UNIFORM LAW CONFERENCE OF CANADA

CIVIL SECTION

UNITED NATIONS CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT

PRE-IMPLEMENTATION REPORT

by Steven P. Jeffery and Marc Lacoursière

Toronto, Ontario
Quebec City, Quebec
March 2006

TABLE OF CONTENTS

UNITED NATIONS CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT

Pre-implementation Report

by Steven P. Jeffery[*] and Marc Lacoursière[**]

March 2006

I. INTRODUCTION

[1] The following report has been prepared at the request of the Uniform Law Conference of Canada, which decided at its August 2005 Annual Meeting to review the advisability of preparing a uniform implementing act for the 1995 ***United Nations Convention on Independent Guarantees and Stand-by Letters of Credit*** (hereinafter referred to as the "Convention")[1]. The report is to be part of a cooperative initiative with the National Conference of Commissioners on Uniform State Law ("NCCUSL") in the United States. The report examines the existing framework for the law of independent guarantees and stand-by letters of credit in Canada, both from a common law and civil law perspective, and considers whether there is a need in Canada for the Convention. The report concludes by recommending whether or not the Convention should be adopted by Canada.

A. Purpose of the Convention

[2] In the Explanatory Note by the United Nations Commission on International Trade Law ("UNCITRAL") Secretariat on the Convention (the "Explanatory Note"), a number of objectives and purposes are set out, including:

1. "to facilitate the use of independent guarantees and stand-by letters of credit where only one or the other of those instruments is traditionally in use" and "to solidif[y] recognition of common basic principles and characteristics shared by the independent guarantee and the stand-by letter of credit"[2];

2. to "establish… a harmonized set of rules for the two types of instruments covered, [thereby] provid[ing] greater legal certainty in their use for day-to-day commercial transactions, as well as marshal credit for public borrowers", to "facilitate the issuance of both instruments in combination with each other, for example, the issuance of a stand-by letter of credit to support the issuance of a guarantee, or the

reverse case" and to "facilitate "syndications" of lenders, by allowing them to combine more easily both types of instruments" [3]; and

3. to "give… legislative support to the autonomy of the parties to apply agreed rules of practice such as the Uniform Customs and Practice for Documentary Credits (UCP), formulated by the International Chamber of Commerce (ICC), or other rules that may evolve to deal specifically with stand-by letters of credit, and the Uniform Rules for Demand Guarantees (URDG, also formulated by ICC)" and to "supplement… their operation by dealing with issues beyond the scope of such rules[,]… in particular regarding the question of fraudulent or abusive demands for payment and judicial remedies in such instances" [4].

[3] Explanatory Note 6 clarifies that "the focus of the Convention is on the relationship between the guarantor (in the case of an independent guarantee) or the issuer (in the case of a stand-by letter of credit) (hereinafter referred to as "guarantor/issuer") and the beneficiary".

B. Terms of Reference of Report

[4] This report will examine existing Canadian law to determine whether it would be useful for Canada to adopt the Convention. In gauging whether it would be useful, the provisions of the Convention will be reviewed in light of Canadian law, both common and civil, and in light of the similar provisions of the UCP, the ISP98 and the URDG. We assume that NCCUSL will be reviewing the Convention in light of Article 5 of the Uniform Commercial Code, and we have therefore not done so.

C. Terminology

[5] This report will adopt the terms used in the Convention and its Explanatory Note, including the UCP and the URDG. The URDG uses terms that apply to both bank guarantees and stand-by letters of credit. Thus, the expression "independent commitment" means an independent guarantee and "stand-by letter of credit" includes the expression counter-guarantor; and "guarantor/issuer" includes a counter-guarantor and a confirmer (or confirming bank).

D. Structure of the Report

[6] The second part of this Report sets out the Canadian legal framework applicable to independent guarantees and stand-by letters of credit (Part II). The presentation is divided into two parts, namely the common law (A.) and the civil law (B.). The third part

examines the scope of application of the Convention (Part III). This focuses on the international nature (A.) and the territorial requirements of the Convention (B.). The fourth part contains a comparative analysis of the Convention and Canadian law and forms the core of our Report (Part IV). We shall consider the following points: definition (A.), issuance (B.), amendment (C.), transfer of beneficiary's right to demand payment (D.), assignment of proceeds (E.), determination of rights and obligations (F.), standard of conduct and liability of guarantor/issuer (G.), demand for payment (H.), and payment and set-off (I.). The fifth part examines in somewhat more detail the most ambitious and, perhaps, controversial provisions of the Convention - those dealing with the fraud exception (A.) and provisional court measures (B.) (Part V). The last part of the report sets out a number of conclusions and the recommendation of the authors (Part VI).

II. CANADIAN LEGAL FRAMEWORK

A. Common Law

[7] Constitutionally, letters of credit are not specifically referred to in the Constitution Act, 1867. It could be argued that, since letters of credit and independent guarantees have traditionally been issued by banks, they come within the "banking" powers of the federal government. Undoubtedly, if the federal government wished to do so, it could amend the Bank Act to include provisions specifically dealing with letters of credit issued by banks, including to insert the provisions of the Convention in the Bank Act. Could the federal government pass more general "letter of credit" legislation, purporting to enact law that would apply to all letters of credit issued by all persons in Canada, even provincially incorporated companies? This seems doubtful. The provinces could probably successfully rely on the "property and civil rights" power of the provinces under the Constitution Act. But, as we will discuss below, the Convention is restricted in its application to ***international*** letters of credit. It may be that, under its trade and commerce and banking powers, the federal government has the legislative authority to enact the Convention as federal legislation. This is not within the scope of this report and will have to be reviewed more closely.

[8] On the common law side of the existing Canadian legal framework, there is no existing legislation that specifically deals with letters of credit or bank guarantees. The law applicable to letters of credit in the common law provinces and federally has been developed by the courts, with reference to the court decisions of other jurisdictions (particularly the United Kingdom and the United States) and international rules of practice such as the UCP. Bank guarantees, ***per se***, as those instruments are understood in Europe, are not used in Canada, although banks and other lending institutions regularly

refer to the standby credits that they issue as "letters of guarantee" in recognition that they are not payment instruments but guarantee instruments.[5] The case of ***Distribulite Ltd. v. Toronto Board of Education Staff Credit Union***[6] was a case dealing with "letters of guarantee" issued by a credit union. In this case, the court correctly noted that, although the letters in that case utilized the word "guarantee" numerous times, "[t]he documents differ, however, from ordinary guarantees because the obligation imposed on the Credit Union did not depend on the liability of the [applicant] to any of the plaintiffs [the beneficiaries]"[7]. The court then stated:

> These differences from an ordinary guarantee bring the documents into a hybrid category variously known as performance guarantees or stand-by credits:
>
> > 'The standby credit is thus something of a hybrid. It partakes of the nature of a guarantee in that the payment obligation is in form secondary, rather than primary; but it shares the characteristics of the traditional documentary credit that payment is required to be made on presentation of a specified document, without reference to the actual facts. Prima facie this is sufficient to prevent it from being legally characterized as a guarantee.'[8]

This essential characteristic of a documentary credit described above is referred to as the principle of autonomy. Although the stand-by credit can be termed a "secondary" obligation because in most cases it is used to secure the obligations of a person and therefore can only be called upon if that person defaults in performing the secured (primary) obligations, this use of the term "secondary" is misleading. Under the principle of autonomy, "the obligation of the issuing bank to honour a draft on a credit when it is accompanied by documents which appear on their face to be in accordance with the terms and conditions of the credit is independent of the performance of the underlying contract for which the credit was issued".[9] Thus, the obligation of the issuer to the beneficiary is in fact a primary obligation. The nature of the issuer's obligation to the beneficiary, and in particular its enforceability at common law (and civil law, for that matter) in light of the fact that there appears to be no consideration flowing from the beneficiary to the issuer, has been the subject of much debate. As the Supreme Court of Canada has noted:

> "There is no doubt that there are important differences between the civil law and the common law concerning the rationale, in contract theory, for the legally enforceable nature of the issuing bank's obligation to the beneficiary under an irrevocable letter of credit. The general opinion appears to be that the obligation is of a ***sui generis*** contractual nature for which no completely satisfactory rationale

has been found in the established categories of contract theory, but the judicial recognition of its legal enforceability is now beyond dispute."[10]

B. Civil Law

[9] The importance of classifying an independent guarantee in the civil law results, on the one hand, from the possibility of harmonizing international standards with Quebec law and, on the other hand, from the ease with which Quebec law can be harmonized with the common law. Some civilians have attempted to associate an independent bank guarantee with certain nominate contracts, including suretyship and delegation of payment[11]. Commercial lawyers, on the other hand, opt instead for an innominate or ***sui generis*** contractual instrument.

i. Suretyship

[10] Jurists in the Romano-Germanic tradition have attempted on many occasions to associate the independent bank guarantee with suretyship. In Quebec, article 2333 C.C.Q. defines suretyship as "a contract by which a person, the surety, binds himself towards the creditor, gratuitously or for remuneration, to perform the obligation of the debtor if he fails to fulfil it". Suretyship is characterized primarily by two elements. First, it is a personal and not a real security. Also, this surety is subsidiary to a principal undertaking (debt).

