PROBLEMS OF BANK GUARANTEE UNDER THAI LAW

BY

MISS WARISA CHAROENSUK

A THESIS SUBMITTED IN PARTIALFULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF LAWS IN BUSINESS LAWS (ENGLISH PROGRAM)

FACULTY OF LAW

THAMMASAT UNIVERSITY

ACADEMIC YEAR 2015

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ENTITLED

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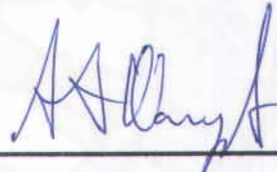
Chairman 
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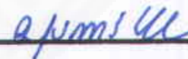
Member and Advisor 
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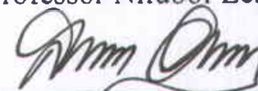
Member 
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ABSTRACT

In international trade, there are several securities for performing an obligation under the international contract. Bank guarantee is one of a significant security which is widely used. Whereas banks are credible institutes, so that the provision of a written undertaking by a bank in favor of a buyer payable on demand is a credible security for both a buyer and a seller. Such undertakings are variously known as demand guarantee.

Demand guarantee is a basic financial instrument issued by a bank under the commitment to pay maximum amount money arising merely upon making a demand for payment in a stipulated form and presenting documents as prescribed in the demand guarantee within the validity period. It means that even if the parties of the underlying contract cannot specify that there is a default under the underlying contract, the bank still has a duty to pay if proper complying documents are presented.

While traditional means of security such as the accessory guarantee or the suretyship, is inconvenient and disadvantageous to a creditor because an accessory guarantor can invoke the principal debtor's defenses against the creditor. While banks shall not act as accessory guarantors since it is difficult to determine in which situations they should pay. In addition, the bank may involve in a dispute between the parties under the underlying relationship.

There are many international rules concerned with the demand guarantees; for instance, the regulations of International Chamber of Commerce ("ICC") such as the Uniform Rules for Demand Guarantee ("URDG"), the Uniform Customs and Practice for Documentary Credits ("UCP") and the International Standby Practices ("ISP"). Under such rules, the demand guarantees are independent undertaking from the underlying contract, and they are paid on demand (primary undertaking) with no proof of default. However, these rules are different from the rules of guarantee under the Civil and Commercial Code of Thailand. The rules of guarantee under the Civil and Commercial Code is a suretyship which the obligation of the surety depends on the default of the principal debtor and does not arise until the principal debtor has failed to perform his primary obligation under the underlying contract. According to the rules of guarantee under Thai law, the guarantor will pay when the principal debtor fail to perform an obligation and the guarantor is not a primary debtor.

At the present, Thailand does not have a direct rule related to the demand guarantee, results in that Thai courts have to decide a case by trying to adapt rules of guarantee under the Civil and Commercial Code of Thailand. While the demand guarantees under ICC regulations are independent undertaking, the guarantee under the Civil and Commercial and Code of Thailand is different. This conflict consequently causes many problems of bank guarantee issued under Thai law. For instance, one of the nature of demand guarantee is the guarantor has to pay on first demand so that the bank has to pay when the creditor presents documents. Nevertheless, under the Civil and Commercial Code, a guarantor has to invoke a primary debtor's defense against a creditor because the guarantor will lose the right to recourse from the debtor if the guarantor ignores to invoke a defense.

Additionally, the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) has stipulated bank guarantee templates which the private companies who are requested the bank guarantee to secure their obligation of the procurement contract with the government agencies, have to use the template attached with these regulations. Whereas there are many differences between the bank guarantee issued to the private sector and public sector such as the bank guarantees

from the principal debtor are the security to perform an obligation under the underlying contract, and they are a penalty which the court may reduce it if it is disproportionately high.

Since Thailand has no direct law or regulation concerning with the demand guarantee, under the doctrine of freedom of contract and autonomy of will, including Section 150 of the Civil and Commercial Code, all parties of demand guarantee should specify conditions of bank guarantee complying with ICC regulations.

Keywords:Bank Guarantee, Demand Guarantee, Independent Guarantee, URDG 758, UCP 600, ISP 98, Bank Guarantee in Thailand, suretyship, rules of guarantee under Thai law

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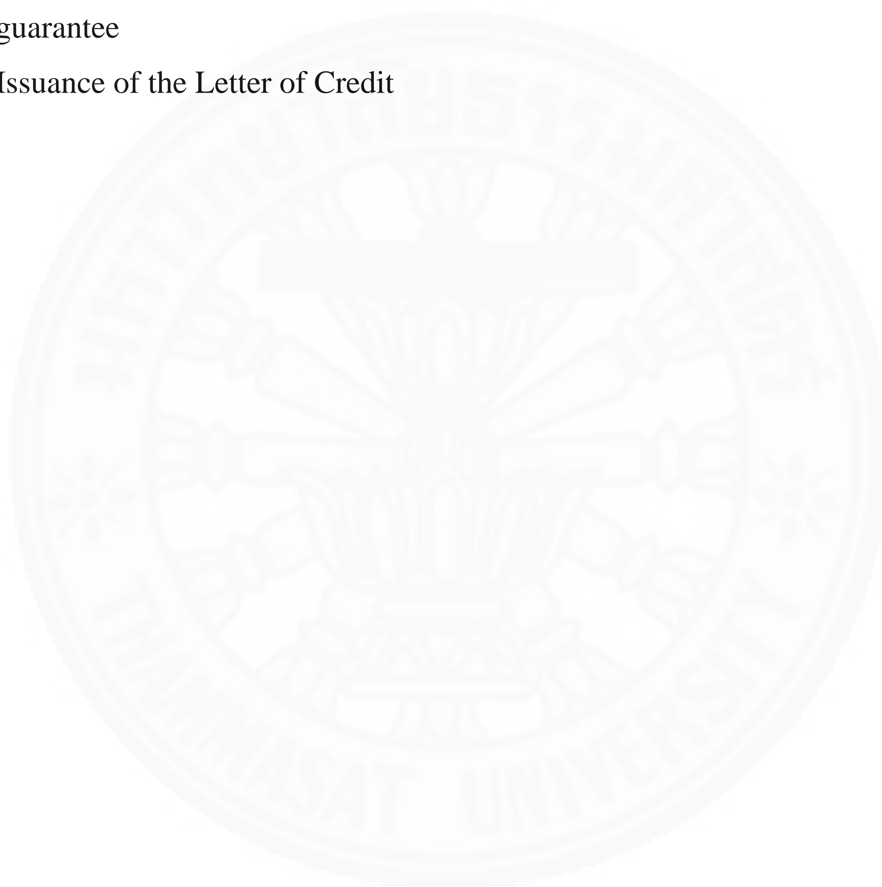

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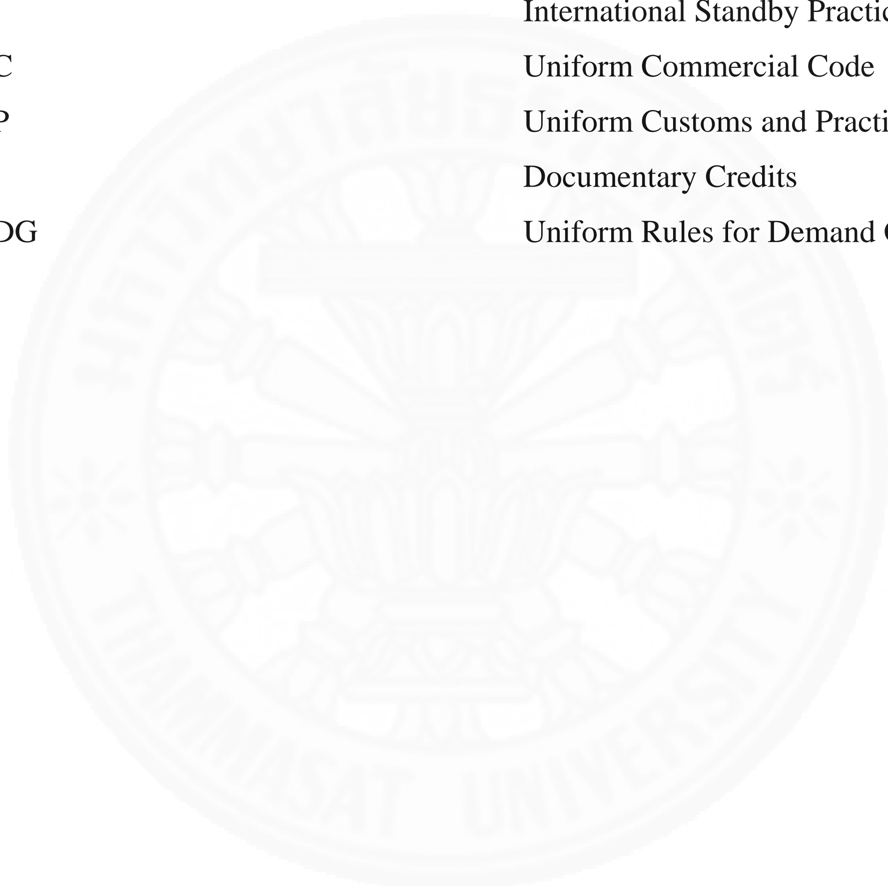
LIST OF ABBREVIATIONS

