The ICC Uniform Rules for Demand Guarantees ("URDG") in Practice:
A Decade of Experience

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I. Introduction

I have been asked to comment on the ICC's Uniform Rules for Demand Guarantees (ICC Publication no. 458) (the "URDG" or "Rules") from the point of view of the exporter or contractor or principal. I will in fact speak from the point of view of a contractor in relation to an international construction project as this is what I am most familiar with. At the same time, a contractor's position is unlikely to differ radically from that of other exporters who find themselves obliged to provide an on demand guarantee in relation to an international commercial contract.

No one likes to be punished who has done nothing wrong. For the same reason, no contractor wants to provide a guarantee which can be called when he has not been at fault.

Yet that risk is inherent in an on demand guarantee as, in its pure form, it is callable simply upon demand, not upon the contractor's default.

Even under the Rules, the guarantee is callable merely upon the beneficiary's statement that the contractor is in breach of a contract and of the respect in which the contractor is in breach. Even if the beneficiary is wrong, the guarantee must be paid. In effect, such a guarantee is a substitute for a cash deposit by the contractor with the owner. Consequently, in principle, contractors do not favor on demand guarantees.

However, since the 1970s, the reality of the international construction business has been that owners have insisted that contractors provide such guarantees and, to compete, contractors have generally had no alternative but to do so. Today, on demand guarantees are a fact of life in international construction, whether contractors like it or not.

Numerous efforts have been made at the international level to try to temper the harshness of such guarantees. Thus, in 1978, the ICC issued Uniform Rules for Contract Guarantees (ICC Publication no. 325), which are to be clearly distinguished from the URDG or Uniform Rules for Demand Guarantees (ICC Publication no. 458). These 1978 rules required the production of a judgment or an arbitral award as a condition of the beneficiary's right to payment. (2) However, these rules were unacceptable to owners who insisted on a guarantee that was immediately enforceable. Hence, these rules were rarely used.

Consequently, to try to respond to the demands of owners, while at the same time trying to limit unfairness to contractors, the ICC developed the Rules which, according to the introduction to the Rules, are said to "reflect more closely the different interests of the parties involved in a demand guarantee transaction". (3)

Are the Rules acceptable to contractors? The Rules fall far short of what, in an ideal world, a contractor might consider acceptable. Unquestionably, they represent a compromise among the competing interests of the parties concerned: the owner, the contractor and banks. Nevertheless, I think they are good rules from the contractor's point of view because they have achieved, as far as practicable, I believe, a fair balance.
among the parties (without which, no set of uniform rules in this area has any chance of acceptance),
because they do moderate the severity for the contractor of a "pure" on demand guarantee and because
uniform rules which address the numerous issues that arise in the complex area of demand guarantees (4)
are in the interests of all parties. Accordingly, I strongly endorse the Rules.

II. Comments on the URDG

Having said that, I shall comment briefly on the Rules, on behalf of the contractor, starting from the
beginning of the Rules and going through to the end. I have basically six comments, as follows:

First, there seems to be the risk of a contradiction between the description of the beneficiary on page 5 and
the very broad definition of a "demand guarantee" on page 8. The description of the beneficiary on page 5
provides:

"The beneficiary wishes to be secured against the risk of the principal's not fulfilling his obligations towards
the beneficiary in respect of the underlying transaction for which the demand guarantee is given. The
guarantee accomplishes this by providing the beneficiary with quick access to a sum of money if these
obligations are not fulfilled." [Emphasis added]

On the other hand, the definition of a demand guarantee in Article 2(a) on page 8 includes "a written
demand for payment" accompanied by, for example, "a judgment or an arbitral award".

As a practical matter, an arbitral award or judgment is likely to take years to obtain. Accordingly, I suggest
either to delete the word "quick" in the description of the "beneficiary" on page 5 or to delete the reference
to "judgment or an arbitral award" in Article 2(a).

I would delete the reference to "judgment or an arbitral award". I say this not merely to eliminate a
contradiction but also because, since the ICC published the Rules in 1992, we now have new procedures for
the settlement of disputes in international construction contracts which can be referred to and which I think
can be used to ameliorate the problem of the first demand guarantee for the contractor. I refer to the
procedure that is called "expert determination" or "adjudication". Thus, the new FIDIC conditions for
international construction contracts, adopted in 1999 (and which, incidentally, incorporate model forms of
guarantee based on the URDG), (5) provide for the settlement of disputes initially by a Dispute Adjudication
Board. The decision of such Board, which is provisionally binding upon the parties (it may be referred to
arbitration), must be rendered within 84 days.

Accordingly, there is no reason why the parties could not agree that any call on a demand guarantee must
be accompanied by a decision from the Dispute Adjudication Board stating that the contractor is in breach
of contract and the amount of damages resulting from the breach.

