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In This Issue...

■ **3 UPDATES:** CFTC Gets Approval to Intervene in ConocoPhillips Case; WTO Scales Back Its Projections for Global Trade; Lawsuit against FIMBank Withdrawn; US Relaxes Sanctions on Burma; US Treasury Imposes Sanctions against Two Banks; FHLB Chicago Reduces LC Pricing; Brief Published on Protection of Security Interests; London, Singapore Seek Greater Share of RMB Business; Acceleration of LCs Prompts MJO Staffing Bankruptcy; Shift from LCs to CAD Seen in Emerging Markets; Investigation Exposes Gold Trading Scam in India



■ **9 THE READERS SPEAK:** Does a Standby Have Life After Expiry?

■ **11 LITIGATION DIGEST:**

- *Louisville Mall Associates v. Wood Center Properties, LLC*
- *Svenska Handelsbanken v. Indian Charge Chrome*
- *North Shore Ventures Ltd v. Anstead Holdings, Inc.*
- Newly Decided LC & Guarantee Cases



■ **28 TEXT:** Florida Department of Business and Professional Regulation Model Documentary Letter of Credit Form and IIBLP Comments Letter

- **36 LC STATISTICS:**
- US Savings Institutions (4Q11)

■ **42 SCAM SURVEY**

■ **45 LC TRADE NEWS**

18 FEATURE



■ **ISP98 FORM 6 – MODEL COUNTER STANDBY WITH ANNEXED FORM OF LOCAL BANK UNDERTAKING**

This ISP98 Form 6 is a model form for a commonly used type of standby. The Counter Standby supports the issuance

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of the beneficiary of the counter standby.

Like other ISP98 Forms published by IIBLP, Form 6 is intended primarily for standby users to provide counter parties and their banks with an appropriately structured and worded independent undertaking. Following Form 6, Paula GREAVES and SOH Chee Seng offer comments and reactions to it.

Next Issue of DCW ...

- **ISP98 Model Forms 7 & 8 and Analysis**
- **ICC Banking Commission Re-Cap**

INTERNATIONAL STANDBY PRACTICES (ISP98) (ICC PUBLICATION NO. 590): VERSATILE RULES FOR MODERN PRACTICE (PART 1 OF 2)

By Professor James E. BYRNE*

This paper was presented at a seminar organized by ICC Japan and conducted by Professor Byrne on 20 October 2011 in Tokyo that formally introduced the Japanese translation of the International Standby Practices (ISP98) to Japanese bankers.

ISP98 was drafted by the Institute of International Banking Law & Practice (IIBLP) and has been indorsed by the United Nations Commission on International Trade Law and the International Chamber of

Commerce, bearing ICC Publication No. 590. The Japanese translation¹ is the most recent translation of these rules from the English original.²

While there is no hard statistical evidence, ISP98 is widely used. Based on informal surveys of US and non US banks in the United States, ISP98 has come to account for a large percentage of the US standby market in the short time it has been in effect.³ Indeed, because of its precision, ISP98 has become the norm for bank enhancement of municipal



bonds and other sophisticated financial obligations. While such use might be expected in the US where standbys

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1. The ICC Japan Translation Committee was chaired by Mr. Kunihiko Minakuchi, The Bank of Tokyo-Mitsubishi, UFJ, Ltd. Its members are Mr. Yoshiharu Takahashi of Sumitomo-Mitsui Banking Corporation and Mr. Tatsuro Kamikawa of Mizuho Corporate Bank, Ltd.

2. In addition to Japanese, ISP98 has been translated into the following languages: Bulgarian, Simplified Chinese, Traditional Chinese (Taiwan), French, Greek, Hebrew, Italian, Korean, Portuguese, Russian, Spanish, and Turkish. As indicated in the Preface to ISP98, the English version is the official text of ISP98.

3. A February 2007 poll of 12 US LC bankers representing major segments of the US market including non US banks in the US revealed that ISP98 accounted for 47% of dollar value of standbys. The poll also revealed that 70% of large dollar standbys were subject to ISP98. With the 2011 decision of the insurance regulators to permit ISP98 to be used in insurance and reinsurance standbys, these figures will increase considerably. See *Poll Shows Two Ways of Measuring Standby Trends*, July/August 2007 DCW 5-6. It took the UCP more than 30 years to gain this level of acceptance.

originated, the rules are also widely used in the United Kingdom and increasingly throughout the world including the Middle East and Asia.

Transactions for Which the Rules were Written. Unlike the UCP which was drafted for commercial letters of credit to provide payment for the sale of goods or services and unlike the URDG which was drafted to provide funds after a default in performance or for refusal to account for advances received or other failure under a contract, ISP98 was designed for any transaction that required an independent assurance of payment. ISP98 standbys are thus regularly used to pay rated debt obligations as they become

due and to pay and to pay for the sale of goods from which payment by the buyer is overdue.⁴ In ISP98, unlike URDG 758, there is no necessary link to a default and no focus on a demand as the only or principal document.

ISP98 uses the term “standby” in the rules to refer to any independent undertaking that is subject to it.⁵ ISP98 is fully usable by independent undertakings, whether called “letters of credit”, “demand guarantee”, “bond”, or any other name provided that the undertaking qualifies under applicable law as “independent” from the underlying transaction. At the fundamental level of law, there is no difference between a standby letter of credit and a demand guarantee.

Judicial Decisions. ISP98 was also written for judges and lawyers. Unlike commercial letters of credit, standbys and demand guarantees are heavily lawyered. Rules of practice, however, are not typically written with the precision needed for legal decisions. A long line of judicial decisions that have struggled with the interpretation of the various versions of the UCP and often misinterpreted it testifies to the difficulties that courts have had with banker-drafted rules of practice.⁶ ISP98 was drafted by lawyers who listened to bankers and attempted to express standard international standby practice in a manner that could be used on a daily basis by bankers and business people but with which lawyers

4. Examples of the wide scope of the transactions supported by standbys include staying an execution of judgment pending appeal, assuring rent payments on realty, assuring payment of sports figures, assuring payment by moving picture investors, assuring payment under reinsurance contracts, assuring payments on excess insurance claims and deduction payments, assuring the repayment of loans, assuring payment of water and sewer impact fees, use as an earnest money deposit for the purchase of a condominium, satisfying a requirement to participate in an auction, assuring the payment of their contributions by Names who are members of Lloyd’s insurance syndicates, and supporting the obligation of investors to make up losses in ticket sales for prize boxing fights and in connection with other sporting events and concerts. These examples illustrate the flexibility of standby letters of credit.

5. ISP98 Rule 1.01(d) (Scope and Application) provides that “[a]n undertaking subject to these Rules is hereafter referred to as a ‘standby’.”

6. See, e.g., *China New Era International Ltd. v. Bank of China (H.K.) Ltd* [Hong Kong] (UCP600 definition of negotiation), abstracted in 2011 *Annual Review of International Banking Law & Practice* 411 [hereafter *Annual Review*]; *Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank) v. Bank of China* [Hong Kong] (UCP500 definition of negotiation), abstracted in 2005 *Annual Survey of Letter of Credit Law & Practice* 269 [hereafter *Annual Survey*]; *Banco Santander SA v. Bayfern Ltd.* [England] (UCP500: protected person under deferred payment undertaking), abstracted in 2000 *Annual Survey* 290; *Seconsar Far East Ltd. v. Bank Markazi Jamhuri Islami Iran* [England] (“reasonable time” under UCP400), abstracted in 1999 *Annual Survey* 381; *Banca Del Sempione v. Provident Bank* [USA] (UCP400 need for confirmer consent to amendment by issuer), abstracted in 1999 *Annual Survey* 324; and *Glencore International Ag v. Bank of China* [England] (originality under UCP500) abstracted in 1996 *Annual Survey* 561.

could work and that courts could apply in the manner intended. The relatively low level of litigation involving ISP98 standbys is itself evidence of the success of this drafting. Those few reported cases in which the interpretation of ISP rules has been at issue were decided in a manner consistent with the drafters' intent.⁷

Bias in the Rules. To the extent that there is a bias in the drafting of ISP98, it is in favor of the rules operating to facilitate prompt payment to a beneficiary under an ISP98 undertaking and reimbursement to banks acting under it. It avoids traps,

attempts to provide clarity, and discourages ambiguity. UCP600 is much less precise⁸ and, because it was not drafted for them, contains traps for users of standbys and demand guarantees. URDG 758, on the other hand, favors the instructing party of a performance guarantee or counter guarantees. Its substantive and notice rules operate to make it easier for the instructing party, in response to an unwanted drawing, to obtain a court freeze order or credibly threaten to withhold reimbursement.

