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Energy Trade & Commodities Alert

URDG 758 – A facelift for the Demand Guarantee Rules

Following what most observers feel has been a successful revision of ICC's Uniform Customs and Practice for Documentary Credits ("UCP 600") which, has led to a significant revival in the fortunes of the documentary credit, the ICC has launched on 1 July 2010 the revised Uniform Rules for Demand Guarantees ("URDG 758").

The new rules - why were they needed?

In a competitive market where the standby credit has, for many, become the demand guarantee of choice employing either UCP 600 or the International Standby Practices 1998 ("ISP 98") as its underlying rules, the URDG based demand guarantee has had relatively limited penetration. Part of its lack of popularity stems from a perception that the rules are pro-applicant/guarantor (generally the contract counterparty and its bank) and not user-friendly for banks. One issue of debate has been the requirement of a beneficiary to justify a demand by reference to a contractual breach (while UCP 600 for example distances the payment obligation in a standby credit from the facts of the underlying contractual performance). The rule was created to protect applicants and guarantors from unjustified calls on guarantees but is unattractive to beneficiaries. There is also anecdotal evidence that less than 5% of these instruments ever result in a pay out so it is unsurprising that the ICC felt it was time to give the old rules ("URDG 458" – a 1992 revision) a makeover.

The new rules came into effect on 1 July 2010 and the most striking change is the adoption of the drafting style and language of UCP 600 to give the rules broader appeal among those used to the well established documentary credit terminology. So who should be looking to use demand guarantees issued subject to the new rules and why?

We look below at some of the key features introduced or changed by URDG 758 and consider where the applicant/guarantor and the beneficiary respectively gain or lose under the new wording.

URDG 758 Articles in the Beneficiary's favour

Presentation (Article 14)
This is a new feature, previously silent in URDG 458. Presentation of a claim must be made at the place of issue or such other specified place on or before expiry of the guarantee. If a presentation indicates that it is incomplete, it can then be completed on or before expiry. An incomplete presentation is unlikely to occur in practice but if it does happen the beneficiary does not suffer a technical knock-out for failing to provide everything in one envelope.

Currency of Payment (Article 21)
Where the guarantor is unable due to illegality or other cause beyond its control to make payment when due and in the currency of the guarantee then, notwithstanding any provision in the guarantee to the contrary, the guarantor can pay in its local currency at the prevailing rate of exchange. If payment is delayed, the beneficiary can require payment to be made in such increased sum as so as to reflect the amount which would have been received according to the exchange rate prevailing when payment was originally due rather than the date of payment if the exchange rate has moved against him.

Non-complying Demand (Article 24)
A major innovation is the new rule that if a guarantor rejects a non-complying demand it must send a rejection notice with five business days setting out all of the discrepancies, as in a UCP 600 documentary credit rejection. Failure to do so results in the guarantor losing its right to claim that the demand does not comply and it is then obliged to pay.

URDG 758 Articles in the Applicant/Guarantor's favour

Requirements for Demand (Article 15)
Demands must be accompanied by such documents as the guarantee specifies and contain a statement setting out "in what respect the applicant is in breach of its obligations under the underlying relationship"[1]. The statement required is slightly simpler than under URDG 458 that may reduce the risk of a non-complying or inaccurate demand. However, the requirement for such a statement at all means that this rule continues to act as a pro-applicant/guarantor provision because it provides a basis upon which a guarantor can challenge a demand claim in court by alleging that an accompanying statement is false while a standby credit could provide for a statement of fact on a payment trigger there is no requirement under VCP 600 or LSP 98 that it does so. As in URDG 458 it remains open to the parties to expressly exclude this provision and it frequently is excluded.

Extend or Pay (Article 23)
The rule on "extend or pay", where the beneficiary makes a demand close to the expiry date and permits the guarantor to extend the validity of the guarantee as an alternative to immediate payment, has also changed. The guarantor now has the option to pay up immediately or to suspend payment for a period not exceeding 30 calendar days following receipt[2] to allow negotiation. Previously it had no choice but to suspend payment while consulting with the applicant in relation to the extension. The guarantor now has a discretionary right to refuse to grant any extensions, "even if instructed to do so"[3] by the applicant, and may simply proceed to pay. Banks will welcome this change.

Transfer of guarantee and assignment of proceeds (Article 33)
Partial transfers of a "transferrable" guarantee which were previously allowed are not now possible and the guarantor has the right to refuse to give effect to a request to transfer a guarantee at all unless it has expressly consented to the transfer. In addition, the agreement of the guarantor is required for the assignment of proceeds under Article 33(b). Failure to obtain such agreement gives the guarantor the right to refuse to pay the assignee in question. The parties can negotiate to exclude this provision if they wish.

Winners and losers

Despite the stated aim of striking a greater balance between the competing interests in any demand guarantee, URDG 758 is still noticeably tilted in favour of the interests of the applicant/guarantor.

The UCP style language should make it easier to use but many beneficiaries who operate within the international trade market will continue to regard the URDG based guarantee as of lesser value than guarantees or standby credits issued without URDG.

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1. Article 15a.
2. Contrast with URDG 458 which required the guarantor to suspend payment in order to allow the negotiation of an extension.
3. Article 23e

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