

UNIFORM LAW CONFERENCE OF CANADA

CIVIL SECTION

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

PROGRESS REPORT

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

Progress Report – July 2019

I. Background

[1] There is no existing legislation in Canada that specifically deals with letters of credit and bank guarantees. The law applicable to letters of credit in the common law provinces and in Québec has been developed by the courts and doctrinal comments. In 1987 in *Bank of Nova Scotia v. Angelica Whitewear Ltd*, [1987] 1 S.C.R. 59, the Supreme Court of Canada confirmed that letters of credit to which the law of Québec applies are subject to interpretation principles consistent with international standards and with those of the common law provinces. Independent guarantees and stand-by letters of credit are similar to letters of credit in that payment is honoured when the conditions for payment are met, independently from the underlying contractual obligations to which the payment relates.¹ Given this similarity, principles laid out in court decisions dealing with letters of credit and their independent character are applicable to independent guarantees and stand-by letters of credit.²

[2] Independent guarantees and stand-by letters of credit covered by the 1995 *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* are basic tools of international commerce used in a variety of situations. They are used, for example, to secure performance of contractual obligations such as the performance of construction obligations or commercial payments; to secure repayment of an advance payment in the event that such repayment is required; or to secure a winning bidder's obligation to enter into a procurement contract. The Convention does not otherwise cover other documentary credit instruments such as letters of credit.

[3] Under the Convention, independent guarantees and stand-by letters of credit are recognized and enforced in all Contracting States. Recognition is extended to all instruments that meet the conditions for independent guarantees set out by the Convention regardless of the name given to the instrument. The Convention also provides for the enforcement of independent guarantees and stand-by letters of credit even in the absence of legislative provisions under domestic law that recognize them. The Convention, if it applied in Canada, would provide additional legal certainty to Canadian traders active in Contracting States whose legal systems are unfamiliar with these instruments or who may impose limitations on the “independent” obligation to pay as required under these instruments.

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[4] At its annual meeting in 2005, the ULCC decided to review the advisability of preparing a uniform implementing act for the Convention. In 2006, the Conference considered a report by Steven Jeffery, Partner, Blaney McMurtry LLP and Marc Lacoursière, Professor, Université Laval, which examined the Canadian legal framework on independent guarantees and stand-by letters of credit, from both common law and civil law perspectives. The report recommended that the Convention be adopted in Canada. The Conference decided to establish a Working Group “to prepare, in accordance with the directions of the Conference, a uniform act and commentaries to implement the Convention for consideration at the 2007 meeting; and to report on the desirability of any other legislative recommendations; and to work in co-operation with the National Conference of Commissioners on Uniform State Laws and the Mexican Uniform Law Centre, should those organizations so desire”.

[5] The Working Group was composed of the following members: Professor Marc Lacoursière (Université Laval), Steven Jeffery (Blaney McMurtry LLP), Michel Deschamps (McCarthy, Tétrault LLP), Professor Benjamin Geva (Osgoode Hall Law School) and representatives from the Department of Justice Canada. The Working Group carried out its work from 2006 to 2013 and made annual reports to the Conference.

[6] The Working Group found that though letters of credit, independent guarantees and stand-by letters of credit are commonly used in domestic and international transactions, in most countries, including Canada, they do not benefit from specific legislative support. In addition, the Working Group found that parties often incorporate by reference specific terms and conditions such as the Uniform Customs and Practice on Documentary Credits of the International Chamber of Commerce, thereby greatly facilitating their interpretation and application. Under Canadian law, independent guarantees and stand-by letters of credit are treated as contracts and rules of construction of contracts apply to them. The Working Group queried whether the introduction of a specific legal regime for international independent guarantees and stand-by letters of credit through the Convention also called for the adoption of similar rules domestically, as well as rules applicable to letters of credit more generally. The Working Group was of the view that doing otherwise would potentially raise questions and lead to uncertainty when an instrument falls outside the scope of the Convention. The Working Group therefore recommended the preparation of an act that would implement the Convention and also create a domestic legislative regime on documentary credit.