Tools for Using ISP98. In addition to the rules

themselves, the Institute has developed a series of tools for teaching and interpreting ISP98. Perhaps the most important is *The Official Commentary on the International Standby Practices*⁹ supplemented by the Official Interpretations of ISP98 by the Council on International Standby Practices.¹⁰ In addition, several online learning programs are available¹¹ as is the Certified Standby and Guarantee Professional Certification programme which will provide standardized tests.¹² In addition, the Institute is completing the ISP98 Model Forms.¹³

7. See, e.g., *Middlesex Bank & Trust Co. v. Mark Equipment Corp.* [USA], abstracted in the 2006 *Annual Survey* 397.

8. See e.g., *China New Era International Ltd. v. Bank of China (Hong Kong) Ltd.* [Hong Kong], abstracted in 2011 *Annual Review* 411, in which the court struggled with the phrase "complying presentation" in the UCP600 definition of "negotiation".

9. James E. Byrne, *The Official Commentary on the International Standby Practices* (Institute of International Banking Law & Practice 1999).

10. The Council on International Standby Practices (CISP) is comprised of 27 members. It is charged with overseeing and interpreting ISP98, assuring that ISP98 remains aligned with international standby practice and law, recommending when and whether revision is appropriate, advising regarding the revision of *The Official Commentary on the ISP*, and advising regarding intervention in litigation as an *Amicus Curiae* (Friend of Court). It also oversees the Certified Standby & Guarantee Professional (CSGP) Certification Programme.

11. In cooperation with Coastline Solutions, the Institute of International Banking Law & Practice (IIBLP), has developed a 12-hour online training course on the ISP98 entitled *ISP Master*. For more information on *ISP Master* and other related products please visit: www.iiblp.org

12. For more information please visit: www.csghonline.org

13. IIBLP is currently editing mature drafts of Model ISP98 Forms and anticipates that they will be available by the end of the 2011 calendar year. The ISP98 Model Forms provide a model standby with and without attached demand and, based on this model, model forms for automatic extension, automatic reduction, demand for automatic transfer, counter standby, and confirmation. Drafts of the forms have been published in *DCW* as will the final versions. They will also be available at the Institute's website, www.iiblp.org.

Fifteen Major Features of ISP98. This tour of ISP98 highlights 15 topics that illustrate its use and function.

1. Independence. One of the primary purposes of ISP98 was to establish definitively that the undertakings to which it applies were intended to be independent (or abstracted) from the underlying transactions which gave rise to them. In many countries, there are statutes covering dependent guarantees or other accessory or suretyship undertakings but not independent undertakings. Moreover many of the forms used, particularly for bank guarantees, are ambivalent and contain terms that could be considered to make them dependent. ISP98 Rules 1.06(c) (Nature of Standbys) and 1.07 (Independence of Issuer-Beneficiary Relationship) were drafted to resolve any doubts about an undertaking subject to ISP98. In a notable English case, *Team Telecom*, the court concluded that an undertaking entitled a “Bond” was independent because it stated that it was subject to ISP98.¹⁴

In addition, ISP98 Rule 1.10 (Redundant or Otherwise Undesirable Terms) takes terms that commonly cause

confusion in standbys and demand guarantees, discourages their use, but provides a definition that captures what is intended by the terms. One such term is “unconditional”. A standby is by its nature a conditional promise that is conditioned on the presentation of required documents. A statement in a standby that it is “unconditional” is not only wrong but may suggest that the undertaking is a different type of undertaking such as a promissory note or contract. ISP98 Rule 1.10(a)(i) provides that the use of “unconditional” “signifies merely that payment under it is conditioned solely on presentation of specified documents.” This approach provides clarity when the text of an undertaking is unclear.

2. Conditions to Issuance or to Availability. ISP98 Rule 2.03 (Conditions to Issuance) clarifies how to prepare the text of a standby and provide it to the beneficiary while preserving the defense that it is not yet issued to the beneficiary (and not yet booked or attracting fees from the applicant). The clarity comes from insisting that any such unissued but delivered text say “not enforceable” or

“not issued” and that it not use ambiguous terms such as “not available” or “not effective”. Second, it clarifies that other words that arguably preserve the “not issued” defense do not; rather, they merely condition availability for drawing. For example, a standby that stated that it was “not available” until the beneficiary tendered its own performance standby in favor of the applicant/ counterparty would be interpreted as having been issued and irrevocable but subject to the documentary condition that the performance standby be presented. Whether a standby says that it is not issued or merely that it is not available until a condition is met, the stated condition must be disregarded if it is non documentary. The rule on non documentary conditions, ISP98 Rule 4.11, provides another level of protection for beneficiaries (and thus for the reputation of ISP98 undertakings).¹⁵

3. Presentation of Documents. Many of the transactions for which standbys are issued require documents other than a simple demand. ISP98 contemplates requiring multiple documents

14. *Team Telecom International v. Hutchison 3G UK Ltd.* [England], abstracted in 2004 *Annual Survey* 335.

15. The rule incidentally reorganizes and supersedes whatever practice there is for “pre-advice”, a UCP600 Article 11 (Teletransmitted and Pre-Advised Credits) twilight zone that is unwanted for the harder edged ISP undertakings.

including a demand,¹⁶ various statements, negotiable documents,¹⁷ legal or judicial documents,¹⁸ and various commercial documents,¹⁹ and provides minimal terms for each document in the event that the standby does not do so. Most importantly, ISP98 does not assume that a drawing will result from a default.²⁰ It is the standby itself and not ISP98 that dictates what documents the beneficiary must present and what they must say.²¹

4. Incomplete Presentations. Unlike UCP600, ISP98 Rule 3.02 (What Constitutes Presentation) contains a default rule for situations where the beneficiary presents less than all the required documents and asks the issuer to wait for the balance. Such a situation may occur, for example, where the standby requires a demand

accompanied by an arbitral award. The beneficiary may present only the demand and ask the issuer to hold it, expecting that the award will come directly from the arbitrator. In such a situation, the issuer has the option of acceding to the beneficiary's request to hold the documents pending completion of the presentation or of treating it as a presentation, examining it, and presumably refusing it because a required document is missing.²² Such a rule enables the issuer to avoid preclusion for failure to give timely notice of refusal and, unlike URDG 758 Article 14(b) (Presentation), does not force an unwilling issuer to retain custody of documents at the election of the beneficiary.

5. Closure on a Business Day. UCP600 assumes that valuable commercial documents are to be timely

received by the issuing bank and then the applicant, and on this basis shifts the risk of force majeure closure to the beneficiary.²³ Most standby beneficiaries are not delivering inherently valuable documents and are therefore not willing to accept such a risk. The UCP force majeure forfeiture rule is excluded and replaced in the text of standbys issued subject to UCP and multiple clauses have emerged attempting to address the problem. Some of these clauses are as problematic as the UCP600 rule itself. ISP98 Rule 3.14 (Closure on a Business Day and Authorization of Another Reasonable Place for Presentation) abandons the obscure notion of "force majeure" in favor of the simple question of whether or not the place for presentation is closed on a business day when it should be open. If so, the rule extends expiry to thirty

16. ISP98 Rule 4.16 (Demand for Payment).

17. ISP98 Rule 4.18 (Negotiable Documents).

18. ISP98 Rule 4.19 (Legal or Judicial Documents).

19. ISP98 Rule 4.20 (Other Documents).

20. ISP98 Rule 4.17 (Statement of Default or Other Drawing Event) does not require a statement of default but merely that "payment is due because a drawing event described in the standby has occurred."

21. This approach contrasts with URDG 758 Article 15 (Requirements for Demand) under which presentation of a "supporting statement" detailing the applicant's "breach" of the underlying relationship.