Owners are much more likely to accept that a call on a demand guarantee be accompanied by the decision
of a dispute adjudication board than by an arbitral award or court judgment. Accordingly, in the case of a
call of an on demand guarantee under an international construction contract, parties should in future
consider requiring the owner to produce a decision in its favor of the Dispute Adjudication Board and I think
the ICC's literature on the Rules should refer to this possibility.

Second, as a contractor, I would be glad to see that, under Article 4, first paragraph, a beneficiary's right to
make a demand under a guarantee is normally not assignable.
When agreeing to provide for issuance of an on demand guarantee, a contractor is doing so in light of the particular identity of the owner or beneficiary. He is weighing the risk of an abusive call by that beneficiary and no other. Accordingly, it is vitally important that the beneficiary not be able to assign the right to make a demand to another person without the contractor's consent.

**Third**, while it is understandable that the URDG contains provisions designed to protect guarantors and instructing parties (essentially banks) from liability in certain instances, Article 13 goes too far in providing that they shall have no liability or responsibility for consequences arising out of "strikes, lockouts or industry actions of whatever nature" (emphasis added). They should not be relieved of liability for "strikes, lockouts or industry actions" that involve their own personnel. These are matters that banks can control or should be able to control. Accordingly, these kind of industrial actions should be expressly excluded from an exculpatory provision like Article 13. Otherwise, Article 13 would be unbalanced in favor of banks.

**Fourth**, on behalf of the contractor, I am naturally pleased that, under Article 17, in the event of a demand, the guarantor must "without delay" inform the principal (the contractor) or, where applicable, his instructing party (such as a bank who has given a counter-guarantee), and in that case the instructing party shall inform the principal (the contractor) (Article 17).

This provision, when coupled with the provision in Article 10 that the guarantor shall have a "reasonable time" within which to examine a demand and to decide whether to pay, are perhaps the most important provisions in the new Rules from the point of view of the contractor. (6)

Without an express provision in the guarantee requiring the guarantor to inform the principal of a demand, it is often unclear whether the guarantor is required to do so before making payment and in fact the new Rules do not say explicitly that he must do so before making payment although I think the implication is there.

It would seem that under American, English and French laws, in the absence of a contractually binding obligation, there is no requirement for the guarantor to inform the principal of a demand before making payment. (7) On the other hand, under Dutch and Swiss laws, a guarantor has to inform the principal of the claim before paying it. (8)

When the contractor is informed that a call has been made, he still has the opportunity of negotiating a settlement with the beneficiary or of taking legal action either to restrain the beneficiary from calling the bond or from receiving payment or to enjoin the guarantor or instructing bank or both from making payment.

While it is extremely difficult to prevent the enforcement of an on demand guarantee, nevertheless, it may at least be possible, in some jurisdictions and depending upon the wording of the guarantee, to delay enforcement by weeks or even months, or (in some cases) to reduce the amount of the demand to correspond to the damages suffered by the beneficiary. (9)

Delaying payment of, say, a US$ 10 million bond or reducing its amount may, depending on the circumstances, be of critical importance to the contractor.

Accordingly, the right to be informed of any call immediately is a crucially important right for the contractor and it is fair and appropriate that it should be provided for in the Rules. (It can also help protect the
guarantor and instructing bank against a claim made later by the contractor that the guarantor and the instructing bank had paid out without justification.)

**Fifth**, according to Article 20 (as we have seen), a demand for payment must be supported, at a minimum, by a written statement stating:

(i) that the contractor is "in breach of his obligations under the underlying contract", and
(ii) "the respect in which" the contractor is "in breach" (Article 20).

While the requirement that the beneficiary describe in writing a "breach of contract" is undoubtedly helpful in discouraging an unfair call, I think the demand could contain a little more detail. For example, the Rules could have required the beneficiary to quantify his demand and to state specifically how much he is claiming as damages as the result of breach of the underlying contract. He does not need to prove his damages but merely declare what he estimates them to be.

However, in the new Rules, there is no suggestion that there should be a correlation between the amount of a demand under the guarantee and the amount of the damages which the beneficiary believes that it has suffered. Under Article 20, the beneficiary merely has to allege a breach of contract, when making a demand for payment, and seemingly he can call the entire amount of the guarantee.

Under construction contracts, performance guarantees are typically for 10 or 15 per cent of the construction contract price. Thus, in the case of a US$ 100 million contract, a performance guarantee could be for US$ 15 million. Although the beneficiary of a US$ 15 million demand guarantee may only have suffered damages of US$ 1 million, the Rules do not expressly preclude him from demanding payment of the entire amount of US$ 15 million.

On the other hand, if he had to provide the guarantor with a certificate as to the estimated amount of his damage, this would diminish the risk of an exaggerated demand without placing an unacceptably heavy burden on the beneficiary.

**Sixth**, Article 28 provides that unless the parties agree otherwise, disputes between the guarantor and the beneficiary shall be settled exclusively by a court in the country of the guarantor or if the guarantor has more than one place of business by a court of the country of the branch which issued the guarantee.

