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Independent Guarantees and Stand-by Letters of Credit

- Working Group Interim Report 2008

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Proceedings

CIVIL SECTION

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

INTERIM REPORT OF THE WORKING GROUP

Readers are cautioned that the ideas or conclusions set forth in this paper, including any proposed statutory language and any comments or recommendations, may not have been adopted by the Uniform Law Conference of Canada. They may not necessarily reflect the views of the Conference and its Delegates. Please consult the Resolutions on this topic as adopted by the Conference at the Annual meeting.

Quebec, QC

August 10-14. 2008

Interim Report of the Working Group August 2008 Background

[1] At its Annual Meeting in 2005, the ULCC decided 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").

[2] In March 2006, the Conference considered a report by Steven Jeffery, Partner, Blaney McMurtry LLP and Marc Lacoursière, Professor, Université Laval, which examined the Canadian framework for the law of independent guarantees and stand-by letters of credit, both from a common law and civil law perspective. The report recommended that the Convention be adopted by Canada.

[3] There is no existing legislation in Canada 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. On the civil law side, some attempt to associate independent bank guarantees with certain nominate contracts and others do so with innominate contractual instruments; the nature of the bank guarantee is still not determined in Quebec civil law.

ULCC Working Group on Independent Guarantees and Stand-by Letters of Credit

[4] A Working Group was established following the 2006 Annual Meeting. Its mandate is to prepare, in accordance with the directions of the Conference, a uniform act and commentaries to implement the Convention, to report on the desirability of any other legislative recommendations and to work in co-operation with the Uniform Law Commission in the United States (previously named the National Conference of Commissioners on Uniform State Laws) and the Mexican Uniform Law Centre, should those organizations be agreeable.

[5] The Working Group is composed of the following members: Mireille Blanchard (International Private Law Section, Justice Canada), Jacques Gauthier (General Counsel, Public Works and Government Services Canada), Professor Marc Lacoursière (Université Laval), Steven Jeffery (Blaney McMurtry LLP), Michel Deschamps (McCarthy, Tétrault SNC), Professor Benjamin Geva (Osgoode Hall Law School) and Clark Dalton (Projects Coordinator for the ULCC).

Overview of Activities

[6] At its Annual Meeting in 2007, the Conference was updated on the Working Group's progress. It considered a draft uniform implementation act and encouraged the Working Group to continue its work in developing both a draft uniform act implementing the Convention and specific rules to address domestic transactions and all aspects of international ones.

[7] The Working Group has been meeting by weekly conference call since September 2007. It attended a joint meeting with United States and Mexican colleagues in Denver in November 2007 to attempt to bring about a harmonized approach to implementing this Convention across the Americas.

[8] One member of the Working Group attended the Americas Annual Survey of Letters of Credit Law and Practice Conference in Tampa in March 2008 and participated on a panel that discussed the Convention and its implementation in Canada and in the United. This forum offered a rare opportunity to consult with letter of credit stakeholders and included participants from both Canada and the United States. The audience was receptive, there was discussion but no objections were raised. Participants either spoke in support of the Convention or asked questions.

[9] From February to June 2008, the Working Group held consultation sessions in Montreal, Toronto and Vancouver with key stakeholders, including major Canadian banks, the Canadian Bar Association and the Canadian Bankers Association, on the merits of this project. The Working Group continues to maintain ongoing discussions with stakeholders. Although stakeholders have yet to provide the Working Group with their official positions, there seems to be support for the project.

[10] There was general agreement among stakeholders that the current system works well. Some expressed concerns about making changes to it. Some seemed to better appreciate the international benefits of ratifying the Convention while others seemed to better appreciate the benefits of adopting domestic rules to increase certainty in addressing domestic transactions and international transactions not covered by the Convention.

[11] Between March and May 2008, the Working Group held two in person drafting meetings. The objective of these meetings was to discuss and agree on various substantive policy issues which were difficult to discuss by conference call.

[12] The Working Group met the legislative drafters in May 2008 and began discussing various issues surrounding the drafting process and approach. The legislative drafting began at that time and is scheduled to continue well into the summer. A final draft uniform act is expected by fall 2008. The legislative drafters assigned to the project are Hélène Rodrigue and Joanne Papich.

