



# **BANKS MUST PLAY A PROACTIVE ROLE TO ADOPT NEW ICC RULES FOR TRADE TERMS AND GUARANTEES**

**By Parama Dharmawardene**

Consultant, Sampath Bank

## **1.0 Introductions**

The environment in which a business has to operate is a key factor in attracting foreign business to any financial centre, and the laws, regulations, practices and procedures adopted by that country is one of the key elements of it. Therefore one of the many challenges in making Sri Lanka a Financial Hub is the need to adopt international standards and rules to make the contracting parties comfortable with the environment in which the business is transacted.

The International Chamber of Commerce (ICC) has taken many initiatives in formulating rules, governing practices and procedures pertaining to international business and it is up to the countries concerned to make the maximum uses of such international best practices formulated by them. It is also pertinent to mention that rules developed by the ICC are mere rules not law and is therefore not automatically applicable to any transactions. If the rules are to be made applicable they must be brought in by specific reference to them in the contract or agreement. However, it must be borne in mind that the local laws supersede any rule referred in a transaction although it is questionable whether Sri Lankan bankers are fully aware of the local laws applicable and their implications.

The latest Rules to be developed by the ICC's are the new revision of the Uniform Rules for Demand Guarantees (URDG758) which was implemented on 01 July 2010, and the latest revision of the Incoterms (Incoterms2010) which comes in to effect from 01 January 2011. How will Banks in Sri Lanka respond in adopting these rules? This article is aimed at highlighting some of the key provisions of these new revisions and why the banks in Sri Lanka should play a proactive role in adopting them and also getting their customers to use them.

## **1.1 ICC their role and how they operate**

ICC was set up to facilitate smooth international trade. They claim to be the voice of world business championing the global economy as a force for economic growth, job creation and prosperity. Because national economies are now so closely interwoven, government decisions have far stronger international repercussions than in the past. ICC - the world's only truly global business organization responds by being more assertive in expressing business views. ICC activities cover a broad spectrum, from arbitration and dispute resolution to making the case for open trade



and the market economy system, business self-regulation, fighting corruption or combating commercial crime. ICC has direct access to national governments all over the world through its national committees. The organization's Paris-based international secretariat feeds business views into inter-governmental organizations on issues that directly affect business operations.

The process adopted by the ICC in formulating new rules or revising existing ones is carried out by the appointment of a Task Force (TF) with specific terms of reference. The TF calls for suggestions from all the National Committees and Groups which represent the ICC in their respective countries for the formulation of new rules or for revising existing rules. The National Committees and Groups make sure that ICC take account of their national business concerns in its policy recommendations to governments and international organizations. The feed back received from them are then discussed by the TF and a revised draft is prepared which is circulated among all the National Committees and Groups for their comments and the draft is revised accordingly. This process is continued several times until some consensus is reached. This document is then put for vote by the ICC with the National Committees exercising their votes and approved by a clear majority before implementation. Therefore the final document becomes one acceptable to, if not all, to a large majority of member countries and groups and it truly has global acceptance.

## **1.2 ICC Rules**

The global rules developed by ICC and used by companies in countless business transactions all over the world are an essential part of ICC's work and set them apart from most other international business organizations. Arbitration under the rules of ICC International Court of Arbitration has been on the increase. Since 1999 the Court has received new cases at a rate of more than 500 a year. ICC's Uniform Customs and Practice for Documentary Credits (UCP 600) are the rules that banks apply to finance billions of Dollars worth of world trade each year. ICC Incoterms are standard international trade definitions used every day in thousands of contracts. ICC model contracts make life easier for small companies that cannot afford big legal departments.

ICC's Uniform Customs and Practice for Documentary Credits and the Uniform Rules for Collection, as it is currently known, which were first published in 1933 and 1956 respectively, are the rules that are being extensively used all over the world by almost every bank dealing in documentary credits and documentary collections. The willingness of banks to embrace these rules may have been more due to the protection they afforded to themselves rather than the eagerness to adopt globally accepted rules. Of course the banks can claim that since they get involved in the documentary credit and documentary collection transactions almost at the commencement of it, they are able to get their customers' consent to make these transactions subject to these rules

In Sri Lanka all banks insist that all documentary credits issued, advised, confirmed or issued by them are subject to ICC's Uniform Customs and Practice for Documentary Credits, and all documentary collections they handle are subject to ICC's Uniform Rules for Collection. However the use of Uniform Rules for Demand Guarantees and the Incoterms has not been that popular.