22. The option appears in ISP98 Rule 3.11(a)(i) (Issuer Waiver and Applicant Consent to Waiver of Presentation Rules).

23. UCP600 Articles 29 (Extension of Expiry Date or Last Day for Presentation) and 36 (Force Majeure).

calendar days after the day that the place of business reopens.²⁴ It should be noted that the thirty day period was chosen because it is the period usually used on standbys in favor of governmental entities or insurers. It can, of course, be varied in the standby. ISP98 Rule 3.14(b) also provides the issuer with the ability to designate another place for presentation, a rule that operates not only when there is closure due to unforeseen circumstances but also when the place for presentation is to be permanently closed due to a planned move or consolidation.²⁵ Thus when the issuer plans to relocate, it can change the place for presentation by notifying beneficiaries of the new place for presentation more than thirty calendar days before the relocation. Provided that the new location is at a reasonable place and that the notice is received by the beneficiary, such a notice will be effective automatically without the need for beneficiary consent.

6. Examination: Inconsistency & Conflict; Degree of Replication. ISP98 Rule 4.03 (Examination for Inconsistency) permits refusal for inconsistency only where the standby specifies the extent to which documents must be consistent. UCP600 assumes that the documents must all show that goods are being delivered for payment of the purchase price under the issuing bank's undertaking. ISP98 does not assume anything about the relationship of the documents to the underlying obligation. Documents required under a standby could contain data that differs considerably from data in other required documents. Issuing banks have an insufficient basis to determine whether or how documents that otherwise comply might nonetheless be inconsistent. Issuers are justifiably fearful of second guessing by applicants and are therefore inclined to raise inconsistency as a discrepancy in case of any doubt.²⁶ ISP98

eliminates the uncertainty for all by eliminating examination for unspecified types of inconsistency.

Commercial letters of credit require commercial documents that fall into certain patterns addressed in UCP rules regarding transport documents, insurance documents, and commercial invoices. For commercial standbys or demand guarantees that assure payment when the buyer fails to pay the seller directly within a certain time period, UCP600's rules for commercial documents may result in refusal. Under UCP600, there is confusion about whether and to what extent copies of unpaid commercial documents should be examined as if they were originals. Where the documents required are originals, the rules apply. However, such documents typically are not prepared for presentation under a letter of credit where payment is expected directly from the buyer. ISP98 Rule 4.20(b)

24. URDG 758 Article 26 (Force Majeure) retains the notion of force majeure and also limits the extension of time to a period 30 calendar days after the day when the undertaking would have expired. This rule would only assist the beneficiary where the reopening of the place for presentation occurred during that period. For many disasters such as hurricanes, earthquakes, and even 9/11, such a timetable is not realistic particularly without a rule such as the ISP98 provision for naming an alternative place for presentation. The URDG 758 rule also reaches documents presented and not examined and those for which payment has not been made, leaving the beneficiary with the risk of delay.

25. ISP98 Rule 3.14(b).

26. Polls consistently showed inconsistency as the most commonly notified reason for refusal. UCP600 substitutes "conflict" for "inconsistency", with little if any reduction in the use of this category of UCP discrepancy and complaints that it is overused. URDG 758 adopted the UCP600 "no conflict" approach. UCP600 Article 14(d) (Standard of Examination) and URDG 758 Article 19(b) (Examination).

(Other Documents) makes it clear that in an ISP98 standby commercial documents should not be examined under commercial letter of credit rules. URDG 758 does not address this issue.

Standbys and demand guarantees frequently require presentation of carefully worded documents and regularly attach an exhibit or use quotation marks to indicate the wording of the document. The standard of examination in UCP600 and URDG 758 (compliance on its

face with the terms and conditions of the credit) is not sufficiently nuanced to provide a bank with guidance in such a situation.²⁷ For example, does the use of quotation marks signify that every word including apparent errors be replicated? ISP98 Rule 4.09 (Identical Wording and Quotation Marks) distinguishes between a required statement without specified wording in which case the statement in the document must convey the same meaning, and specified

wording through an exhibit, blocked text, or quotation marks. The rule also provides that, unless the standby requires that the document must be "exact" or "identical" to be quoted or blocked text, the document must contain the specified wording but need not replicate punctuation or errors that are apparent when read in context. ■

(Part 2 of ISP98: Versatile Rules for Modern Practice will appear in the Nov/Dec 2011 issue of DCW.)

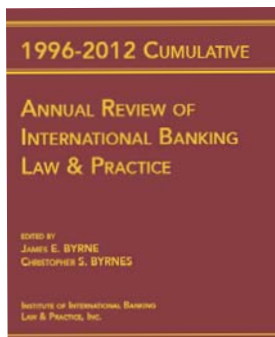
27. See UCP600 Article 14(a) (Standard for Examination of Documents). URDG 758 Article 14(a) (Examination) contains the same unnuanced standard.

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INTERNATIONAL STANDBY PRACTICES (ISP98) (ICC PUBLICATION NO. 590): VERSATILE RULES FOR MODERN PRACTICE (PART 2 OF 2)

By Professor James E. BYRNE*

Appearing here is part 2 of a paper presented at a seminar organized by ICC Japan and conducted by Professor Byrne on 20 October 2011 in Tokyo that formally introduced the Japanese translation of the International Standby Practices (ISP98) to Japanese bankers.

This part 2 begins with the seventh of fifteen Major Features of ISP98 that illustrate its use and function. For part 1, see October 2011 DCW at page 24.

7. Counter Standbys and Confirmation. While both UCP600 and ISP98 provide rules for confirmation, URDG 758 does not, depriving users of this valuable tool. While both ISP98 and URDG 758

facilitate counter guarantee/standby practice, UCP600 does not. Only ISP98 facilitates both.

Counter guarantees/standbys present unique problems in situations where there is misalignment between the counter guarantee/standby and the local undertaking. While URDG 758 contains many references to counter guarantees, it fails to provide workable rules for two serious problems that regularly arise. One involves the presentation of documents to the counter guarantor that were presented under the local undertaking. Is the counter guarantor supposed to examine these documents if the counter guarantee does not so provide? Can the counter guarantor refuse to honor a complying presentation by the local bank which is the issuer



of the local undertaking and beneficiary of the counter guarantee because the documents presented by the local beneficiary against which it paid under the local undertaking do not comply in the opinion of the counter guarantor?²⁸

While it may be thought that the local undertaking is independent from the counter

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28. URDG 758 Article 22 (Transmission of Copies of Complying Demand) incidentally requires that the documents presented under the local undertaking be transmitted to the counter guarantor and forwarded in turn to the instructing party but it does not give guidance about this situation.

guarantee, URDG 758 Article 5(b) (Independence of Guarantee and Counter Guarantee) (which so provides) contains a significant qualification. It states that the counter guarantee's independence exempts it from defenses or claims that result from "any relationship *other than a relationship*" between the counter guarantor and the local bank. [*Emphasis added.*] Since the counter guarantor has requested the local bank to incur a debt obligation for the benefit of the counter guarantor and its applicant, a legal relationship arises under which the counter guarantor is obligated to reimburse the local bank if it pays under its obligation. This obligation is not necessarily limited to the terms of the counter guarantee but may arise from general principles of the law of obligations and suretyship or

accessory undertakings.²⁹

ISP98 Rule 4.21 (Request to Issue Separate Undertaking) anticipated and addressed both of these problems. Rule 4.21(b) and (c) provide that the issuer of a counter standby may disregard any documents presented under the local undertaking and forwarded to it by the local bank that were not required by the counter standby. The issuer of the counter standby cannot refuse an otherwise complying presentation on its counter standby because of a claimed discrepancy in presentation on the local bank undertaking.

Rule 4.21(a) expressly deals with the extent of the reimbursement obligation of the issuer of the counter standby. It provides that the local bank "receives no rights other than its rights to draw under the standby even if the issuer pays a fee to the

beneficiary [local bank] for issuing the separate undertaking."