Results of Activities

[13] The Working Group developed a draft uniform act in two parts (attached). Part 1 establishes domestic rules, basically codifying existing common law and civil law rules that are consistent with the Convention. It addresses domestic transactions in the area of independent guarantees and letters of credit as well as aspects of international

transactions not covered by the Convention. It will eventually include commentaries.

Part 2 implements the Convention in Canada and includes commentaries.

[14] The United States signed the Convention in 1997 and is currently working towards ratification. The rules of the Convention are generally consistent with those in Article 5 of the Uniform Commercial Code of the United States. Because of this congruence, the adoption of the Convention by the United States will cause little change in American law and implementation of the Convention will likely be done primarily through Article 5 (referred to as the “pre-implementation” method).

Next Steps

[15] The Working Group intends to maintain ongoing discussions with stakeholders, including beneficiaries of letters of credit, who have not yet been consulted.

[16] The Working Group expects that once the consultations have been completed and the results have been reviewed, a final draft act and report on the project will be prepared for consideration at the 2009 ULCC Annual Meeting.

[17] The Working Group expects to complete the draft uniform act and commentaries for presentation to the ULCC Annual Meeting in 2009.

[18] The Working Group seeks comments from the Civil Section on the scope of the project, the interview methodology (including its follow up) and the commentary, which the Working Group will be drafting over the next year.

APPENDIX

Part 1 - Draft Uniform Independent Guarantees and Letters of Credit Act

(Draft 12: includes changes to June 6, 2008)

Scope of Application

1 (1) Part 1 applies to:

(a) all UNDERTAKINGS to which Part 2 does not apply, and;

(b) all UNDERTAKINGS to which Part 2 applies but only to the extent Part 1 applies to matters to which Part 2 does not apply.

(2) With the exception of this subsection, sections 3, 12(c) and 22(4), and subject to subsection (3) the effect of this Act may be varied by agreement or by a provision stated or incorporated by reference in an UNDERTAKING. A term in an agreement or UNDERTAKING generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this Act.

(3) The obligations of good faith, diligence, reasonableness, and care may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever this Act requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(4) An ISSUER, nominated person or adviser may not be exempted from liability for any grossly negligent.

(4.1) All provisions that apply to an ISSUER apply equally to a CONFIRMER other than:

(Comment: We need to set out the exceptions to the general rule)

(4.2) All provisions that apply to an UNDERTAKING apply equally to a confirmation other than:

(Comment: We need to set out the exceptions to the general rule)

(5) The statement of a rule in this Act does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this Act.

(COMMENT: We have to have a provision that will guide interpretation so that it is clear that deviation from the language of the Convention doesn't necessarily mean that Part 1 is to be interpreted differently from Part 2. The two parts are to be construed consistently.)

Definitions

1.1 (1) In this Part:

(a) "adviser" means a person who, at the request of the ISSUER, or another adviser, notifies or requests another adviser to notify the beneficiary that an UNDERTAKING has been issued, confirmed, or amended;

(a.1) "applicant" means a customer of the ISSUER or other person at whose request or for whose account an UNDERTAKING is issued. Where a person requests an ISSUER to issue an UNDERTAKING on behalf of another, if the person making the request undertakes an obligation to reimburse the ISSUER, each person is an applicant;

(b) "beneficiary" means a person who under the terms of an UNDERTAKING is entitled to have its complying presentation honoured and the term includes a person to whom drawing rights have been transferred under a transferable UNDERTAKING;

(c) "confirmation" of an UNDERTAKING means a commitment added to that of the ISSUER, and authorized by the ISSUER, providing the beneficiary with the option of demanding that the CONFIRMER honour the UNDERTAKING instead of the ISSUER,

upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the confirmed UNDERTAKING, without prejudice to the beneficiary's right to demand that the ISSUER honour the UNDERTAKING;

(d) "CONFIRMER" means a nominated person adding a confirmation to an UNDERTAKING;

(e) "counter-guarantee" means an UNDERTAKING given to the ISSUER of another UNDERTAKING by its instructing party and providing for honour upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the UNDERTAKING, indicating, or from which it is to be inferred, that honour of that other UNDERTAKING has been demanded from, or made by, the person issuing that other UNDERTAKING;

