

WORLD

Documentary Credit

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■ **SIMPLIFYING LCs**

Why and how did letters of credit get so complicated? More importantly, what can be done to return to the primary reason an LC is used in the first place? By virtue of its decision not to revise UCP600, the industry roundly rejected the notion that the existing practice rules are to blame for declining commercial LC use. The Bank Payment Obligation was an attempt to fill the void by transforming the process, but nor was it a satisfactory response. Dismissing calls to craft a new set of simplified rules, Buddy Baker contends the answer is simplifying LCs. At its core, the letter of credit is a means of payment. Yet banks have made things unnecessarily complicated for themselves and their customers. Drawing on what he perceives to be the deficiencies – and merits – of BPO's approach, Baker makes his case for how banks can give applicants and beneficiaries what they want ... simplified LCs



INTERVIEW

VINCENT O'BRIEN SPEAKS WITH AMIT AGGARWAL

On the occasion of the CCOIC Trade Finance Annual Survey in Hangzhou, China (21-22 September 2019), Vincent O'Brien, ICC Banking Commission Executive Committee Member and DCW Contributing Editor, sat down with Amit Aggarwal, Partner and Head of Corporate Practice of SNG & Partners (India), for an in depth look at international guarantee practice and law in India, including the highly-charged topic of expiry dates and claim periods.

VOB: Welcome to afternoon session here at this important ICC China Annual Trade Finance event in Hangzhou China. I am delighted to have 20 minutes with Amit Aggarwal who is a partner with SNG & Partners, a leading trade and international banking law firm in India. Amit is very well known among leading trade finance banks and commodity traders in India. Amit, welcome!

Trade and international contracts between India and China continue to grow at an incredible pace. Despite both economies slowing somewhat international trade and contracting remains strong. However, India's trade deficit with China was nearly USD 54 Billion by the end of March this year. What do you make of this?

AA: Clearly it would be better if the trade balance between India and China was more balanced and to be fair in recent months India has played catch-up to a degree with the trade deficit narrowing to an extent.

Vin, you made the point yesterday when presenting findings from IIBLP research that China has been very successful at making the best of WTO rules in the past and I agree with that point. The best way is to negotiate "win-win" changes to avoid trade wars.

VOB: Good comment, Amit, and that brings us right to the substance of our conversation ... guarantee practice in India. As we saw in my report on "Trends in Global Trade: Setting the Scene" yesterday, LC volumes are in decline globally but we are seeing an increase in the use of demand guarantees and, in particular, standbys. Is this also the case in India?



AA: Pretty much the same. The core proposition of LCs is very powerful but they are cumbersome and can be complex with high discrepancy levels. Demand guarantees and the use of standbys are on the increase in India, both in terms of traditional trade and also in the context of Supply Chain Finance.

VOB: What about usage of URDG 758 for demand guarantees and ISP98 for standbys?

AA: We see both URDG 758 and ISP98 in the market in India. [Prior to 2010,] URDG 458 was not used much but URDG 758 has made impact. UCP600 is still prevalent for standbys but ISP98 has in recent times gained momentum and will in my view be the dominant set of rules.

VOB: Now I want to get to the core question which relates to the validity, expiry, or claim period for enforcement of guarantees in India. Within the international banking community there is confusion regarding when exposure terminates under guarantees, especially in context of supporting counter guarantees issued by international banks for support of local guarantees for contracts in India.

AA: Yes, Vin, we get a lot of queries on this subject and given the huge value of guarantee amounts involved it is a very important question. The story starts with Section 28 of The Indian Contract Act, 1882. Don't worry Vin, I am not going to give you a long history lesson, but this Act provided:

"Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights is void to that extent."

VOB: OK, so simply put, a restriction on enforcing rights was not allowed or was void under the Act?

AA: Well let me go further to explain. The 1882 Indian Contract Act was amended in 1997. The 1997 amendment came up for interpretation before the Delhi High Court in a number of high profile cases.

In a nutshell, a party has the right to enforce their rights by approaching the court of law within the normal period of limitation as set out in the Act. However, there was confusion on the interpretation of “enforcement” and it appears banks took up the matter with Indian Bank Associations and the Law Commission of India. Then by virtue of the Banking Laws (Amendment) Act, 2012 which entered into force in 2013, an exception for bank guarantees was carved out of the Indian Contract Act.

VOB: Ok, Amit, now you are losing me. This is where I have some difficulty in understanding. So, by the word “rights”, is it the right to take **legal action** against another party — such as a guarantor — or is it the right to **make a demand** under a guarantee?