Symbols/Abbreviations	**Terms**
BOT	Bank of Thailand
ICC	International Chamber of Commerce
ISP	International Standby Practices
UCC	Uniform Commercial Code
UCP	Uniform Customs and Practice for Documentary Credits
URDG	Uniform Rules for Demand Guarantee



CHAPTER 1
INTRODUCTION

1.1 Backgrounds and issues

A common practice for parties entering into a contract for the sale of goods or the international trade is that they may desire to have security for performing an obligation to ensure that the terms of their contract are adhered to, particularly when no previous dealing has taken place between them.

In the international trade, it was prevailing to require the furnishing of a cash deposit as security, but with the expansion of international trade it became excessively expensive for the counterparty and in due course gave away to be a more convenient safeguard. Hence, traders tried to create a new legal instrument for supporting their international trade security instead of a cash deposit. According to banks are credible institute, so that the provision of a written undertaking by a bank in favor of a buyer payable on demand is a reliable security for both a buyer and a seller. Such undertakings are variously known as bond, security, guarantee, demand guarantee, bank guarantee, letter of guarantee (L/G) or standby letter of credit (SBLC).

The traditional means of security such as the accessory guarantee or the suretyship is inconvenient and disadvantageous to a creditor because an accessory guarantor can invoke the principal debtor's defenses against the creditor. Moreover, banks should not act as accessory guarantors because it is too difficult to determine in which situations they should pay or deny to pay, in addition, they might involve in a dispute between the parties under the underlying relationship.[1]

Demand guarantee is typically used in international trade contracts. Whereas documentary credits, such as a letter of credit, are used to ensure that the seller will be paid for the price of goods, demand guarantee is intended to secure the

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[1] Roeland Bertrams, **Bank Guarantees in International Trade**. Kluwer Law International, 2 (2004)

buyer against non-performance by the seller. Most demand guarantees are issued by banks so that many people call the demand guarantee as the bank guarantee.

In general, the demand guarantee is an essential instrument issued by a bank under the commitment to pay maximum amount money arising merely upon making a demand for payment in a stipulated form and presenting documents as prescribed in the demand guarantee within the validity period.[2] It means that even if the parties of the underlying contract cannot specify that there is a default under the underlying contract, the bank still has a duty to pay if proper complying documents are presented. Therefore, sometimes the demand guarantee is also referred as an "unconditional guarantee".[3]

There are several rules concerned with the demand guarantees. For instance, the regulations of International Chamber of Commerce ("ICC") such as the Uniform Rules for Demand Guarantee ("URDG"), the Uniform Customs and Practice for Documentary Credits ("UCP") or the International Standby Practices ("ISP"). Under such rules, the demand guarantees are independent undertaking from the underlying contract, and they are paid on demand (primary undertaking) with no proof of default. However, these rules of guarantee are different from the rules of guarantee under the Civil and Commercial Code of Thailand. The rules of guarantee under Thai law, the guarantor will pay in case that the parties of the contract default in the performance of an obligation, and the guarantor is not a primary debtor.

Even though the uses of the bank guarantees are widespread and the volume has expanded dramatically, at the present, Thailand does not have a direct rule related to the demand guarantee. Results in that, Thai courts have to decide a case by trying to adapt rules of guarantee under the Civil and Commercial Code of Thailand. Whereas the demand guarantees under ICC regulations are independent undertaking, the guarantee under the Civil and Commercial and Code of Thailand is different. The guarantee under Thai law, namely "Suretyship", is a secondary obligation which depends on the default of the principal debtor and the obligation of the guarantor,

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[2] Michelle Kelly-Louw, "Selective Legal Aspects of Bank Demand Guarantee", University of South Africa (2008)

[3] Roeland Bertrams, *supra* note 1, at 3.

namely "Surety", does not arise until the principal debtor has failed to perform his obligation under the underlying contract. This conflict consequently causes many problems of bank guarantee issued under Thai law. For instance, one of the nature of demand guarantee is the guarantor has to pay on first demand so that the bank has to pay when receives documents from a creditor. Nevertheless, under the Civil and Commercial Code, a guarantor has to invoke a primary debtor's defense against a creditor because a bank will lose the right to recourse from the debtor if a bank ignores to invoke a defense.

Moreover, URDG and UCP specified that a party who makes a demand for payment has to present a demand before an expiry date of a bank guarantee. It means that a bank guarantee under URDG and UCP must have a claim period. On the contrary, the Civil and Commercial Code of Thailand does not specify a claim period as same as URDG and UCP. Additionally, when the Supreme Court judges decide cases related to a bank guarantee which includes a condition related to a claim period, they usually have two different views as follows:

First, the court adjudges that if the guarantee imposes a claim period, it means that the guarantor tries to reduce the period of prescription due to the prohibition of Section 193/11 of the Civil and Commercial Code.[4]

Second, there are other cases that the court adjudges that the bank who is the guarantor has the right to specify a claim period because this condition did not reduce the period of prescription.[5]

Additionally, the bank guarantee issued to secure performance under the procurement contract between the private company and the government agency has to use bank guarantee template attached with the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992). The Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) are the rules for parties under the procurement contract with the government agencies. There are many differences between the bank guarantee issued to the private sector and the public sector. For example, the bank guarantees issued under procurement contract are the security for performing the obligation of the principal debtor, if the principal debtor did not

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[4] The Supreme Court's Decision No. 16947/2557 and No. 2208/2558

[5] The Supreme Court's Decision No.6622/2546 and No. 3739/2551

perform obligation, the bank guarantees are a penalty which the court may reduce it if it is disproportionately high. Besides, if there are disputes between the private sector and public sector concerning an administrative contract, these cases have to be filed at the Administrative Court subject to the Establishment of Administrative Courts and Administrative Court Procedure Act B.E.2542 (1999). These cases have to be filed within five years from the day that the cause of action has known or should have been known.

Furthermore, the Bank of Thailand (BOT), a regulator who is authorized to control every financial institute in Thailand, does not have a direct supervision to control issuing bank guarantee. Therefore, many obscured arguments related to issuing the letter of guarantee still exist because of the difference rules between international regulations and Thai law.

1.2 Hypothesis

There are many differences between the demand guarantee which is widely used in the international transaction and the rules of guarantee under the Civil and Commercial Code of Thailand. Also, heretofore, the issuing bank guarantees in Thailand has to comply with the rules of guarantee of the Civil and Commercial Code, also, none of any organizations has authority to impose or control or supervise the bank guarantee. Therefore, it is difficult to decide cases concerned with the bank guarantee which possibly impacts on the reliability of international business because of refusing of the bank to pay. Consequently, Thailand lacks a direct rule dealing specifically with the demand guarantee, and the knowledge and deep understanding of the parties, who involves in the bank guarantee such as the buyer, the seller, and the bank. It is necessary to find a proper solution to issue bank guarantee complying international regulations and suitable for all parties under existing Thai law.

1.3 Objectives of study

1.3.1 To consider characteristics of the demand guarantee through historical development, definitions, types, the parties involved in and structures of the

demand guarantee under international rules. Furthermore, to study the international regulations related to bank guarantee.

1.3.2 To study and research the problems on the issuing of bank guarantee in Thailand.

1.3.3 To analyze the present Thai laws and regulations associated with issuing bank guarantee. Additionally, to analyze the court's decisions pertinent to issue bank guarantee.

1.3.4 To study on the comparison rules potentially affiliated with bank guarantee under international rules and Thai law and regulations.

1.3.5 To study bank guarantee templates under the Regulations of Office of the Prime Minister on Procurement B.E.2535 (1992) and analyze the difference between bank guarantee issued to the private sector and the public sector.