(f) "counter-guarantor" means the person issuing a counter-guarantee;

(g) "dishonour" of an UNDERTAKING means failure timely to honour or to take an interim action, such as acceptance of a draft, that may be required by the UNDERTAKING;

(h) "document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, communication, statement, or representation of fact, law, right, or opinion that provides a complete record thereof;

(h.1) "draft" means a bill of exchange under the *Bills of Exchange Act (Canada)*;

(i) "electronic" includes created, recorded, transmitted or stored in digital form or in other intangible form by electronic, magnetic or optical means or by any other means that has capabilities for creation, recording, transmission or storage similar to those means;

(j) "good faith" means honesty in fact in the conduct or transaction concerned;

(k) "honour" of an UNDERTAKING means performance of the ISSUER's commitment in the UNDERTAKING which may be stipulated in the undertaking to be made in any form, including:

(a) payment in a specified currency or unit of account;

(b) acceptance of a draft and at maturity, its payment;

(c) incurrence of a deferred payment obligation and at maturity, its payment; or

(d) supply of a specified item of value;

(COMMENT: May need to be cleaned up)

(l) "ISSUER" means a bank or other person that issues an UNDERTAKING, and

includes a counter-guarantor, but does not include an individual who makes an engagement for personal, family, or household purposes;

(m) "nominated person" means a person whom the ISSUER

- (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under an UNDERTAKING; and
- (ii) undertakes by agreement or custom and practice to reimburse;

(n) "presentation" means delivery of a document to an ISSUER or nominated person for honour or giving of value under an UNDERTAKING;

(Comment: Definition needs reworking eg. "presentation of a document". Convention talks about "demand" accompanied by the document being either the delivering of documents or the documents themselves. Will come back to this later)

(o) "presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person;

(p) "record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form;

(q) "successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law;

(r) "UNDERTAKING" means an independent commitment, known in [international practice] as an independent guarantee or as a letter of credit given by an ISSUER 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, and includes a counterguarantee;

(COMMENT: Need to look into a definition of "independent guarantee" from various sources. If this is defined, we need a definition of "letter of credit".)

See also:

Article 2. UNDERTAKING

(1) For the purposes of this Convention, an UNDERTAKING is an independent commitment, known in international practice as an independent guarantee or as a stand-by letter of credit, given by a bank or other institution or person ("guarantor/ISSUER") 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, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of

any mature indebtedness undertaken by the principal/applicant or another person.

(Definitions Source: 5-102 – UCC)

Giving of an UNDERTAKING

2(1) The UNDERTAKING may be given:

- (a) at the request or on the instruction of the applicant;
- (b) on the instruction of another person ("instructing party") that acts at the request of the applicant of that instructing party; or
- (c) on behalf of the ISSUER itself.

2(2) The UNDERTAKING may stipulate that the ISSUER itself is the beneficiary when acting in favor of another person.

2(3) Consideration is not required to issue, amend, transfer, or cancel an UNDERTAKING, advice, or confirmation.

(COMMENT: To be added to the Commentary to this section: Subsection (4) is not required under the Quebec Civil Code}

Independence of UNDERTAKING

3. For the purposes of this Act, an UNDERTAKING is independent where the ISSUER's obligation to the beneficiary is not:

- (a) dependent upon the existence or validity of any underlying transaction, or upon any other UNDERTAKING (including letters of credit or independent guarantees to which confirmations or counter-guarantees relate); or
- (b) subject to any term or condition not appearing in the UNDERTAKING, or to any future, uncertain act or event except presentation of documents or another such act or event within an ISSUER's sphere of operations.

(Source: Article 3 - Convention)

Principles of interpretation

4. In the interpretation of this Part, regard is to be had to the need to promote uniformity in the international practice of independent guarantees and letters of credit.

(Source: Article 5 - Convention)

Binding on Crown

5. This Act is binding on the Crown in right of (*name of the enacting jurisdiction*).

Comment: *The Convention is drafted on the assumption that it applies to all independent guarantees and stand-by letters of credit otherwise within its scope whether or not they involve governmental entities. Section 5 merely confirms this. Of course, if a jurisdiction's interpretation legislation already provides that the Crown is bound unless otherwise stated in the particular act, there is no need to include it* Issuance, form and irrevocability of **UNDERTAKING**

Issuance, form and irrevocability of UNDERTAKING

6. (1) Issuance of an **UNDERTAKING** occurs when and where the **UNDERTAKING** leaves the control of the ISSUER concerned.

