Demand guarantees as per latest rules: URDG N° 758

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What is new and how to operate between the rules

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Objective and importance of today’s trade: the common reference and application of the rules

The main objective of today’s trade is to facilitate and simplify the way of doing international business. Throughout its presence on the market, the International Chamber of Commerce (ICC) had aimed to highlight the use of the most important instruments of trade to achieve that goal through the continuous efforts and needs of bankers, traders, experts and lawyers. The recent major development was the worldwide adoption at a large voting majority of the “Uniform Rules for Demand Guarantees (URDG), brochure N° 758” at the ICC Commission on Banking Technique and Practice meeting on November 24, 2009.

This set of rules (35 articles) will bring in most cases a reply and a solution for a fair balance of parties’ interests. The rules will help to avoid hesitation, misunderstanding and confusion leading to unnecessary and lengthy litigation. The common reference and application of the rules in today’s world is intended to fill many gaps of the practice should it be based solely on the consideration of merely agreed terms and formats. In many cases, practice has shown that a guarantee is an instrument for remedying difficult and controversial situations. The acceptance of the rules by the parties, unless modified or excluded, will assist them in their day-to-day work.

In the life cycle of guarantees, mainly in international field, the independence principle from the underlying relationship and the assumption of irrevocability have dominated the use of these instruments. Indeed a lot of matters are related to the drafting, use and comprehension of a guarantee. The topics may vary but in fact they are often present in the guarantee environment (as an enumerative and non limitative list), such as guarantor and counter-guarantor’s duties and responsibility, non-documentary conditions, advising a guarantee and amending its terms, variation of its amount, requirements for demand, separateness of each demand, examination and time for examination of demand, extend or pay, non-complying demand, reduction and termination, force majeure, disclaimers, indemnity for foreign laws and usages, transfer of guarantees and assignment of proceeds, governing law and jurisdiction. These are issues that regularly arise in guarantees. Many questions can be settled by applying conveniently the URDG (Brochure N° 758). The still active URDG (Brochure N° 458) adopted by ICC Executive Council on December 20, 1991 have been thoroughly revised and recently gave way to URDG (Brochure N° 758) which will enter into force on July 1, 2010.
Worldwide priority: Securing monetary and performance obligations

Securing monetary and performance obligations has become a worldwide priority at a time where many intervening parties are concerned by international and domestic contracts as well. From the formulation under the first article, the rules are binding on “all parties” to the demand guarantee or counter-guarantee, and this applies to the international and domestic field. More increasingly the rules are destined at present to become the international standard for demand guarantees practice in the 21st century.

It should be noted that the rules are innovative in many grounds. The development of practice and the need to avoid disputes have been a leverage to start up new rules offering original and constructive treatments for payment contingencies. Key changes will contribute positively, first to put the light on the new approach of the rules, and second to encourage users to bind themselves by those rules unless modified or excluded by the demand guarantee or counter-guarantee as far as they have agreed to insert them in their transactions.

Uniform Rules for Demand Guarantees: do they represent today a high level of market needs for instruments to parties eager to improve deals?

The adoption of the Uniform Rules for Demand Guarantees URDG (ICC Publication 758) represents today a high level of market need for instruments that open the door to parties to improve their deals. As a matter of fact parties search to stand the underlying transaction on a reliable and acceptable tool of the trade. In this respect, banking system supported by traders has been able to perfect and promote documentary credit rules where first rules have been promulgated by the International Chamber of Commerce (ICC) in 1933.

The flow of international trade was the primary objective of the ICC (established in 1919) and Uniform Customs and Practice for Documentary Credits were first introduced, then followed other publications, such as for Documentary Collection, international standby practices, incoterms, guarantees. The fact is that 3 instruments consisting of documentary credits, standby letters of credit and guarantees have in common their nature in the meaning that they are irrevocable, independent, documentary and binding undertaking.

These general principles are the cornerstone that clarifies the rights and obligations of the parties to a deal. Should they choose to apply for guarantee they will realize how important is to know exactly what are the advantages (or inconveniences) to incorporate to URDG in their deal (the underlying transaction). Thus the underlying transaction will take into consideration the URDG at the time when the relative guarantee will be issued by the guarantor. In this context the rules will be construed to be an all-party instrument rather than a banker’s specialty. A set of rules that could satisfy the banker and the trader is an ideal that could be reached as far as a fair play understanding is achieved.
Where is the confinement of URDG between Domestic Guarantees and Demand Guarantees?

Primarily URDG are intended for use in international transactions. Normally solutions must be found to problems that may be encountered in international demand guarantees. Practice shows however that many of such problems are present in domestic transactions as well. What would happen where some points are raised in domestic area?

Let us take some points from the URDG 758: examples:

- Independence of guarantee and counter-guarantee
- Documents v. goods, services or performance
- Non-documentary conditions
- Advising of guarantee or amendment
- Issue and amendment
- Presumption of irrevocability
- Guarantor’s duties
- Variation of amount
- Partial demand and multiple demands
- Separateness of each demand
- Extend – or pay
- Reduction and termination
- Transfer of guarantee and assignment of proceeds.