1.4 Scope of study

This thesis delimits to study on:

1.4.1 The problems related to issuing bank guarantee under Thai laws:

1.4.1.1 The bank is unable to recourse from the debtor under the Civil and Commercial Code of Thailand if the bank issues the "pay on first demand" bank guarantee.

1.4.1.2 The claim period of the bank guarantee may be unenforceable under the Civil and Commercial Code of Thailand.

1.4.2 The regulations of demand guarantee in international trade and the rights of the relevant parties under demand guarantee which are subject to URDG 758, UCP 600 and ISP 98 for finding the proper solution for issuing bank guarantee and the suitable conditions of bank guarantee in Thailand.

1.4.3 The regulations related to Thai law such as the Civil and Commercial Code of Thailand, Bank of Thailand's regulation, and the Unfair Contract Terms Act B.E.2540 (1997) by comparing with the international regulations.

1.4.4 The cases law concerned with the bank guarantee.

1.5 Methodology

The thesis methodology is mainly based on theoretical approaches through the study of Thai and foreign legislation, case law, legal textbooks, journal articles, and websites. In particular, comparative analysis with the legislations is applied to the analytical approaches to find out the well-established principles for improvement of the Thai legislations associated with the bank guarantee and discover a proper way for issuing bank guarantee to comply with existing Thai law.

1.6 Expected results

The benefits to be derived from this thesis are;

1.6.1 To understand the principles of the demand guarantee, standby letter of credit and letter of credit for securing performance of the parties' obligations under the international regulations such as URDG, UCP and ISP

1.6.2 To understand the different regulations between Thai law and regulations and international rules of the demand guarantee.

1.6.3 To understand the problems with the practices of issuing bank guarantee under existing Thai law.

1.6.4 To provide recommendations for issuing bank guarantee to comply with the existing Thai law and international regulations.

CHAPTER 2
AN INTRODUCTION TO DEMAND GUARANTEE

2.1 Brief historical development and purpose of demand guarantee

During the early 1970s, the increasing wealth in the oil-exporting countries in the Middle East resulted in the rise of major contracts with western firms for large-scale projects, such as the improvement of the infrastructure, public works, industrial and agricultural projects.[6] In the meantime, some buyers were cheated on their contracts, so they suffered from the default of the exporter who failed to fulfill the contractual obligation. Moreover, buyers also found that it was excessively difficult, expensive and took an inert compensation through filing in the courts.

The device of guarantees payable on demand originated from the former practice of exporters and contractors having to place a cash deposit which could immediately be seized by the importer and employer in the event of default. This technique was found inconvenient. It necessitated exporters and contractors raising funds which remained tied up for a considerable period and this adversely affected their liquidity position.[7] Then the idea of first demand guarantee was created to substitute for cash deposits. Exporters agreed to provide the guarantee in exchange for obtaining cheap working capital more than their requirement to fulfill the contract. It was not until the Iranian revolution of 1979-1980 when huge numbers of guarantees in favor of Iranian Government agencies and banks were called for payment and when Western firms in many countries went to the courts trying to prevent payment, which this new breed of demand guarantee began to attract the attention of lawyers and courts. This period was the beginning of the development of the law in this new area.[8]

Furthermore, the banks found that the guarantee was a valuable new source of fee income which could be earned simply by only committing their name and ability to pay. Their guarantee was purely financial nature secured against the assets of the exporters. As the result, buyers required the provision of unconditional

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[6] Roeland Bertrams, *supra* note 1
[7] *Id* at 53.
[8] *Id* at 3.

bank guarantee which paid simply on first demand.[9] Consequently, it was called the demand guarantee.

However, there is one word that may be confused with the demand guarantee; it is “bond”. Normally, a bond requires no consideration[10] since it is issued under seal, while a guarantee must be supported by consideration.[11] In addition, bond or surety bond contains several conditions.[12] Nevertheless, at present, either bond or demand guarantee is used as the same purpose as a financial instrument.

As mentioned before, the banks became significant guarantors who support securities to the parties of contracts. Therefore, almost demand guarantees or independent guarantees are bank guarantees. In addition, bank guarantee can provide securities to both the party who is entitled to receive payment; such as the seller, contractor, lender, lessor, etc., and the party who has the right to receive goods or services; such as the buyer, employer, lessee, etc.[13] The demand guarantee creates different payment mechanisms because it entitles the party to receive payment from the guarantor without any proof or confirmation of the principal debtor’s default.

2.2 Definition of the demand guarantee

According to a definition of the demand guarantee from Dr. Georges Affaki, who was a chairperson of the URDG 758 Drafting Group and Sir Roy Goode, who was a chairperson of the Drafting Group that finalized the International Chamber of Commerce’s first Uniform Rules for Demand Guarantee 458[14], it is defined as follows:

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[9] Anthony Pierce, **Demand guarantees in international trade**, London: Sweet & Maxwell, (1993)

[10] Consideration is the thing of value promised to the other party in exchange for something else of value promised by that other party. Consideration binds the parties together. As a general rule, an agreement without consideration will not be an enforceable contract. (Gordon W.Brown and Paul A. Sukys, Business Law with UCC Applications (11th edition) : McGraw=Hill/Irwin, 185, 191 (2006)

[11] Anthony Pierce, *supra* note 9 at 5.

[12] *Id* at 10.

[13] Roeland Bertrams, *supra* note 1, at 2.

[14] Affaki,G.,& Goode, R.M., **Guide to ICC Uniform rules for demand guarantees URDG 758**, Paris: International Chamber of Commerce, (2011)

"A demand guarantee (also called independent, autonomous or first demand guarantee) is an irrevocable undertaking issued by the guarantor upon the instructions of the applicant to pay the beneficiary any sum that may be demanded by that beneficiary up to a maximum amount determined in the guarantee upon presentation of a demand complying with the terms of the guarantee."[15]

In addition, the International Chamber of Commerce ('ICC') defined a demand guarantee in Article 2(a) of its Uniform Rules for Demand Guarantees, ICC Publication No. 758, 2010 Revision[16] as follows:

*"**Demand guarantee** or **guarantee** means any signed undertaking, however named or described, providing for payment on presentation of a complying demand."*

According to the definition of demand guarantee under Article 2 of the Uniform Rules for Demand Guarantees, a demand guarantee has to be signed as an independent undertaking which will be paid when the party presents a demand for payment in a prescribed form and other documents (if any).

In summary, a demand guarantee is an instrument that is issued by a bank (or the other kind of financial institutions) under an obligation to pay a specified maximum amount of money arises merely upon the making of a demand for payment in the prescribed form and presenting documents as stipulated in the demand guarantee within the period of validity of the guarantee.[17]

However, it is a misapprehension to presume that the demand guarantee is always payable on demand without any evidence of default.[18]

2.3 Types of Demand Guarantee

In general, when any parties enter into the construction contracts, sale of goods contracts or other contracts, other parties always desire a security of performing

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[15] *Id* at 1.
[16] The ICC Uniform Rules for Demand Guarantees, ICC Publication No. 758, 2010 Revision
[17] Michelle Kelly-Louw, *supra* note 2, at 17.
[18] Roeland Bertrams, *supra* note 1, at 5.

an obligation under such contracts; therefore, the parties may require appropriate types of demand guarantee to secure their performance obligations. According to several types of contract and variety of risks which serve the conclusion and execution of the contracts, so there are several different demand guarantee types for a suitable purpose to the contracts. In general, the different types of the demand guarantee serve the same overall purpose to protect non-performance obligation. Accordingly, there are two main types of demand guarantee: the first type is the demand guarantee provided to secure financial obligations and the second type is the demand guarantee provided to secure non-financial obligations. Examples of demand guarantees are given as follows:

2.3.1 Tender Guarantee (also called "Bid Bond")

When tenderers (bidders) are invited to join the bidding arranged by any beneficiary, the crucial condition is that the tenderer will not withdraw the bid during the validity period of the bid and will sign the contract or provide the performance guarantee or other guarantees if the bidding is awarded to him.

The purpose of the tender guarantee is to protect the beneficiary against the tenderer from breaching an undertaking when submitting the tender. It is to ensure that the tenderer will not withdraw or alter his tender before adjudication and that he will accept and sign the contract if and when awarded to him.[19] The tender guarantee is regularly issued for an amount between one and five percent of the contract price.[20]

Tender guarantee usually contains a fixed expiry date which conforms with the expected end date of the bidding and last day to sign a contract. However, bidding may be extended and tender guarantee should extend to the extension date. If the tenderer wins the bidding but fails to sign the contract or withdraws his tender before its expiry, the beneficiary has the right to claim the guarantor to pay 1) a specified amount of money designed to compensate him for trouble, 2) an expense that he suffers from awarding the contract, and 3) additional

[19] *Id* at 38.
[20] Anthony Pierce, *supra* note 9, at 5.

cost of the bidding contract which sum up to the maximum amount specified in the tender guarantee.