The Arbitration rules are hardly used may be due to the fact that the costs may be considered prohibitive for a country like Sri Lanka..

### **1.3 Standby Letters of Credit**

A Standby Letter of Credit is an instrument developed by the Americans in order to overcome the statutory prohibition placed on banks in USA from issuing bank guarantees. Therefore it is extensively used in USA but, is does not have the same popularity with the rest of the world, with Sri Lanka being no different, although statistics are not available to support this claim Standby Letters of Credit may be issued subject to either Uniform Customs and Practice for Documentary Credits (UCP600) or the International Standby Practices (ISP98) and are not classified as guarantees and therefore the rules applicable to guarantees cannot be applied to them. The issue of Standby Letters of Credit in Sri Lanka is few and far between.

## **2.0 ICC UNIFORM RULES FOR DEMAND GUARANTEES (URDG)**

Since their first adoption in 1991, ICC's URDG, ICC publication number 458 (URDG458), which reflect international standard practice in the use of demand guarantees and balance the legitimate interests of all parties, have gained international acceptance and official recognition by bankers, traders, industry associations and international organizations including UNCITRAL, FIDIC and the World Bank. However, it was not readily adopted by banks as was the case with UCP and URC and it is almost impossible to find a bank which is not handling documentary credits subject to UCP and to a lesser extent, documentary collections subject to URC. A quick survey carried out regarding the adoption of ICC's URDG in issuing guarantees by the licensed commercial banks in Sri Lankan revealed that banks do not use it as a practice unless specific instructions are given by the instructing party to issue the guarantee subject to URDG. This position continues to be the same even after the new revision was implemented.

### **2.1 Revision of URDG458**

The ICC in 2008 appointed the URDG Task Force to work on the proposed revision of URDG458 in order to reflect the Best Practices for Guarantees globally .It has taken them about two and-a half years to complete the process as described above and the revised Uniform Rules for Demand Guarantees (URDG758) was finally was implemented with effect from 01 July 2010.

This revision was more than an update of the existing rules, the revised URDG 758 are a new set of rules for the twenty-first century URDG 758 contains significant changes practitioners will need to know, including: new definitions and interpretation rules for greater clarity and precision; treatment of non-documentary conditions, incomplete presentations, and many other contentious practices; a comprehensive coverage of advice of guarantees, amendments, electronic documents, transfers and more; a provision on force majeure that triggers an extension of a guarantee for thirty calendar days; replacement of "reasonable time" with fixed periods for the examination of demands, the extension of guarantees and the suspension of payments.



In addition, the new URDG758 includes; a clear layout of the examination process for demands, a step-by-step roadmap for handling extend or pay demands, a checklist of drafting recommendations and ready-to-use model forms. A notable achievement by the ICC was to obtain the agreement of the World Bank and the ADB to make URDG758 with its model forms the standard for any guarantee to be issued in respect of projects financed by them.

The new revision was built on 17 years of URDG practice, including countless comments received by the Task Force through seminars, banking networks and industry feedback from banks, companies, international organizations, lawyers and consultants from various countries and economic sectors. Also, since the entry into effect of the URDG in 1992, important events have contributed to reshaping the regulatory scenery of demand guarantees. They include the adoption of the UN Convention on Independent Guarantees and Stand-by Letters of Credit, ISP98 and UCP 600, all of which deal with URDG-type demand guarantees or independent undertakings of the same nature as demand guarantees. The ICC Banking Commission has also adopted a number of opinions answering queries on the URDG and has approved DOCDEX decisions applying the rules. The new revision builds on ideas and approaches developed in the UN Convention, UCP and ISP where deemed equally beneficial to demand guarantee practice, while ensuring their necessary adaptation to suit the practice and expectation of the demand guarantee market.