Why has it been felt necessary to restrict the place of suit in this way? The only explanation which I have heard is that it was thought desirable that, in principle, the place of suit be located in the same country as the one whose law would normally govern the guarantee or counter-guarantee (see Article 27) as the courts of that country would be best able to apply that country's law. However, this objective could have been achieved by a provision that both parties consent to the non-exclusive jurisdiction of the courts of such country, as this would have given each party the option, if it were the claimant, to bring suit before the courts of that country. There was no need to provide that such courts have exclusive jurisdiction, thereby preventing a claimant party from bringing suit in any other country should it wish to do so.

As in the case of Article 13 (referred to in my third comment above), this appears to be another example of where the Rules seem overprotective of banks which, when they have branches in different countries, may
not welcome exposure to a lawsuit in each of those countries, even though this may be preferred by their customers.

I will illustrate below the practical difficulty to which this provision may give rise for the contractor.

In the case of a main construction contract, the guarantor will normally be in the country of the beneficiary, e.g., for a project in Egypt, an owner in Egypt will insist that the guarantee be issued by a bank in Egypt. In these circumstances, this provision causes no problem.

But a contractor will often subcontract parts of the works to subcontractors and to protect himself under the main contract guarantee he will require on demand guarantees from his subcontractors. While the contractor will have given a guarantee to the owner in the owner's country - Egypt - as a practical matter, it is often very difficult for a contractor to persuade its subcontractors, who may be in different parts of the world, to provide on demand guarantees from banks in the contractor's country.

Take the Egyptian project I have mentioned as an example. If the main contractor working in Egypt is a Korean contractor, who subcontracts part of the works to companies in Italy or Germany, then he will want to get "back-to-back" guarantees from them. To be perfectly "back-to-back", these should be issued by banks in Korea.

But as a practical matter, while an owner can usually obtain an on demand guarantee from a bank in the owner's country, it can be very difficult for the contractor to persuade its subcontractors to provide guarantees from banks in the contractor's country. Subcontractors will often insist that they be supplied by banks, or branches of banks, in the subcontractors' country.

On the other hand, if they are issued by a bank in the subcontractor's country, then, by virtue of the exclusive forum provisions in the Rules, the contractor will be forced to bring suit in the courts of the country of the subcontractor - an obvious disadvantage.

One obvious compromise solution is for them to be issued by a major international bank with branches in many different countries (and not just the subcontractor's country), so that the contractor can bring suit in any of those countries, wherever it is convenient to the contractor - if not in the contractor's country then at least outside the subcontractor's country. But this is not possible without a special modification to the new Rules which subcontractors may not agree to.

It is not clear why the drafters of the Rules felt it compelled to introduce an exclusive forum clause into the Rules. As I have explained, the Rules could perform their function perfectly well without it. At all events, contractors would want this exclusive forum provision deleted because of the problems it is likely to create for a contractor's dealings with its subcontractors.

III. Conclusion

In conclusion, subject to the minor reservations which I have expressed, I believe contractors have every reason to be happy with the Rules. They both achieve a fair balance among all interested parties and, I think, take due account of market conditions.

Sir Roy Goode and Georges Affaki, (10) among others, are rendering an invaluable service to the cause of world commerce by educating people about, and promoting, these excellent rules.
Of course, to achieve wide-spread adoption, they must be acceptable to the intended beneficiaries (owners), because in the construction industry, as a practical matter, it is the beneficiaries who tend to decide the forms of the guarantees which the contractor is to provide, e.g. in invitation to tender documents. To promote their use by the intended beneficiaries, the Rules need, among other things, to be incorporated into international standard bidding documents, just as FIDIC has incorporated them as annexes into its standard forms of construction contract. They also need the support of financing institutions like The World Bank. This will permit them to be more readily accepted as fair rules by beneficiaries, whose support is essential if the Rules are to achieve the universal acceptance which I believe they deserve.

ENDNOTES

(1) The views expressed in this paper are the author's personal views, based on his experience of representing international contractors, and not necessarily those of any firm or organization he represents.

(2) See Article 9(b) of the ICC's Uniform Rules for Contract Guarantees (ICC Publication No. 325).

(3) ICC URDG booklet, p. 5.

(4) E.g. whether the beneficiary may assign a guarantee, whether and when the guarantor must inform the contractor of a call, how the beneficiary requests an extension of a guarantee as an alternative to a demand for payment, when a guarantee expires and whether it must physically be returned.

(5) See Clause 20 of, for example, FIDIC's Conditions of Contract for Construction (1999), or "Red Book".

(6) See also Article 21 which provides that the guarantor shall "without delay" transmit the beneficiary's demand and any related documents to the principal.


(9) For a case where the amount of a demand was reduced in this way, see the decision of the Singapore Court of Appeal in Eltraco International Pte Ltd. v. CGH Development Pte Ltd. reported in an International Law Office newsletter (Drew & Napier, "Court Considers Payment of On-Demand Bond", March 23, 2001).

(10) The principal draftsmen and advocates for the Rules.