As a rule, the authors are agreed in stating that an independent bank guarantee cannot constitute a suretyship. In fact, although it is a personal security, this bank guarantee is nevertheless independent of the underlying contract between the parties[12] and this independence cannot confer on it the subsidiary status inherent in a suretyship. While the theory is simple in appearance, judges do not seem to find it so. In our view, this may result from the confusion sometimes expressed by judges between a letter of credit and a simple suretyship, since the letter of credit sometimes serves as a guarantee and not as payment.[13] For example, in ***Banque Nationale du Canada*** v. ***Construction Lamcorp Inc.***[14], the duty to provide a suretyship in accordance with article 2779 C.C.Q. was fulfilled by the issuance of an irrevocable letter of credit, which the judge also called a letter of bank guarantee. Thus, the court associated a suretyship with a letter of credit, but did not provide more detailed explanations. The other decisions in Quebec are to the same effect.[15]

In French law, the analysis suggested by the courts, including the Cour de cassation, is more rigorous but produces results similar to those of Quebec law. On this point,

Professor Cantamine-Raynaud has brought several interesting decisions to our attention. She analyses two decisions of the Chambre commerciale[16] and the 1re Chambre civile,[17] in which those courts held that the distinction between an independent bank guarantee and a suretyship depended solely on their purpose. In the first case, the title of the contract referred to as suretyship, but the contract itself was riddled with contradictions. Nevertheless, as Professor Cantamine-Raynaud notes, [TRANSLATION] "the instrument contained …, among other wording, an undertaking to pay '***all amounts owed by Horizon 91 in the event of default by Horizon 91***'"[18]. As the author indicates, it is necessary to ask why, among several possible formulations, only this wording was chosen. It is possible that the court favoured the more explicit evidence of a suretyship than that of an independent guarantee and that, given the doubts, the former prevailed. In the second decision, there was less ambiguity and the Cour d'appel confirmed that the parties had expressed the wish that [TRANSLATION] "payment should be made simply on demand".[19] The 1re Chambre civile opted instead for a traditional view, according to which [TRANSLATION] "the undertaking at issue involved the actual debt of the principal debtor and was not independent".[20] The problem appears therefore to be as follows: when the parties intend to create an independent guarantee, it is necessary to indicate that payment will be made simply on demand. However, the reference to a principal debt to determine the amount payable may mislead some judges who are not familiar with independent guarantees.[21]

Finally, Switzerland seems to share the viewpoint of the courts in Quebec and France. For example, a decision of the Tribunal fédéral suisse considers in greater detail the differences between independent guarantees and subsidiary guarantees – namely sureties[22] – and quotes the Swiss authors Guggenheim[23] and Thévenoz.[24] In the first case, the Court notes that, once the conditions imposed have been met, the beneficiary will have a remedy against the guarantor, who may not raise objections based on the contractual relationship between the beneficiary and the vendor. In the second case, the effects of the subsidiary or dependent guarantee, [TRANSLATION] "are similar to those of a suretyship",[25] since the nullity of the principal cancels the effects of the guarantee.

It may happen that the distinction between an independent and a subsidiary guarantee will come to light only with difficulty, as happened in the decision of the Chambre commerciale of the Cour de cassation in France in 1997. While the French court merely based its decision on the purpose of the contract, the decision of the Swiss court provided a more detail legal analysis. The court suggested several ***indicia*** for determining the subtle difference between an independent bank guarantee and a surety. First, although it was not conclusive, a guarantee issued by a bank indicates that it may be an independent guarantee. Use of a guarantee in an international transaction suggests that this guarantee is independent. Further, [TRANSLATION] "the reference to the underlying contract alone does not justify a conclusion that a subsidiary undertaking exists…, because an

independent guarantee is never completely separate from the underlying contract, since, even where it is, the beneficiary must at least allege a failure to perform".[26] Similarly, an irrevocable undertaking is not conclusive either, because it often involves "a standard form of banking practice", and this form may accordingly not always involve a renunciation of rights or even of oppositions to exceptions or objections. However, this renunciation is nevertheless viewed as a conclusive indication by the authors. Finally, the guarantor's undertaking to pay on first request suggests the existence of an independent guarantee.[27]

ii. Delegation of Payment

[11] Another school of thought attempts to like the independent bank guarantee to a delegation of payment.[28] Article 1667 C.C.Q. defines a delegation of payment as follows: "Designation by a debtor of a person who is to pay in his place constitutes a delegation of payment only when the delegate obligates himself personally to the delegatee to make the payment; otherwise, it merely constitutes an indication of payment". At first glance, the analogy is attractive: three parties are involved in the transaction and there is a personal obligation of the delegate to make payment. As far as application of the theory of delegation to the world of finance is concerned, some would argue that this theory explains a number of funding mechanisms.[29]

It is difficult to argue, however, that delegation might make it possible to explain the mechanism of the independent guarantee. First, although article 1669 C.C.Q. provides that "[t]he delegate may not set up against the delegatee the defences he could have raised against the delegator, even though he did not know of their existence at the time of the delegation", it is important to consider article 1670 C.C.Q., which provides that "[t]he delegate may set up against the delegatee all such defences as the delegator could have set up against the delegatee. The delegate may not set up compensation, however, for what the delegator owes to the delegatee or for what the delegatee owes to the delegator". This possibility that the delegator may raise any defence against the delegatee, except for compensation, means that an imperfect delegation of payment contradicts the fundamental principle of the independence of the documentary credit and the independent bank guarantee. Second, the economic purpose of the delegation is in fundamental contradiction with the documentary credit: the delegation arises from earlier legal relationships designed for economy in multiple transfers of securities,[30] whereas an irrevocable documentary credit – which is, in this regard, similar to a guarantee – requires the intervention of a banker who will pay in exchange for the proper documents.[31] Third, in delegation, the initiative is taken by the delegator, whereas in an independent bank guarantee, the beneficiary triggers the transaction.[32] Fourth, article 1668 C.C.Q. must be

interpreted in accordance with the new concept of imperfect delegation of payment, which does not appear to require the consent of the delegatee, unlike the situation of perfect delegation.[33] When transposed to the situation of an independent bank guarantee, this implies that the beneficiary must indicate his consent to the banker. This requirement, which is hard to reconcile with banking practice, especially on the international level, is utopian in the circumstances. In other words, as a French author has pointed out, [TRANSLATION] "this approach fails in seeking the actual spirit of the [right] to credit: the independent nature of the banking undertaking in light of the underlying contract of sale".[34]

Perfect delegation of payment involves novation by a change of debtor, creditor or debt. In an independent bank guarantee, the bank of the principal for the guarantee does not replace but is added to the debtor, as is the case with a surety. Also, the principal debt is not extinguished by the guarantee provided by the bank. In all cases, article 1665 C.C.Q. clearly states that the ***animus novandi*** cannot be assumed and must be clear.[35] Whereas all the essential elements of the delegation must be found in the credit, it would be difficult to find a credit in a perfect delegation.[36]

iii. The innominate or sui generis *contract*

[12] In our opinion, the difficulty experienced by civilians in classifying independent bank guarantees under nominate contracts – and thus under the Civil Code of Quebec – must be resolved by determining that the nature of this instrument is that of a ***sui generis*** contract. This solution is more suitable for an independent bank guarantee than for the traditional institutions of the civil law, including suretyship and delegation, since the independent guarantee has changed constantly and more markedly over the years than suretyship and delegation.[37] In particular, likening an independent bank guarantee to the traditional institutions distorts this credit, which, as we have seen, has been forged by banking practice and commercial usage.[38]

III. SCOPE OF APPLICATION OF THE CONVENTION

A. The Internationality Requirement

[13] Article 1(1) of the Convention states that the Convention applies to "an international undertaking". The "internationality" aspect of the undertaking is further defined in article 4 of the Convention, which provides that an "undertaking is international if the place of business, as specified in the undertaking, of any two of the following persons are in different States: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer".

[14] The Explanatory Note does not explain why the Convention applies only to an international undertaking. Presumably, the United Nations concerns itself only with "international" law, and not with the internal laws of countries that deal with letters of credit. However, why should an "international undertaking" have a codified set of rules as set out in the Convention, while a non-international undertaking would not be subject to such rules? This has the potential of leading to two sets of rules for letters of credit in Canada, one for domestic credits and one for international credits.[39] If Canada were to adopt the Convention, it would have to give serious consideration to eliminating this artificial distinction - i.e. Canada would have to consider adopting a law similar to the Convention for non-international undertakings.

B. Territorial Scope

[15] Article 1(1) continues by providing that the Convention applies to an international undertaking (a) if the place of business of the guarantor/issuer at which the undertaking is issued is in a Contracting State (i.e. a state that has ratified, accepted or approved the Convention) or (b) if the rules of private international law lead to the application of the law of a Contracting State, unless, in either case, the undertaking excludes the application of the Convention. Article 1(2) provides that the Convention applies also to an international letter of credit not falling within article 2 if it states that it is subject to the Convention. This allows the parties to a commercial or documentary credit to adopt the Convention, if they wish for some reason to do so. Finally, article 1(3) provides that the provisions of articles 21 and 22 apply independently of article 1(1).

[16] Article 21 states that the undertaking is governed by the law the choice of which is (a) stipulated in or demonstrated by the terms and conditions of the undertaking or (b) agreed elsewhere by the guarantor/issuer and the beneficiary. Article 22 provides that failing a choice of law in accordance with article 21, the undertaking is governed by the law of the State where the guarantor/issuer has that place of business at which the undertaking was issued.

[17] In summary, then, the Convention will apply to the undertaking if (a) in the case of an international letter of credit not falling within article 2, the undertaking states so, (b) the place of business of the guarantor/issuer at which the undertaking was issued is in a Contracting State, unless the undertaking excludes the Convention or makes a choice of law of a non-Contracting State, (c) the rules of private international law lead to the application of the law of a Contracting State, unless the undertaking excludes the Convention or makes a choice of law of a non-Contracting State, or (d) the choice of law

set out in or demonstrated by the undertaking or agreed elsewhere by the guarantor/issuer and the beneficiary is the law of a Contracting State.

IV. COMPARATIVE ANALYSIS

A. Definition of "Undertaking"

[18] A standby letter of credit can be used in any payment or guarantee situation and appears to be distinct from the documentary or commercial credit only in that the documents to be presented in order to obtain payment are non-existent or very simple. Examples of uses to which a standby credit may be put are:

1. as a payment device:
   (a) that is revocable, to pay salaries abroad, make intercompany payments or pay expense accounts; and
   (b) that is irrevocable:
      (i) to pay principal, purchase price or interest on bonds;
      (ii) to be provided in lieu of stock transfer contracts;
      (iii) to make progress payments;
      (iv) to make payments under promissory notes; or
      (v) in lieu of a documentary credit, to pay for goods or services, where the parties trust each other and, to save costs, have eliminated the need for extensive documentary requirements; and

2. as an irrevocable guarantee device, in lieu of bid, performance and surety bonds, in lieu of bank guarantees, in lieu of cash or other collateral or to support another bank's (for example, a subsidiary bank in another country) guarantee or undertaking[40] or to "secure performance of contractual obligations including construction, supply and commercial payment obligations; to secure repayment of an advance payment in the event that such repayment is required; to secure a winning bidder's obligation to enter into a procurement contract; to ensure reimbursement of payment under another undertaking; to support issuance of commercial letters of credit and insurance coverage; and to enhance creditworthiness of public and private borrowers" (see Explanatory Note 3).