8. Extend or Pay.

Sometimes the expiry date on a standby is shorter than the performance of the underlying transaction. When a beneficiary is concerned about a pending expiration, it will often indicate to the issuer that it is demanding payment unless the undertaking is extended. This "extend or pay" demand is not limited to counter undertakings but is common under them. In such a situation, the local beneficiary will make an extend or pay demand on the local bank which will in turn make a similar demand on the counter guarantor/issuer. It does not necessarily follow that the beneficiary has or is able to make a complying demand in an extend or pay situation.³⁰

29. This point is illustrated by the obligation that all counter guarantors believe that they have to pay the fees of the local bank when there is no drawing under the local undertaking. Since there is no drawing on the counter undertaking, one must ask from whence this obligation arises since it does not arise from the terms of the counter undertaking. Rather than limiting the reimbursement obligation to the terms of the counter guarantee, URDG 758 Article 5(b) expressly includes the relationship between the two banks within the scope of the reimbursement obligation. As a result, the expiration of the counter guarantee would not be a defense to the counter guarantor against a local bank that honored a complying demand on its local undertaking. For an example of a case in which such a problem arose, see *American Express Bank Ltd. v. Banco Español de Crédito, S.A.* [USA], abstracted in the 2010 *Annual Review* 428. In that case, the New York Court of Appeals noted that the pending expiration of a counter standby issued by a Spanish bank in favor of the Pakistani branch of the US bank which was asked to issue its local undertaking in favor of a Pakistani governmental agency, did not justify a drawing on the counter guarantee although the local bank was embroiled in litigation in Pakistan. The US court opined that the US local bank should win in the Pakistani litigation but noted that "if [Local Bank paid Local Beneficiary] because it [had] been ordered to do so by a Pakistani court, Counter Guarantor [would] be under an obligation to reimburse it. In such circumstances, [Local Bank] could make a good faith demand for honor of the counter guaranties"

30. UCP600, which does not address this phenomenon, is unclear whether there is a presentation requiring examination for compliance. The risk that the issuer bears in such a situation is being precluded from claiming that the demand did not comply.

ISP98 Rule 3.09 (Extend or Pay) addresses this situation. It does not assume that the beneficiary has made a complying presentation.³¹ Rule 3.09 treats the extend or pay demand as a presentation

9. Disposition of Documents and Preclusion.

Because the UCP was not drafted for standby practice, UCP600 Article 16(c) & (f) (Discrepant Documents, Waiver and Notice) is

Article 24 (Non-Complying Demand, Waiver and Notice) has copied the ISP98 approach.

10. Cancellation.

Cancellation of a standby or demand guarantee is not uncommon. Requests for cancellation present unique issues for an issuer or guarantor which are different than those connected with the presentation of documents.

The identity and authority of the beneficiary are but two of them. Unlike a demand in the name of the beneficiary even if made by a stranger or person without authority,³³ the issuer is exposed if it cancels and releases collateral at the request of a stranger or a person without authority. UCP600 contains no rules regarding cancellation.³⁴ ISP98 Rules 7.01 (When an Irrevocable Standby is Cancelled or Terminated) and 7.02 (Issuer's Discretion Regarding a Decision to Cancel) contain detailed guidance for the issuer's consideration.³⁵ URDG 758 Article 25 (Reduction and

"ISP98 Rule 3.09 ... does not assume that the beneficiary has made a complying presentation."

requiring examination, gives the issuer discretion to consult the applicant and extend, and the maximum time in which to do so before it is required to give notice of refusal. In the event that the undertaking is extended, the beneficiary is deemed to have consented to the amendment and withdrawn its demand.

Although URDG 758 Article 23 (Extend or Pay) follows part of the ISP98 rule, there is one notable difference. Article 23 only applies to a "complying demand". Where the demand does not comply, which is a common situation, the URDG extend or pay rule provides no guidance.³²

predicated on the notion that the documents are valuable, their return to the beneficiary is essential, and failure to include a recital regarding disposition in the notice of refusal will result in preclusion. Because documents presented under a standby rarely have value, this rule exposes issuers, guarantors, and confirmers to highly technical application of the preclusion rule. Under ISP98 Rule 5.07 (Disposition of Documents), the issuer has no obligation to give notice regarding the disposition of the documents presented and would not incur preclusion for failure to do so. URDG 758

31. If there is a complying presentation, the issuer can honor or extend. The problems arise where the demand does not comply.

32. Moreover, there is a risk that an unwary banker may overlook the technical phrase that limits the scope of the rule, apply it when the demand does not comply, suspend payment for up to 30 days as permitted, and then be precluded because it has not given timely notice of refusal.

33. See ISP98 Rule 4.13 (No Responsibility to Identify Beneficiary).

34. While UCP600 Article 10(a) (Amendments) has a reference to cancellation, it contains no specific provisions.

35. One of its important rules is the provision that the beneficiary's request for cancellation is irrevocable, thus preventing it from invoking the doctrine of mistake where the issuer has arguably not relied on the request to cancel.

Termination) contains far less detailed provisions on cancellation (or “termination” in its terminology). However, Article 25(b)(iii) requires a signed “release from liability” by the beneficiary.³⁶

11. Transfer and

Assignment. Transfer under a standby or demand guarantee is very different than transfer under a commercial letter of credit because the transactions giving rise to the need for transfer differ. Under a transferable commercial letter of credit, the first beneficiary is expected to use a transferred credit to pay one or more suppliers. Under a transferable standby, the transferor beneficiary is expected to transfer the entire right to be paid.³⁷ Commercial letter of credit transfers focus on partial transfer of drawing rights, the transfer only occurring once (with possible multiple partial transfers), and substitution of documents. In a standby or demand guarantee, it is expected that the transfer is entire (with no partial transfers) and that there may be multiple entire transfers.

There are also concerns about the authority of the person requesting transfer. Therefore, UCP600 Article 38 (Transferable Credits) is not appropriate for transferable standbys or demand guarantees. ISP98 Rule 6.02 (When Drawing Rights are Transferable) restricts transfers of transferable standbys to entire transfers but permits more than one. It requires that the demand be signed by the transferee beneficiary. It also protects the rights of an issuer or nominated person to reimbursement as if it had made payment to the beneficiary where it takes steps to satisfy itself as to the existence and authenticity of the original standby, receives a request for transfer in an acceptable form, and the original standby is tendered.

URDG Article 33(a)-(f) (Transfer of Guarantee and Assignment of Proceeds) is similar although it contains an unusual provision. Article 33(d)(ii) requires that the transferor submit a signed statement of the acquisition by the transferee of the

transferor’s “rights and obligations in the underlying relationship.”³⁸

UCP600 Article 39 (Assignment of Proceeds) renders an assignment of proceeds subject to local law. In most countries, courts would turn to the general law of obligations and not letter of credit law for questions regarding assignments. As a result, the issuer may be obligated to recognize an assignment based on a notice from a stranger who claims to be the assignee. The assignment, however, is the wrong place to start for independent undertakings. What is of value to potential assignees is not a promise from the assignor but an acknowledgement of the assignment by the issuer or guarantor and its irrevocable promise to pay any proceeds to the assignee. ISP98 Rules 6.06 – 6.10 (Acknowledgment of Assignment of Proceeds) explain letter of credit practice regarding assignments in sufficient detail to enable a court to distinguish independent undertakings from general contractual

36. Such a requirement does not reflect practice and, while it may be prudent, it is too formal and should not prevent termination of the obligation where there is other probative evidence that the beneficiary has consented to cancellation.

37. This transfer of the entire right to draw (sometimes referred to as a “whole” transfer) to the transferee beneficiary divests the transferor beneficiary of any right in the standby or demand guarantee.

38. This requirement would prevent transfer of drawing rights to a bank providing financing to the transferor beneficiary. Article 33(d)(i) also suggests by omission that pending amendments are not transferred. One would expect that proposed amendments would also have been transferred since they are irrevocable by the guarantor.

obligations. Among other things, Rule 6.07(a) (Request for Acknowledgment) does not require the bank to give effect to an assignment or to acknowledge it. While omitting details regarding practice, URDG 758 Article 33(g) provides that a guarantor is not obligated to pay an assignee unless it agrees.

12. Transfer by Operation of Law. Situations arise where a stranger (i.e. not the named beneficiary) draws in its own name on a standby or demand guarantee that is not transferable or, if transferable, has not been transferred, and claims to be the legal successor of the named beneficiary. Such situations arise where the beneficiary has been acquired, has legally changed its name, is represented by an appointed successor due to insolvency, or has died. Under UCP600 and URDG 758, a demand by such a person in its own name would be non-complying and payment to such a person would jeopardize the right of the bank to reimbursement.

ISP98 Rules 6.11-6.14 (Transfer by Operation of Law) provide a means by which a complying presentation can be made without amendment or jeopardizing the right to reimbursement. Under these rules a successor beneficiary can present an additional document (not required by the standby) that is issued by a public official and that establishes the succession. The rule allows the bank to suspend the time for examination of documents until it is satisfied about the succession, during which time it may request additional documentation. Where it receives the additional document establishing the authority of the successor to act in the name of the beneficiary, the issuer or nominated person is entitled to reimbursement as if it had paid the named beneficiary.

