



2009 HONG KONG GUARANTEE & STANDBY FORUM SUMMARY

Editor's Note: On 14 July 2009, the second annual Hong Kong Guarantee & Standby Forum was held. To begin the program, delegates introduced themselves and stated their reasons for attending the event. Institute Director and Event Chair James E. BYRNE explained that most all topics addressed during the event would not have a single correct answer. Rather, panelists leading the discussions would offer their thoughts on topics in order to help participants make informed decisions within their own professional environment. The following represents the executive summary report of the event.

Distinguishing Types of Guarantees: Suretyship from Independent

Ambiguity within certain guarantees that are issued continues to result in court cases each year. Delegates were asked to consider the terms of the guarantee from the 2008 English case, *IIG Capital v. Van Der Merwe* (abstracted at Feb 2009 DCW 16). Some participants mentioned that they see such undertakings and view them as on-demand guarantees. Beneficiaries might receive them as a form of structured trade financing.

The guarantee from this case prompts several

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questions. A banker would first want to determine how to book the obligation. What are the characteristics one looks for in these obligations? When the beneficiary wants to claim on it, what defenses can be asserted?

Panelists emphasized the major problem in the guarantee industry is terminology. Too many guarantees contain mixed and conflicting language which brings into question the character (independent or not) of the undertaking.

Saibo JIN (Beijing Commerce & Finance Law Firm) then shared insight from China. "The Supreme People's Court of China has stated in several leading cases that all domestic guarantees within China are to be treated as accessory guarantees and cannot be regarded as independent, even if the guarantee articles provide that this instrument is an independent guarantee. But several earlier local court case

reports had taken a different position. I know of at least two reported cases published by two provincial High People's Courts that have confirmed the independent character of an independent guarantee."

In summary, it is vitally important to determine whether a "guarantee" is independent or not. There are several indicators, but the most important is the terms of the guarantee. For instance, payment against presented documents (independent) instead of the occurrence of an event (dependent). When independence is wanted, it is advisable to call it a standby LC or to make the undertaking subject to rules intended for independent guarantees.

The URDG Revision

Panelists first commented on **issuance of independent guarantees**. One Hong Kong banker indicated that guarantees might be issued by loan departments, legal counsel, or others. In his experience, this causes a great deal of confusion and inconvenience. In Mainland China, departments have different sections for LCs and guarantees. One non-Asian banker considers the guarantee to be a medieval instrument that companies with old-fashioned management rely upon.

As of July 2009, the process

to revise the Uniform Rules for Demand Guarantees (URDG 458) continues. From Draft 4 of the URDG revision, panelists referenced three articles for the Hong Kong audience: Article 15 (Context of demand); Article 16 (Information about demand); and Article 31 (Extend or pay).

The opinion was expressed that these are three issues that were not resolved in URDG 458 and will not be resolved in forthcoming the URDG 758. It was predicted that the revised URDG will work well for simple, unsophisticated guarantees, but will not be used for serious financial guarantees.

Abusive Drawings & Injunctions in Hard Economic Times

Dr. Alan DAVIDSON took up discussion of *Clough Engineering v. Oil and Natural Gas Corp.* (Apr 2009 DCW 26) in which the Full Court of the Federal Court of Australia accepted unconscionability as an exception to the independence principle and that the beneficiary was entitled to make a demand under the performance guarantees. The question before the court was whether the applicant was abusing its position by not completing the fourth stage of a project. The behavior was not viewed as fraud, but it was judged to be unreasonable or

unconscionable. The letter of credit community is deeply concerned about the notion of unconscionability. Said BYRNE: "If this was an abuse, I would prefer that this be under the rubric of fraud instead of unconscionability which has no limit or bounds. It is not an LC defense and is another effort to avoid LC independence."

The panel then commented on lessons from *Jaffe v. Bank of America* (Apr 2009 DCW 26) in which the applicant, alleging fraud, sued the issuer to enjoin honor of the LC. Panelists agreed that banks should try not to avoid payment based on unconfirmed rumors of fraud. If a bank receives a letter alleging fraud, it is not obligated to take such notice and should not act upon it.

From the perspective of a bank consultant, MP TSIM added that banks need to keep in mind reputational concerns. If a bank makes the wrong decision, then its standbys could be unwelcome. Knowing your customer's customer is also important, especially in the situation when a transferee beneficiary is involved.

Confronted with allegations of LC fraud, a banker might be tempted to encourage the applicant "off the record" to obtain an injunction so that the bank can indicate it wants to pay, but cannot. Instead, delegates were urged to resist this action and pay upon a

complying presentation. The onus is on the applicant to consult a lawyer.