(1.1) An **UNDERTAKING** is deemed to have left the control of the ISSUER when it has been sent or otherwise transmitted to the person requested to advise it, or to the beneficiary.

(2) An **UNDERTAKING**, advice, transfer, amendment or cancellation may be issued in any form which preserves a complete record of its text and provides authentication of its source by generally accepted means or by a procedure agreed upon by the parties.

(3) From the time of issuance of an **UNDERTAKING**, a demand to honour the **UNDERTAKING** may be made may be made in accordance with the terms and conditions of the **UNDERTAKING**, unless the **UNDERTAKING** stipulates a different time.

(4) An **UNDERTAKING** is irrevocable upon issuance, unless it stipulates that it is revocable.

(Source: Article 7 - Convention)

Amendment

7. (1) An **UNDERTAKING** may not be amended except in the form stipulated in the **UNDERTAKING** or, failing such stipulation, in a form referred to in section 6(3).

(2) Unless otherwise stipulated in the **UNDERTAKING** or elsewhere agreed by the ISSUER and the beneficiary, an **UNDERTAKING** is amended upon issuance of the amendment if the amendment has previously been authorized by the beneficiary.

(3) Unless otherwise stipulated in the **UNDERTAKING** or elsewhere agreed by the ISSUER and the beneficiary, where any amendment has not previously been authorized by the beneficiary, the **UNDERTAKING** is amended only when the ISSUER receives a notice of acceptance of the amendment by the beneficiary in a form referred to in section 6(3)

(4) An amendment of an **UNDERTAKING** has no effect on the rights and obligations of:

- (a) the applicant;

- (b) an instructing party; or
- (c) a CONFIRMER of the UNDERTAKING

unless such person consents to the amendment.

(Source: Article 8 – Convention)

CONFIRMER, Nominated Person, and Adviser

8. (1) A CONFIRMER is directly obligated on an UNDERTAKING and has the rights and obligations of an ISSUER to the extent of its confirmation. The CONFIRMER also has rights against and obligations to the ISSUER as if the ISSUER was an applicant and the CONFIRMER had issued the UNDERTAKING at the request and for the account of the ISSUER.

(2) A nominated person who is not a CONFIRMER is not obligated to honour or otherwise give value for a presentation.

(3) A person requested to advise may decline to act as an adviser.

(4) An adviser is not obligated to honour or give value for a presentation.

(5) An adviser undertakes to the ISSUER and to the beneficiary accurately to advise the terms of an UNDERTAKING, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise.

(6) Even if the advice is inaccurate, an UNDERTAKING, confirmation, or amendment is enforceable as issued.

(7) A person who notifies a transferee beneficiary of the terms of an UNDERTAKING, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (3) to (6).

(8) The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by an UNDERTAKING, confirmation, amendment, or advice received by the person who so notifies.

(Source: 5-107 – UCC)

Warranties

8.1 In addition to warranties arising under any other law, if a presentation is honoured, the beneficiary warrants:

(a) to the ISSUER, any other person to whom presentation is made, and the applicant that there is no fraud by or to the knowledge of the beneficiary; and

(b) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary.

(Source: 5-110 – UCC)

(COMMENT: Deal with the policy issue with fraud in UCC and Canadian law in the Commentaries)

Transfer of Beneficiary's right to demand payment

9. (1) The beneficiary's right to demand that the UNDERTAKING be honoured may be transferred only if authorized in an UNDERTAKING, and only to the extent and in the manner authorized in the UNDERTAKING.

(2) If an UNDERTAKING is designated as transferable without specifying whether or not the consent of the ISSUER or another authorized person is required for the actual transfer, neither the ISSUER nor any other authorized person is obliged to effect the transfer except to the extent and in the manner expressly consented to by it.

(COMMENT: In the commentary draw attention to paragraph 31 of the Commentaries to the Convention)

Transfer by operation of law

9.1(1) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(2) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary,

(3) An ISSUER shall recognize a disclosed successor under subsection (2) of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the ISSUER of a transfer of drawing rights by operation of law under the standard practice of financial institutions that regularly issue UNDERTAKINGS.