AA: That is the key question, Vin. Like many legal issues, it is often best answered by a simple example with a clear opinion. Of course, more complex examples result in more complex opinions.

VOB: I like that approach, Amit. Let me ask the simple question then!

AA: Well I was going to suggest a question but as we appear to be on the same page please proceed.





VOB: Question 1: A local guarantee is issued by local bank in India with an expressly clear expiry date of 30 September 2019 for presentation of a demand – right?

AA: Right!

VOB: Only one demand was made, but made on 10 October 2019, which is clearly after the expressly stated expiry date in the guarantee – right?

AA: Right!

VOB: Has the guarantor's financial obligation expired or terminated?

AA: Yes, there is no right to make demand. If no demand was made before the stated expiry date for presentation in the guarantee the bank's financial obligation under the guarantee instrument has terminated.

VOB: Thank you for the clear answer to question 1. Now here is question 2.

AA: Question 2?

VOB: Yes, Question 2!

VOB: If an international counter guarantor has issued its counter guarantee subject to URDG 758, will its financial obligation under its counter guarantee also have terminated?

AA: Surprisingly, we also get asked this question quite often. The answer is that if the counter guarantee is issued by an international bank then the counter guarantee will expire on that counter guarantee's stated expiry date for presentation in the counter guarantee.

Furthermore, if the counter guarantee is issued subject to URDG 758 then, as per Article 34 of URDG 758, its governing law, unless otherwise stated, shall be that of the location of the guarantor's branch or office that issued the guarantee.

VOB: Great answer, Amit, crystal clear!

Ok, so the expiry date for presentation of a demand remains the expiry date for presentation of a demand but the bank is permitted under this law to limit the period after the expiry event in which parties can make legal claims or legal challenges?

AA: That is the core substance. For example, the beneficiary may make a timely demand that is before the stated expiry date for presentation. However, it can easily happen that the bank determines the demand does not comply but the beneficiary maintains it was a complying demand. A lawsuit may then ensue so this limitation period would relate to the enforcement of the beneficiary's legal rights, if any.

The amendment made to Section 28 of the Indian Contract Act, 1872, has helped banks contain their exposure. Pursuant to the amendment, if the text of the bank guarantee stipulates a limitation period which is not less than one year, for the beneficiary to enforce its claim before judicial authorities, and the beneficiary doesn't take any enforcement action then Banks will be within their rights to close the exposure in their account books, notwithstanding the limitation period prescribed under the Limitation Act, 1908.

VOB: That turns the issue around completely in my mind. Some commentators felt these legal provisions in India extended bank's undertakings to pay demands under independent guarantees presented beyond the expressly stated expiry date; in effect, forcing them to accept presentations after the expiry date which is alien to international practice. Whereas, on the contrary, the reality is that the expiry date for presentation remains as stated in the guarantee but as I now understand there are limits on the time available after expiry for legal action to be taken.



AA: Yes, Vin, that is it. But just to wrap it up, one final clarification, if I may. The Banking Laws (Amendment) Act, 2012 which entered into force in 2013 contained an exception to cover this particular point known as “Exception 3’.

In simple terms, Exception 3 gave banks the privilege of limiting the exposure by stipulating in the terms of a guarantee a provision for discharge of liability in respect of actions or legal suit under a guarantee on the expiry of a specified period, which in the context of our discussion today is not less than one year from the date of the express expiry date stated in the guarantee.

VOB: Excellent, Amit. As we are sitting here in the trade heartland of China, I am just wondering what you think of the Chinese Rules for Independent Guarantees which became effective as law within China on 1 December 2016?

AA: These Interpretations represent an excellent work, clearly following the natural life cycle of international demand guarantees. This positive development is driven by the One Belt One Road Initiative where security of obligations is of paramount importance.

In particular, the protection provided in Article 14 [Suspension of Payment] to a foreign local guarantor who acted in good faith in paying out on a local guarantee is an exceptionally positive step for secure international demand guarantee business. Other countries could learn from this important initiative from China.

VOB: I agree 100%. Thank you, Amit, for your most valuable insights, your clear examples, and open approach to discussing such issues.

AA: You are most welcome, Vin, and we are ready and willing to work with our Chinese friends in doing business in India. This was an excellent forum with ICC China and top Chinese Trade Finance Experts. I hope we can consider having a similar forum in India.

VOB: Let’s not consider it – let’s just do it! ■

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