

SHOULD REFERENCE TO STANDBYS REMAIN IN UCP?

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ADC-PRO Interview with Vincent Maulella*

DC-PRO: Do you believe that UCP should continue to include reference to standbys?

VM: The language used in UCP 500 (1993 Revision) in relation to Standbys is basically a repeat of the text present in UCP 400 (1983 Revision).

A continuation of this parenthetical “including to the extent to which they may be applicable to Standby Letters of Credit” language in the new UCP - two decades after the Banking Commission and the UCP formally recognized standbys - would not be sufficient to seriously or specifically address the uniqueness of standbys.

I don’t believe that standbys will receive the required level of treatment. And that being the case, the new UCP should not continue to include reference to standbys.

The UCP was not created for standbys and was not changed in two previous revisions to accommodate or, to use the UCP’s language, “include” standbys.

The UCP’s *raison d’être* never was standbys, whereas, the ISP98 was written to specifically address standby practice.

A better question might be: “Why continue to muddy the waters and confuse the market?”

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DC-PRO: Why do you think the market is confused?

VM: Simple, too many choices. The ICC offers standby users three alternatives: **ISP98**, effective January 1, 1999 (ICC Pub.No.590), **UCP 500**, effective January 1, 1994 (ICC Pub.No.500) and **URDG**, effective January 1, 1992 (ICC Pub.No.458).

While all three sets of “rules” define their product in similar terms, and use the expression “however named or described”, only ISP98 unequivocally states that it is “intended to be applied to standby letters of credit.”

UCP500 includes standby under the rubric of documentary credits but only “to the extent to which they [the UCP] may be applicable.”

URDG doesn’t even use the word standby.

DC-PRO: If ISP98 is so clear in this regard, why hasn’t the market simply adopted it as an automatic replacement rule for standbys?

VM: Bernard Wheble may have said it best when he said: “the inertia of tradition” or was it “the tradition of inertia”? Either way, people - and bankers may be at the top of that list - resist change.

Change, even positive change, requires time, effort and impetus. Think back to January 1, 1999, the effective date of ISP98, the market was more focused on Y2K than on ISP98. In addition, there was no perceived need to change; standbys had been issued subject to the UCP since the 1950's.

By 1999, the ICC and the courts recognized standbys subject to UCP. No one sensed a need - much less an urgency - to change. When I started in banking 1970, standbys were issued subject to UCP Brochure No. 222. On January 1, 1974, standbys were issued subject to UCP 290 - a natural transition.

Neither of these predecessors to the current UCP even mentioned the word standbys! Standbys were first recognized by name in UCP 400 and then subsequently in UCP 500.

But at that time, there was no alternative. So, for better or worse and I think for the better, standbys were issued subject to the then current UCP. No choice, no decision.

DC-PRO: Why do you think standbys were included in the 1983 revision?

VM: Well. As I recall, the only contemporaneous resource published at that time was ICC Publication No. 411 ("the Comparison"). While not an official publication of the Banking Commission, it does give us insight into what the drafters were thinking and why they did what they did.

Since that publication is no longer available and as many of today's LC users may not have been practicing LC back in 1983 or may not have access to it, let me quote from that publication. The reason for extending the UCP to Standbys was stated as:

"In March 1977 the Banking Commission expressed its opinion that a stand-by letter of credit fell within the UCP (publication No. 290, General Provisions and Definitions, paragraph b) definition of a documentary credit and should there-

fore be subject to UCP (No. 371, p. 11). Since stand-by credits are being increasingly used in a growing number of countries and publication 371 may not be known to all concerned with standby credits, it was felt desirable to remove any doubt and make it clear by wording in the UCP that the UCP applied to such letters of credit."

This comparison also gives us further insight:

"The role of the traditional documentary credit (commercial credit), issued at the request of the buyer in favor of the seller, has been to enable the seller to obtain the payment due to him from the buyer when he, the seller, has fulfilled his part in the commercial contract and "evidenced" this fact by presenting "stipulated documents".

The role of the stand-by credit is different, although it possesses all the elements of a documentary credit subject to UCP. It is often used in lieu of the performance guarantee, e.g. in respect of major construction contracts or major long-term sales. But it may sometimes be used for other purposes, such as form of guarantee by, for example, a parent company of loans granted to a subsidiary. The stand-by letter of credit ensures payment if and when the subsidiary fails to repay the loan when due. Sometimes, on the other hand, a stand-by letter of credit may be issued in favour of the seller to ensure that if payment is not received under some other pre-agreed method it will be made under the stand-by credit upon the seller fulfilling his part of the stand-by credit.

Basically, however, the stand-by credit is intended to cover a "NON-PERFORMANCE" (default) situation instead of a "PERFORMANCE" situation, as with the traditional documentary credit. This affects both the position of the issuing bank and the type of documentation called for. Even if the applicant

claims that he has “performed”, the bank must pay under the terms of the credit if the specified document is presented - usually a sight draft on the issuing bank accompanied by a statement of claim issued by the beneficiary. (This position has been upheld in a number of cases where the courts have ruled against the applicant seeking an injunction to prevent the issuing bank from honouring its undertaking.)