2.3.2 Performance Guarantee (also called "Completion Guarantee")

Performance guarantee is the guarantee type used most frequently. It is a mean of ensuring completion of the contract which covers the obligation of a party to fulfill the underlying contract. It is sometimes conceived as the balance that the buyer's obligation to procure the issue of a documentary credit to assure that the seller is paid. This is done by offering an assurance to the seller that he will be paid by the guarantor in case of the buyer's non-conforming delivery of the goods. Or in the event that the contractor has not, not timely, not completely or not properly fulfilled his obligations from the underlying contract, the performance guarantee will assure payment to the employer. Therefore, performance guarantee covers all compensation in the event of non-performance of the parties. Performance guarantee is regularly issued for an amount between five and ten percent of the value of the underlying contract.[21]

The performance guarantee should be valid until the undertaking of a party is completed.

2.3.3 Advance Payment Guarantee (also called "Repayment Guarantee")

In some contracts, a party may request an advance payment which ordinarily ranges from five to thirty percent of the contract value [22] in order to be able to finance the transaction. In the return, another party paying the advance payment will require an advance payment guarantee to assure the certain repayment when no execution of the underlying contract. Therefore, the advance payment guarantee is the guarantee supplied by a party who receives an advance payment. It provides that the advance money will be fully repaid if the agreement is not fulfilled. The advance payment guarantee is issued for the full amount of that advance payment.

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[21] Roeland Bertrams, *supra* note 1, at 39.
[22] *Id* at 28.

The advance payment guarantee should be valid until the advance payment has been received.[23]

2.3.4 Retention Guarantee

Due to a common practice in construction contracts to provide payments against the defects of the project, the employer may retain a partial or full payment, retention money, for pending final acceptance or expiration of the warranty period. The retention guarantee is used as a security to release such retention money which ordinarily entitled to maintain a percentage of the installments, normally between five and ten percent.[24]

The retention guarantee assures the employer that if the contractor fails to perform his obligation before receiving final acceptance from the employer or fails to complete the project, the retention money will be repaid in full amount by a third party.

The retention guarantee has to be valid until the contractor receives the final acceptance of the construction contract from the employer.

2.3.5 Maintenance Guarantee (also called "Warranty Bond")

During the warranty period or the maintenance period specified in the contract, if the obligations of the contractor (or the supplier) do not complete, the employer (or the buyer) may request for the warranty bond or the maintenance guarantee to secure him during such period.

The purpose of the maintenance guarantee is to ensure that the contract will be completed and the employer already paid at the full contractual price to the contractor and the contractor will fulfill the obligations during the warranty period. If the contractor does not fulfill his obligation during such period, the employer will be compensated by a third party.

The maintenance guarantee will be requested when the contract does not provide retention money[25] or the contractor (or the supplier) intends to

[23] *Id* at 41.
[24] *Id* at 42.
[25] Anthony Pierce, *supra* note 9, at 7.

release retention money.[26] The maintenance guarantee should be valid over the warranty period or maintenance period. In addition, the amount of the maintenance guarantee should equal the amount of the released installments.[27]

2.3.6 Payment Guarantee

The payment guarantee is used for assuring payment in sale transactions and covering all payment obligations so that it seems like a function of the documentary credit. But the difference is that the documentary credit is used for the normal course of the event to complete sale transactions, whereas the seller of a payment guarantee is expected to seek payment from the buyer first and the seller can call the demand guarantee only when the buyer fails to pay.[28]

2.3.7 Other types of demand guarantee

There are other types of demand guarantee which does not relate to the obligation of the parties under the underlying contract, for instance, customs guarantee, freight guarantee or judicial guarantee.

2.3.7.1 Customs Guarantee

The customs guarantee is issued to the Customs Authority for covering any duty or liability of the importer that may become payable when imported goods and will be released from duty if re-exported within a specified time. The customs guarantee may be claimed if the goods have not left the country by the end of the expected period of use.[29]

2.3.7.2 Freight Guarantee

Freight guarantee is often used in the international construction industry which special freight rates are evaluated for a two-way transportation of the construction factory. The freight guarantee assures the shipping

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[26] Ali Malek QC and David Quest, **Jack: Documentary Credits**, 4th ed, Tottel publishing Ltd, 356, (2009)
[27] Roeland Bertrams, *supra* note 1, at 41.
[28] *Id* at 43.
[29] *Id* at 44.

company that if the construction factory is sold off locally and is not reshipped, then the unearned discount on the freight will be repaid.[30]

2.3.7.3 Judicial guarantee (or court guarantee)

The purpose of the judicial guarantee is to ensure that the plaintiff will be in a position to satisfy a future judgment in his favor by seizing the defendant's asset. In the other side, the defendant may use judicial guarantee against discharge of the court orders. The amount of judicial guarantee must be fixed by the courts.[31]

2.4 The parties involved in Demand Guarantee

In general, demand guarantee will have at least three parties involved. Nevertheless, it possibly increases up to four parties, which are defined as follows:

2.4.1 Applicant (also called "Principle", "Account Party")

The principle or the account party or the applicant, is the party who has a duty to perform an obligation which imposes in the underlying contract, for instance, a contractor, a supplier, or an exporter. The principle is the party who has to perform the work covered by the underlying contract and requires securing his performance by the demand guarantee.[32] However, this thesis uses the "applicant" to represent this party.

2.4.2 Beneficiary

The beneficiary is another party of the underlying contract, for example, a buyer, an employer, or an importer, who favors the issued demand guarantee. The beneficiary is the merely party that has a right to claim under the demand guarantee.[33]

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[30] Anthony Pierce, *supra* note 9, at 8.
[31] Roeland Bertrams, *supra* note 1, at 44.
[32] Anthony Pierce, *supra* note 9, at 8.
[33] *Id* at 8.

2.4.3 Guarantor

The guarantor is the party, e.g., the bank, who issues the demand guarantee on behalf of the applicant. However, the coverage of the guarantor in this thesis is only a bank.

2.4.4 Instructing Party

Generally, the instructing party will involve in the demand guarantee when the applicant and the beneficiary are in difference countries. From the beneficiary's point of view, the locally-issued guarantee should be avoided if possible, because it is difficult to control unjustified claim payable overseas.[34] When the beneficiary requires demand guarantee issued by his satisfied bank, which normally locates in his country (beneficiary's bank), and the applicant does not use banking service with such bank, the applicant will request his bank (applicant's bank) to communicate with the beneficiary's bank (counter-guarantor), which usually locates in the beneficiary's country, to issue the demand guarantee to the beneficiary. Therefore, the instructions are given by the applicant's bank (instructing party) to the beneficiary's bank (counter-guarantor)[35] to issue the demand guarantee against a counter-guarantee by the instructing party who is entitled to an indemnity with the applicant.[36]

2.5 Demand Guarantee Structures

In general, a contract structure has two parties; a creditor and a debtor. A demand guarantee is also a contract between two parties; the guarantor and the beneficiary, too. The demand guarantee is a promise of the guarantor that if the third party (the applicant) has failed to perform his obligation, the guarantor will pay instead. However, the demand guarantee is not just a two-party relationship between the beneficiary and the guarantor because there is a contract between the guarantor and the applicant; moreover, there is a contract between the beneficiary and the

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[34] Anthony Pierce, *supra* note 9, at 27.
[35] See article 2 of the ICC Uniform Rules for Demand Guarantees, ICC Publication No. 758
[36] Michelle Kelly-Louw , *supra* note 2, at 21.

applicant. Hence, the demand guarantee is a multi-party relationship which is linked with each contract together. The demand guarantee has three parties or four parties involved. The relationship of the parties under the demand guarantee has two structures as follows;

2.5.1 Direct Demand Guarantee

As aforementioned, three parties guarantee is generally called "direct demand guarantee" because the applicant's bank directly issues the guarantee.[37]

For example, **A** is in Thailand has negotiated a sale of goods contract with **B** who lives in another country. A condition of the contract between **A** and **B** specifies that A has to provide a bank demand guarantee for securing performance obligations to **B**. Therefore, **A** (the applicant) requests **G Bank** (the guarantor) which is Thai Bank, to issue the guarantee in favor of **B** (the beneficiary). **G Bank** is not obliged to carry out this instruction unless it has agreed to do so, and it will require to set aside funds or to have other provisions to cover its prospective liability under the guarantee.