## **2.2 General orientations for the revision:**

Amongst the many other sets of rules of demand guarantees or independent undertakings from which this revision seeks inspiration, UCP 600 is paramount. The reason is two fold. First, many back offices, especially in small and medium banks, but also in companies, manage both guarantees and letters of credit in the same service line. Their staffers have reported some difficulty to adjusting to two different sets of vocabulary used in URDG and UCP while referring to an identical concept (e.g. applicant / principal). They have also expressed uneasiness towards divergent rules in UCP and URDG (e.g. the preclusion rule, the process of issuance of the notice of rejection, and the treatment of non-documentary conditions).

Demand guarantees and letters of credit share an identical independent nature and, in the case of URDG guarantees, the same exclusively documentary character. ICC felt that there was no justification for keeping contrasting solutions in two sets of ICC rules dealing with similar instruments. While a documentary credit will always be functionally different from a guarantee, this revision brings the UCP and the URDG closer than ever before. This move will go to great lengths in streamlining demand guarantee practice, rather than disrupting demand guarantee practice.

Although this revision is more detailed than URDG 458, it is still not exhaustive, nor does it pretend to reach that stage. UCP attempted to remedy the uncertainty left by areas not covered in the rules by bringing into the rules in 1993 the concept of international standard banking practice as reflected in the UCP. That was done in two stages. First, stating the concept in article 13(a) of UCP 500, and then undertaking a non-exhaustive codification of those standards in ISBP



(ICC Publication 590). The revised URDG follows the same approach. Stage one is achieved by bringing into the revised URDG the new concept of “international standard demand guarantee practice so far as not inconsistent with these rules”. This is a prelude to supplementing in the next few years the revised URDG with a body of codified standard practices similar to ISBP when ICC feels that Opinions, DOCDEX decisions and other position papers would facilitate in identifying distinctively such a body of standards. In the meantime, ICC felt that the new concept of “International Standard Demand Guarantee Practice so far as consistent with the URDG” will allow parties, judges and arbitrators more latitude in identifying solutions to disputes while remaining within the spirit and general principles of the URDG.

The revision process is free from any preconceived position. Accordingly, the drafting group had reviewed the very foundations of URDG 458 and each of their distinctive features. Finding that the majority of those foundations is now well accepted by the market and has even contributed to shaping some of the market practices (an evident example is the noticeable shift towards a pattern of systematic presentation by the beneficiary of a statement of breach supporting the demand for payment), they have reaffirmed those foundations in this draft while ensuring a clearer phraseology to facilitate an easier translation into other languages, achieve more certainty, and avoid ambiguity. Thus, the revision: keeps the set of comprehensive information duties owed to the applicant throughout the main stages of the life cycle of the guarantee, while clarifying when such a duty is due reiterates the exemption of liability of the guarantor for acts done in the course of carrying out the applicant’s instructions and the duty of the applicant to indemnify the guarantor of the consequences of those acts, unless those acts are done otherwise than in good faith (articles 25 to 31); confirms the minimum requirements for a complying demand, whether a strict payment demand or an extend or pay demand, unless the relevant URDG provisions are expressly excluded. In particular, the content of the statement of breach is clarified to avoid unnecessary rigidity (article 17); and emphasizes URDG 458’s approach to extend or pay demands under which the suspension of payment following the presentation of a complying demand to allow the parties to agree on an extension dispenses with the need for the beneficiary to reiterate the demand should no extension by agreed upon (article 32).

One of the criticisms voiced against URDG 458 is that some of their provisions referred only to guarantees, but not to counter-guarantees. This gave the impression that a number of rules addressed only the practice they purported to cover in a guarantee but not in a counter-guarantee. The ICC Banking Commission approved in 2000 an Opinion (470/TA.454rev, 14 June 2000) stressing that URDG provisions referring to guarantees but not to counter-guarantees should be read, where the context so requires, as also referring to counter-guarantees. The revision codifies this Opinion in a general statement indicating the same (definition of “demand guarantee” in article 2) and, for sake of clarity, additionally refers to counter-guarantees wherever the rule for a guarantee requires any adaptation when viewed in the context of a counter-guarantee (see articles 35 and 36).