The type of documentation referred to above gives some indication of the “extent to which they (UCP) may be applicable” to stand-by letters of credit. Thus, Articles 23 and 46 would seem likely to apply, whereas articles dealing with “Documents” would seem likely not to be applicable.”

Quite a detailed explanation, especially given that one of the prime drafters of UCP 400, Bernard Wheble, considered standbys as “problem children” to its venerable parent, the commercial letter of credit. Perhaps that is why standbys is hyphenated in the 1983 revision (“stand-bys”) and recognized in parentheses.

Also, a professed “look to the future” cited in the Introduction to this Comparison was “to allow for the development of new types of documentary credits, such as the deferred payment credit and the stand-by credit.” That alone should have alerted the market to be suspect of the attention these innovations would receive.

“New”? My sources tell me that both deferred payment LCs and standbys were around since at least the 1950s.

DC-PRO: So, what do you feel is the single key deficiency in UCP as regards Standbys?

VM: Quite simply, as I have already mentioned, UCP was written to govern commercial credits - not standbys. In ICC terms, UCP does not “cater “to standbys.

The simplest example that I can provide, let me see ... which articles of UCP apply to Standbys?

Determining which articles of UCP may be applicable is not as easy as it sounds. It should be immediately apparent from the UCP rules, but it is not. Even for very experienced practitioners, it is not clear-cut, so it must be a minefield for traders/practitioners new to standbys who look to the rules for direction and guidance.

Let’s take another brief look at the wording of ‘the Comparison’ (ICC Publication No. 411) in relation to the applicability of UCP to standbys.

It indicates:

articles 23 (Issuer and data content) and 46 (Expiration date and presentation) “would seem likely to apply” to standbys whereas “articles dealing with ‘Documents’ would seem likely not to be applicable.”

This wording is non-specific, non-authoritative, and when one reads the related sections, definitely not helpful in determining which articles are applicable.

DC-PRO: OK. Your views as regards UCP and standbys are very clear. But what would you see as being the main advantages of using ISP98?

VM: Tricky question. When you say “advantages”, I think it implies “advantages” for one and “disadvantages” for the other. To me, ISP98 is clear and concise and neutral; all parties know up front what to expect. No surprises. Say what you mean and mean what you say. I believe ISP98 reflects the better practice of the better practitioners and gives all parties those benefits.

DC-PRO: What do you see being the result of the present UCP revision process as regards standbys?

VM: I see a group, well, really two groups, which have their work cut out for them. Clearly, the revi-

sion of UCP for commercial credits is daunting in itself. I see them being somewhat overwhelmed and 'time pressured' into performance and publication.

Hopefully, they have the expertise and can enlist and energize the commercial parties and third party logistics providers to participate in this process for commercial credits.

As I said earlier, I do not see this revision seriously and specifically addressing standbys. I do not see the groups as currently constituted to have the standby experience to specifically and unequivocally incorporate standbys. But, more importantly, I do not see the need to include standbys as the market already has a set of rules "intended to be applied to standbys."

DC-PRO: But it looks like the present revision will include Standbys. What concern, if any, does this cause?

VM: My concern is that too many will simply avoid the time and effort to make a well-informed decision i.e. to compare ISP98 to the new UCP as it relates to standbys.

I believe that many will proceed on a BAU (business as usual) mode and do themselves and their customers a disservice.

It must be remembered that the inclusion of Standbys in the new UCP is not a natural transition - as it has been in the past. A choice exists now!

For standbys issued prior to January 1, 1999 there was no real choice of rule -URDG was never an alternative for standby issuers. To solve problems arising after January 1, 1999, most users would admit to looking to ISP98 for solutions.

That was good and that worked; and the courts have even taken that route. But, what will happen now? Will the courts continue to look to ISP98 for guidance if the standby is issued subject to UCP? Probably not; that safety net is gone.

Now, if you want a rule written specifically for standbys you will have to issue your standby subject to ISP98.

DC-PRO: Any final words?

VM: Clearly, if you haven't already guessed, I am an advocate for ISP98. However, my final word, since you put it that way, is for your readers not to rely on my word or the word of the Banking Commission. Read the rules available and decide for yourself. Don't let lack of knowledge be the determining factor in choosing the rule you use for standbys.

The Annual Survey of LC Law & Practice typically includes a poll of attendees regarding ISP98 usage. These results indicate that the main reason for not using ISP is that standby users have not read it, don't understand it, and don't think they need it.

No one has cited a specific article or substantive issue that ISP98 does not address or that they disagree with. In any event, if one is so inclined, ISP98 Rule 1.01(c), accommodates the exclusion of specific provisions of the rules.

I believe that if this revision does not include standbys, the market will have to read and consider and use ISP98 as the authoritative rule for standbys and that will be good for the market.