The guarantee will specify, e.g. the parties, the underlying contract, the period of the guarantee, the amount or the maximum amount for which can be called for a claim and the documents presented by **B** when **B** makes a claim. The guarantee may be directly submitted by **G Bank** to **B** or through G Bank's correspondent bank. This structure can be expressed as Figure 2.1:

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[37] Roeland Bertrams, *supra* note 1, at 16.

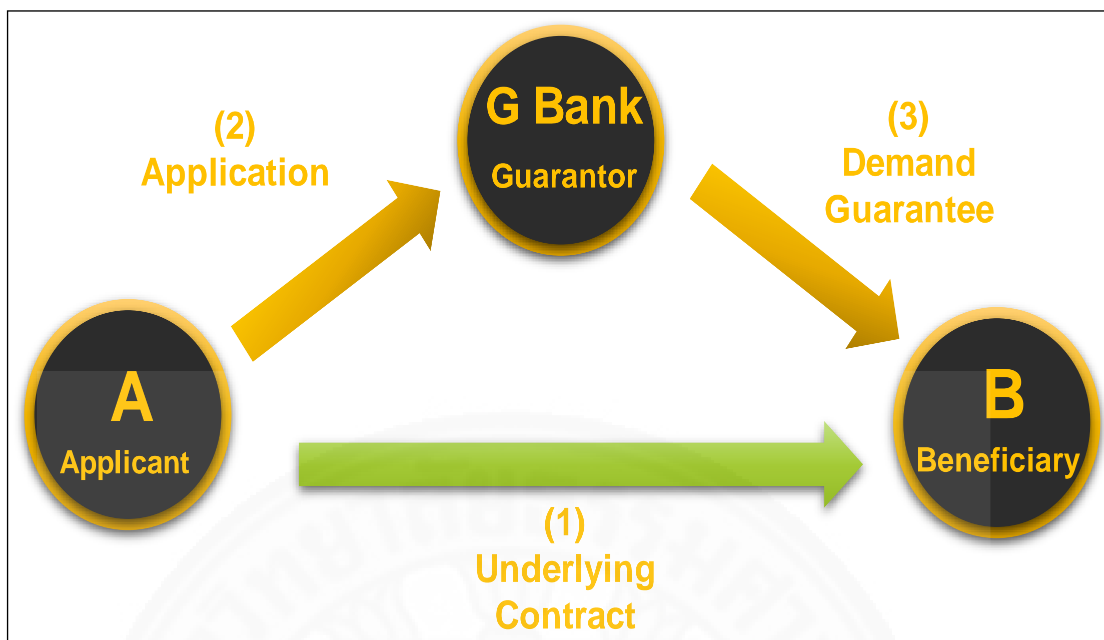

Figure 2.1: Structure of a direct demand guarantee[38]

When **B** believes that **A** has breached the underlying contract, **B** will present a demand to **G Bank**, with other documents specified in the guarantee (if any). **G Bank** must pay to **B** and then claim reimbursement from **A** under their contract (the application).[39] This structure can be expressed as Figure 2.2 by the arrows indicating the direction of claims:

[38] Figure 2.1 has been adapted from Affaki,G.,& Goode, R.M., *supra* note 14

[39] Article 2 of URDG 758 specified that "Application means the request for the issue of the guarantee."

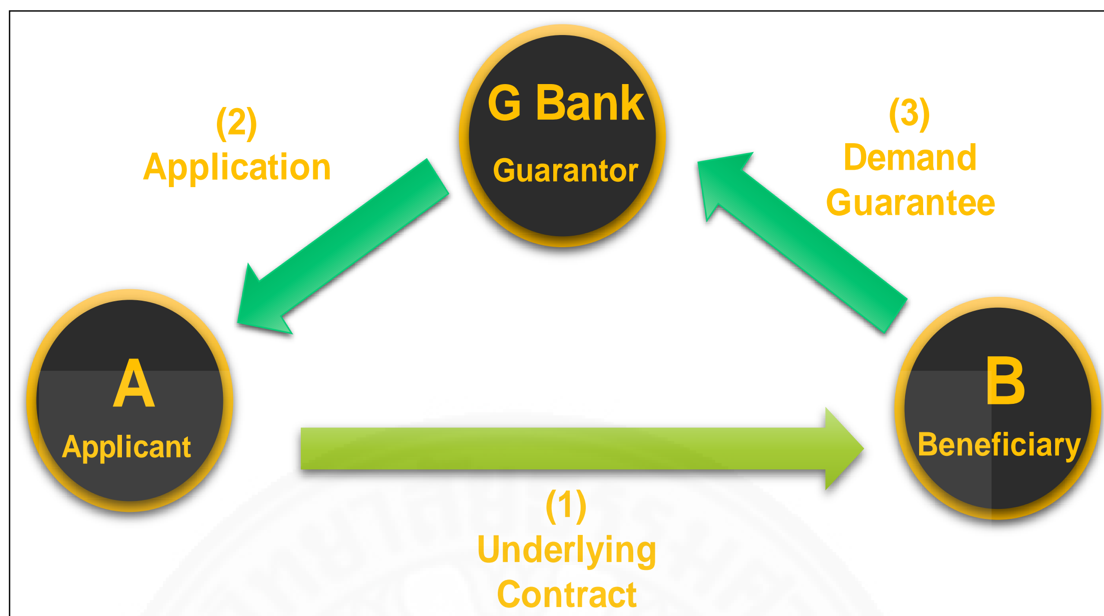

Figure 2.2: Structure of direction of claims for payment of a direct demand guarantee[40]

According to the direct demand guarantee structure, it shall be separated into three separate contracts as follows:

1. The underlying contract between **A** and **B**;
2. The application (counter-indemnity or reimbursement contract), independent undertaking between **A** and **G Bank**; and
3. The demand guarantee (or guarantee) issued by **G Bank** in favor of **B**

From this structure, if **A** and **B** are in different countries, **G Bank** may decide to have the guarantee advised and transmitted to **B** by **B**'s bank, instead of transmitting the guarantee itself. Such B's bank may be called an advising bank.[41] This does not change the structure of demand guarantee. The guarantee is still a direct guarantee because a function of B's bank is limited merely to check the signatures of the beneficiary on the guarantee that appear to be genuine, to advise, and to transmit

[40] Figure 2.2 has been adapted from Affaki,G.,& Goode, R.M., *supra* note 14
[41] In some country, a bank that is authorized to issue guarantee directly in favor of the beneficiary must issue the guarantee through a local advising bank, such bank is called the advising bank. (Roeland Bertrams, *supra* note 1, at 16)

the guarantee issued by **G Bank** to **B**. Therefore, it incurs no liability under the guarantee by itself.

A characteristic feature of the relationship between the guarantor (G Bank) and the applicant (A) who is the bank's customer is that the bank enters into the demand guarantee for the risk and account of the applicant. Therefore, it is necessary that the bank is entitled to reimbursement for payment that paid to the beneficiary from the applicant according to the terms and conditions specified in the application which is separated from the contract between the applicant and the beneficiary (the underlying contract).

2.5.2 Indirect Demand Guarantee (counter-guarantee)

In case of the beneficiary requires the guarantee issued by a bank in his country, the applicant who is not a customer of the beneficiary's bank has to ask his bank to communicate with the local bank in the beneficiary's country to issue the guarantee. Instructions are then given by the applicant's bank (instructing party) to the beneficiary's local bank to issue the guarantee against a counter-guarantee by the instructing party who in turn is entitled to an indemnity from the applicant. In this situation, the beneficiary's bank (counter-guarantor) is the issuer of the demand guarantee and the guarantor of the demand guarantee.

Thus, the applicant (**A**) arranges for its bank, the instructing party (**IP Bank**), to request the other bank (**G Bank**), based in the country of the beneficiary (**B**), to issue the guarantee to **B** against a counter-guarantee from **IP Bank**. This four- party guarantee is termed an indirect demand guarantee. Instead of **A**'s bank directly issues the guarantee to **B**, which is similar to a direct guarantee structure, **IP Bank** has to communicate with **G Bank** to issue the guarantee to **B**.

Therefore, in direct demand guarantee, there is an additional contract (the counter-guarantee) that is the contract between the instructing party and the guarantor who is the bank in the beneficiary's country.