[19] As far as the Convention is concerned, article 2 defines an "undertaking" as "an independent commitment, known in international practice as an independent guarantee or a stand-by letter of credit". The independence criterion, which characterizes this instrument, is based on the letter of credit and is codified in article 3 of the ***Uniform Customs and Practices for Documentary Credits***.[41] The Convention adds that

independence does not depend on an underlying obligation, any commitment or a term or condition, except [TRANSLATION] "presentation of documents or another such act or event within a guarantor/issuer's sphere of operations".[42]

[20] The intrinsic characteristic of the independence of a letter of credit – which, in this regard, is subject to the same principles as an independent guarantee or stand-by letter of credit – does not cause any problems in Canadian law, either for the judges or the authors. In the case of a stand-by letter of credit, the definition in the Convention reflects the independence characteristic that is referred to in the case of ***Distribulite Ltd. v. Toronto Board of Education Staff Credit Union,***[43] where the court stated that the "essential characteristics" of a stand-by credit were that the "obligation is secondary and depends on the customer's default and ...payment flows from the presentation of the required documents, independent from and without proof of the underlying facts".[44] As far as a letter of credit is concerned, acceptance of the theory of the independence of the instrument from the underlying contract was recognized by the Supreme Court of Canada in the famous decision in ***Bank of Nova Scotia*** v. ***Angelica-Whitewear Ltd. et al***.[45] In that case, Le Dain J. asserted, in an often quoted passage, that "[t]he fundamental principle governing documentary letters of credit and the characteristic which gives them their international commercial utility and efficacy is that the obligation of the issuing bank to honour a draft on a credit when it is accompanied by documents which appear on their face to be in accordance with the terms and conditions of the credit is independent of the performance of the underlying contract for which the credit was issued".[46] Among the many comments concerning this decision, it is interesting to note the opinion of the French Professor Michel Vasseur: [TRANSLATION] "This ***very important decision of the Supreme Court of Canada*** witnesses, if that were necessary, to the fact that the conceptual unity of the documentary credit, governed on the international level by the rules and usages, has the result that the problems it raises occur in the same way in all countries, even though they are not resolved in the same way" [emphasis added].[47]

[21] Besides the fact that a letter of credit, a stand-by letter of credit and an independent guarantee are independent, it is important to consider whether the definition of these instruments in Canadian law complies with the Convention. We must first note, in both common law and civil law, one concern with having a codified definition of a standby letter of credit is whether it will be broad enough or too broad.

[22] In the ***Distribulite*** case, the court distinguished between letters of credit and stand-by credits, the latter being "furnished by way of security, not by way of payment and because payment is made by the issuer only if the principal defaults".[48] In contrast to the lengthy list of uses set out above to which stand-by credits may be put, the Canadian

common law courts' definition of a standby letter of credit can be seen to be not particularly evolved at the point in time of the ***Distribulite*** decision (in 1987). The small volume of cases in Canada since then has not advanced the case law that much. Thus, to codify it now may remove flexibility from the courts in the future in deciding whether a particular document is a stand-by credit.

[23] As referred to above, the definition begins by stating the commitment is "known in "international practice" as an independent guarantee or a stand-by letter of credit". The meaning of the quoted term "international practice" is unclear. As is discussed further below in connection with Article 13(2) of the Convention, this language is similar to language used in the UCP and ISP98, but its lack of clarity troubles at least one commentator. A technical concern is raised from the ***Distribulite*** case, which referred to the fact that many stand-by credits in Canada are referred to as "letters of guarantee". The Convention does not refer to a "letter of guarantee". Presumably, this technicality will not remove these letters of guarantee from being considered to be "undertakings" within the meaning of that term in the Convention. The Convention does specifically provide, in Explanatory Note 8, that demand, first demand, simple demand or bank guarantees are all within the scope of the Convention (being different names for independent guarantees). Quebec law, especially the judicial decisions, which regularly refer to this concept of international practice, does not go into details concerning its content.

[24] The definition continues by stating that the commitment is "given by a bank or other institution or person". These words seem broad enough to deal with the situation that existed in the ***Distribulite*** case - the standby credit being issued by an institution that was not a bank ("bank" being the only type of issuer referred to in the UCP 500, for example). This requirement does not cause a problem in Quebec law. It is possible that the commitment will be given by an entity other than a bank,[49] although an independent guarantee is usually an independent bank guarantee.[50]

[25] The definition continues by stating that the commitment is "to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking". Again, these words are very broad - an "undertaking" could be a documentary credit under this wording.

[26] The definition continues by stating that the demand is to "indicat[e], or from which it is to be inferred, that payment is due [1] because of a default in the performance of an obligation [2] or because of another contingency [3] or for money borrowed or advanced [4] or on account of any mature indebtedness undertaken by the principal/applicant or another person". Again, this wording is very broad - an "undertaking" could be a

guarantee (only payable upon a default by the applicant) or a payment mechanism (payable upon demand to pay a debt owing, whether default has occurred or not).

[27] It would seem that the definition of "undertaking" is probably broad enough that concern does not arise that it will impede the courts in the future from determining whether a particular document before the court is a stand-by credit or not. ***Au contraire***, it is to be hoped that this definition will help judges in their analysis of stand-by letters of credit.

[28] One issue that arises from article 1 of the Convention arises from the provisions of articles 1(2)(c) and 1(4), which permit an issuer to issue an undertaking on its own request (i.e. the issuer is both issuer and applicant) or to issue an undertaking that names the issuer as the beneficiary. Professor Dolan, in his article on the Convention,[51] sees the risk of a conflict arising out of these situations as being something that should not be sanctioned by the Convention.

B. Issuance

[29] Article 7 is the first article in Chapter III of the Convention, entitled Form and Content of Undertaking. Under article 7(1), "issuance" of an undertaking occurs when and where the undertaking leaves the sphere of control of the guarantor/issuer. This is similar to the definition in the ISP98, s. 2.03, with the words "sphere of" added (presumably to make the concept of the control of the issuer broader - so that if, for example, an agent or lawyer for the issuer held the undertaking at the time of its issuance, the undertaking could not be said to have left the "sphere of control" of the issuer). Explanatory Note 25 claims this provision "promotes certainty in an area traditionally of some uncertainty owing to the existence of differing notions". Leaving the sphere of control of the issuer is likened in such note to "when it is sent to the beneficiary". There is little Canadian law on the subject of issuance of a credit. A letter of credit may be sent to the beneficiary in different ways. For example, an advising bank may be sent notice of the credit and asked to advise it to the beneficiary.[52] This will be deemed to be issuance - for example, under article 11(a) of the UCP, where an issuer instructs an advising bank to advise a credit by authenticated teletransmission, the transmission becomes the operative instrument. It appears that article 7(1) is broad enough to include all forms of issuance, but whether it clarifies the area of advised credits is itself unclear.

[30] Article 7(2) specifies that an undertaking may be issued in any form which preserves a complete record of the text of the undertaking and provides authentication of its source by generally accepted means or by an agreed-upon procedure. This method is based

directly on article 4A-202 of the ***Uniform Commercial Code***[53] and article 5(2) of the ***UNCITRAL Model Law on International Credit Transfers*** (***Model Law on Transfers***).[54] As will be seen, this broad definition of the form of an undertaking is referred to a number of times in the Convention. In Explanatory Note 26, it is noted that this definition is "flexible and forward-looking" and, by not requiring a "written" form, "accommodates issuance in a non-paper-based medium (e.g. by means of electronic data exchange)". It is interesting that the Convention is open to new technologies but a further step must be taken in order to accommodate users of the Internet, as the International Chamber of Commerce ("ICC") recently did in the ***Supplement to the UCP 500 for Electronic Presentation***.[55] Canadian and Quebec law have been modernized in this regard. The UCP and ISP98 contemplate written letters of credit, while the URDG definition of a guarantee also contemplates a written document. So the definition in the Convention is certainly flexible and broad. Whether it is particularly helpful is perhaps another question.

[31] Note that, in the definition of an "undertaking" in article 2, the term "issue" is not used - the more general term "give" is used. What, then, is the importance of "issuance"? It appears, from article 7(3), that demand for payment under the undertaking may only be made from the time of its issuance. Further, article 8(2) provides that an undertaking is amended only upon issuance of the amendment. Issuance is also important under article 12(c) relating to expiry.

[32] Article 7(4) provides that an undertaking is irrevocable upon being issued unless it stipulates otherwise. This is in keeping with the UCP article 6(c) and URDG art. 5. Under the ISP98, s. 1.06, standby credits are irrevocable.

C. Amendment

[33] An amendment under article 8(1) must either be in the form stipulated in the undertaking or, failing such stipulation, in a form referred to in article 7(2). Under articles 8(2) and (3), unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, an undertaking is amended upon issuance of the amendment if the amendment has previously been authorized by the beneficiary or, if the amendment has not been previously authorized by the beneficiary, it is accepted by the beneficiary in a form referred to in article 7(2). In other words, an amendment is not binding upon a beneficiary unless it consents to it. This accords with the UCP article 9(d)i, which states that a credit "can neither be amended nor cancelled without the agreement of the Issuing Bank, the Confirming Bank (if any), and the Beneficiary". The reference to the amendment being accepted in a form referred to in article 7(2) may be problematic. Under the common law, "[c]onsent to the amendment need not be in writing

nor express. It has been held that the presentation of shipping documents required by the terms of the amendment may be deemed to be an acceptance of the amended terms…."[56]. Thus, to the extent that the requirement that an amendment or its acceptance be in a form referred to in article 7(2) would be interpreted by the courts to mean that the amendment or its acceptance must be in writing or expressly consented to in writing, this would be different from the existing common law and would appear to remove some flexibility that the law currently has.

[34] The aforementioned provision in the UCP is notable for its failure to refer to the applicant. It is generally agreed that, although it does not say so in the UCP, the agreement of the applicant is also necessary to an amendment to the letter of credit[57]. The Convention, in its focus only on the issuer/beneficiary relationship, refers only to the beneficiary and the issuer in articles 8(2) and (3). Interestingly, though, the Convention then specifically goes on, under article 8(4), to provide that an amendment has no effect on an applicant or confirmer unless such person consents to it.[58]

D. Transfer/Assignment of Proceeds

[35] Under article 9(1), the beneficiary's right to demand payment may only be transferred if authorized, and only to the extent and in the manner authorized, in the undertaking. This is similar to URDG article 4, 1st paragraph. Article 9(2) then states that if a transferable undertaking does not specify whether the consent of the issuer is required for the transfer, then the issuer is not obliged to effect any transfer without first consenting thereto. This is similar in effect to UCP articles 48(a), (b) and (c), which have been upheld by the courts: see ***Bank Negara Indonesia 1946 v. Lariza (Singapore) Pte. Ltd.***[59] Otherwise, it is to be noted that these provisions of the Convention have much less detail than article 48 of the UCP and ISP98 Rule 6, leaving out such issues as more than one transfer, partial transfers, advising of amendments and transfer fees.