One panelist then discussed a type of standby LC arrangement that, while complicated, has become common at this time for his bank. As confirmer, the bank is not part of the loan and does not obtain details of the underlying transaction which demonstrates the importance of knowing its customer and having the situation in hand.

The panel then turned to *DBS Bank v. Carrier Singapore* (June 2009 DCW 10) which one panelist regards as “the most novel, indeed, revolutionary decision issued in several years.” Are there basis for liability, post-payment? The Singapore court granted judgment in favor of the issuer for deceit. Each year in Hong Kong, there are four or five criminal fraud cases in which a bank is defrauded. For experts which track LC litigation, the *DBS Bank* case is the first seen outside the US which allows for judgment of deceit and therefore is a decision that should garner attention.

Updates

Panelists provided brief updates of three projects and initiatives impacting guarantees and standbys. The **ISP Model Forms Project** is an effort begun by IIBLP to educate users and familiarize them with ISP98 standbys and

independent guarantees. Various ISP98 forms, clauses, notices, and request documents are being developed which demonstrate the versatility of these instruments. Draft versions are being released for public comment. Once final, the model forms will be freely available for use. Revision of the *ISP Official Commentary* has also commenced and is continuing.

Delegates were then updated about the UN Convention on Independent Guarantees and Standby Letters of Credit (**UN LC Convention**). Eight UN member states have ratified it. If adopted by the US, it is likely that other countries will follow.

In early 2009, “**Rethinking Trade Finance 2009: An ICC Global Survey**” was an online survey compiled by Coastline Solutions in early 2009. The 43-page survey released in March 2009 examines the impact of the economic crisis on trade finance based on responses from 122 banks in 59 countries.

Perpetual Undertakings & Duration

The panel discussed use of **evergreen clauses**. The concept behind this type of clause is that an LC can remain in effect unless it contains a device to terminate it. For LC practice however, the actual word “evergreen” is a redundant

term and has no single accepted meaning. Without context, it cannot be given effect. Panel members further recommended that specialists remove “auto-renew” from their LC vocabulary. Instead, they should think of “auto-extension”.

Singapore banks cannot issue so-called “open-ended guarantees”. Singapore does allow for auto-extension, but banks must provide an “escape clause” and inform the customer one month in advance. Within the US, the Office of the Comptroller of the Currency (OCC) requires that there must be a way to terminate an obligation. In Hong Kong and other jurisdictions, delegates were urged to ascertain the standards that govern auto-extension and one’s ability to terminate.

Guarantee & Standby Law

In advance of the Forum, panelists identified the most significant guarantee & standby LC cases from the past year.

In *Uniloy Milacron v. PNC Bank* (Sept 2009 DCW 14), the beneficiary sued the issuer for wrongful dishonor under a commercial standby. One of the stated discrepancies was that the serial number shown on one invoice (N01A0100088) did not match the serial number on the LC

(N01A010088). Given the numbers differed by one “0” and that the merchandise descriptions on the invoice and in the LC were identical, the court found the differing serial numbers were the product of an obvious typographical error. One delegate commented that model numbers make a bigger difference than serial numbers. For a model number, the delegate would want exactness instead of “correspond”. In *Uniloy*, mention of the serial number on the invoice is just a recital. One lesson from the case is that some courts will look at data in other documents to make a determination.

Other topics emerging from recent cases warranting discussion included: Contract to Issue an LC (*Associate Warehousing*, noted at 2009

ANNUAL REVIEW 397); Contract to Provide an LC (*K.G. Cornwall*, Jan 2009 DCW 12); “Non Operative” Undertaking (*Capital Investments-USA*, Jan 2009 DCW 11); and Reimbursement & Aligning Contracts with Replacement LC (*Cass County Bank*, 2009 ANNUAL REVIEW 402).

The panel also addressed possible ramifications of ICC **Opinion TA644rev** on standbys. The Opinion, referencing UCP600 Article 14(h), finds that banks will deem a non-documentary condition as not stated and will disregard it. The Opinion further states that UCP600 Article 14(h) “is not absolute and is qualified by the content of” UCP600 Article 14(d).

Some experts disagree with this assessment and believe that banks can escape liability

by pointing to UCP600 Article 14(h). For them, ICC Opinion TA644rev provides an invitation to refuse under UCP600 standbys.

Open Forum

During this session to conclude the day, one question asked about **choice of law preferences**. Where the law of a third (neutral) country is required, panelists indicated that most major trading houses will accept English law or Swiss law.

Another question asked which set of **rules** is most appropriate for bank guarantees. In spite of its name, the International Standby Practices (ISP) may be used. For purposes of these rules, any undertaking issued subject to ISP is referred to as a standby. ■

2009 Americas Standby & Guarantee Forum

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