The structure of an indirect demand guarantee can be expressed as Figure 2.3:

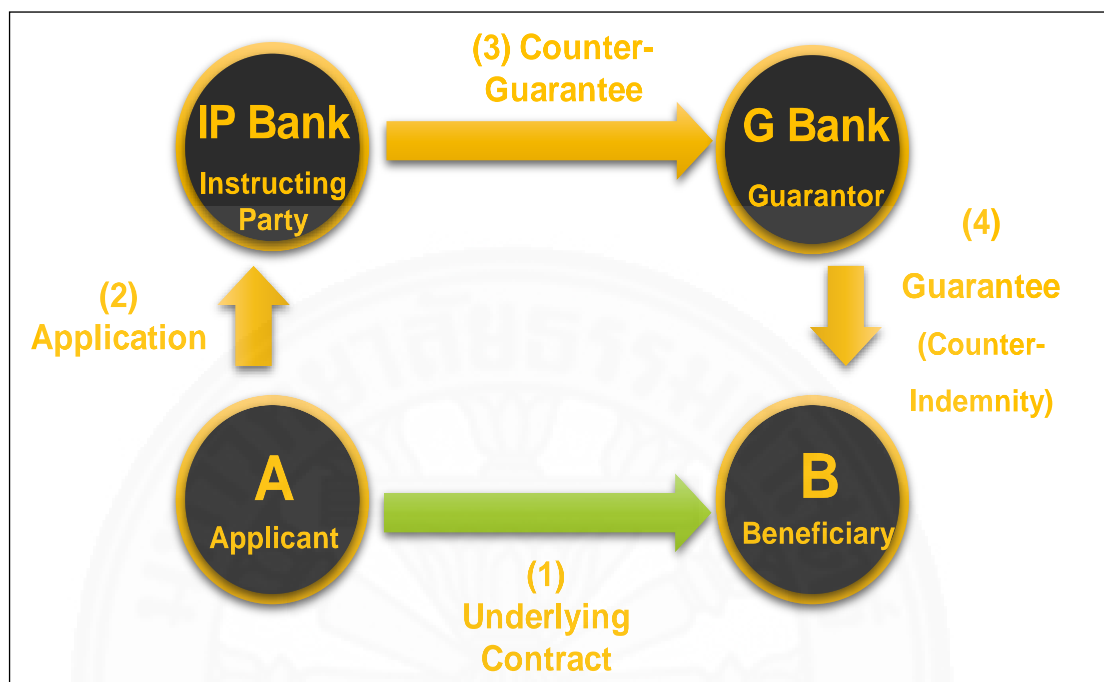

Figure 2.3: Structure of an indirect demand guarantee[42]

When **B** believes that **A** has broken the underlying contract, **B** will present his demand to **G Bank** which is responsible for paying, **G Bank** makes a demand on **IP Bank** under the counter-guarantee, and if this is in order, **IP Bank** must pay. **IP Bank** collects reimbursement from its customer (**A**) under the counter-indemnity or the reimbursement agreement or the application between them.

This structure can be expressed as follow in Figure 2.4 as the arrows indicating the direction of claims:

[42] Figure 2.3 has been adapted from Affaki,G.,& Goode, R.M., *supra* note 14

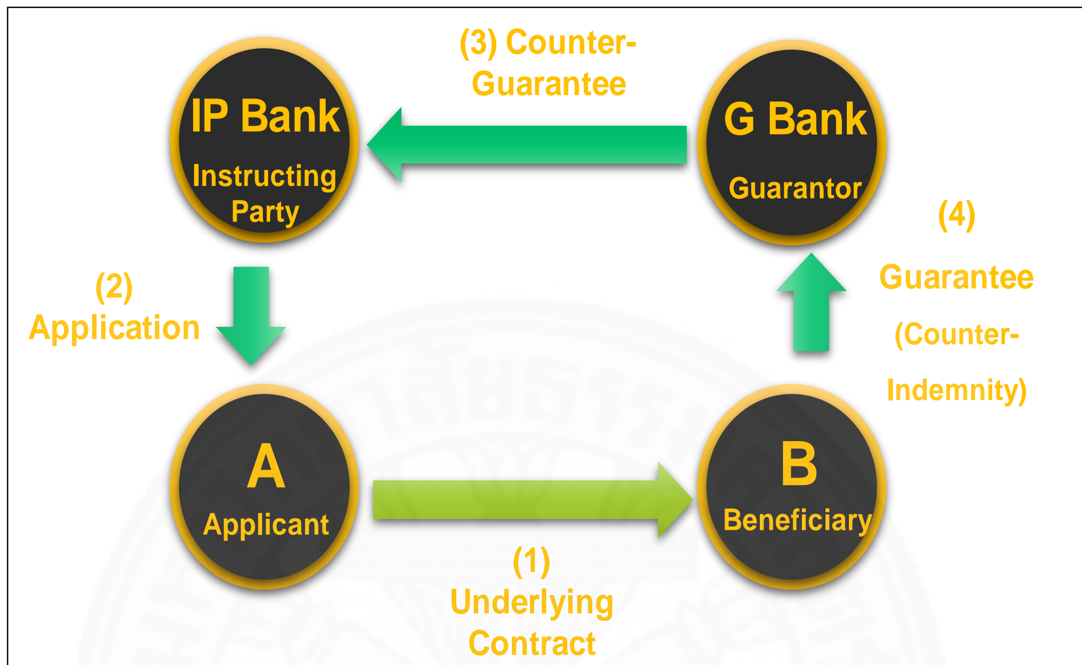

Figure 2.4: Structure of direction of claims for payment of indirect demand guarantee[43]

In an indirect guarantee structure, there are four separate contracts as follows:

1. The underlying contract between **A** and **B**;
2. The application (counter-indemnity or reimbursement contract), independent undertaking between **A** and **IP Bank**
3. The counter-guarantee issued by **IP Bank** to **G Bank**
4. The guarantee issued by **G Bank** to **B**

Each of these contracts is separated from the others. **A** instructs **IP Bank** to arrange **G Bank** for issuing the demand guarantee to **B**, while **G Bank** gives **IP Bank** a counter-guarantee against his liability.

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[43] Figure 2.4 has been adapted from Affaki,G.,& Goode, R.M., *supra* note 14

The counter-guarantee is issued to secure the guarantor when the guarantor is claimed from the beneficiary. The counter-guarantor will issue counter-guarantee which is irrevocable undertaking to pay any sum that may be claimed by the beneficiary, normally, the counter-guarantor will pay an equal amount to the sum that the beneficiary claimed from the guarantor.

Additionally, the counter-guarantee is independent from the guarantee, the underlying contract and the application. Each undertaking is subject merely to its terms so that the parties of each undertaking will only comply with their terms and conditions which are specified in their contract. Furthermore, the expiry of the guarantee does not automatically lead to the expiry of the counter-guarantee.[44]

2.6 Relationships Created by Demand Guarantee

Due to the structure of the demand guarantee, it is clear that each of the contractual relationships is separated from the other. The obligation of each party depends on terms and conditions specified in each contract.

2.7 Natural Characteristics of Demand Guarantee

In general, apart from the specifically agreed on terms and conditions, the rights and obligations of parties under the accessory guarantee or the suretyship[45] are fixed by the extensive underlying contract. By virtue of this principle, the underlying relationship is transferred to the relationship between surety and beneficiary so it extends the surety's liability which is determined by the principal debtor's liability towards the beneficiary according to the underlying relationship.

The demand guarantee shows a reverse pattern. The principle of the independent guarantee is separation of guarantee and the underlying contract. The demand guarantee is primary in form, in contrary, secondary in intent.[46] It means that the parties of the demand guarantee will be bound only in contract form between

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[44] Affaki,G.,& Goode, R.M., *supra* note 14, at 14.
[45] See 2.9.3
[46] Michelle Kelly-Louw, *supra* note 2, at 39.

them. Both of the parties intend to bind the demand guarantee if the applicant fails to perform his obligation. The parties of demand guarantee intend to rely on the contents specified in demand guarantee and desire to claim for payment in the condition that the guarantor will pay if the beneficiary presents a demand and all other documents stipulated in the demand guarantee. Therefore, the guarantor promises or gives a primary or direct undertaking to perform the obligation of the applicant, irrespective of whether the application's obligation under the underlying contract is enforceable.