## 2.3 New provisions contained in URDG758

The URDG758 is different in both form and substance from URDG 458. All changes are aimed at achieving a better practice of demand guarantees under a more comprehensive set of rules.

- Spread throughout the articles in URDG 458, the definitions and rules of interpretation are now assembled in three comprehensive articles (articles 2 to 4), following the distinctive approach in UCP 600.
- While undoubtedly a necessary conclusion of URDG 458, the exclusively documentary nature of demand guarantees is now expressly affirmed. Its corollary in deeming non-documentary conditions as not stated and offering clear rules to assess conformity is now codified in distinct rules (articles 7 and 21).
- The advice of guarantees, not covered in URDG 458, is deemed sufficiently widespread in demand guarantee practice today so as to warrant its codification in a distinct new rule (article 10). It draws heavily on, but is not identical to, the standard set in UCP 600. Conversely, confirmation of demand guarantees, rarely encountered in practice and difficult to envisage in a set of rules that emphasizes the counter-guarantee/ guarantee structure, is not covered.
- Amendment of guarantees is now covered (article 11), following in that the standard set by UCP 600.
- Transfer of guarantees (assignment of the beneficiary's right to present a demand for payment, as opposed to a mere assignment of proceeds) has been dealt with summarily in URDG 458 article 4, essentially by discouraging such transfers which have sometimes lent themselves to fraudulent schemes. Consistent feedback that ICC received indicates that transferable guarantees utilised in conjunction with an assignment of the beneficiary's rights under the underlying transaction can perform a valuable service. This is particularly the case in financial or operating leases of aircrafts, ships or equipment (including high technology equipment). Lessors sometimes sell the leased property to a purchaser who would legitimately expect to continue benefiting of a demand guarantee covering the lessee's obligation to pay rentals. In such a case, the transfer of the guarantee in combination to the transfer of the underlying lease agreement provides the obvious solution. New article 33 in the draft attempts to provide a rule that would dispense with otherwise required lengthy drafting while mindful of avoiding lending itself to a dubious use. UCP and ISP98 have provided a helpful model in drafting the new provision on transfers, with however the draft making significant departures where deemed necessary.

## 3.0 ICC's INCOTERMS

ICC's official rules for the interpretation of trade terms are called Incoterms. These rules explain standard terms that are used in contracts for the sale of goods. They are essential ICC tools that help traders avoid misunderstandings by clarifying the costs, risks, and responsibilities of both buyers and sellers. Because the rules are developed by experts and practitioners brought together by ICC, and involve a long consultative process, they are globally accepted and have



become the standard in international business rules setting. The Incoterms standard clauses are one example of the ICC rules governing international business activities, with rules setting making up one of the three pillars of ICC's activities along with policy advocacy and dispute resolution through arbitration.

The Incoterms rules are a perfect example of an efficient standardization of an international business tool. Their day-to-day use in international sales contracts brings legal certainty to business transaction while simplifying the drafting of international contracts.”

When ICC first introduced the Incoterms standard commercial terms in 1936 they caused a sensation in the international business world. Representing a radically new concept in an industry regulated by local rules of law, the new terms were the first real attempt to bring coherence to a commercial and judicial system that diverged widely from one country to another. Since they were first introduced, the Incoterms rules have been revised about once a decade to keep up with the rapid expansion of world trade and globalization. Since the last revision in 2000, much has changed in global trade. Cargo security is now at the forefront of the transportation agenda for many countries. In addition, the United States' Uniform Commercial Code was revised in 2004, resulting in a deletion of US shipment and delivery terms. The latest version of the Incoterms rules will reflect these changes and others.

Incoterms rules define the responsibilities of buyers and sellers for the delivery of goods under sales contracts. Incoterms2000 contained 13 terms and were divided into four groups. The first was the Group E – Departure; which contained only one term EXW. Group F – Main Carriage Unpaid; contained three terms; FCA, FAS, and FOB. Group C – Main Carriage Paid; contained four terms CFR, CIF, CPT and CIP and the Group D – Arrival; contained five terms DAF, DES, DEQ, DDU and DDP. The terms FAS, FOB, CFR and CIF were exclusively for sea shipments whilst the others could be used for any form of transport or multimodal transport.