[36] Under article 10(1), unless otherwise stipulated in the undertaking or elsewhere, the beneficiary may assign the proceeds to which it may be or become entitled. Article 4 of the URDG, 2nd paragraph, and article 49 of the UCP simply state that proceeds are assignable by the beneficiary, while section 6.07 of the ISP98 provides that the issuer is not obliged to give effect to an assignment of the proceeds that it, the issuer, has not acknowledged. Under article 10(2), if the issuer receives notice of an irrevocable assignment of the proceeds, payment to the assignee by the issuer discharges the issuer's liability to pay under the undertaking. This appears to leave open the question posed by the rule as is set out in the ISP98 - may the issuer choose whether to acknowledge the

assignment, i.e. may the issuer choose to pay the assignor even after receiving the notice of the assignment?

[37] In Ontario, section 53(1) of the ***Conveyancing and Law of Property Act***,[60] provides that "any absolute assignment …of any debt or other legal chose in action of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to receive or claim such debt or chose in action is effectual in law, subject to all equities …, to pass and transfer the legal right to such debt or chose in action from the date of such notice, and all legal and other remedies for the same, and the power to give a good discharge for the same without the concurrence of the assignor." In other words, if the issuer receives notice of an assignment of the proceeds and still pays the assignor, it could be doubly liable.

In Quebec, the obligations imposed by articles 1637 ***et seq.*** C.C.Q. are similar. The creditor may assign his claim on condition that this does not make the obligation more onerous for the debtor.[61] When this debtor "has acquiesced in it or received a copy or a pertinent extract of the deed of assignment or any other evidence of the assignment which may be set up against the assignor", the assignment may be relied upon against this party and against third parties from that point.[62] The Convention does not expressly state anything that is contrary to this.

E. Cessation of Right to Demand/Expiry

[38] Under article 11(1), the right of the beneficiary to demand under the undertaking ceases when (a) the issuer receives a release from the beneficiary, (b) the beneficiary and the issuer have agreed on termination of the undertaking, (c) the amount available under the undertaking has been paid, unless the undertaking otherwise provides, or (d) the validity period of the undertaking expires (as to which, see article 12). This concept is not specifically dealt with in the URDG, UCP or ISP98. The cessation of the right of the beneficiary to demand under a letter of credit after the expiry date set out in the credit has been recognized by the courts,[63] even where the issuer, in error, has already made payments under the credit after the expiry date.

[39] Under article 11(2), an undertaking may stipulate or the parties may agree elsewhere that return of the undertaking is required for cessation of the right to demand payment, but in no case shall retention of the undertaking by the beneficiary after the right to payment ceases preserve any rights of the beneficiary. In Explanatory Note 34, it is noted that there is a "degree of uncertainty…surround[ing], in some jurisdictions, the question of the effect of retention of the …undertaking as regards definitive cessation of the right to demand payment". This may be because this issue is not dealt with in the UCP. The

URDG, article 24, and ISP98, section 9.05, specifically provide that retention does not preserve any rights.

[40] Article 12 stipulates when the validity period of an undertaking expires. Paragraph (a) refers to the expiry date, which may be a specified calendar date or the last day of a fixed period, provided that if the expiry date is not a business day at the place of business of the issuer, then the expiry date is extended to the next business day. Under the UCP, article 42(a), and the ISP98, s. 9.01, a credit must contain an expiry date (or be revocable by the issuer under section 9.01 of the ISP). The concept of automatically extending the expiry date if it falls on a non-business day is in article 44(a) of the UCP and s. 3.13 of the ISP98. The URDG does not deal with this. Paragraph (b) refers to the occurrence of an act or event not within the issuer's sphere of operations - if this is the trigger that leads to the undertaking expiring, then it expires when the issuer is advised that such act or event has occurred by presentation of the document specified for that purpose in the undertaking or, if no such document is so specified, by certification of such act or event by the beneficiary. This is not dealt with in the UCP, ISP98 or UDRG. Paragraph (c) introduces a useful concept of finality - if the undertaking does not specify an expiry date, or if the act or event on which expiry is stated to depend has not occurred, then the undertaking expires six years after its issuance. This is not dealt with in the UCP, ISP98 or UDRG, but the UCC in article 5-106(c) and (d) provides that a credit that does not specify an expiry date expires in one year and a credit that specifies that it is "perpetual" expires in five years.

F. Determination of Rights

[41] Article 13 is the first article in Chapter IV of the Convention, entitled Rights, Obligations and Defences. Article 13(1) provides that the rights and obligations of the guarantor/issuer and the beneficiary arising from the undertaking are determined by the terms and conditions set out in the undertaking, including any rules, general conditions or usages specifically referred to therein (such as the UCP, ISP98 or URDG) and by the provisions of the Convention. In Canada, there is no doubt that references in letters of credit to the UCP and similar rules, and the rules set out in the UCP and other sets of rules, will be enforced by the courts.[64]

[42] Article 13(2) provides that, in interpreting the undertaking and settling questions not addressed by it or by the Convention, regard is to be had to "generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice". This language is similar to article 13(a) of the UCP, which refers to

"international standard banking practice" and to section 4.01(b) of ISP98, which refers to "standard standby practice". John Dolan comments on this language as follows:

> "[D]oubt remains that there are such standards in all instances. It is further questionable whether in some instances such standards will not be produced in an ad hoc manner and crafted by expert witnesses in retrospect. One must also question whether these "practices" should not be proved in a manner consistent with traditional notions of proving industry practices and standards -- that is, by showing that the practice has "such regularity of observance in a …trade as to justify an expectation that it will be observed with respect to the transaction in question." [citing UCC section 1-205(2)] To the extent that rules promulgated by the ICC are incorporated into an undertaking, such an expectation is reasonable. However, where "practices" are not so codified, [footnote omitted] courts should put parties alleging these "practices" on their proof. [footnote omitted]"[65]

When contracts are interpreted in Quebec civil law, article 1426 C.C.Q. provides that it is necessary to take into account "the nature of the contract, the circumstances in which it was formed, the interpretation which has already been given to it by the parties or which it may have received, and usage".[66] Although they are secondary sources of law, customs and usage are recognized in Quebec law for the interpretation of a contract, as long as five conditions are met, namely that they be old, common, public, general and uniform.[67] However, Quebec judges are discreet with respect to the meaning to be given to an international banking practice or even international usage. Although usage is provided for in several places in the C.C.Q., note should be taken of article 1434 C.C.Q., which states that "[a] contract validly formed binds the parties who have entered into it not only as to what they have expressed in it but also as to what is incident to it according to its nature and in conformity with usage, equity or law". Thus, Quebec law recognizes that usage serves not only to interpret but also to bind the co-contractors.

[43] There is no doubt that international stand-by practice is already taken into account when letters of credit are interpreted by the courts. Indeed, the UCP and other publications of the ICC are taken as examples of the practice of the industry, and these publications in turn refer, indeed defer, to standard stand-by practice in the industry. The reference in the Convention, then, to these practices is nothing new. Does the fact that the Convention is potentially adopted as the law in Canada somehow give these "practices" more stature than they have now in the UCP? We would not think so, although Dolan's admonition about how such practices must be proven to exist becomes, perhaps, that much more important for the courts to bear in mind, as they, ultimately, are the arbiters of whether, in fact, a practice exists.

G. Standard of Conduct

[44] Article 14(1) provides that, in discharging its obligations under the undertaking and the Convention, the guarantor/issuer is to act in good faith and exercise reasonable care having due regard to generally accepted international practice of independent guarantees or stand-by letters of credit. Article 14(2) provides that a guarantor/issuer may not be exempted from liability for its failure to act in good faith or for any grossly negligent conduct. In the case of the guarantor/issuer's duty to take reasonable care when performing his obligations, this obligation is similar to that set out in article 13(a) of the UCP and article 9 of the URDG. However, all these rules state that the guarantor/issuer must take reasonable care in determining whether the documents are accurate, though there is no such statement in the Convention. Nevertheless, this omission does not seem very important, since the reference in article 14 to "generally accepted international practice", which is similar to the expressions used in the UCP, URDG and ISP98, justifies the inference that an examination of the documents is referred to. In any event, article 16(1) clarifies this, by providing that the guarantor/issuer must examine the demand and any accompanying documents in accordance with the standard of conduct referred to in article 14(1). This duty (of reasonable care in examining the documents) does not cause any particular problem in the Canadian decisions.

[45] The duty to act in good faith imposed by article 14 of the Convention, however, raises the delicate question of its relevance to the document. The viewpoints of the common law and the civil law differ in this regard. In the case of the common law, it is interesting to quote Professor Dolan who, in his article on whether the Convention should be adopted, states the following:

> "The reference to the good-faith obligation introduces undesirably vague standards for measuring the guarantor/issuer's duty against the firmer standard of determining that the documents comply with the terms and conditions of the credit. It is arguable that that compliance standard is strict. If the guarantor/issuer satisfies the standard, it has properly discharged its duties; if it does not observe the standard, it has not discharged them. In either case, the guarantor/issuer's good faith or observance of due care should be irrelevant."[68] [footnote omitted]

Dolan also refers to Professors Goode and Kozolchyk as agreeing with this position. The UCC, in the old (1962) version of article 5-109, used to provide that "[a]n issuer's obligation to its customer includes good faith and observance of any general banking usage". However, this reference was modified in the 1995 version of the UCC. There is now no general obligation of good faith imposed on the issuer under article 5 of the UCC,

although it remains in some cases. Such general obligation is not set out in the UCP or ISP98, but is provided for in article 15 of the URDG. At common law, it is often said that there is "no general doctrine of good faith",[69] although there are many notable exceptions.[70] Imposition of a general obligation of good faith would therefore represent a change from the existing common law.

[46] How would this change impact the courts? One area that may be affected would be the law regarding the fraud exception to the principle of autonomy. Under the UCC, good faith is referred to in article 5-109(a)(2), which provides that the issuer, when presented with a demand under a credit that appears to comply with the terms of the credit, but a required document is fraudulent or honouring the presentation would facilitate a material fraud, may, acting in good faith, honour or dishonour the presentation. In short, under the UCC, an issuer, even when presented with evidence of fraud, may nevertheless honour the demand under the letter of credit, so long as it is acting in good faith.