According to the difference of the demand guarantee and the accessory guarantee or the suretyship, it causes to the characteristics of demand guarantee which are difference and has unique characters as follows;

2.7.1 Independence of the guarantee from the underlying contract: The Principle of Autonomy or Independence

Despite the fact that the issuing of the demand guarantee takes after forming the underlying contract between the applicant and the beneficiary, the demand guarantee is separated from such underlying contract. The rights and obligations created by the guarantee are independent of those arising from the underlying contract, which the guarantor is generally not concerned. This is an essential feature of the demand guarantee because this characteristic makes a flexibility to claim from the security of payment (demand guarantee). Most demand guarantees issued in practice are payable 'on demand' or 'on first demand', which clearly implies that such guarantees create a binding obligation to pay against the simplest of demands by the beneficiary without any proof of any default by the applicant on the underlying contract. Therefore, a guarantor who issues a demand guarantee must honor the demand guarantee according to its terms. The guarantor is not concerned at least with relationships between the applicant and the beneficiary; nor with the question of whether or not the applicant has performed regarding the underlying contract; and nor with the question of whether or not the applicant defaults. The guarantor of the demand guarantee undertakes an absolute obligation to pay the beneficiary according to the conditions of the guarantee.[47] On the other hand,

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[47] Affaki,G.,& Goode, R.M., *supra* note 14, at 17.

when the guarantor proceeds to payment, the applicant who is the principal debtor must reimburse the guarantor without the evidence concerning the applicant's default.[48]

Since the demand guarantee is separated from the contract between the applicant and the guarantor (the application), the guarantor is not entitled to invoke a breach of such contract (the applicant).[49] The first demand guarantee is sometimes referred to as "unconditional guarantee".[50]

In addition, the demand guarantee is separated from the underlying contract so that the guarantor cannot invoke defenses derived from the underlying contract.[51]

2.7.2 Documentary Character

The demand guarantee is documentary in character in the sense that the amount and duration of the duty to pay[52]. The conditions of payment and termination of the payment obligation depend on the terms of the guarantee itself. Additionally, the presentation of a demand and other related documents may be stipulated in the guarantee. The duty of the guarantor is to pay against specified documents that are presented within the period and in accordance with the other conditions of the guarantee. The guarantor does not have the obligation to authenticate the submitted documents.[53] The guarantor is therefore not interested in the investigation of external facts, such as the default of the applicant in the performance of the underlying contract or the amount of loss actually suffered by the beneficiary as a result of that default.[54]

2.7.3 No proof of breach

As a result that the guarantor is not a party of the underlying contract, the guarantor has not a duty to proof a default occurred under the underlying

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[48] Roeland Bertrams, *supra* note 1,at 11.
[49] Affaki,G.,& Goode, R.M., *supra* note 14, at 19.
[50] Roeland Bertrams, *supra* note 1, at 49.
[51] *Id* at 11.
[52] Michelle Kelly-Louw, *supra* note 2, at 49.
[53] *Id*.
[54] Affaki,G.,& Goode, R.M., *supra* note 14, at 19.

contract. The guarantor complies only with the terms and conditions specified in the demand guarantee. Unless the beneficiary is required to present a document showing that has incurred a default, the beneficiary is entitled to call for payment without asserting. However, this does not mean that the beneficiary can claim the demand guarantee when the applicant has not committed a default under the underlying contract.

2.8 Information that should be contained in demand guarantee

According to various types and characteristics of demand guarantee, hence each demand guarantee may have different conditions complying with the type of the demand guarantee. However, all demand guarantees should contain the following minimum information:[55]

(1) name of the beneficiary;

(2) name of the guarantor;

(3) name of the applicant;

(4) purpose of guarantee; its terms complied with the underlying contract;

(5) effective date; started date of the guarantor's liability

(6) date guarantee expires and becomes unenforceable; the guarantor knows when to pay;

(7) maximum amount guaranteed; the amount payable under a claim is limited;

(8) any reduction provisions

(9) manner of claiming payment; the reason and procedure for making a claim are specific;

(10) documents to support a claim

(11) law and jurisdiction

[55] Anthony Pierce, *supra* note 9, at 40.

The terms and conditions of demand guarantee indicate risk of the parties. The guarantee wording should not only prevent unfair claims but should also reduce risks of the parties.

2.9 Comparison of demand guarantee, letter of credit, standby letter of credit and suretyship

There are several types of documentary credits which are known and used around the world as financial instruments to secure proper payment of cross-border transactions. There are various features that can be used to classify commercial credits such as their function, payment mechanism, documentary requirement, time or certainly enforcement.[56] One of documentary credits which their characteristic may be confused with characteristic of the demand guarantee is a letter of credit. In addition, there are two types of guarantee that are similar to the demand guarantee; standby letter of credit and suretyship, which are described as follows.

2.9.1 Letter of Credit

In the international trade, the buyer and the seller are always in different countries then they have to find some financial instrument to secure their cross-border payment. A letter of credit is one of the documentary credits which the payment under them is made when the beneficiary presents documents complying with the conditions of the letter of credit.[57] The letter of credit is often used in international transactions to assure the seller that payment of the purchase price of goods will be received.[58] It minimizes the risk of delivery of goods without payment. In another side, the buyer can access to the seller as a source of supply without having

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[56] Professor Dr. Rolf A. Schutze and Dr. Gabriele Fontane, **Documentary Credit Law throughout the world**, Paris: International Chamber of Commerce, 16, (2001)
[57] *Id.*
[58] Charles Proctor LLD (B'HAM), **The Law and Practice of International Banking**, Oxford University Press Inc, New York, 443, (2010)

to pay cash in advance because the seller must not rely on the buyer's credit. The seller can rely on the credit of the bank of the buyer.[59]

In general, there are two or three banks related to a letter of credit. First bank is the issuing bank which is a bank that the buyer requests to issue letter of credit.[60] Second bank is the advising bank which is a bank advising the seller that the letter of credit has been issued.[61] And third bank is the nominated bank which is a bank that has various functions: paying, accepting, incurring a deferred payment obligation and negotiating.[62] The advising bank and the nominated bank may be the same bank. When the buyer and the seller have already agreed that they will use the letter of credit for paying price of goods, the buyer will request the issuing bank to issue the letter of credit, to a bank in the seller's country (the advising bank), usually by sending a message via SWIFT.[63] Then the advising bank will advise and create an operative original letter of credit to the seller. Consequently, the seller will present the letter of credit to the nominated bank, which may also be the advising bank, and when the nominated bank examines the documents whether they comply with the terms and conditions of the letter of credit, the nominated bank will honor the seller's demand and pay to the seller.

In addition, in order to exchange message over SWIFT, two banks will set one another up by exchanging correspondent agreements and SWIFT digital signature keys (authenticator keys).[64] Then when the advising bank received a SWIFT transmission indicating that the issuing bank has issued a letter of credit, the advising bank will use the key to access the digital signature which usually uses a code

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[59] Walter (Buddy) Baker and John F Dolan. **Users' Handbook for Documentary Credits under UCP 600**, ICC Services Publications,49, (2008)
[60] *Id* at 43.
[61] *Id* at 51.
[62] *Id* at 55.
[63] SWIFT or the Society for Worldwide Interbank Financial Telecommunication is a community of international banks all around the world which the main service is a provider of secure financial messaging services. The main components of the original services included a messaging platform, a computer system to validate and route message and set of message standard. (https://www.swift.com) (accessed June 10, 2016)
[64] Walter (Buddy) Baker and John F Dolan, *supra* note 59, at 52.

number. When a letter of credit is issued, the issuing bank must pay it if the documents are in order and the terms of the credit are satisfied.

The following is diagram illustrating an issuance of the letter of credit.