Above examples are issues that regularly arise in the life cycle of domestic guarantees. Can these questions be settled by applying the relevant URDG rule? It is open to the parties in domestic transaction to incorporate them by mere reference to the URDG for the reason that these rules are of a contractual nature. However to note here that URDG articles related to governing law and jurisdiction would serve little purpose in guarantees where the applicant and beneficiary are located in the same country.

Demand Guarantees rules: a new contractual package?

Changes are occurring worldwide for a new sight in trade. Is this due because of the parties searching a new package that suits everywhere their needs following globalization trend? Why Demand Guarantees at a moment where some years ago another instruments of the trade have been landed on the market:

UCP 600: Uniform Customs and Practice for Documentary credits – 2007 (ICC Publication 600).

As a matter of fact, financial aspects of the trade have spread rapidly in this decade and the authority of Demand Guarantees stems from the parties’ choice to contract. Demand Guarantees rules are of contractual nature whereby the parties may elect to apply them in order to give weight to their transactions. Parties may consider that the Demand Guarantees be enacted as a law whenever they can be adapted as such in a national law. A contractual package depends solely on the parties to be binding when they express the
intention to adhere to the rules. A Demand Guarantees package is a response to market expectations to offer a fair compromise among parties’ interests.

**Non-Banks Guarantees and the Demand Guarantees**

Bankers have well perceived that they should not be missed in trade operations that open them the door to be the major player both in initiating and financing these operations. Documentary credits enter in this context, but neither standby nor Demand Guarantees are invited to involve Banks first.

Why this discrimination? US banks regulations go back to Glass-Steagall Act enacted in 1933 which made a separation between commercial banks and investment banks and prohibited commercial banks to issue undertakings for their own account. Even today “Volcker rule” from name of economic counsel (former president of the FED 1979 – 1987) should prescribe to major banks in the US a slimming cure to stem a systemic risk. President Obama presented in March 2010 a draft for “bank regulation” which should forbid banks to do “operations for their own” whereby they intervene on the market disconnected from their counsel investment activity. This step will enhance non-bank institutions to deal largely with Demand Guarantees. URDG rules clarify this inclination in using terms such as “advising party”, “business day” “guarantor” “counter-guarantor” “guarantor own records” “instructing party”.

Although it has been the common practice that demand guarantees and counter-guarantees be handled by Banks in proportion to non-banks, it is open to non-banks (example, insurance companies, a person, private and public bodies) to issue demand guarantees and counter-guarantees. What about limitations which might result from provision in regulations or applicable law?

**Electronic demand guarantees, demands and documents**

In line of electronic communications development the URDG rules apply to traditional paper-supported guarantees as well as to electronic guarantees. Several parts of the URDG refer such as:

- Document means a signed or unsigned record of information, in paper or electronic form, that is capable of being reproduced in tangible form by the person to whom it is presented.
- Where the guarantee indicated that a presentation is to be made in electronic form, the guarantee should specify the format, the system for data delivery and the electronic address for that presentation.

Issuance of a guarantee or counter-guarantee can be made in an electronic form, and also the presentation of a demand for payment (including the statement of breach), the statement of release from liability under a guarantee… The combination is also possible, in a single demand, for electronic documents and paper documents.

**Where proof of breach is not required**
A demand under the guarantee is fundamental for a requirement of a claim. In addition to this demand, the guarantee may require as a condition for its payment the presentation of specified document(s). According to the rules, a demand under the guarantee shall be supported by such other documents as the guarantee specifies, and in any event by a statement, by the beneficiary. This statement will indicate in what respect the applicant is in breach of its obligations under the underlying relationship. Unless the guarantee requires a statement (or a document) substantiating the breach, the beneficiary will be entitled to claim payment without asserting, providing proof, that the applicant is in breach of its obligation.

By choosing to instruct a guarantor to issue a guarantee subject to the 758 rules, applicant renounces defence derived from the underlying relationship with the beneficiary, including the breach of obligations by applicant. Proof by the beneficiary of the applicant’s breach and of the extent of his loss are postponed until after the payment of the guarantee. In order to present a complying demand for payment under the rules, beneficiary is expected to describe (and not to prove or justify) in general terms the nature of the applicant’s breach. The requirement of this minimum statement can vary according to parties, either by excluding it in the guarantee or providing for additional documents as well (engineer’s certificate, surgeon’s report, judgement…)

In all cases, the applicant who believes that a demand is unjustified can seek repayment from the beneficiary after settlement under the guarantee. This recourse remains outside the frame of the rules. The “Uniform Rules for Demand Guarantees” represent a new set of reasonably balanced contractual rules for the market existing needs and practices. This set of rules will undoubtedly work to describe a fair instrument of the trade. Their practical approach, clear wording and simplicity of use will serve in an operational text of the life cycle to parties who will find an understandable basic for their contracts both in commercial and financial. Moreover, because of their contractual nature, these rules are flexible. This will carry the parties to adapt them to the transaction as long as they have not modified or excluded them. When they have agreed on the rules in their transaction and the demand guarantee is issued subject to these rules, the parties will rely on a cornerstone that identifies their rights and obligations. Since the demand guarantee is intended to be an all-parties instrument, the rules will provide an ideal operational framework for a majority of situations where a demand guarantee is applicable. This fact will cover many aspects that can be devised in practice.