

# **UNIFORM LAW CONFERENCE OF CANADA**

## **CIVIL SECTION**

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

#### **INTERIM REPORT OF THE WORKING GROUP**

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**Whitehorse, YK**

**August 12-16, 2012**

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

## **Interim Report of the Working Group**

**August 2012**

### **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 in 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, there have been attempts to associate independent bank guarantees with certain nominate contracts. Others have done so with innominate contractual instruments. However, 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 (ULC) and the Mexican Uniform Law Centre, should those organizations be agreeable.

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

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### Activities

#### *Draft Uniform Act*

[6] At its Annual Meetings from 2007 to 2011, the Conference was updated on the Working Group's progress. It considered a draft uniform 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 completed its policy considerations and instructions to legislative drafters in May 2009. 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.

#### *Developments in the US*

[8] The United States signed the Convention in 1997 and has drafted uniform implementing legislation. It is expected that the Convention will be sent to the White House soon for decision as to whether it should be transmitted to the Senate. 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.

#### *Consultations*

[9] Various stakeholders were consulted between February 2008 and May 2009 (in-person consultation sessions and/or consultations through letters and teleconferences). The Canadian Bar Association has expressed its support for the project. Other key stakeholders (major Canadian banks, the Canadian Bankers Association, beneficiaries of letters of credit through Canada's largest trade and industry association: Canadian Manufacturers and Exporters) haven't provided any comments to the Working Group regarding the project.

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### *Legislative Drafting*

[10] The legislative drafting process officially began in the spring of 2008 but progress has been slow because the legislative drafters responsible for the project have had to deal with Parliamentary matters. To expedite the legislative drafting process, the Working Group undertook to complete a first draft of the uniform act (attached) in the spring of 2012. Two two-day meetings were held in Ottawa for that purpose. This draft uniform act will eventually have to be reviewed by the legislative drafters. A final draft uniform act with commentaries is expected by spring 2013.

### *Outline of Draft Uniform Independent Guarantees and Letters of Credit Act*

[11] In 2011-2012, legislative drafters were provided with the opportunity to collaborate with the Working Group in the development of the Uniform Act in its current format. The following is a brief outline of the key elements in the Act:

- *Scope of application (s. 4)*: The Uniform Act applies to all Canadian and international letters of credit and bank guarantees contracts, which are referred to as “undertaking” in the Uniform Act. An undertaking represents a contract that may be amended by the parties as they wish, with a few exceptions, like the obligation to act in good faith and exercise reasonable care in fulfilling their obligations.
- *Stakeholders (s. 3)*: The main stakeholders to an undertaking are as follows:
  - *applicant*: the person (i.e. the client, or the buyer) who requests the issuance of an undertaking;
  - *beneficiary*: person (i.e. the seller) who receives the payment;
  - *issuer*: bank that issues the undertaking: first, it verifies the compliance of the documents submitted by the beneficiary and then pays the beneficiary;
  - *advisor*: beneficiary’s bank that is responsible for submitting the documents received by the beneficiary and then transmitting the applicant’s payment, via the issuer, to the beneficiary;
  - *confirmer*: bank that has a role similar to that of the advisor with respect to payment, but that must, in addition, verify the documents in the same way as the issuer; it is somewhat of a safety valve for the applicant.
- *Undertaking (s. 6)*: As pointed out above, an undertaking represents, in concrete terms, a letter of credit (also called “documentary credit”) and an independent bank guarantee (also called “stand-by letter of credit”); the first constitutes a method of payment particularly valued in international trade reporting, but also internally, and the second is generally treated as a performance guarantee. What is most unique about these two financial instruments, the functioning of which is similar, concerns their independence with respect to the base contract (or sales contract): the banker shall make payment at any time following a payment order, except when the documents provided by the

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beneficiary to testify to the beneficiary's entitlement to payment are not compliant with what was agreed between the parties and in cases of fraud by the beneficiary.

- *Characteristics of undertaking (ss. 7-10)*: Made by the applicant (s. 7), the undertaking must be submitted in writing, regardless of the means used (s. 8), and may be amended under certain conditions (s. 9). It is terminated at the time agreed on by the parties or, failing that, within six years of its issuance.
- *Standard of conduct (s. 16)*: Banks involved in an undertaking process must act in good faith and with reasonable care in accordance with generally accepted standards in international undertaking practices; those standards have existed for many decades, are adhered to by all stakeholders and are regularly upheld in court.
- *Presentation and examination of documents (ss. 17-21)*: As agreed with the applicant, the beneficiary must present certain documents to be paid (invoices, bills of lading, etc.); the issuer and the confirmer, if need be, must examine those documents with reasonable care within a time period deemed reasonable in the circumstances but not exceeding seven days; further to that examination, the issuer may pay or refuse to pay.
- *Payment (s. 22)*: When documents are compliant, with the exception of fraud, the beneficiary is entitled to payment. That right is terminated when: the beneficiary has discharged the issuer, the undertaking was paid, the validity period has expired or the undertaking was terminated.
- *Exception to payment obligation (s. 24)*: The issuer's obligation to pay the beneficiary ceases once the beneficiary commits fraud. The fraud exception, which constitutes one of the fundamental elements of any normative framework for letters of credit and independent bank guarantees, was adapted in the Uniform Act from the landmark decision *Bank of Nova Scotia v. Angelica-Whitewear*, [1987] 1 S.C.R. 59. More specifically, the issuer may withhold payment from the beneficiary when it is "manifest and clear" that a document is not genuine or has been falsified or when the payment will facilitate fraud with a serious impact on the issuer or the applicant.
- *Provisional court measures (s. 25)*: If there is *prima facie* evidence of fraud, a court may, at the applicant's request, seek a provisional measure, that is, an injunction or a garnishment, to prevent the issuer from making the payment.
- *Choice of applicable law*: The parties agree on the choice of applicable law for the undertaking; failing that, the law for the location where the undertaking was issued, or was paid, depending on the circumstances, applies.

### Next Steps

[12] The current draft uniform act is substantively complete but will be reviewed by legislative drafters, editors and jurilinguists before it can be considered a final draft. Over the next year, the Working Group will develop commentaries to accompany the draft uniform act.

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[13] The Working Group will carry out another round of consultations with stakeholders in the fall 2012 and winter 2013 using the current draft. The Working Group would welcome the Conference's questions or comments on the draft uniform act.

[14] A final draft uniform act with commentaries will be presented at the 2013 ULCC Annual Meeting.