In Canada, as stated above, there is no general obligation of good faith. In ***Angelica-Whitewear***, the Supreme Court of Canada made it clear that, when an applicant has alleged fraud to the issuer and the issuer must exercise its own judgment in deciding whether or not to pay, the standard to be met is "whether fraud was so established to the knowledge of the [issuer] before payment of the draft as to make the fraud clear or obvious to the [issuer]".[71] This is a difficult burden for an applicant to meet. This appears to be similar to the UCC standard, where the issuer must only act in good faith. It would presumably not be in good faith for the issuer to ignore completely the evidence of fraud that has been presented to it by the applicant. But, unless the fraud is "clear or obvious", under both the UCC and the law in Canada, the issuer will in fact be entitled to ignore the evidence given to it by the applicant of the alleged fraud and pay the beneficiary.[72]

[47] Dr. Jens Nielsen, a lawyer in Germany, and Nicolai Nielsen, an American lawyer, refer in an article examining the ISP98[73] to the standard of good faith that is imposed by many civil law systems on all commercial dealings. In their view, section 1.06(c)(iv) of the ISP98, which provides that the enforceability of an issuer's obligations under a standby does not depend on the issuer's knowledge of performance or breach of any reimbursement agreement or underlying transaction, is void under German law insofar as this section directs or allows the issuer to pay on demand even in a case of obvious fraud. In their view, the obligation of good faith imposed on issuers in general obligates them not to pay when demand is made by an unauthorized person or when a demand is "objectively illicit", even if no actual malice exists (that is, there is no "fraud" in the sense that "fraud" implies subjective deceit or dishonesty by the beneficiary), which the authors claim is a requirement of U.S. law.

However, it appears that this view of the authors is at odds even with European law. The authors themselves note that "a strong opinion supported by the literature and jurisdiction [sic - jurisprudence?] requires as an element of fraud obvious willfulness, fraud or malice…[or] a subjectively reproachable attitude of the defendant [applicant]".[74] The authors note that "a subjective intent to harm" is also required by French and English courts.[75] In Canada, this is also the case. In ***Cineplex Odeon Corp. v. 100 Bloor West General Partner Inc***.,[76] the court defined fraud as follows:

> Fraud is not simply a legitimate dispute or disagreement over the interpretation of a contract, however one-sided that dispute may appear. While the notion of fraud may elude precise definition, it is a concept well-known to the law, and it must, in my view, import some aspect of impropriety, dishonesty or deceit. In ***Washburn*** v. ***Wright*** (1913), 31 O.L.R. 138 (App. Div.), Mr. Justice Riddell said, at p. 147:
>
> > But, suppose the defendant was wrong in this or in any other respect, there is absolutely no evidence of fraud. Fraud is no mistake, error in interpreting a contract; fraud is "something dishonest and morally wrong, and much mischief is ... done, as well as much unnecessary pain inflicted, by its use where 'illegality' and 'illegal' are the really appropriate expressions:" ***Ex p. Watson*** (1888), 21 Q.B.D. 301, per Wills, J., at p. 309.[77]

In short, it appears that the authors may be incorrect in their assertions about the effect of article 5-109(a)(2) of the UCC and section 1.06(c)(iv) of the ISP98 - these provisions do not "require the bank to refuse payments in obvious cases of fraud".[78] On the contrary, Canadian and U.S. law both require the issuer not to pay if fraud is obvious. It seems, then, that imposing an obligation of good faith on the issuer will not result in a change in the law in the area of the fraud exception.

Nielson's civilian standpoint reflects in part the concerns of Quebec jurists about the concept of good faith in contracts. This duty to exercise one's rights in good faith, which is based on French law, may be found in articles 6, 7 and 1375 C.C.Q. The last of these articles provides that "[t]he parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished". As the authors Jobin and Vézina[79] point out, however, the concept of good faith is assessed not only subjectively – [TRANSLATION] "the state of mind of a person when he or she acts" –, but also objectively, as was required by the Supreme Court in three important decisions.[80] Thus, [TRANSLATION] "good faith has therefore become the behavioural ethic required

in contracts …. This presupposes faithful and honest behaviour [footnote omitted]. It is then possible to speak of acting in accordance with the requirements of good faith".[81]

In Quebec civil law, it is important to distinguish carefully between the duty to act in good faith in examining documents and the reaction of an issuing bank to the demand of a principal claiming to be the victim of fraud. The duty of good faith exists in both these situations. The onus of proof imposed on the principal when checking that documents are accurate is not as demanding as it is when the principal alleges that fraud has occurred. In the former case, the issuing bank must merely act in good faith, without malice aforethought, in performing the task. In the latter case, the onus of proof imposed on a principal in Quebec is essentially the same as that imposed by the common law in Canada. In certain cases, therefore an issuing bank's failure to act in good faith toward the principal might be insufficient in itself for the principal to be granted provisional relief – for example, an injunction – and to prevent the principal's bank from paying a beneficiary. Finally, we should note that the good faith requirement in the Convention does not raise any problems in the eyes of French civil lawyers.[82]

Consequently, it appears that the good faith required by the Convention is compatible with the civil law of Quebec, but it is difficult to match it with the common law concepts. Thus, to the extent that article 14, by importing an obligation of good faith that may not exist in general at common law, represents a change in the common law, or gives the courts another tool with which to interpret a letter of credit transaction, Professor Dolan and others view this as not a good thing.

H. Demand and Examination of Demand

[48] Article 15(1) provides that any demand for payment under the undertaking is to be made in a form referred to in article 7(2) and in conformity with the terms and conditions of the undertaking. Article 15(2) provides that, unless otherwise stipulated in the undertaking, the demand shall be presented within the time that it may be made and to the guarantor/issuer at the place where the undertaking was issued. Article 15(3) provides that the beneficiary, when demanding, is deemed to certify that the demand is not in bad faith and that none of the elements referred to in article 19(1)(a), (b) and (c) are present.

[49] As referred to above, article 16(1) provides that the guarantor/issuer must examine the demand and any accompanying documents in accordance with the standard of conduct referred to in article 14(1) and that, in determining whether documents are in facial conformity with the terms and conditions of the undertaking, and are consistent with one another, the guarantor/issuer must have due regard to the applicable international standard of independent guarantee or stand-by letter of credit practice.

Article 16(2) gives the guarantor/issuer a reasonable period of time, but not more than seven business days, to examine the documents, decide whether or not to pay and (if the decision is not to pay) give notice thereof to the beneficiary. Such notice is to be given by teletransmission or other expeditious means and is to indicate the reason for the decision not to pay. These provisions are essentially identical to articles 13(a) and (b) and 14(d) of the UCP. The UCP has more detail. They are similar to article 10 of the URDG, which has less detail. The provisions of the Rule 5 of ISP98 are also similar, though much more detailed. The requirements of compliance and consistency are in keeping with Canadian law.[83]

I. Payment and Set-off

[50] Article 17 requires the guarantor/issuer to pay against a demand made in accordance with the provisions of article 15, which payment shall be made promptly, unless the undertaking provides for payment on a deferred basis. Any payment against a demand that is not in accordance with the provisions of article 15 does not prejudice the rights of the principal/applicant.

[51] Article 18 allows the guarantor/issuer to discharge the payment obligation by availing itself of a right of setoff, unless otherwise agreed, and except with any claim assigned to it by the principal/applicant. This is in keeping with the common law and civil law.[84]

V. FRAUD EXCEPTION AND PROVISIONAL COURT MEASURES

A. Fraud Exception

[52] Explanatory Note 45 states that a "main purpose" of the Convention "is to establish greater uniformity internationally in the manner in which guarantor/issuers and courts respond to allegations of fraud or abuse in demands for payment under independent guarantees and stand-by letters of credit" and notes that this "has been a particularly troublesome and disruptive area in practice". Note 48 adds that the Convention tries to "strike… a balance between different interests and considerations at play".

[53] In fact, fraud in documentary credits and abuse of the independent guarantee, the criteria for assessing which are the same in the decisions and the authors, are not regulated at all in Canada and everything is left to the courts.[85] Outside Canada, the UCP is also silent concerning fraud. However, note should be taken of article 5-109 of the UCC,[86] which admits fraud as an exception to the principle of independence, whether it is

committed by the beneficiary or a third party. It is very interesting to note that article 19 of the Convention is also to this effect.

[54] Article 19(1) provides that "[i]f it is manifest and clear that: (a) any document is not genuine or has been falsified; (b) no payment is due on the basis asserted in the demand and the supporting documents; or (c) judging by the type and purpose of the undertaking, the demand has no conceivable basis, the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment." Article 19(2) "provides illustrative examples of cases in which a demand would be deemed to have no conceivable basis".[87] In summary, the wording of article 19(1)(c) of the Convention is very similar to the existing common law, as will be seen. It seems that article 19(1)(b) is simply a subset of the circumstances set out in article 19(1)(c) - if no payment is due on the basis asserted in the demand and the supporting documents, then presumably there is no conceivable basis for the demand. The question becomes, what do articles 19(1)(a) and (b) add to this - are they necessary and are they a useful addition to the law?

[55] We saw earlier that the documentary credit is primarily marked by its independence from the underlying contract. The fundamental exceptions to the independence of the documentary credit involve either slight differences that may affect the documents submitted for payment or, when the documents are accurate, an objection by the principal to payment of the letter of credit if it is the product of fraud. ***Fraus omnia corrumpit***, as the old adage says. Thus, when the principal finds that fraud has occurred, he may attempt to object to payment by his bank. It must be noted that the courts have found it difficult to attain the appropriate view inspired by the Convention. In Canada, the classic case is the Supreme Court of Canada decision in ***Angelica-Whitewear Ltd. v. Bank of Nova Scotia***,[88] in which case the court confirmed the law with respect to the fraud exception.

[56] First, the court found that "...the fraud exception...should not be confined to cases of fraud in the tendered documents but should include fraud in the underlying transaction of such a character as to make the demand for payment under the credit a fraudulent one".[89] This view is in accordance with those expressed by the authors, who feel that the cases of fraud in the documentary credit are either material or intellectual in origin, the former resulting from fraudulent documents and the latter occurring when genuine documents contain false statements.[90] Subsequent – and even prior – to this decision, the courts recognized both these types of fraud.[91] This requirement is met by article 19 of the Convention.

[57] Second, the Court gave a restrictive interpretation to the origin of the fraud when it stated that the principal could rely on this exception only when the fraud was perpetrated by the beneficiary, not by a third party (unless the beneficiary was aware of the third party's

fraud).[92] This interpretation has been followed by the courts in Canada.[93] For example, in ***Geestemünder Bank AG*** v. ***Barzelex Inc.,***[94] the Quebec Court of Appeal held that since a principal was unable to establish that the fraud of the third party occurred with the beneficiary's knowledge, the claim was dismissed.[95]

Article 19(1)(a) of the Convention appears to be much broader than the law as set out in ***Angelica-Whitewear***, when it provides that the guarantor/issuer may withhold payment if it is clear that "any document is not genuine or has been falsified". Under this wording, if the documents have been falsified by a third party, then the guarantor/issuer may withhold payment, even if the beneficiary is unaware of the act of the third party. Further, under article 19(1)(c), if the demand "has no conceivable basis", the guarantor/issuer may withhold payment. Is it conceivable that an act of a third party may result in the demand having no conceivable basis?