(4) An ISSUER is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(5) An ISSUER who honours a purported successor's apparently complying presentation has the rights specified in section 17(4), even if the purported successor is not the successor of a beneficiary.

(6) A beneficiary whose name is changed after the issuance of an UNDERTAKING has

the same rights and obligations as a successor of a beneficiary under this section.

(Source: 5-113 UCC)

Assignment of proceeds

10. (1) Unless otherwise stipulated in the UNDERTAKING or elsewhere agreed by the ISSUER and the beneficiary, the beneficiary may assign to another person any proceeds to which it may be, or may become, entitled under the UNDERTAKING.

(2) If the ISSUER or another person obliged to honour an UNDERTAKING has received a notice originating from the beneficiary, in a form referred to in section 6(2), of the beneficiary's irrevocable assignment, honour of the UNDERTAKING to the assignee discharges the obligor, to the extent of such honouring, from its liability under the UNDERTAKING.

(Comment June 2: Clean up the wording)

(3) In this section, "proceeds" means the cash, cheque, accepted draft, or other item of value to be paid or delivered upon honour or giving of value by the ISSUER or any nominated person under the UNDERTAKING, but does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(Source: Article 10 – Convention and UCC 5-113 (a))

Cessation of right to demand payment

11. (1) Subject to subsection (3), the right of the beneficiary to demand honour of the UNDERTAKING ceases when:

(a) the ISSUER has received a statement by the beneficiary of release from liability in a form referred to in section 6(2);

(b) the beneficiary and the ISSUER have agreed on the termination of the UNDERTAKING in the form stipulated in the UNDERTAKING or, failing such stipulation, in a form referred to in section 6(2);

(c) the amount available under the UNDERTAKING has been paid, unless the UNDERTAKING provides for the automatic renewal or for an automatic increase of the amount available or otherwise provides for continuation of the UNDERTAKING; or

(d) the validity period of the UNDERTAKING expires in accordance with the provisions of section 12.

(2) The UNDERTAKING may stipulate, or the ISSUER and the beneficiary may agree elsewhere, that return of the document embodying the UNDERTAKING to the ISSUER, or a procedure functionally equivalent to the return of the document in the case of the

issuance of the **UNDERTAKING** in non-paper form, is required for the cessation of the right to demand payment, either alone or in conjunction with one of the events referred to in subsections (1)(a) and (b).

(3) In no case shall retention of any document by the beneficiary after the right to demand honour of an **UNDERTAKING** ceases in accordance with subsection 1(c) or (d) preserve any rights of the beneficiary under the **UNDERTAKING**.

(Source: Article 11 – Convention; Article 11(2) is split into subsections (2) and (3))

Expiry

12. The validity period of the **UNDERTAKING** expires:

(a) at the expiry date, which may be a specified calendar date or the last day of a fixed period of time stipulated in the **UNDERTAKING**, provided that, if the expiry date is not a business day at the place of business of the ISSUER at which the **UNDERTAKING** is issued, or of another person or at another place stipulated in the **UNDERTAKING** for presentation of the demand for honour, expiry occurs on the first business day which follows;

(b) if expiry depends according to the **UNDERTAKING** on the occurrence of an act or event not within the ISSUER's sphere of operations, when the ISSUER is advised that the act or event has occurred by presentation of the document specified for that purpose in the **UNDERTAKING** or, if no such document is specified, of a certification by the beneficiary of the occurrence of the act or event; or

(c) if the **UNDERTAKING** does not state an expiry date, or if the act or event on which expiry is stated to depend has not yet been established by presentation of the required document and an expiry date has not been stated in addition, when six years have elapsed from the date of issuance of the **UNDERTAKING**.

(Source: Article 12 – Convention)

Determination of rights and obligations

13. (1) The rights and obligations of the ISSUER and the beneficiary arising from the **UNDERTAKING** are determined by the terms and conditions set forth in the **UNDERTAKING**, including any rules, general conditions or usages specifically referred to therein, and by the provisions of this Act.