13. Variations: Time to Pay or Give Notice. ISP98 Rule 1.01(c) (Scope and Application) notes that ISP98 can be varied by the terms of the undertaking. In situations

where there were not uniform practices, the ISP98 Rule reflected either the most common or best practice.³⁹ As a result, some provisions of ISP98 are regularly varied in standbys. Two commonly varied provisions are the time within which payment must be made and the time within which to give notice of refusal.

Under ISP98, payment must be made within the time available for the examination of documents, namely a time that is not unreasonable not to exceed seven banking days.⁴⁰ In order to provide certainty regarding payment, it is common for ISP98 standbys to indicate the timing and method of payment. For example, *"Payment against a complying presentation shall be made within 3 business days after presentation at the place for presentation or by wire transfer to a duly requested account of Beneficiary [with an advice of payment sent to Beneficiary at the above address]."*

The time for giving notice of dishonor under an ISP98 standby is also a time that is not unreasonable.⁴¹ Given that

39. One such provision already mentioned is the 30 day period after reopening of the place of presentation in ISP98 Rule 3.14 (Closure of a Business Day and Authorization of Another Reasonable Place for Presentation).

40. ISP98 Rule 2.01(c) (Undertaking to Honour by Issuer and Any Confirmer to Beneficiary) indicates that an issuer acts in a timely manner if it honors within the time permitted for examining the presentation and giving notice of dishonor.

41. A period in excess of seven banking days after the banking day following the banking day of presentation is deemed to be unreasonable. ISP98 was drafted so as not to depart significantly from the time period for giving notice of refusal under the current UCP rule, UCP500 Article 14 (1993 revision) (Discrepant Documents and Notice).

UCP600 Article 16 (Discrepant Documents, Waiver and Notice) and URDG 758 Article 24 (Non-complying Demand, Waiver and Notice) now have a fixed five day rule, banks using ISP98 may wish to vary the ISP98 rule by inserting a provision in the ISP98 standby. For example, *“Any notice of refusal must be sent by prompt means before the close of the fifth banking day following the banking day of presentation.”*

14. Standby Texts: Automatic Amendments Regarding Duration or Amount. Beneficiaries expect a standby or demand guarantee to be in effect for the duration of the underlying transaction. On the other hand, issuers or guarantors are reluctant to make credit decisions for periods longer than one year. One common solution is to provide for automatic extension of the duration of the undertaking. While no practice rules contain detailed provisions on automatic extension, ISP98 Rule 2.06 (When an Amendment is Authorized and Binding) does

recognize this practice and distinguishes it from a traditional amendment which requires consent of the beneficiary. It is the text of the standby itself, however, that must contain the detailed provisions for an automatic extension. Neither UCP600 nor URDG 758 provide for automatic extension.

Among the elements to be considered in drafting an automatic extension clause or a demand to be made in light of it are the cycle of the extensions, the amount of time before the pending expiration that notice of non extension must be given, whether the notice must be sent or received by this time, whether the sending of the notice of non-extension and the failure of the applicant to replace the standby constitutes a separate basis for drawing, what recitals the beneficiary must make with respect to the proceeds when it draws before the underlying obligations becomes absolute and matured, and whether or not there is to be a final expiration date that is not subject to

automatic extension.⁴²

Another matter commonly treated in the standby text is the automatic reduction of the amount available under the standby or demand guarantee as the transaction is completed where the amount required for assurance commonly decreases. Reduction of the amount outstanding reduces costs, benefitting both applicant and beneficiary. Reduction may be accomplished by amendment requiring beneficiary and issuer to consent. Reduction may also be made automatic in the text of the undertaking. If it is possible to determine the time when the reduction should occur, then the undertaking can so provide. If not, then the undertaking may provide for a document to be presented that will automatically trigger the reduction.⁴³ URDG 758 Article 13 (Variation of Amount of Guarantee) contemplates such a documentary reduction which would constitute an “automatic amendment” under ISP98.⁴⁴ UCP600 does not address either situation.

42. These matters are addressed in webinars “Drafting ‘Evergreen’ Clauses” and “Drafting Revolving Credits” (each hour long webinar is available from IIBLP at <http://www.iiblp.org/>), ISP98 Model Form 3 (Model Standby Providing for Extension, Reduction, and Transfer) and Attachment 3A (Model Attached Payment Demand with Alternative Non-Extension Statement) contain model text. This device also requires careful consideration of internal operations by the issuer and its credit department as well as awareness of its significance by the beneficiary.

43. This process is “automatic” in that presentation of the document results in the reduction without the necessity of consent.

44. ISP98 Model Form 3 and Attachment 3B also provides model terms.

15. Variations: Transfer on Demand. Another variation appropriate for sophisticated financial standbys would be a provision in the ISP98 standby varying the rules requiring issuer consent for a transfer of a transferable standby. Standbys backing municipal bonds, for example, are issued in favor of a trustee who represents all of the bond holders. The trustee is required by the terms of the trust to make regular drawings of principal and interest. The trustee is also required to draw in the event of a default by the issuer of the bonds. As a result, it is essential that there always be a trustee who is able to act. Accordingly, the standby in favor of the original trustee must provide for transfer of all rights in the event that the current trustee resigns or is disqualified to act for whatever reason, so as to allow the current trustee or the successor trustee to present a demand that

drawing rights automatically and immediately be transferred. Because a right to demand transfer does not exist under ISP98 or any practice rule, it would need to be in the terms of a standby. ISP98 Model Form 3 (Model Form Providing for Extension, Reduction, and Transfer) and Attachment 3C (Model Attached Demand for Transfer) provide for transfer on presentation of the beneficiary's demand for transfer.

Conclusion. This brief comparative tour of ISP98 should give some insight into the nature of the rules and their interpretation. Hopefully, it has also provided an appreciation of their transactional context and application. It is conservatively estimated that there is more than US\$ 1.5 trillion outstanding in standby letters of credit and demand guarantees.⁴⁵ With less need for processing than commercial

letters of credit, increasing market acceptance, and the constant need in commerce for a dependable and certain independent assurance mechanism, standbys and demand guarantees represent the future of the field of letters of credit. In terms of outstanding amounts, they already dwarf commercial letters of credit by a ratio of approximately 17:1 in amount outstanding. However, to be effective, they require effective rules. A credible case has been made that practice rules are stifling the commercial letter of credit. ISP98 was drafted to prevent that from happening to standbys and those demand guarantees that are issued subject to it. Not every transaction requires an independent undertaking, but where one is issued, it is in the interest of the banking financial, and commercial community to be sure that it works in a certain and efficient manner. ISP98 is a tool designed to assure that result. ■

45. The top 300 US banks reported outstanding standby obligations of US\$427.3 billion and US\$25.4 billion in commercial LCs in the second quarter of 2010. Nov./Dec. 2010 DCW 40. Totals for the same quarter of 2009 for the top 300 US Banks were US\$465.4 billion in standbys and US\$22.4 billion in commercial LCs. Nov./Dec. 2009 DCW 39. Quarterly figures for outstanding LCs are reported regularly in DCW. The top 187 non-US banks with offices in the US reported outstanding standby obligations at the end of the second quarter 2010 at US\$201.5 billion and commercial LC obligations at US\$7.3 billion. Oct. 2010 DCW 36. Totals for the same quarter of 2009 for the top 186 non-US banks were US\$232.4 billion in standbys and US\$7.9 billion in commercial LCs. Nov./Dec. 2009 DCW 45.

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ISP98 FORM 3 – COMMENTARY

POINTS TO PONDER REGARDING ISP98 MODEL FORM 3

By T. Kursad AKPINAR*

As was already made known to *DCW* subscribers, the Institute of International Banking Law & Practice had started a model forms project to produce various forms under the auspices of ISP98 for the purpose of standardizing the wording of standby letters of credit and related instruments thereto according to the needs of the beneficiaries and applicants.

No doubt, the mutual adoption and usage of these forms by the parties to the standby not only will result in sound wording for standbys issued subject to ISP98, but also provide operational efficiency by allowing speedy operations of standby credits.

In this issue of *DCW*, I offer my comment on ISP98 Model Form 3 (Model Standby Providing for Reduction and Incorporating Annexed Form of Reduction Demand) from a banker's perspective.