The reasoning behind a restrictive rule, as persuasively set out by Lord Diplock in the ***United City Merchants*** case, cannot easily be dismissed and can be said to be more in keeping with the commercial purpose of letters of credit, the autonomy rule and the rules in articles 4, 13(a) and 15 of the UCP. Lord Diplock refers to the legal maxim ***ex turpi causa non oritur actio*** or fraud unravels all, but (in seeming answer to the immediate question "if fraud unravels all, then why does fraud by a third party not unravel all?") clarifies that this means that "courts will not allow their process to be used ***by a dishonest person*** to carry out a fraud".[96] As we indicated earlier, the Supreme Court agrees with this assertion, which noted that fraud "should not include fraud by a third party ***of which the beneficiary is innocent***" [emphasis added].[97] However, Le Dain J. asserted in the preceding paragraph of this decision that "the fraud exception to the autonomy of a documentary credit should extend to any act of the beneficiary of a credit the effect of which would be to permit the beneficiary to obtain the benefit of the credit as a result of fraud".[98] Thus, there is nothing to prevent a principal from applying to prohibit his bank from making payment when the fraud was committed by a third party if the beneficiary is aware of the fraud and benefits from it.

The Convention is not very clear concerning the question of fraud by a third party, but an analysis of the wording of article 19 justifies the conclusion that it is in line with Canadian law. First, the wording of article 19(1)(a) is very broad, as we indicated earlier, and, more generally, article 19 of the Convention does not use the word fraud, but refers to it in the Explanatory Note. Second, the goal of the Convention is to establish a greater uniformity regarding fraud in guarantees and standby letters of credit. Hence, if the beneficiary is aware of a fraud from a third party, he is responsible, otherwise, he is not.

Article 19(2) only specifies the "beneficiary" and nobody else. Does this exclude fraud by a third party? Article 19(2) is not limitative and may include other situations[99].

[58] Thirdly, the court in ***Angelica-Whitewear*** specified that "...the fraud exception should not be opposable to the holder in due course of a draft on a letter of credit".[100] This follows the seminal case of ***Sztejn v. J. Henry Schroder Banking Corp.***[101] and ***Discount Records Ltd. v. Barclays Bank Ltd.***[102] In Quebec, this question was considered by the Superior Court in ***Les industries Almac Ltée*** v. ***Al-Arishi***.[103] In that case, the defendant alleged that he was a regular holder following the acquisition of the letter of guarantee as a result of negotiations. Not only was this not established but also the defendant had committed fraud against the plaintiff.[104] The Court held, properly in our view although it acknowledged the controversy surrounding this question,[105] that since the defendant had not negotiated the draft, he did not have status as a regular holder and consequently could not contest the application for an injunction.[106] The Convention is silent on this point of law.

[59] Fourthly, we have briefly reviewed above the meaning of the word "fraud" in Canadian letter of credit law - it imports some aspect of impropriety, dishonesty or deceit.[107] In the case that gave us this wording, the court went on to say that "where the demand on the letter of credit can be said to be 'clearly untrue or false', or 'utterly without justification', or where it is apparent there is 'no right to payment', all fall within the foregoing principles [of a strong ***prima facie*** case of fraud]"[108]. The decision in ***Angelica-Whitewear*** is to the same effect.[109] This interpretation of the fraud exception has been approved by many courts, and in a recent case the court formulated the exception with these words: "a demand for payment is only fraudulent if the claim to the funds is not even colourable as being valid or has absolutely no basis in fact."[110] This wording is similar to that used in the leading U.S. cases, which Dolan summarizes as "the beneficiary had no basis in fact to make the assertion called for by the credit",[111] and to the description of fraud by a leading commentator on letters of credit as "the beneficiary acts without any shred of honest belief in his rights".[112] Obviously, the drafters of article 19(1)(c) of the Convention had this language in mind when drafting that article.

[60] In short, the provisions of the Convention concerning the exception of payment in the event of fraud committed by a beneficiary are partly in accordance with the situation in Canada, in both the common law and the civil law. It must be noted that the Convention is not sufficiently precise on the issue of the assessment of the extent of the fraud committed by the beneficiary, which is to say that no subjective element of dishonesty on the part of the beneficiary is required. Finally, as far as fraud committed by a third party is concerned, although the Convention is not clear on this point, we have already stated that an

interpretation of the Convention justifies the assumption that such fraud is covered by the Convention.

B. Provisional Court Measures

[61] It should be noted at once that, in a decision of the Quebec Superior Court, Downs J. stated that [TRANSLATION]: "The court recognizes that international transactions should always be promoted and their implementation facilitated. It was, moreover, for this reason that the ICC must have adopted its standard rules and 'usages' for documentary credits."[113] However, situations occur in which the principal must resort to provisional measures.

Unlike the UCP, URDG and ISP 98, article 20 of the Convention specifically provides for the possibility that a principal who believes that he has been defrauded by a beneficiary may apply for provisional or interlocutory court measures.[114] It emerges first that the weight of the onus of proof on the principal must be the "basis of immediately available strong evidence" and that there be a "high probability" that one of the circumstances listed in article 19 has occurred, that is to say that the principal was the victim of fraud by a beneficiary. The wording of this provision is far from clear but it emerges that this requirement is similar to that imposed in Canada, in both the common law and the civil law.

Indeed, on an application for an interlocutory injunction, the Supreme Court has stated that a "strong ***prima facie*** case of fraud would appear to be a sufficient test".[115] This test has also been followed in other decisions involving both the common law and the civil law. Thus, the Canadian courts require a sufficiently high level of proof from an applicant before it will be able to avail itself of provisional measures, which burden approaches that imposed by the Convention.

In Quebec law, another remedy is available to the principal, namely seizure before judgment. In ***Paris Sportswear Ltd.*** v. ***Lanifico Itlam***,[116] the Court of Appeal acknowledged that in a case of fraud by the beneficiary of a documentary credit, seizure before judgment, also called garnishment in the circumstances of the case, will have the same effect as an injunction in that funds are held temporarily until a court has rendered a decision on the merits of the case and has agreed to cancel the letter of credit,[117] although an injunction is the more commonly sought remedy.[118] The Superior Court reiterated a few years later that [TRANSLATION] "seizure before judgment is just as appropriate a remedy as an injunction",[119] even though it was considering an injunction application and not a seizure before judgment.

Thus, the courts in Canada require a sufficiently high standard of evidence from a principal to apply provisional measures since the nature of this onus is close to that required by the Convention.

VI. CONCLUSION

[62] In ***Angelica-Whitewear***, LeDain J. referred to "the desirability of as much uniformity as possible in the law with respect to" letters of credit.[120] The Convention is an attempt to promote such uniformity. However, this attempt appears to have led to a set of rules that, for the most part, are general. However, although there is no specific legislation concerning independent bank guarantees and stand-by letters of credit, the Convention is generally in line with the Canadian and Quebec decisions, albeit with the exception of the requirement that the guarantor/issuer act in good faith when fulfilling its obligations (art. 14(1)) and the absence of assessment of fraud.

In the eyes of common law jurists, this general approach causes a problem since its usefulness is questionable. For example, for these common lawyers, the articles on issuance and form, amendment, transfer and assignment, cessation of right to demand, expiry, demand and examination of documents are all so general that they add little to the law or to the existing sets of rules such as the UCP. Civil lawyers are used to this approach, which is similar to several provisions of the Civil Code of Quebec. These lawyers will find the yardsticks that the Convention provides judges and lawyers useful, since most judges and lawyers are not familiar with independent bank guarantees and stand-by letters of credit.

[63] Generally speaking, the Convention is in line with Canadian law governing stand-by letters of credit and independent bank guarantees. It may be assumed that the courts will interpret the few provisions that are still too broad or vague in light of Canadian law. Consequently, we recommend that the ULCC adopt the Convention as a model law for possible adoption by Parliament and the provincial legislatures. In making this recommendation, we are mindful that there will be future discussions on this subject with the NCCUSL and that it would be useful if Canada's largest trading partner, the United States, also adopted the Convention.

* Partner, Blaney McMurtry LLP, Toronto.

** D.Jur. (York), LL.M. (Laval), Professeur agrégé, Faculté de droit, Université Laval.

1 United Nations Commission on International Trade Law (UNCITRAL), ***United Nations Convention on Independent Guaranties and Stand-by Letters of Credit,*** U.N. Doc. A/CN.9/431, 11 December 1995, 2169 UNTS 163 (in force 1 January 2000), Art. 2.

2 UNCITRAL, ***United Nations Convention on Independent Guarantees and Stand-by Letters of Credit***, "Explanatory note by the UNCITRAL Secretariat on the Convention on Independent Guarantees and Stand-by Letters of Credit", Explanatory note n° 2.

3 ***Supra*** note 2, Explanatory note n° 4.

4 ***Ibid.***, Explanatory note n° 5.

5 It appears that banks in Canada have the power to issue independent guarantees, provided they have a reimbursement agreement in place: see ***Bank Act***, S.C. 1991, c. 46, s. 414.

6 (1987), 45 D.L.R. (4th) 161 (Ont. H. C.).

7 ***Ibid***. at 206.

8 ***Ibid.*** (quoting from R. M. Goode, ***Commercial Law*** (Markham: Penguin Books 1982) at 697).

9 ***Bank of Nova Scotia v. Angelica-Whitewear Ltd.***, [1987] 1 S.C.R. 59 at 70.

10 ***Ibid.*** at 82.

11 For a discussion of other civil law institutions see: Jean-Laurent Anglade, ***Droit et pratique de la lettre de crédit standby*** (Paris : Litec, 2000), at n^{os} 60-64, pp. 43-45.

12 Charles Moumouni, « Le régime juridique et les clauses essentielles du contrat de garantie bancaire "à première demande" », (1997) 31 ***R.J.T.*** 781, 795; Monique Cantamine-Raynaud, « Existe-t-il une troisième voie entre le cautionnement et la garantie indépendante? Distinction entre le cautionnement et la garantie indépendante », (Mai/juin 1997) 61 ***Revue de droit bancaire*** 123.

13 More precisely, the letter of credit is a hybrid device since it serves as both a payment and a credit device: Marc Lacoursière, « Designing an Electronic Documentary Credit for Small and Medium-Size Enterprises », (2003) 18 B.F.L.R. 155 à la p. 159.

14 REJB 1998-09200 (C.S.).

15 ***Couvoir Scott ltée*** c. ***Volailles du Fermier inc.***, REJB 2000-20606 (C.S.); ***3099-2325 Québec Inc. c. 2849-6810 Québec Inc.***, REJB 1999-13879 (C.A.); ***Produits pétroliers Bernières inc. c. Banque Nationale du Canada***, REJB 1998-05528 (C.S.).