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[7] The Working Group completed a draft Uniform Letters of Credit and Independent Guarantees Act and presented it to the Conference at its annual meeting in 2013. That draft Uniform Act, in addition to implementing the Convention, provided rules applicable to domestic transactions and international letters of credit not covered by the Convention. More specifically, the Uniform Act introduced domestic rules on letters of credit and independent guarantees codifying existing common law and civil law rules under Part I. Part II of the Act implemented the Convention by giving it force of law. The Uniform Act was presented by the Working Group on the understanding that it needed to be revised in order to meet legislative standards.

[8] The Conference accepted the report of the Working Group and directed it to continue preparing uniform legislation in accordance with the recommendations of the report and the directions of the Conference. The Conference stressed the importance of the Working Group's obtaining comments from users and issuers of independent guarantees and stand-by letters of credit. In addition, legislative drafters and editors identified a large number of drafting concerns, which needed to be addressed before a final version of the act could be presented to the Conference.

II. International developments

[9] The Convention entered into force on January 1, 2000 after its fifth instrument of ratification was deposited. As of July 2019, Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama, and Tunisia are Contracting States.

[10] The United States signed the Convention in 1997 and worked with the Uniform Law Conference of Canada and the Mexican Centre of Uniform Law towards ratification. The rules of the Convention are generally consistent with those found in Article 5 of the Uniform Commercial Code of the United States. On February 10, 2016, the President of the United States sought advice and consent from the US Senate for the ratification of the Convention. Since then, no further development in relation to the Convention has taken place in the US.

III. Recommendation

[11] The use of electronic communications has facilitated domestic and international payments and increased the speed at which payments are made. Payments can take place in whole or in part using electronic means, including in relation to letters of credit and international independent guarantees. Despite the increase of electronic communications, the Convention remains relevant because a requirement that something be done in writing in relation to a matter associated with the Convention can be met by electronic means as a

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result of the *UN Convention of the Use of Electronic Communications*³ and because the Convention offers a legal framework that is relevant for international guarantees regardless of the support that is being used.

[12] International trade and commerce have continued to grow since the Convention was adopted by the United Nations in 1995 and new mechanisms to secure payment under a guarantee are being developed. Independent guarantees and stand-by letters of credit covered by the Convention remain, however, a key mechanism in use today. Consultations with key stakeholders have confirmed that they are used regularly by Canadian businesses and financial institutions.⁴

[13] The 2006 Pre-implementation Report by Steven P. Jeffery and Marc Lacoursière did not identify problems with respect to the domestic legal framework on letters of credit or independent guarantees. Consultations with stakeholders throughout the work of the Working Group have shown that there is general agreement among them that the current domestic system works well.⁵

[14] Users and issuers of independent guarantees and stand-by letters of credit have not provided comments on the draft Uniform Act since the 2013 annual meeting of the Conference. In that context, given the absence of reported problems with respect to domestic rules on letters of credit, the introduction of a new domestic legislative framework (i.e., Part I of the draft 2013 Uniform Act) does not appear to be warranted at this time. For this reason, the Advisory Committee on Program Development and Management has suggested leaving aside the domestic aspect of the project and focusing on the implementation of the Convention as a priority.

[15] A revised draft Uniform Act will then be based on Part II of the draft 2013 Uniform Act. It will need to reflect the ULCC's 2014 *Principles for Drafting Uniform Legislation Giving Force of Law to an International Convention* and any other norms that may develop as a result of the Conference's review this year of existing uniform acts that implement other international conventions. Once those modifications have been made, the Working Group and legislative drafters will need to consider the revised draft. It is anticipated that a final revised draft would be presented to the Conference for adoption at the 2020 annual meeting.

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¹*Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59, paragraph 10. The Supreme Court of Canada stated that “The 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”.

² *Distribulite Ltd. v. Toronto Board of Education Staff Credit Union* (1987), 45 D.L.R. (4th) 161; 1987 CanLII 4162 (ON SC).

³ Note that Canada has not yet ratified the *Convention on the Use of Electronic Communications*.

⁴See reports from the Working Group in 2008, paragraphs 7-10, 2009 paragraphs 12-13, 2010 paragraph 10, 2011 paragraph 10, and 2012 paragraph 9. Informal consultations carried out by Justice Canada in 2019 have also confirmed this conclusion.

⁵ 2008 report from the Working Group, paragraph 10.