In general, the wording of the form and its annexes are clean, clear, and to the point but I wish to express the following points:

– The first paragraph (Issuance):

Given increasing regulatory and compliance requirements worldwide, the paragraph could include a space to mention a brief description of the underlying relationship on which the standby is based. If I were the advisor, I would prefer to know of the basis from which the standby has emanated before advising to the beneficiary.

– The third paragraph (Expiration):

Many practitioners realize that there are various expiration options, however the model form only covers a fixed expiry date scenario. A clause which gives the combination of a expiration clause containing the alternatives of an expiry event which might end the validity of the standby or a fixed expiry date could be more helpful.

– The fourth paragraph (Optional Payment Clause):

As an issuer, I would not wish to confine myself to a period of 3 business days during which the examination, determination of compliance, and payment should be made. Further, the phrase “duly requested account of Beneficiary” should be made clearer as what constitutes “duly requested” could change from person to person.

– The fifth paragraph (Reduction):

The general wording of the reduction clause is very simple and avoids risks of misunderstanding. However, the clause for automatic reduction covers only the case in which beneficiary demand triggers reduction. In daily practice many banks issue standbys with a condition of automatic reduction on presentation of some kind of documents by the applicant or third parties, as stipulated by the contract, which could also be useful to mention in this model form.

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ISP98 FORM 3 – COMMENTARY

– The eighth paragraph (Optional Communications Clause):

This clause well provides various ways to allow communications to occur between the beneficiary and the issuer. Hence, if one means does not work, any other could be used by the parties, however I would rather the notice of change of beneficiary's address was to be suggested to be given not only to the applicant but also directly to the issuer in case the applicant does not so notify the issuer in a timely manner or at all thus resulting in the delay of communication between the issuer and the beneficiary.

– Annexed Payment Demand:

The wording of the demand was very well drafted from the following standpoints: From top to down, it includes spaces for date and addressee in full compliance with ISP98, indicates that the beneficiary demands a certain monetary amount, and most importantly, encourages the beneficiary to expressly state that the applicant is obliged to the beneficiary which I believe reduces the likelihood of an abusive drawing. The optional clause that follows further helps mitigate the possibility of an abusive drawing.

– Annexed Reduction Demand:

In some underlying relationships, it may be contemplated that as the applicant carries out part of its obligations vis-à-vis the beneficiary, the relevant standby undertaking will automatically be reduced. However very few contracts/agreements include the wording and content of the document by which the standby is to be used and so it could be problematic when presented by the beneficiary under a standby as to whether the wording of the document so presented is to be acceptable from the issuer and applicant's perspective and could cause delay in the reduction of the standby. By providing the content and wording of such a reduction letter, ISP Form 3 disciplines such a process and pre-empts the occurrence of any such delay.

Of course, in practice there are standby texts to the effect that the issuer will automatically reduce the amount of standby or cancel it as the case may be, unilaterally and without obtaining the consent of the beneficiary on presentation of a copy of a document to this end. For example, take it as a commercial standby and the applicant is the importer of the goods and/or services and

thus the beneficiary is the exporter or service provider. Then, the standby is stating that the issuer will reduce its amount or cancel it when the applicant provides the copy of a SWIFT message evidencing that certain amount of sum has been effected by the applicant through its bankers which bank is different to the standby issuer. In these cases no beneficiary consent is needed. However, it should be admitted that for such a provision to appear in the standby, it should be allowed in the underlying contract for the applicant not to fall foul of breaching the contract by having the standby issued incorporating reduction clauses not allowed therein. This scenario is also typical in the case of an advance payment standby in that the applicant of the standby who is the exporter or the service provider wants to be certain that its risk will be decreased once it carries out a certain portion of the work or effects the exportation of some quantity of goods in return for the advance payment received from the importer, the beneficiary of the standby. This is reasonable given that the beneficiary of the standby could make an unfair drawing if it gets into a financially difficult position even if the applicant has carried out what it had promised. ■

ISP98 Form 6 Model Counter Standby with Annexed Form of Local Bank Undertaking*

[name and address of local bank beneficiary]

[date of issuance]

At the request and for the account of [name and address of applicant] (“Applicant”),¹ we [name and address of issuer at place of issuance] (“Issuer”) issue this irrevocable standby letter of credit number [reference number] (“Counter Standby”) in favour of [name and address of beneficiary] (“Beneficiary”)² in the maximum aggregate amount of [currency/amount].

This is a counter standby³ letter of credit supporting Beneficiary’s issuance of its separate [local bank] undertaking⁴ in the form of the Annexed Local Undertaking⁵ [to be issued on or before [date]].⁶

Issuer undertakes to Beneficiary to pay Beneficiary’s demand that includes⁷ Beneficiary’s statement⁸ that Beneficiary issued its Local Undertaking as provided in the Counter Standby and has received [and honoured] a complying demand under its Local Undertaking in the amount hereby demanded from Issuer, if Beneficiary’s demand is presented to Issuer on or before the expiration date either as an originally signed paper document at Issuer’s above-stated address or as an authenticated SWIFT message sent to Issuer’s SWIFT address [SWIFT code] from Beneficiary’s SWIFT address [SWIFT code].⁹

The expiration date of this Counter Standby is [date].¹⁰

[Payment against a complying presentation shall be made within three business days after presentation at the place for presentation or by wire transfer to a duly requested account of Beneficiary.]

This Counter Standby is issued subject to the International Standby Practices 1998 (ISP98) (International Chamber of Commerce Publication No. 590).¹¹

[Issuer’s name]

[signature]

Authorized Signature

FEATURE

Annexed Local Undertaking

[INSERT DATE]

[name and address of person indicated in counter standby as the intended local beneficiary of the local bank undertaking]

On the application of **[counter standby applicant's name and address]**, **[counter standby issuer's name and address]** has issued to us a standby letter of credit supporting our issuance of this undertaking to you.

We, **[name and address of local bank]**, issue in your favour our *[standby letter of credit]* *[guarantee]* *[undertaking]* No. [INSERT REFERENCE NUMBER] in the amount of **[currency/amount]** payable against your demand for payment presented on or before **[date]** to us at **[address of place for presentation]**, that identifies this undertaking, states the amount demanded, and includes your certificate that the amount demanded is due to you from **[counter standby applicant's name]** under *[numbered agreement sections or identified obligations to perform bid, bonding, delivery, warranty or other obligation or to account for advance payments received of]* your agreement titled **[agreement title]** and dated **[date]**.¹²

Our undertaking is subject to the International Standby Practices 1998 (ISP98) (ICC Publication No. 590).¹³

[local bank issuer's name]

[INSERT ORIGINAL SIGNATURE]
Authorized Signature

[Before the counter standby with annexed form of local bank undertaking is issued, all text in **[bold]** should be completed, and optional text in *[italics]* should be included or deleted (or redrafted). All text preceded by "INSERT" (or other ALL CAPITALS guidance) and in [ALL CAPITALS UNDERLINED] is to be completed as indicated when the annexed local undertaking is prepared and issued.]

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This ISP98 Form 6 is a model form for a commonly used type of standby. As described in the Preface to ISP98, a “Counter Standby” supports the issuance of a separate standby or other undertaking by the beneficiary of the counter standby. The beneficiary of a counter-standby is typically another bank familiar with acting as a standby beneficiary and issuer and doing so by receiving and sending authenticated SWIFT messages as well as paper documents. Most counter standbys are issued as inter-bank authenticated SWIFT messages, and this ISP98 Form 6 could be adapted to a SWIFT message format.

The annexed form of local bank undertaking is also an ISP98 standby, but it could take many other forms. The local undertaking to be annexed to a counter standby should reflect the input of the local bank and local beneficiary, as well as the counter standby issuer and its applicant.

The endnotes to this ISP98 Form 6 refer to ISP98 rules of particular relevance to counter standbys. See the endnotes to ISP98 Form 1 for explanation of wording that is common to ISP98 Forms 6 and 1 and for alternative and optional wording.

A standby that provides for confirmation by another bank serves substantially the same purpose as a counter standby that supports another bank’s local undertaking. Either type of standby can be worded to reduce or expand the differences between the two under ISP98. See the ISP98 Form 7 Model Standby Providing for Confirmation for an alternative to this Form 6 Model Counter Standby with Annexed Form of Local Bank Undertaking.

