments have excluded any reference to “Reimbursement Obligations” (Rule 8), or “Syndication/Participation” (Rule 10, ISP 98). Furthermore, the focus has been to highlight the European perspective and demonstrate from this viewpoint critical issues, which will not be recognized as such by someone familiar with the American legal system.

This having been said, the following summarizes similarities and differences between bank guarantees, letters of credit and the ISP 98: in regard to the independence of basis contract and payment obligation by bank guarantee, letters of credit and standbys are of equal value. The prerequisites for bridging this independence were intentionally not regulated, but rather left for national courts to determine.

Rule 1.06, ISP 98, stipulates that the issuer’s knowledge of performance or breach of any reimbursement or underlying transaction is

¹⁸² Nielsen, *ibid.*, Art. 20, marginal note 148; c.f. ferner, B. Wheble, *Documentary Credits: Uniform Customs & Practice* (State Mutual Book & Periodical Service, Ltd., 1974/1983), revisions compared and explained at 42.

immaterial. This provision contravenes not only the jurisdiction of the BGH in regard to the undue demands, but also the jurisdiction in other European countries (Switzerland, Austria, France), and is void, according to the opinion of this author. The same applies to Rule 3.10, ISP 98, according to which “an issuer is not required to notify the applicant of receipt of a presentation under the standby.”

It is not acceptable that proofs regarding the non-occurrence of the guaranteed case are excluded.

The inspection of the documents submitted under a standby concurs with the proven practice, particularly Art. 13, UCP 500, since the principle of strict compliance applies and only the objective conformity between payment terms and submitted documents will be taken into consideration.

Serious deviations exist also insofar as the presentation of only one out of several documents triggers duties to inspect and deadlines; furthermore, a bank is not obliged to examine the documents for inconsistencies. This author considers this to be disadvantageous, since it not only excludes the assessment of inconsistencies in the documents with one another, but also prevents the beneficiary from being able to cure the defects. Take for example, a standby that specifies presentation of a copy of a document, e.g., a shipping advice, certified by the beneficiary. The beneficiary uses a rubber stamp with the name of the firm. Doubts about the document's authenticity can be excluded if all documents, including the shipping advice, bear the same company information (address, telephone number, fax) in the letterhead.¹⁸³

The exclusion of an inconsistency check leads to the consequence that each document will be examined individually to determine whether it complies with the terms of the standby. This is particularly true if in accordance with Rule 4.09(c), ISP 98, the standby requires exact reproduction of certain information, a requirement that extends to punctuation and even spacing.

Rule 4.13, ISP 98, provides that an honouring bank is not obligated to ascertain the identity of the person making a presentation. Burdening the applicant instead of the bank with the risk of misidentification will very likely be considered void under German law.

¹⁸³ C.f. Stapel, *supra*, n. 11 at 154.

The appeal process in the case of presentation of non-compliant documents is in accordance with Art. 14, UCP 500, providing, in particular, that it is permissible not to keep the documents at the disposition of the presenter. Even American authors consider it disadvantageous that according to Rule 5.06(c), ISP 98, the beneficiary forgoes the right to contest the justification of a complaint by the applicant when the presenter requests that the presented documents be forwarded to the issuer.

The use of third parties as “nominated persons” deviates from Art. 10, UCP 500, insofar as the nominated person is not authorized to bind the person making the nomination. The official ICC commentary, however, considers only those acts as immaterial which go beyond the original mandate: “Were the adviser to misadvise the standby, the issuer would not thereby be bound as to the misadvised terms (though the adviser may itself be obligated).”¹⁸⁴

The lack of liability of a legal entity for acts of its agencies, branches, or other offices, contradicts basic principles of European corporation law, and even, according to the ABA, should be expressly excluded.

The enumeration of further idiosyncrasies could be easily continued. Hence, this author suggests, banks unfamiliar with U.S. standby practices should not blindly reference the ISP 98. Rather, reference to the ISP 98 should be modified according to the suggestions made in this article and by the ABA. Herein lies one of the main differences with the UCP 500, which can be used in practice without modifications. The question remains as to whether the ISP 98 really constitutes an advance in the field of standbys and guarantees, even when taking into account that there are no guidelines reflecting uniform practices for guarantees.

¹⁸⁴ Byrne, *supra*, n. 5 at Rule 1.04 at 76.

Glossary

AGBG — (Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen, 1976) *German Unfair Contract Terms Act*.

BGB — Bürgerliches Gesetzbuch, German civil code

BGH — Federal Supreme Court of Justice in Civil Matters

Einheitliche Richtlinien und Gebräuche für Dokumenten-Akkreditive — Uniform Customs and Practices for Documentary Credits

ERA — UCP; see *Einheitliche Richtlinien und Gebräuche für Dokumenten-Akkreditive*

Lex mercatoria — merchant law

LG — Landgericht: Court of first instance in cases where the value at stake exceeds 10,000 DM (approximately US\$4,800).

WM — *Wertpapiermitteilungen*, a German legal magazine

ZIP — *Zeitschrift fuer Insolvenzpraxis*, a German legal magazine