

ISP98 and the standby letter of credit

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The standby letter of credit is an American invention. Because United States banks were historically not permitted to issue guarantees, they issued letters of credit payable against a statement of default, which became known as standby credits. The standby is functionally a demand guarantee in the form of a letter of credit. It may be issued subject to UCP 600, which applies to standby credits "to the extent to which they may be applicable" (Art. 1 UCP 600). More commonly it is issued subject to the International Standby Practices (ISP98), drafted by the Institute of International Banking Law and Practice and published by the ICC. ISP98 has applied since 1 January 1999.¹ ISP98 contains detailed rules on presentation, examination and transfer that suit the standby's use as a payment and financial guarantee, for example in support of trade receivables or of a borrowing base facility.

In the Lugano cluster, standbys appear mainly as payment instruments in open account trade with buyers in the Middle East and Asia, where the buyer's bank issues a standby in favour of the trader to secure a series of deliveries. They also appear as security for prepayment facilities. The difference between a URDG guarantee and an ISP98 standby is mainly one of documentation and of the parties' familiarity with the rules. Swiss courts treat both as independent undertakings under Article 111 CO.

1 Article 111 CO and the distinction from suretyship

Swiss law has no special statute on bank guarantees. Courts and doctrine base the independent guarantee on Article 111 CO, which provides that a person who promises to another the performance of a third party is liable for damages if the third party does not perform. The guarantee under Article 111 CO is independent of the obligation it secures. It must be distinguished from the suretyship (*Bürgschaft*) under Articles 492 ff. CO, which is accessory to the principal debt. A contract of surety is valid only if

the surety declares it in writing and states the maximum amount of its liability, and a natural person acting as surety must in addition use the form of a public deed (Art. 493 paras. 1 and 2 CO). The distinction is a question of interpretation. The Federal Supreme Court treats a promise of payment "on first demand" as an indication of an independent undertaking and gives decisive weight to a clause by which the guarantor waives all objections and defences.² A guarantee that a Lugano bank issues on the URDG 758 form is therefore governed by Article 111 CO, interpreted in light of the rules incorporated into it.

The Federal Supreme Court summarized the principles in BGE 138 III 241 of 13 February 2012. The guarantor must pay regardless of any dispute over the underlying contract if the conditions of the guarantee are fulfilled. The beneficiary must fulfil all the conditions laid down in the guarantee clause and no others. A strict formal approach applies, and the guarantor examines only the wording of the guarantee and the documents presented. The independence of the guarantee finds its limit only where it is manifestly abused.³ Earlier, in BGE 122 III 321 of 21 August 1996, the court had held that an independent guarantee is never entirely detached from the underlying contract. A beneficiary who invokes it "au mépris manifeste des règles de la bonne foi" cannot claim payment. The court found such abuse where the beneficiary, an Italian company, sought to use a guarantee to cover a risk other than the one that the guarantee had been given to secure.⁴

2 Notes

1. Institute of International Banking Law and Practice, International Standby Practices (ISP98), ICC Publication No. 590 (1998), effective 1 January 1999. ↩
2. CO, Art. 111 ("A person who gives an undertaking to ensure that a third party performs an obligation is liable in damages for non-performance by said third party") and Art. 493 paras. 1 and 2, official English translation at [droit-bilingue.ch](https://www.droit-bilingue.ch), <https://www.droit-bilingue.ch/en-de/2/22/220-111-123.html> and <https://www.droit-bilingue.ch/en-de/2/22/220-493-707.html>. Federal Supreme Court, BGE 131 III 511 of 31 May 2005, <https://servat.unibe.ch/dfr/bge/c3131511.html>, E. 4.2, distinguishes the independent guarantee from accessory undertakings, treats payment on first demand as an indication of independence and a waiver of all objections as decisive, and holds that the content of the

relationship between applicant and guarantor is irrelevant to the guarantor's obligations towards the beneficiary. ↩

3. Federal Supreme Court, judgment of 13 February 2012, BGE 138 III 241, <https://servat.unibe.ch/dfr/bge/c3138241.html> ("Die Unabhängigkeit der Garantie findet ihre Grenzen dort, wo sie offensichtlich rechtsmissbräuchlich beansprucht wird"; "Der Begünstigte muss dem Garanten gegenüber nur die (aber auch alle) Voraussetzungen erfüllen, die in der jeweiligen Garantieklausel festgelegt sind"). The case concerned a construction guarantee insurance. ↩
4. Federal Supreme Court, judgment of 21 August 1996, BGE 122 III 321, <https://servat.unibe.ch/dfr/bge/c3122321.html> ("Une garantie indépendante n'est cependant jamais totalement 'dégagée' du contrat de base"). ↩

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