



*The below request for an ICC opinion on ISP98 was referred to the Institute of International Banking Law & Practice, Inc. ("IIBLP") from the ICC Banking Commission Technical Advisors on 25 June 2021, and is followed by the IIBLP Response. The request is reproduced in its entirety.*

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[Start of Request for Opinion]

San José de Costa Rica  
14 June 2021

Dear Sirs:

**TECHNICAL ADVISORS**  
ICC Banking Commission

On behalf of the National Committee of Costa Rica, we would like to present the situation occurring with Bank  $\alpha$ , for which we request the Opinion of the ICC Banking Commission in the following terms:

**1. Facts.**

**1.1. Bank  $\alpha$  issued a counter-guarantee in favor of Bank  $\beta$  as a standby letter of credit. It is subject to the International Standby Practices (ISP 98), publication 590, of March 31, 2010.**

**1.2. The following are the parties of the counter-guarantee standby letter of credit:**

- **Applicant:** Company  $\delta$ .
- **Beneficiary:** Bank  $\beta$
- **Issuing Bank:** Bank  $\alpha$
- **Purpose:** issuing a performance and immediate execution bond.
- **Original Time of Expiration:** April 5<sup>th</sup>, 2011. So far is renewed until July 27, 2021.
- **Amount of the counter-guarantee:** USD 3,308,379.18

**1.3. Purpose of the Guarantee.**

The applicant, Company  $\delta$ , signed a contract with Company  $\Omega$  to build a Two-way Road, for which they were requested a performance and immediate execution bond issued locally by Bank  $\beta$ . They were provided support with a counter-guarantee from Bank  $\alpha$ .



#### 1.4. Expiry Date.

The Counter-guarantee was originally issued with automatic renewals in favor of Bank  $\beta$  unless said bank notified, at least one month before the expiration date, that the renewal would not be necessary.

However, on April 5th of 2010 this condition was deleted and since then, the counter-guarantee has been renewed from time to time and is currently valid until July 27th 2021.

#### 1.5. Terms to execute the counter-guarantee standby letter of credit:

The following was established in the counter-guarantee issued by Bank  $\alpha$ :

*“FUNDS UNDER THIS LETTER OF CREDIT ARE AVAILABLE TO YOU UPON YOUR SENDING AN AUTHENTICATED SWIFT MESSAGE DRAWING TO US MENTIONING THEREIN OUR STANDBY LETTER OF CREDIT NUMBER AND STATING THAT THE BENEFICIARY HAS DEMANDED PAYMENT UNDER YOUR LOCAL GUARANTEE AND THAT YOU ARE REQUIRED TO (OR ALREADY HAVE) EFFECTED SUCH PAYMENT.”*

#### 1.6. Current problem.

- 1.6.1. On December 18, 2020, Bank  $\beta$  received instructions from Company  $\Omega$  to renew or execute the local performance bond, in light of which the mentioned bank, on December 21, 2020 sent a SWIFT message to Bank  $\alpha$  in order to renew the counter-guarantee, and noting that in the event of such renewal not being accepted that message would be considered as a demand for payment.
- 1.6.2. On December 24, 2020, Bank  $\alpha$  received a SWIFT message from Bank  $\beta$  indicating that they had received a “PRECAUTIONARY MEASURE ORDERING NOT TO RENEW OR EXECUTE THE LOCAL GUARANTEE”
- 1.6.3. Bank  $\alpha$  was informed on December 24, 2020 by the Applicant, Company  $\delta$ , that it had begun contentious litigation on November 2, 2020 against Company  $\Omega$  with respect to contract of the Two-way Road.
- 1.6.4. On December 30, 2020, Bank  $\alpha$  received a SWIFT message from Bank  $\beta$  once again requesting the renewal of the counter-guarantee. Otherwise, it indicated that the Beneficiary, would make the counter-guarantee enforceable because the Beneficiary, Company  $\Omega$ , had indicated it would proceed to execute the counter-guarantee if it was not renewed.
- 1.6.5. In light of the above, Bank  $\alpha$  answered on January 15, 2021 through a SWIFT message that the instructions between December 24 and 30 were contradictory and, therefore, they considered that the claim was confusing.
- 1.6.6. Bank  $\alpha$  renewed the counter-guarantee with Bank  $\beta$  until April 27, 2021, but without conveying the instructions to renew the local guarantee before Company  $\Omega$ .



- 1.6.7. On February 2, 2021, Bank  $\alpha$  received a new SWIFT message from Bank  $\beta$  requesting the renewal or payment of the standby letter of credit.
- 1.6.8. Bank  $\alpha$  was informed on February 8, 2021 by the Applicant, Company  $\delta$ , that a local Court of Justice had, since December 11, 2020, issued a precautionary measure against Bank  $\beta$  with the “PROHIBITORY INJUNCTION AND INHIBITION OF EXECUTING the Guarantee Bond FOR ANY REASON”
- 1.6.9. On February 11, 2021, Bank  $\alpha$  sent a SWIFT message indicating it would not pay the counter-guarantee because the instructions of the Court of Justice were in effect. They issued a precautionary measure against Bank  $\beta$  with the “**PROHIBITORY INJUNCTION AND INHIBITION OF EXECUTING the Guarantee Bond FOR ANY REASON, IN COMPLIANCE WITH CONTRACT.**” Therefore, Bank  $\beta$  cannot renew or execute the Local Guarantee which is the purpose of the counter-guarantee standby letter of credit.
- 1.6.10. The prohibitory injunction under the national law means the performance bond is aimed at keeping a certain reality from changing for the sentence or final ruling to be effective. It must also be considered that this precautionary measure cannot cause more damage than that which it is intended to prevent.
- 1.6.11. On February 22, 2021, Bank  $\alpha$  received a SWIFT message from Bank  $\beta$ . They requested payment according to the SWIFT message received by Bank  $\alpha$  on February 2, or extend the validity of both the standby and the local guarantee as indicated in the message received on 21 December.
- 1.6.12. On March 2, 2021, Bank  $\alpha$  received a SWIFT message from Bank  $\beta$  where they requested immediate payment of the standby letter of credit.
- 1.6.13. On March 3, 2021, Bank  $\alpha$  answered the Swift message indicating that Bank  $\beta$ , cannot renew or execute the local guarantee because have to fulfill with the precautionary measure order. Besides, Bank  $\alpha$  have been acting timely in the whole claims.
- 1.6.14. Finally, on April 16, 2021, Bank  $\beta$  stopped collecting the counter-guarantee, but insisted on extending it until July 27, 2021.
- 1.6.15. On April 23th 2021, Bank  $\alpha$  answered the SWIFT messages from Bank  $\beta$ , indicating the renewal of the counter-guarantee until July 27, 2021.