(2) In interpreting terms and conditions of the **UNDERTAKING** and in settling questions that are not addressed by the terms and conditions of the **UNDERTAKING** or by the provisions of this Act, regard shall be had to generally accepted international rules and usages of independent guarantee or letter of credit practice.

(Source: Article 13 – Convention)

Standard of conduct and liability of ISSUER

14. In discharging its obligations under the UNDERTAKING and this Act, the ISSUER, nominated person or advisor shall act in good faith and exercise reasonable care having due regard to generally accepted standards of international practice of independent guarantees or letters of credit.

(Source: Article 14 – Convention)

Demand

15. (1) Any demand for honour of an UNDERTAKING shall be made in a form referred to in section 6(2) and in conformity with the terms and conditions of the UNDERTAKING.

(2) Unless otherwise stipulated in the UNDERTAKING, the demand and any certification or other document required by the UNDERTAKING shall be presented, within the time that a demand for honour may be made, to the ISSUER at the place where the UNDERTAKING was issued.

(Comment: need to consider the ISSUER, the CONFIRMER or the nominated person. How do we deal with Nominated person)

(3) The beneficiary, when demanding payment, is deemed to certify that the demand is not in bad faith and that none of the elements referred to in paragraphs 19(2) (a), (b) and (c) are present.

Examination of demand and accompanying documents

16. (1) The ISSUER shall examine the demand and any accompanying documents in accordance with the standard of conduct referred to in section 14 in order to determine whether the demand and any accompanying documents are, on their face, in strict compliance with the terms and conditions of the UNDERTAKING and consistent with one another.

(2) Unless otherwise stipulated in the UNDERTAKING or elsewhere agreed by the ISSUER and the beneficiary, the ISSUER shall have reasonable time, but not more than seven business days following the day of receipt of the demand and any accompanying documents, in which to:

- (a) examine the demand and any accompanying documents;
- (b) decide whether or not to honour;
- (c) if the decision is not to honour, issue notice thereof to the beneficiary.

(3) The notice referred to in subsection (2)(c) shall, unless otherwise stipulated in the UNDERTAKING or elsewhere agreed by the ISSUER and the beneficiary, be made by

teletransmission or other electronic means or, if that is not possible, by other expeditious means and indicate the reason for the decision not to honour the **UNDERTAKING**.

(4) An **ISSUER** is precluded from asserting as a basis for dishonour any discrepancy with respect to which it has not given timely notice under subsection (2)(c).

(5) Failure to give the notice specified under subsection (2)(c) or to mention fraud, forgery, or expiration in the notice does not preclude the **ISSUER** from asserting as a basis for dishonour fraud or forgery or expiration of the **UNDERTAKING** before presentation.

(6) If an **UNDERTAKING** contains nondocumentary conditions, an **ISSUER** shall disregard the nondocumentary conditions and treat them as if they were not stated.

(Source: Article 16 – Convention – Jeffery Draft redrafted to 4 subsections)

Payment

17. (1) Subject to section 19, when a demand is made in accordance with the provisions of section 15, the **ISSUER** shall honour in the manner stipulated in the **UNDERTAKING**.

(Source: Article 17(1) split)

(Source: new in accordance with the instructions)

(2) Following a determination that a demand for honour is made in accordance with the provisions of section 15, honour shall be effected promptly, unless the **UNDERTAKING** stipulates honour on a deferred basis, in which case honour shall be effected at the stipulated time.

(Source: Article 17(1) split)

(3) Any honour against a demand that is not in accordance with the provisions of section 14 does not prejudice the rights of the applicant.

(4) An **ISSUER** who honours a presentation :

- (a) is entitled to be reimbursed by the applicant on demand; and
- (b) takes the documents free of claims of the beneficiary or presenter.

(Source: Article 17(2))

(COMMENT: We need to look at “payment” vs. “honour”)

Set-off

18. Unless otherwise stipulated in the **UNDERTAKING** or elsewhere agreed by the **ISSUER** and the beneficiary, the **ISSUER** may discharge its obligation under the **UNDERTAKING** by availing itself of a right of set-off, except with any claim assigned to it

by the applicant or the instructing party.

(Source: Article 18 Convention)

Exception to payment obligation

19. (1). If it is manifest and clear that there has been fraud by the beneficiary, then the ISSUER, acting in good faith, has a right, as against the beneficiary, to withhold honour of the UNDERTAKING.