16 Cass. com., 11 mars 1997.

17 Cass. civ. I, 18 mars 1997.

18 M. Cantamine-Raynaud, ***supra*** note 12 at 123 [original italics].

19 ***Ibid.*** at 124.

20 ***Ibid***.

21 ***Ibid***.

22 ***X***. c. ***Banque n° 1***, 4C.380/2004/ech, 31 mai 2005, 1re Cour civile, on line at: <http://wwwsrv.bger.ch/cgi-bin/AZA/JumpCGI?id=31.05.2005_4C.380/2004>.

23 Daniel Guggenheim, ***Les contrats de la pratique bancaire suisse***, 4th ed. (Geneva: Georg, 2000), at 340.

24 Luc Thévenoz, « Les garanties indépendantes devant les tribunaux suisses », in ***Journée 1994 de droit bancaire et financier*** (Berne: Staempfli, 1994), 167, 169 ff., cited in ***X***. c. ***Banque n° 1***, 4C.380/2004/ech, 31 mai 2005, 1re Cour civile, on line at: <http://wwwsrv.bger.ch/cgi-bin/AZA/JumpCGI?id=31.05.2005_4C.380/2004>.

25 ***X***. c. ***Banque n° 1***, ***ibid.*** at n° 4.2; art. 492 ff. of the Swiss ***Code des obligations***.

26 ***X***. c. ***Banque n° 1***, ***ibid.*** at n° 4.3.

27 ***X***. c. ***Banque n° 1***, ***ibid.*** at n° 4.3.

28 Joseph Hamel, Gaston Lagarde and Alfred Jauffret, ***Traité de droit commercial***, vol. II (Paris: Dalloz, 1966) at n° 1823, at. 850; Albert Dieryck, ***Les ouvertures de crédit : étude juridique*** (Bruxelles : Établissements Émile Bruylant, S.A., 1946) at n° 281, at 296.

29 Pierre-Gabriel Jobin and Nathalie Vézina, ***Baudouin et Jobin – Les obligations***, 6th ed. (Cowansville: Yvon Blais), at n° 1011, at 1027; Benoît Moore, « De la délégation ***certaine*** à la délégation ***incertaine : error communis facit jus… et legem*** », (2004) 38 R.J.T. 475, pp. 476-477.

30 Henri De Page, ***Traité élémentaire de droit civil belge***, vol. III (Bruxelles: , Bruylant, 1962), at n° 606, at 603.

31 Ligia Maura Costa, ***Le crédit documentaire : étude comparative*** (Paris: L.G.D.J. 1998), at n° 337, at 151.

32 ***Ibid***.

33 P.-G. Jobin and N. Vézina, ***supra*** note 29, at n° 1025, at 1037.

34 L.M. Costa, ***supra*** note 31, at n° 332, at 150.

35 ***Banque Nationale de Paris (Canada)*** c. ***Creadev inc.***, REJB 2003-41182 (C.S.), par. 81-82; ***Bronfman*** c. ***Banque Royale du Canada***, REJB 1997-00337 (C.A.). See also: L.M. Costa, ***ibid.*** at n° 327, at 147.

36 L.M. Costa, ***ibid.*** at n° 327, at 147.

37 ***Ibid.*** note 30, at n° 422, at 179.

38 ***Ibid.*** at n° 428, at 180.

39 See Paul S. Turner "The United Nations Convention on International Standby Letters of Credit: How Would It Change Existing Letter of Credit Law in the United States?" (1997), 114 Banking L. J. 790, where the author suggests that, in cases involving international letters of credit, "the courts in the United States should continue to apply UCC Article 5 as they have done in the past, provided that they interpret Article 5 in a manner that is consistent with the provisions of the Convention." (p. 802) Otherwise, "if the courts were to refer principally to the Convention in cases involving international standby letters of credit, the result could be the development of a case law for international standby credits that is markedly different from the law applicable to commercial

credits and domestic standby credits. This would be an anomalous and could be a very unfortunate result." (p. 802)

40 See Citibank N.A.'s Booklet, An Introduction to Letters of Credit (1997) at 53. And see the list of uses in Gordon B. Graham and Benjamin Geva "Standby Credits in Canada" (1984), 9 C.B.L.J. 180 at 185.

41 Publication CCI n° 500 (1993).

42 Convention, art. 3.

43 (1987), 45 D.L.R. (4th) 161 (Ont. H. C.).

44 ***Ibid***. The characterization of the standby obligation as secondary is, however, unfortunate.

45 ***Supra*** note 9 at 70. This decision has been followed in Quebec law: ***Agence pour la sécurité de la navigation aérienne en Afrique et à Madagascar (ASECNA)*** c. ***Groupe Tecnum Inc.***, J.E. 2005-2024 (C.A.) ; ***Banque Nationale du Canada*** c. ***CGU, compagnie d'assurances du Canada***, J.E. 2005-246 (C.S.) ; ***Bombardier Inc.*** c. ***Hermes Aero l.l.c.***, J.E. 2004-233 (C.S.) ; ***Casatex Inc.*** c. ***Sufi Weaving Industries (P.V.T.) Ltd.***, J.E. 98-1894 (C.S.) ; ***Les industries Almac Ltée*** c. ***Al-Arishi***, [1991] R.J.Q. 830 (C.S.) (en appel) ; ***Banque de Montréal*** c. ***Européenne de condiments S.A.***, [1989] R.J.Q. 246 (C.A.) ; ***Paris Sportswear Ltd.*** c. ***Lanificio Itlam*** (1987), 7 Q.A.C. 265 (C.A.).

46 ***Ibid***.

47 D.1987.Somm.186.

48 ***Ibid.*** at 207.

49 ***Société en commandite de financement Gaz métropolitain*** c. ***3370224 Canada Inc.***, J.E. 2003-543 (C.S.) ; ***Pollan Trade Inc.*** c. ***Finamar Investors Inc.***, [1993] R.D.J. 544 (C.A.).

50 The term "bank guarantee" is understood to include a guarantee issued by a co-op.

51 John F. Dolan "The UN Convention on International Independent Undertakings: Do States with Mature Letter-of-Credit Regimes Need It?", (1997-8) 13 B.F.L.R. 1.

52 See, for example, Lazar Sarna ***Letters of Credit - The Law and Current Practice*** (3rd ed.) (Toronto: Thomson Canada Limited, 2005) at 1-1:

> "The issuance of a credit relates to the transmission of the letter by the issuer,…
>
> In the United States of America, a credit is said to be effective or established between the issuer and the customer when the letter of credit or advice of its issuance is sent to the beneficiary, and to be established as to the beneficiary when the latter receives either the letter of credit or written advice of issuance…".

Under s. 5-106(a) of the UCC, a "letter of credit is issued…when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary."

53 ***Uniform Commercial Code***, 1990.

54 ***UNCITRAL Model Law on International Credit Transfers***, UN Doc. A/CN.9/346 (1992).

55 Publications CCI n° 500-3 (2002).

56 See L. Sarna, ***supra*** note 52 at 7-7, citing ***United City Merchants (Invt.) Ltd. v. Royal Bank of Canada***, [1979] l Lloyd's Rep. 267 at 275 (Q. B.); affd [1982] 2 All E. R. 720 (H.L.).

57 See Eliahu Peter Ellinger "Documentary Letters of Credit: A Comparative Study" (1970), University of Singapore Press, Singapore, p. 180; L. Sarna, ***ibid.***, states at 7-7: "One must presume that the applicant's consent is required by article 9(d) of the 1993 Revision [to the UCP]…".

58 The wording of article 8(4) obviously leaves open the question of whether the applicant's consent is necessary to the validity of an amendment. As Sarna, ***ibid.*** at 7-8, "[i]t has been said that the consent of the customer to an amendment of an irrevocable credit is theoretically not necessary because the credit once established creates a legal relationship between the issuer and the beneficiary to which the customer is not a direct party." [footnote omitted] The Convention does not move to resolve this theoretical question. The wording of article 8(4) is similar to that of UCC article 5-106(b).

59 [1988] 1 A. C. 583 (P.C.). This case has not been cited in Canada.

60 R.S.O. 1990, c. C.34

61 Art. 1637 C.c.Q.

62 Art. 1641 C.c.Q. See: P.-G. Jobin and N. Vézina, ***supra*** note 29 at n^{os} 948-950, at 969-970.

63 See ***Co-operative Fisheries Ltd. v. Canadian Imperial Bank of Commerce*** (1969), 7 D.L.R. (3d) 610 (Sask. Q. B.).

64 See, for example, the numerous approving references to the provisions of the UCP made by LeDain, J. in ***Angelica-Whitewear, supra*** note 9 at 70-71, 94 and 98-9 and at 93, where he states: "The documentary requirements under a letter of credit are determined by the terms and conditions of the credit, as supplemented by the ***Uniform Customs and Practice for Documentary Credits,***…". This language almost matches the language of the Convention, word for word.

65 ***Supra*** note 51 at 13. And see Kevin P. McGuinness, ***The Law of Guarantee*** (2nd ed., 1996) (Toronto: Carswell) at 799 (footnote 96), where he states: "Trade custom may be held to form part of mercantile law, but only where the terms of that custom have been judicially ascertained and established", citing ***Brandao v. Barnett*** (1846), 12 Cl. & Fin. 787, 136 E.R. 207, and L. Sarna, ***supra*** note 52 at 2-22.1 - 2-23, where he observes the following with respect to practices or customs:

> "In the common law jurisdictions, the court may, in certain circumstances, incorporate trade or market custom into any contract unless the custom is inconsistent with the nature of the contract. The contract is interpreted in the light of custom where the parties know, or are deemed to know, of the custom. Trade custom or usage may be used for interpreting terms of a contract, as well as adding new terms or obligations and rights to the existing agreement. The justification for incorporation of terms derived from custom or usage is founded on the presumed intentions of the parties notwithstanding that such presumption is often not founded on the facts in the particular case. In order for usage or custom to affect the terms of the contract, the practice must be notorious, reasonably certain, and must obtain the force of law in the locality in question.",

citing in support of the last sentence G.H.L. Fridman, ***The Law of Contract in Canada*** (Scarborough, Ont.: Carswell, 1976) at 262-64 and Guenter Treitel, ***The Law of Contract***, 5th ed. (London: Stevens, 1979) at 149-50.

66 Art. 1426 C.c.Q.

67 Nabil Antaki and Charlaine Bouchard, ***Droit et pratique de l'entreprise*** (Cowansville (Québec): Éditions Yvon Blais, 1999), at 73-74.

68 ***Supra*** note 51 at 15.

69 S. M. Waddams ***The Law of Contracts***, 4th ed. (Aurora: Canada Law Books Inc., 1999) at 366.

70 ***Ibid***. paras. 499-508 and 550.