## 1.7. Query

Based on the presented facts, we would like to ask the ICC Banking Commission if not paying a counter-guarantee is valid when it is subject to a precautionary measure in local regulations to immediately suspend its renewal or execution by a Court of Justice that, in addition, notified the Local Bank (Bank  $\beta$ .), issuer of the local guarantee (performance and immediate execution bond).



We strongly believe that banks issuing letters of credit should observe court orders or any other government-ordered measure prohibiting payment under a LC, but only if the prohibition on payment by the LC is clear.

In this matter it is our view that the independence principle in LCs may be breached by illegality in the underlying contract as the illegality extends to the letter of credit.<sup>1</sup> There are case-law precedents which have recognized that, if the underlying contract is illegal or unlawful, and if the LC is being used as a mean of paying sums due under that underlying relationship, provided that all this is clearly established, the bank must be prevented from making the payment.<sup>2</sup>

It has also been pointed out that, in the same way that a beneficiary would not be entitled to benefit from his own fraud as a matter of public policy, he must not be allowed to “*enforce part of an underlying transaction that would have been unenforceable on the grounds of illegality, if no letter of credit had been involved*” regardless of the severity of the illegality.<sup>3</sup>

According to the above it is important to mention that collecting a local counter-guarantee against a judicial order is an alleged illegal collection of a contractual guarantee (as indicated in the paragraph 1.6.10). Therefore, Bank α cannot endorse a failure to comply with a judicial order, and much less the actions of the local bank, Bank β, committing a presumed illegal activity.

Finally, we would like to ask to the ICC Banking Commission if it is possible to avoid the payment of a counter-guarantee standby letter of credit, when an illegality act happens as have been indicated in the present case.

[End of Request for Opinion]

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## **IIBLP Response to the National Committee of Costa Rica’s Request:**

This is the response of the Institute of International Banking Law & Practice, Inc. (“IIBLP”) to the above 14 June 2021 query (“the query”).

The query asks whether an outstanding court order may excuse the issuer of a counter standby subject to ISP98 Rules from performing its obligations under the standby’s stated and incorporated ISP98 terms and conditions.

ISP98 does not provide answers to this query. ISP98 Rule 1.02(a) provides that ISP98 Rules supplement applicable law to the extent not prohibited by that law, and Rule 1.05(c) states that the Rules do not define or otherwise provide for “defenses to honour based on fraud, abuse, or similar matters” and leaves such matters “to applicable law.”

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<sup>1</sup> Mahonia Ltd v. West LB AG (No 2) [2004]

<sup>2</sup> Group Josi Re v. Walbrook Insurance Co Ltd [1996]

<sup>3</sup> Mahonia Ltd. v. JP Morgan Chase Bank, [2003]



THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES<sup>4</sup> includes in the official comments on Rule 1.05(c) the following general comment regarding “Fraud, Abuse, or Similar Matters”: “**Generally.** The presence and consequences of fraud, abuse, illegality, or similar matters are left to applicable law such as Rev. UCC Art. 5 Section 5-109 or the UN Convention Art. 19 as indicated by Subrule (c) of this Rule.”

Other similar matters left to applicable law include issuer action or inaction compelled by a judicial order or government regulation applicable to the issuer. The ISP98 Form 1 Model Standby (published in 2012 and available at the IIBLP website<sup>5</sup>) addresses this topic at endnote 19 (Incorporation of ISP98; law, court; arbitration, and sanctions<sup>6</sup>). Where the issuer’s excuse is based on a judicial order, determining the validity of the excuse may require, for example, consideration of the procedural and substantive laws applied by the court hearing the applicant’s claim for relief from an allegedly fraudulent demand and also of the laws applied by a different court hearing the beneficiary’s wrongful dishonor claim and defense against recognition of a foreign court order.

**Disclaimer:** This response is given for educational purposes and is not to be construed as providing legal, accounting or other professional advice. Individuals relying on this response should consult with their own lawyers and advisers in the drafting or use of a standby letter of credit. ISP98 educational and training materials are available from IIBLP at [www.iiblp.org](http://www.iiblp.org)

Best Regards,

Michael P. Byrne  
CEO  
Institute of International Banking Law & Practice

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<sup>4</sup> THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES, Professor James E. Byrne (James G. Barnes, editor), Institute of International Banking Law & Practice, Inc. (1999) (353 pages).

<sup>5</sup> [www.iiblp.org/isp-forms/](http://www.iiblp.org/isp-forms/)

<sup>6</sup> [www.iiblp.org/sanctions-clause/](http://www.iiblp.org/sanctions-clause/)