(2) Fraud is deemed to have occurred if it is manifest and clear that:

- (a) any document is not genuine or has been falsified;
- (b) honour is not 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.

(3) For the purposes of subsection (2)(c), 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 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) fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary;
- (e) in the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has honoured in bad faith as an ISSUER of the UNDERTAKING to which the counter-guarantee relates.

(4) For the purposes of subsections (1) and (2),

- (a) the fraud of a third party of which the beneficiary is innocent shall not constitute fraud; and
- (b) the fraud of a beneficiary cannot be raised against the holder in due course of a draft on an UNDERTAKING.

(5) In the circumstances set out in subsection (1), the applicant is entitled to provisional court measures in accordance with section 20.

(Source: Article 19 Convention - Jeffrey Draft)

(Comment: Benjamin Geva to look at the term "invalid")

Provisional court measures

20. (1) Where, on an application by the applicant or the instructing party, it is shown that there is a strong *prima facie* case of fraud with regard to a demand made, or expected to be made, by the beneficiary, the court, may:

- (a) issue a provisional order to the effect that the ISSUER not honour the UNDERTAKING, including an order that the 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 applicant would be likely to suffer serious harm.

(2) The court, when issuing a provisional order referred to in subsection (1), may require the person applying 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 subsection (1) based on any objection to honour of the UNDERTAKING other than fraud or use of the UNDERTAKING for a criminal purpose.

(Source: Article 20 Convention Jeffery Draft)

Choice of applicable law

21. (1) The UNDERTAKING is governed by the law the choice of which is:

- (a) stipulated in the UNDERTAKING or demonstrated by the terms and conditions of the UNDERTAKING; or
- (b) agreed elsewhere by the ISSUER and the beneficiary.

(2) The liability of a nominated person or adviser is governed by the law of the jurisdiction chosen by an agreement by the affected parties.

(3) Failing a choice of law in accordance with subsections (1) or (2), the UNDERTAKING or liability is governed by the law of the jurisdiction where the ISSUER or the party liable has its place of business at which the UNDERTAKING was issued or the liability is incurred.

(Source: Article 21 Convention - 5-116 – UCC)

Subrogation of ISSUER, Applicant, and Nominated Person

22. (1) An ISSUER that honours a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the ISSUER were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if

the ISSUER were the secondary obligor of the underlying obligation owed to the applicant.

(2) An applicant that reimburses an ISSUER is subrogated to the rights of the ISSUER against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the ISSUER and has the rights of subrogation of the ISSUER to the rights of the beneficiary stated in subsection (1).

(3) A nominated person who honours a draft or demand presented under an **UNDERTAKING** is subrogated to the rights of:

(a) the ISSUER against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the ISSUER by the applicant;

(b) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(c) the applicant to same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(4) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (1) and (2) do not arise until the ISSUER honours the **UNDERTAKING** and the rights in subsection (3) do not arise until the nominated person honours the **UNDERTAKING**.

(5) Until the rights of subrogation stated in subsections (1) (2) and (3) arise, the ISSUER, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

(Source: 5-117 – UCC)

Part 2

Interpretation

1. (1) The following definitions apply in this Act.

“Convention” means the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* set out in the schedule. (*Convention*)

Comment: This is a standard provision in uniform acts implementing international conventions. For previous examples, reference may be made to subsection 1(2) of the Uniform International Commercial Arbitration Act and subsection 1(2) of the Settlement of

International Investments Disputes Act.

“declaration” means a declaration made by Canada under the Convention with respect to (name of province or territory). (déclaration)

Comment: Article 25 of the Convention provides for the deposit of declarations by contracting States:

Article 25 is a standard provision in private law conventions. It allows federal States to identify by declaration the territorial units to which the convention is to extend. Canada will make declarations pursuant to Article 25 upon the request of provinces and territories that adopt implementing legislation.

(2) Unless a contrary intention appears, words and expressions used in this Part have the same meaning as in the Convention.