This form is published for educational purposes and not as legal or professional advice. Potential users should consult with their own advisers in the drafting or use of a standby letter of credit. ISP98 and letter of credit educational and training materials, including The Official Commentary on the International Standby Practices containing official interpretations of ISP98, are available from IIBLP at www.iiblp.org.

¹ Applicant. The applicant for a counter standby typically has a “bid”, “performance”, “advance payment”, or other such obligation to a distant contracting party that must be supported by a local bank standby, guarantee, bond, or other undertaking. The applicant for the counter standby applies to its bank for issuance of a counter standby in order to meet the requirements of a local bank for an assured right of incoming payment in case the local bank must honour its local undertaking.

² Beneficiary. The beneficiary named in a counter standby (like the issuer of the counter standby) is typically a bank that, on the basis of the counter standby, issues its own local bank standby, guarantee, bond, or other undertaking. The references in this model form and endnotes to “local bank” and “local bank undertaking” (and to “local undertaking” and “local beneficiary”) are for convenience in distinguishing the two different undertakings and the two different sets of issuers and beneficiaries involved in counter standby practice. The beneficiary of the counter standby need not be a bank. Its status as a non-bank might affect the nature of its local undertaking, but should not affect the independence of the counter standby under ISP98.

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³Counter standby name. While this model form is named a “counter standby”, the name is not determinative of its character as an undertaking within the scope of ISP98 or as an independent undertaking under applicable law. As noted in the ISP98 Preface, categorizing standbys based on the type of underlying transaction does not affect the application of the ISP98 Rules.

⁴Request for local bank undertaking. This counter standby form assumes, but does not itself request, issuance by the beneficiary of a separate undertaking. ISP98 Rule 8.02 (Charges for Fees and Costs) obligates an issuer to pay the reasonable and customary fees and expenses of a beneficiary requested by the issuer to issue a separate undertaking, if otherwise unrecovered and unrecoverable. Accordingly, it may be desirable to clarify in the counter standby whether and to what extent the counter standby issuer must pay such fees and expenses.

ISP98 Rule 4.21(a) (Request to Issue Separate Undertaking) provides that a beneficiary of a counter standby receives no rights “other than its rights to draw under the standby even if the issuer pays a fee to the beneficiary for issuing the separate undertaking.”

⁵Form of local bank undertaking. The local bank undertaking may be a standby letter of credit, independent guarantee, dependent guaranty, bond, or contractual promise. This model form of counter standby specifies by annex the type and terms of the local bank undertaking.

⁶Delivery of local undertaking. If the local bank undertaking is to be delivered to the applicant’s representative, then details for such delivery (and the effect of non-delivery or return of the local bank undertaking) should be added to the counter standby.

If it is desired that issuance of the counter standby be deferred until the local bank undertaking is issued, then ISP98 Rules 2.03 (Conditions to Issuance) and 4.11 (Non-Documentary Terms or Conditions) should be consulted. These same rules should be consulted if it is desired that issuance of the counter standby be deferred until an advance payment is actually made to the applicant for the counter standby.

⁷Unstated requirements for demand. The word “includes” signals that there are unstated requirements for a complying demand, i.e., the demand must also include a date and identification of the counter standby. See ISP98 Form 1, endnote 10, and ISP98 Form 5, endnote 3.

⁸Statements. Beneficiary statements included in a counter standby form of demand are sometimes limited to the beneficiary’s issuance of the requested local bank undertaking, receipt of a complying demand for payment thereunder, and incurrence of an absolute obligation to pay. Beneficiary statements under a counter standby sometimes also recite that payment has been made under the local bank undertaking (in which case the counter standby may provide for same day payment or payment with value from the date the beneficiary states that it funded its local undertaking).

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If a counter standby requires presentation of (a copy of) the local bank undertaking issued or of the demand received under the local bank undertaking, then the standby text should state whether and how such documents are to be examined by the counter standby issuer. If a counter standby does not require their presentation but such documents are nonetheless presented under the counter standby, then ISP98 Rule 4.21(c) (Request to Issue Separate Undertaking) provides that the issuer of the counter standby “shall disregard their compliance or consistency with the standby, with the beneficiary’s demand under the standby, or with the beneficiary’s separate undertaking” and may return or forward any such documents.

Beneficiary statements typically are made to the issuer of the counter standby (bank to bank) and not to the applicant for the counter standby. They typically do not include representations as to whether the applicant is obligated in any underlying transaction. In this regard it is assumed that the documentation for the transaction underlying a local bank undertaking will adequately establish the applicant’s contractual obligations to provide a local bank undertaking and the applicant’s contractual rights and remedies in case of a disputed drawing or a disputed use of proceeds from a drawing.

If a counter standby provides that it may be terminated on advance notice given by the issuer, then the required form of beneficiary statement should permit the local bank beneficiary to demand payment under the counter standby and hold the proceeds as security against a possible future drawing under its local bank undertaking. See ISP98 Form 2 for model wording and alternative and optional wording for automatic extension and for demand following a notice of non-extension.

⁹Presentation via SWIFT. This counter standby form expressly permits presentation of a demand via authenticated inter-bank SWIFT message. ISP98 Rule 3.06 (Complying Medium of Presentation) permits such presentations without express wording in the standby as between SWIFT bank members.

¹⁰Expiration. The terms of a counter standby and of a local bank undertaking should be drafted in light of the terms of the underlying obligation and should address the possibility that the counter standby or the local bank undertaking or both may expire prematurely relative to the underlying transaction.

ISP98 Rule 3.09 (Extend or Pay), while not specific to counter standbys, addresses a practice that is particularly associated with demands made under counter standbys. Typically the beneficiary of a counter standby issues a local undertaking that will expire several days before the counter standby will expire. If the counter standby issuer does not timely affirmatively extend its counter standby, then the local bank beneficiary of the counter standby may make a so-called “extend or pay” demand before the counter standby will expire. Under this ISP98 rule, an issuer examines any “extend or pay” demand for compliance as a demand for payment and, whether or not the demand complies, treats the demand as separately requesting an amendment extending the counter standby. See ISP98 Form 2, endnote 13.

Some counter standbys provide for automatic extension with a right to terminate a future automatic extension by giving advance notice. In such cases particularly, the counter standby and local bank undertaking should be aligned so that the local bank beneficiary may demand payment whenever the counter

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standby is about to expire before the local bank undertaking will expire. See endnote 8 to this ISP98 Form 6.

¹¹Choice of law; choice of forum. A counter standby may usefully include a choice-of-law and choice-of-forum clause. A choice of law or forum or both in a counter standby would apply to the standby issuer's obligations and not to the obligations of the local bank beneficiary under its separate undertaking. See ISP98 Form 1, endnote 19, on law/forum clauses, including the availability of arbitration under the ICLOCA rules.

¹²Certificate. The certificate may be included in the demand made under this form of local bank undertaking. If in separate documents, the certificate, as well as the demand, should be dated and signed. See ISP98 Rules 4.07 (Required Signature on a Document), 4.12 (Formality of Statements in Documents), 4.16 (Demand for Payment), and 4.17 (Statement of Default or Other Drawing Event).

¹³Incorporation of ISP98. This form of local bank undertaking states that it is subject to ISP98. ISP98 is available for use in any country that will enforce letters of credit and demand guarantees independently of the issuer's reimbursement rights and the beneficiary's rights in the underlying transaction.

Issuance of a counter standby subject to ISP98 does not require that the local bank undertaking also be issued subject to ISP98 (or by a bank). Unless an ISP98 counter standby otherwise states, the local bank undertaking could be issued as an independent undertaking subject to ISP98 or to other rules or to no rules, or it could be issued as a dependent undertaking. Similarly, the local bank undertaking could be issued subject to law other than the law applicable to an ISP98 counter standby or to any underlying transaction.

[IIBLP as of 31 March 2012]

ISP98 FORM 6: A WINNING FORMULA FOR COUNTER STANDBYS

By Paula GREAVES*

The Institute of International Banking Law & Practice, Inc.'s (IIBLP) development of eight Model Standby Forms under ISP98 provides the letter of credit industry model guidance as well as tremendous learning and reference tools. By publication of these models, including the important and precise endnotes,¹ parties to standby letters of credit and their legal representatives using these models will have a level field upon which negotiations can take place. Let the games begin!