### **3.1 Incoterms2010**

The latest revision Incoterms2010, will be launched in September and come into effect on 1 January 2011. It takes into account the latest developments in commercial practice, and updates and consolidates some of the former rules.

The number of terms in this new revision has been reduced to eleven and instead of the five groups contained in Incoterms2000 a new classification system has been adopted dividing the eleven Incoterms rules into two distinct groups: Rules for any mode of transport: Rules for waterway transport: In addition to the 11 rules, Incoterms2010 includes, extensive guidance notes and illustrative graphics to help users efficiently choose the right rule for each transaction; new classification to help choosing the most suitable rule in relation to the mode of transport; advice for the use of electronic procedures; information on security-related clearances for shipments; and advice for the use of Incoterms2010 in domestic trade.



- Rules for any Mode or Modes of Transport are; EXW - Ex Works, FCA - Free Carrier, CPT - Carriage Paid To, CIP - Carriage and Insurance Paid to, DAT - Delivered at Terminal, DAP - Delivered At Place and DDP Delivered Duty Paid.
- Rules for Sea and Inland Waterway Transport are; FAS - Free Alongside Ship; FOB - Free On Board; CFR - Cost and Freight; and CIF - Cost Insurance and Freight

It is important to remember that Incoterms are a set of rules and not a law and unless specific reference to them is made in a contract, they do not apply automatically to it. Also, they do not provide a complete set of contractual terms. They only help in reducing a fair amount of details from the trade contract. Any requirement which is not specifically stated in the Incoterm used will have to be mentioned in the trade contract.

### **3.2 Some of the differences between Incoterms2000 and Incoterms2010**

Incoterms have been reduced from 13 different terms to 11. This has been achieved by substituting new term DAT Delivered at Terminal and DAP - Delivered at Place, for DAF, DES and DDU.

The thirteen terms in Incoterms2000 were classified under four clusters by initial letter, i.e. EXW, the “F” terms”, the “C” terms and the “D” terms. This classification reflected the level of the seller’s responsibilities towards the buyer. FCA, or for domestic sales, EXW, imposes the least duties on the seller with delivery happening and risk passing to the buyer at the earliest possible time. The “D” – or “delivered” – terms, on the other hand, impose the most duties on the seller, with delivery happening and risk passing to the buyer at the latest possible time. That categorisation remains very important, particularly when the parties decide which of the eleven Incoterms2010 to use.

The eleven terms in Incoterms2010 are presented, however, in two distinct classes as explained earlier. Each of the terms contains a Guidance Note at the start of the term which helps the users to understand the fundamentals of each term: when it should be used; when risk passes; how costs are allocated between seller and buyer

Since the revised Incoterms have still not been officially launched it is not possible to go into greater detail. However the news releases put out by the ICC gives a clear indication of the steps taken to further simplify and bring in greater clarity to the terms for the benefit of the users.

### **4.0 CONCLUSION**

The revised URDG, is a much more clearer, precise and comprehensive set of rules than the URDG458. Since the liabilities, responsibilities of each party are now clearly laid down in the revised rules, it is advantageous not only for the beneficiaries but also the issuers of guarantees or counter-guarantees, The similarity of the URDG to the style adopted by UCP600 will make it



much easier for the operational staff in issuing guarantees or processing documentation in handling claims lodged under guarantees.

Similarly Incoterms2010 will also help the parties to a trade contract to have a better understanding of the obligations of each party to the contract whilst eliminating a great amount of detail from the contract by the use of a three letter code followed by a named port or place. It has been found that a large majority of importers and exporters in Sri Lanka do not even have a properly executed trade contract and it is time that they make a move to overcome this deficiency and use legally enforceable trade contracts bringing in Incoterms2000 by specific reference and benefit from the advantages indicated above.

If Sri Lanka is to move into the big league and become a Financial Hub it is essential that the entire economy shifts to a higher level. The way we do business is one of the most important factors. Keeping abreast of the latest developments in the international world therefore is absolutely essential and it is time the banks in Sri Lanka play a proactive role in they themselves using these new rules and educating their customers and make them adopt the best business practices, by using the rules developed by the ICC, not only for the benefit of their customers but for their own benefit as well.

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