71 ***Supra*** note 9, following ***Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.,*** [1978] 1 All E.R. 976 (C.A.).

72 As to the law in the U.S., see John F. Dolan ***The Law of Letter of Credit***, Rev. ed. (Austin, Texas: Alex eSolutions, Inc., 2003 (looseleaf)), para. 7.04(4)(h): "Issuers that honor a letter of credit when they have clear notice of fraud are not entitled to reimbursement."

73 Dr. Jens Nielsen and Nicolai Nielsen "Standby Letters of Credit and the ISP98: A European Perspective" (2001), 16 B.F.L.R. 163.

74 ***Ibid.*** at 182.

75 ***Ibid.*** at 183.

76 [1993] O.J. No. 112 (Gen. Div.).

77 ***Ibid.*** paras. 29 and 30. This description of fraud in the context of letters of credit has been cited by some other Ontario judges since: see e.g. ***Royal Trust Corporation of Canada v. Royal Bank of Canada***, [1993] O.J. No. 718 (Gen. Div.); ***930154 Ontario Inc. v. Onofri***, [1994] O.J. No. 2095 (Gen. Div.); ***Royal Bank v. Gentra Canada Investments Inc.*** (2000), 1 B.L.R. (3d) 170 (Ont. S.C. [Commercial List]); additional reasons at (2000), 2000 Carswell Ont 2837; affd. (2001) 15 B.L.R. (3d) 25, 147 O.A.R. 96 (Ont. C. A.). And see ***Royal Bank of Canada*** v. ***Darlington,*** [1995] O.J. No. 1044 (Gen. Div.), where the court reviewed definitions of fraud provided to bank officers who testified at the trial, which definitions stressed that fraud required an absence of actual and honest belief in the truthfulness of a statement and an intention to deceive or the reckless disregard of the truth: see paras. 154 and 155.

78 As the authors appear to state at 181, ***supra*** note 73.

79 P.-G. Jobin and N. Vézina, ***supra*** note 29 at n° 98, at 143.

80 ***Banque Nationale du Canada*** c. ***Soucisse***, [1981] 2 R.C.S. 339; ***Banque Nationale du Canada*** c. ***Houle***, [1990] 3 R.C.S. 122; ***Banque de Montréal*** c. ***Bail Ltée***, [1992] 2 R.C.S. 554.

81 P.-G. Jobin and N. Vézina, ***supra*** note 29 at n° 98, at 143-144.

82 Jean Stoufflet, « La convention des Nations unies sur les garanties indépendantes et les lettres de crédit stand-by », (Juil./août 1995) 50 Revue de droit bancaire 132 at 136 (at n° 33).

83 See ***Angelica-Whitewear***, ***supra*** note 9 at 94 (strict compliance requirement) and 98 (consistency).

84 See L. Sarna, ***supra*** note 52 at 5-4, citing ***Hongkong and Shanghai Banking Corp. v. Kloeckner & Co.***, [1989] 3 All E.R. 513 (C.A.).

85 ***Offshore Trading Company, Inc.*** c. ***Citizens National Bank of Port Scott, Kansas***, 650 F.Supp. 1487, 1491 (D. Kan. 1987).

86 Paul S. Turner, « Revised UCC Article 5: The New U.S. Uniform Law on Letters of Credit », (1996) 11 ***B.F.L.R.*** 205, at p. 224. Article 5-109 provides as follows:

An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or

(c) based on knowledge or lack of knowledge of any usage of any particular trade. [nos italiques]

87 See paragraph 47 of the Explanatory Note. Article 19(2) provides: "For the purposes of subparagraph (c) of paragraph (1) of this article, the following are types of situations in which a demand has no conceivable basis:

(a) the contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized;

(b) the underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking;

(c) the underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;

(d) fulfillment of the underlying obligation has clearly been prevented by willful misconduct of the beneficiary; and

(e) in the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter-guarantee relates."

88 ***Supra*** note 9.

89 ***Ibid.*** at 83.

90 Jean-Pierre Mattout, ***Droit bancaire international*** (Paris: Éditions La Revue banque, 1987), at pp. 357 and 358 ; Marc Lacoursière, ***La sécurité juridique du crédit documentaire informatisé*** (Cowansville (Qué.): Yvon Blais, 1998), at 26-27.

91 See e.g. ***supra*** note 9 at 83.

92 ***Ibid.*** at 83-84, following ***United City Merchants (Investments) Ltd. v. Royal Bank of Canada***, [1983] 1 A.C. 168 (H.L.).

93 See ***Global Steel Ltd. v. Bank of Montreal*** (1999), 50 B.L.R. (2d) 219, 1999 CarswellAlta 1008, 244 A.R. 341, 209 W.A.C. 341 (Alta. C.A.).

94 [1995] R.J.Q. 88 (C.A.).

95 Note that this is not the law in the United States: see J.F. Dolan, ***supra*** note 72 at 7-78, where he states that "***United City Merchants*** is not consistent with the language of the [UCC] and is probably not good authority in the United States." He does note that it may be good authority in Canada.

96 ***United City Merchants (Investments) Ltd. v. Royal Bank of Canada, supra*** note 92 at 184. [italics added]

97 ***Angelica-Whitewear***, ***supra*** note 9 at 84.

98 ***Ibid.*** at 83.

99 J. Stoufflet, ***supra*** note 82 at 137 (para. 46).

100 ***Supra*** note 9 at 84.

101 31 N.Y.S.2d 631 (1941).

102 [1975] 1 All E.R. 1071 (Ch.D.). In ***Angelica-Whitewear***, ***supra*** note 9, the court also referred at 78 to the case of ***European Asian Bank A.G. v. Punjab and Sind Bank***, [1983] 1 Lloyd's Rep. 611 (C.A.).

103 [1991] R.J.Q. 830 (C.S.).

104 This was a case of "intellectual" fraud.

105 The majority of courts affirm that the holder of a draft must have acquired it as a result of negotiations in order to have the status of a regular holder: Nicole L'Heureux, Édith Fortin and Marc Lacoursière, ***Le droit bancaire*** (Cowansville: Éditions Yvon Blais Inc., 2004) at n° 2.70, at 507-514. See, in the same vein: ***Goody Goody Clothing International Inc.*** c. ***Five Star Knitters***, J.E. 91-1358 (C.S.) ; Daniel E. Murray, « Letters of Credit and Forged Documents: Some Altered Suggestions », (1993) 98 ***Com. L.J.*** 505, 508.

106 ***Les industries Almac Ltée*** c. ***Al-Arishi***, [1991] R.J.Q. 830, 835 (C.S.) (en appel). In this case the court seems to distinguish between a letter of credit and a letter of guarantee, which does not always seem to be the case: ***Banque de Montréal*** c. ***Européenne de condiments***, [1989] R.J.Q. 246, 249 (C.A.). In any event, Canadian and English courts treat fraud with respect to guarantees and documentary credits according to the same general principals: Claude Gilbert, « Similarités et distinctions entre la fraude du bénéficiaire d'un crédit documentaire et celle du bénéficiaire d'une garantie de bonne exécution », (1987) 17 R.D.U.S. 585, 606 ff. ; Raymond Jack, ***Documentary Credits*** (London: Butterworths, 1993), n° 9.11 ; ***Edward Owen Engineering*** c. ***Barklays Bank***, [1978] 1 All E.R. 976, 983 (C.A.).

107 See ***supra*** note 77 and accompanying text.

108 ***Supra*** note 76 para. 31, citing ***C.D.N. Research and Development Ltd. v. Bank of Nova Scotia*** (1980), 18 C.P.C. 62 (Ont. H.C.).

109 ***Angelica-Whitewear***, ***supra*** note 9 at 84-85.

110 ***Royal Bank v. Gentra Canada Investments Inc.*** (2000), 1 B.L.R. (3d) 170 (Ont. S.C. [Commercial List]) at 182, citing ***Ward Petroleum Corp. v. Federal Deposit Insurance Corp.***, 903 F. 2d 1297 (U.S. 10th Cir. Okl. 1990) at 1301. See also ***Intraworld Industries Inc. v. Girard Trust Bank*** (1975), 336 A. (2d) 316 (S. C. Penn.) where the court said, at 324-5, that if the call documents "are genuine in the sense of having some basis in fact", then no injunction would be warranted, an injunction being warranted only if the beneficiary "has no ***bona fide*** claim to payment" (quoted in McGuinness, ***supra*** note 64 at 825, footnote 190).

111 See J.F. Dolan, ***supra*** note 72 at 7-84 [footnote omitted].

112 Eliahu Peter Ellinger "Fraud in Documentary Credit Transactions", (1981) J. Bus. L. 258 at 262, cited in J.F. Dolan, ***ibid.*** footnote 303.

113 ***Barzelex Inc.*** c. ***M.E.C.S. International Canada Inc.***, [1988] R.J.Q. 437, 444 (C.S.), reversed on appeal (on another issue of law): ***Geestemünder BANK AG c. Barzelex Inc.***, ***supra*** note 94.

114 (1) Where, on an application by the principal/applicant or the instructing party, it is shown that there is a high probability that, with regard to a demand made, or expected to be made, by the beneficiary, one of the circumstances referred to in subparagraphs (a), (b) and (c) of paragraph (1) of article 19 is present, the court, on the basis of immediately available strong evidence, may:
(a) Issue a provisional order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the undertaking, or

(b) Issue a provisional order to the effect that the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm.
(2) The court, when issuing a provisional order referred to in paragraph (1) of this article, may require the person applying therefor to furnish such form of security as the court deems appropriate.
(3) The court may not issue a provisional order of the kind referred to in paragraph (1) of this article based on any objection to payment other than those referred to in subparagraphs (a), (b) and (c) of paragraph (1) of article 19, or use of the undertaking for a criminal purpose.

115 ***Ibid***.

116 (1987), 7 Q.A.C. 265, 268 (C.A.).

117 ***Ibid.*** at 270 and 271. However, to seize funds held by a bank, the funds must have first moved into the bank's patrimony: ***Burney Silverware & Gifts Inc.*** c. ***Henry Birks & Sons (Montréal) Ltd. et al.***, [1987] R.J.Q. 176, 179 and 180 (C.S.) (out of court settlement).

118 ***Paris Sportswear Ltd.*** c. ***Lanifico Itlam***, ***ibid.*** at p. 269.

119 ***Goody Goody Clothing International Inc.*** v. ***Five Star Knitters***, ***supra*** note 105 at 19. See also: L. Sarna, ***supra*** note 52 at 8-6 and 8-7 ; Manon Pomerleau, « La fraude du bénéficiaire du crédit documentaire irrévocable », (1984) 44 R. du B. 113, 131.

120 ***Supra*** note 9 at 83.