In this article we will examine ISP98 Model Form 6 - Model Counter Standby with Annexed Form of Local Bank Undertaking. This model form contemplates the scenario where the issuer provides their standby letter of credit, which purpose is in support of the Beneficiary's issuance of its

separate *local bank* undertaking. Model Form 6 provides for both the model of the counter standby and, as an annex, the model of a local bank undertaking. This local bank noted in the ISP98 Form 6 endnotes that a standby letter of credit that provides for confirmation by another bank serves substantially the same purpose as a counter standby that supports another bank's local undertaking. Either type of standby can be worded to reduce or expand the differences between the two under ISP98. Later this year, editions of *Documentary Credit World* will publish viewpoints on ISP98 Form 7 Model Standby Requiring Confirmation and ISP98 Form 8 Model Confirmation of Standby for an alternative to this Form 6 Model Counter Standby with Annexed Form of Local Bank Undertaking.

As with other model forms, ISP98 Model Form 6 provides: sample structure and wording, optional language, and sections where the user could insert applicable information and, of course, the model provides for standards seen in standby LC issuance, as described in ISP98 Form 1. The importance of Form 6 is that it also provides two critical components that allow the counter standby configuration to work by:

- A) Informing the Beneficiary of the purpose of the counter standby LC. (The purpose statement makes it clear that the counter standby is issued only for the Beneficiary in support of the Beneficiary's issuance of its local bank undertaking by a certain date and in the form of

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1. ISP98 Model Form 6 builds on the basic provisions in ISP98 Model Form 1 and adds to it, various counter-standby provisions, including a model form of local bank undertaking. To avoid making the forms too long, the endnotes to Form 1 are generally not repeated in subsequent Forms, such as ISP98 Form 6, that use text that was also included and explained in Form 1.

the Annexed Local Undertaking. It has been the author's experience that non-standard information in a counter Standby LC regarding its purpose [or no information at all], often leaves the Beneficiary with concerns about its position and the intent of the standby LC itself.)

- B) Providing terms that must be met in order to present a complying draw under the counter standby LC. (It is in these terms that it is made clear that the Beneficiary must have issued their local bank undertaking as provided in the counter standby [as an Annex] **and** that the Beneficiary has received a complying draw under that local bank undertaking **and as optional language**, has honored that complying draw).

There are winners all around when the Issuer of the counter standby has followed the guidance of this model form and provided The

Annexed Local Undertaking as part of their counter standby. For instance:

- A) The Beneficiary of the local bank undertaking – This Beneficiary has its locally issued and governed undertaking from an institution that it trusts and has clear access to.
- B) The Beneficiary of the counter standby/Issuer of the local bank undertaking -- The issuer of the counter standby has made unambiguous what requirements the local bank undertaking must provide in order for the local bank undertaking's beneficiary to make a complying demand. Furthermore, the counter standby provides a clear roadmap to the counter standby Beneficiary that, if followed, will assure them of backing should their local bank undertaking be called upon.
- C) The Issuer of the counter standby – The Issuer

maintains control over the precise circumstances under which it may be called upon to honor its undertaking and when that obligation expires.

- D) The Applicant of the counter standby – The Applicant has assurance that, only in the instance of a complying draw under a local guarantee to which it has had full visibility, will it be required to reimburse the Issuer of the counter standby for complying drawings under the counter standby.

Industry models and standards such as IIBLP's eight Model Standby Forms under ISP98 provide the global letter of credit community a valuable tool-kit to bring consistency to our standby letter of credit/demand guarantee business, thus mitigating operational, legal, and reputational risk. While banks are in the business of taking risks, it is only by understanding, managing, and mitigating those risks that the business of letter of credit/demand guarantee banking works. ■

ISP98 FORM 6: MAKING THE COUNTER STANDBY MORE SIMPLE AND PRECISE

By SOH Chee Seng*

A counter guarantee or counter standby is quite commonly used when the parties in a contract, the project owner, and the contractor are from different countries.

For example, to ensure completion of the project, the project owner in country B requires the contractor in country A to provide a performance guarantee or standby to be issued by a local bank in country B in favor of the project owner. The contractor may then request its banker in country A to issue a counter standby in favor of the local bank in country B for the account of the contractor.

The amount of the counter standby could be 5% to 10 % of the contract amount as agreed in the contract. The local bank in country B will then, at the request of the issuer of the counter standby, issue its own local undertaking

in favor of the project owner in accordance with the specified text or particulars stated in the annexed document for the account of the issuer in Country A.

As Professor James Byrne pointed out in his article in *DCW*, “[C]ounter guarantee practice grew out of the murky suspicions in the 1960s and 70s that led Mid Eastern beneficiaries to devise strategies to defeat the attempts of European and North American banks to favor their clients in letter of credit type transactions” by not being prepared to honor their undertakings under letters of credit. As a result, the Mid Eastern beneficiaries required a firm promise of reimbursement from their local bank and elected to follow European guarantee practice. Hence, the parties in Europe arranged with their bankers in Europe to provide a counter

guarantee in favor of the local bank.¹

Though both the counter standby and local undertaking refer to the same contract and project, they are separate and independent undertakings. As the counter standby, by its nature, is independent, the right of the local bank that issues the local undertaking to reimbursement by the issuer under the counter standby is defined solely by reference to the terms and conditions stated in the counter standby. However, in the case of a counter guarantee, the principle of independence in relation to the local guarantee is not always absolute but subject to certain limits which are similar to those in respect of the ordinary guarantee.

There are reported cases in Europe in which a court granted a stop payment order against the issuer of a counter guarantee, although the

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1. “Counter Standby/Counter Guarantee Practice: The Problems of Nomenclature” by James E. Byrne, *DCW* July/August 2011, p. 16.

counter guarantee stated it was to be payable on demand without any condition of payment where the terms of the local guarantee had not been complied with.² There could be a fraud exception under the principle of independence. However, apart from fraud, unconscionability was also used as a ground for the granting of an interim injunction restraining a beneficiary from making a call under a guarantee in some countries. The court commented that even where a performance bond was expressed to be payable on first demand without proof or conditions, there was no reason why fraud should be the sole ground for restraining a call.³

Counter guarantees may be issued in different formats, but they often include terms and/or phrases like “we shall unconditionally pay the amount ... on your first demand despite any contestation by our principals”, “we undertake to hold you fully indemnified and harmless from any claim, loss or expenses ...”, “despite

any contestation between party XXX and party YYY ... and without it being necessary for you to produce or adduce any proof or any judicial ... whatsoever in support of your claim”, or terms and phrases of similar effect. Sometimes the counter guarantee prescribes a comprehensive text with specific provisions that include details of the underlying contract. Such wording may lead to confusion as to whether the issuer has provided an independent undertaking under the counter guarantee.

The terms and conditions of a counter standby should be made simple, complete, and precise. If it provides complicated details and information, it may lead to misinterpretation. In the Singapore case of *JBE Properties Pte Ltd v. Gammon Pte Ltd*,⁴ the performance guarantee stated that the Bank was obliged to indemnify JBE only against “all losses, damages, costs, expenses or [sic] otherwise sustained by [JBE]” [emphasis added] as a result of Gammon’s breach of the Building Contract. Therefore,

the court held that the obligation of the Bank under the Bond was limited to indemnifying JBE against actual losses which it sustained due to Gammon’s breach of the Building Contract. Since the payment obligation of the Bank was so limited, the Bond had the character of a true indemnity performance bond. A similar argument may also apply to the counter guarantee and the local guarantee.

ISP98 Form 6 provides a simple, complete, and precise format for use of a counter standby. Though the counter standby format clearly states that it is in support of a local undertaking to be issued by the beneficiary (local bank), the issuer undertakes to pay the beneficiary’s demand that includes a statement as required in the counter standby. It does not provide detailed provisions or phrases like we commonly see in a counter guarantee. The format clearly provides that the undertaking of an issuer of the counter standby is independent especially when it is issued subject to ISP98. ■

2. Roeland F. Bertrams, “Bank Guarantees in International Trade”, 2nd revised edition, ICC Publishing S.A. Paris – New York and Kluwer Law International, The Hague – London – Boston, p. 43.

3. *JBE Properties Pte Ltd v. Gammon Pte Ltd*, [2010] SGCA 46, [2011] 2 SLR, p. 47-60.

4. *Id.*

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