(3) In interpreting this Part and the Convention, recourse may be had to

- (a) the commentary prepared by the United Nations Commission on International Trade Law with respect to the Convention; and
- (b) the Report of the United Nations Commission on International Trade Law on its twenty-eighth session, 2-26 May, 1995, General Assembly Official Records, Fiftieth session, Supplement No. 17 (A/50/17).

Comment: The supplementary interpretive sources listed in paragraph (3) conform to the interpretive sources sanctioned by Article 32 of the Vienna Convention on the Law of Treaties, Can. T.S. 1980 No. 37. The object of permitting judicial recourse to these sources is reflected in the observation of Justice La Forest in *Thomson v. Thomson*, [1994] 3 S.C.R. 551, at pp. 577-578, that “It would be odd if in construing an international treaty to which the legislature has attempted to give effect, the treaty were not interpreted in the manner in which the state parties to the treaty must have intended. Not surprisingly, then, the parties made frequent references to this supplementary means of interpreting the Convention, and I shall also do so. I note that this Court has recently taken this approach to the interpretation of an international treaty in Canada (*Attorney General v. Ward*, [1993] 2 S.C.R. 689.”

For an example of a similar provision, reference may be made to subsections 14(1) and (2) of the Uniform International Commercial Arbitration Act.

To facilitate ease of access to the sources referred to in paragraph (3), enacting jurisdictions may wish to include reference to the UNCITRAL web address (<http://www.un.org/>) from which they may be downloaded in their Gazettes or other appropriate governmental organ.

The list in paragraph (3) is not intended to be exhaustive. It merely indicates the principal

sources to be used in interpreting the Convention. It is expected that over time other helpful resources will emerge. In particular, over time UNCITRAL's Case Law on UNCITRAL Texts (CLOUT) will provide a useful source of the evolving jurisprudence on the Convention from the courts in all Contracting States.

Purpose

2. The purpose of this Part is to implement the Convention.

Publication

3. A notice shall be published in (*name of publication*) of the day on which the Convention comes into force, or a declaration or withdrawal of a declaration takes effect, in (*name of province or territory*).

Force of law

4. Subject to any declaration that is in force, the Convention has the force of law during the period that it is, by its terms, in force in (*name of province or territory*).

Comment: *Under this Part, the Convention is given the force of law domestically only from the date the Convention comes into force at the international level for Canada in the jurisdictions declared pursuant to Article 25. That date is (i) the first day of the month following the expiration of one year after the date of deposit of Canada's instrument of accession, pursuant to Article 28(2); or (ii) in the case of a jurisdiction adopting implementing legislation after accession by Canada, the first day of the month following the expiration of six months after the date the declaration extending the application of the Convention to that jurisdiction is received by the depositary, in accordance with Article 25(3).*

The ULCC Uniform International Interests in Mobile Equipment Act (Aircraft Equipment) excluded specific (final) provisions from having the force of law. However, the preferred approach has been to give the force of law to all the provisions of a Convention. This approach eliminates the risk of inadvertently overlooking provisions or omitting substantive provisions. To the extent that the final provisions of the Convention are not substantive but are binding as to States on an international level, they would produce no legal effect in provinces or territories in any event.

Inconsistent laws

5. If a provision of this Part, or a provision of the Convention that is given the force of law by section 6, is inconsistent with any other Act, the provision prevails over the other Act to the extent of the inconsistency.

Comment: *This Part and Convention need to prevail over inconsistent provisions in other*

Acts to ensure that Canada is in conformity with its international obligations. To avoid internal conflict, enacting jurisdictions should ensure that if an equivalent provision appears in other Acts with which this Part or the Convention might potentially be inconsistent, those other Acts should be amended to give precedence to this Part and the Convention.

Coming into force

6. This Act comes into force on (_____).

OR

6. The provisions of this Act come into force on a day or days to be fixed by (_____).

Comment: *There is a need to co-ordinate the entry into force of the Convention at the international level, the coming into force of domestic implementing legislation, and giving the Convention force of law. A provision in the implementing legislation stating that the Act comes into force when the Convention enters into force for enacting jurisdictions is not recommended since the actual date is not transparent on the face of the legislation. Accordingly, it is recommended that the legislation implementing the Convention state that it comes into force on Royal Assent or similar means. Enacting jurisdictions will need to communicate with Justice Canada officials to coordinate dates.*

Uniform Law Conference of Canada
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