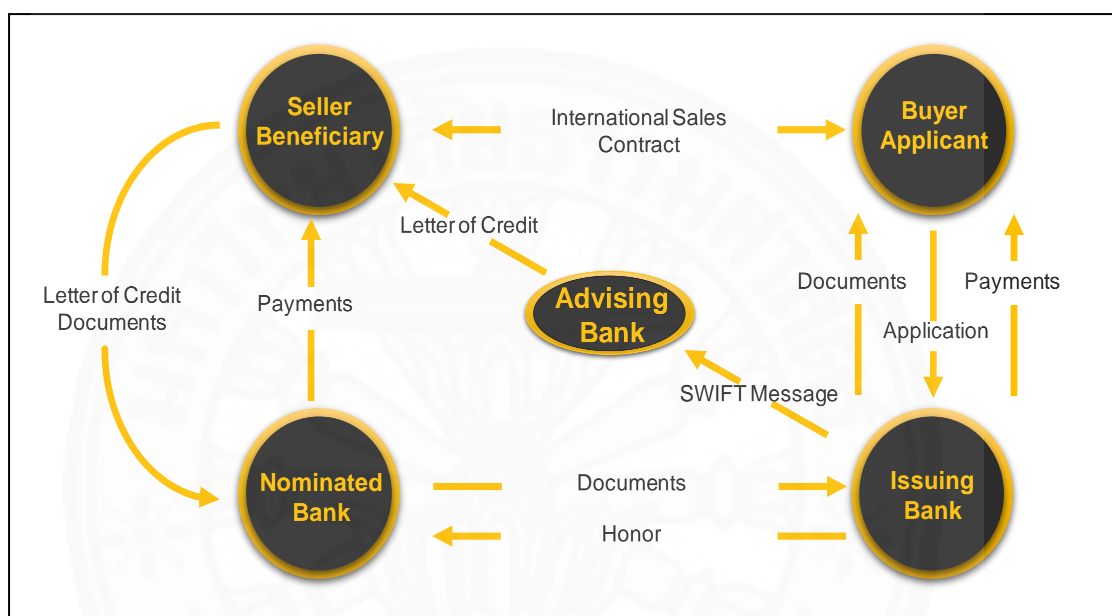

Figure 2.5: Issuance of the Letter of Credit[65]

Although the letter of credit and the demand guarantee are documents issued by banks, there are similarity and difference as follows;

2.9.1.1 Similarity of the demand guarantee and the letter of credit

Demand guarantee and commercial letter of credit have several same characteristics as follows:

(1) Concept of undertaking to pay

Both demand guarantee and letter of credit are not required to comply with the validity of the underlying transaction. In case of the letter

[65] Figure 2.5 has been adapted from Walter (Buddy) Baker and John F Dolan, *supra* note 59, at 48.

of credit, when the issuer nominates a bank to pay, the beneficiary (the seller) only presents its draft drawn on the nominated bank and the relevant document to the nominated bank and the nominated bank examine the documents whether they comply with the terms and conditions of the letter of credit. And then the nominated bank will honor the beneficiary's demand and pay to the beneficiary. In case of the demand guarantee, when the beneficiary believes that the applicant has breached the underlying contract, the beneficiary will present a demand to the bank, with other documents specified in the guarantee (if any). The bank must pay to the beneficiary and then claim reimbursement from the applicant under the application without proving a default of the applicant before.

(2) Independence in character

The bank has a duty to pay against merely the conforming documents. In case of the letter of credit, if there is proper performance of the underlying of the parties, the bank has to pay to the presenter. Regarding the demand guarantee, if there is a breach of the underlying contract, the bank has to pay to the beneficiary.

(3) Documentary in character

For both demand guarantee and letter of credit, the bank fulfills its duty by paying against merely documents. The conditions of the payment and termination of the payment obligation depend on the terms of the letter of credit or the demand guarantee itself.

2.9.1.2 Difference between the demand guarantee and the letter of credit

Although the demand guarantee and the letter of credit have many similarities, some essential differences are described as follows:

(1) A function of the letter of credit is setting up a payment, in addition, it is a means of payment of the purchase price and actual payment occurs in the ordinary course of events whereas the demand guarantee does not. The demand guarantee provides security and payment of compensation in the unexpected event of non-performance of the principal debtor. When parties agree on a letter of credit, their intention is that the party has to receive the money through the use of that letter of

credit.[66] On the contrary, the demand guarantee will rarely be used if the risk occurs. Therefore, the payment on the letter of credit is the normal course of the execution of the contract while the payment on the demand guarantee is the exception.

(2) The nature of documents to be proposed under the letter of credit is different from the documents that are presented in the case of demand guarantee. In case of the letter of credit, the documents proposed by the beneficiary represent and relate to the merchandise and have a natural commercial value, whereas the documents presented under the demand guarantee relate to the applicant's non-performance and do not have any natural commercial value.

(3) The bank will pay for the letter of credit only if things go right. This means that the letter of credit is designed to ensure the performance of a payment obligation. However, the bank will pay on the demand guarantee only if things go wrong. In other words, the demand guarantee is used to secure the performance of the party, and the guarantor involves if the party defaults.

(4) The letter of credit is issued by the applicant's bank (the issuing bank) which is in the applicant's country and advised to the beneficiary by a bank in the beneficiary's country (the advising bank). The letter of credit is accepted by the nominated bank are passed to the issuing bank for reimbursement. Whereas, under the indirect demand guarantee (counter-guarantee), when the guarantor (the beneficiary's bank) receives the demand from the beneficiary, the guarantor does not pass it to the instructing party or the applicant because the guarantor has to pay to the beneficiary by itself.[67]

2.9.2 Standby letter of credit

Most standby letters of credit are used as guarantee of performance of contracts. Although a demand guarantee would accomplish the same objective, United Stated of America banks are prevented from issuing a demand guarantee (performance bond) by the Glass Steagall Act which prohibited banks from entering

[66] Michelle Kelly-Louw, *supra* note 2, at 75.
[67] Ali Malek QC and David Quest, *supra* note 26, at 373.

into areas of insurance. Therefore, banks instead issue standby letters of credit which serve as a guarantee.[68]

The term standby letter of credit is of the American making. The National Bank Act issued in 1864 sets out the activities in which banks are authorized to engage. As a result, it has been assumed that banks lacked the power to answer for the debts of others as same as to issue the guarantee. Therefore, American banks try to seek for a suitable device to serve the purpose to guarantee; they endorsed the bills of exchange and issued the letters of credit. These techniques undeniably serve the purpose of guarantee potential debts of their customers.[69]

Whereas guarantees were initially used primarily in support of non-financial obligations, but the utilization of the standby letters of credit was at first confined to secure the financial obligations.

2.9.2.1 Comparison of standby letter of credit and letter of credit

Although the letter of credit and the standby letter of credit share same characteristics, i.e., independence from the underlying contract, documentary character, some parts of them are still different. For instance, in case of the letter of credit, the party who has the duty to perform the underlying contract and has the right to receive the payment is the beneficiary, whereas under the standby letter of credit, the party who has to perform the underlying contract is the applicant but the party who has the right to receive the payment is the beneficiary.

2.9.2.2 Comparison of standby letter of credit and demand guarantee

As aforementioned, characteristics of the standby letter of credit and the demand guarantee are independent undertaking and documentary in character. In contrast, the crucial difference between the standby letter of credit and the demand guarantee is the form. The standby letter of credit is used in a form of a

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[68] Richard Schaffer, Beverley Earle and Filiberto Agusti, **International Business Law and Its Environment**, 4th ed, West Educational Publishing Company, (1999)
[69] Roeland Bertrams, *supra* note 1, at 6.

letter of credit while the demand guarantee is used in a form of a letter of guarantee. In primary, guarantees were initially used to support of non-financial obligations, but the utilization of the standby letters of credit was at first confined to secure the financial obligation.[70] It seems that the different between the standby letter of credit and the demand guarantee, is in business practice, not in law.[71]

Both the standby letter of credit and the demand guarantee intend to secure performance of the applicant's obligation, but the letter of credit is not interested in the performance or the failure of performing obligation of the applicant.[72]

2.9.3 Suretyship

The suretyship or the accessory guarantee is the contract which one person (the surety) agrees to answer for some existing or future liability of another person (the principal debtor) to a third person (the creditor).[73] Additionally, in case where there is a primary and secondary liability of two persons for the same debt, they will stand in the relationship to each other of principal and surety even though there is no express contract of suretyship between them.[74] Contract of suretyship falls into two main categories: contract of guarantee and contract of indemnity.

A contract of guarantee is a contract that the surety promises to the creditor for the performance by the principal debtor of his existing or future obligations to the creditor not only the principal debtor fails to perform obligations but also to secure that the principal debtor will perform his obligations.[75] The essential feature of a contract of guarantee is that the liability of the surety is always secondary while the principal debtor remains a primary liability to the creditor. There is no liability on the surety unless and until the principal debtor has failed to perform his obligations. Consequently, the nature of the secondary obligation is that the surety

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[70] *Id* at 8.
[71] Indira Carr, **International Trade Law**, 5th edition, Routledge, The United of Kingdom, 471, (2014)
[72] Michelle Kelly-Louw, *supra* note 2, at 82.
[73] Geraldine Mary Andrews and Richard Mille, **Law of Guarantees**, 5th ed, Sweet & Maxwell Limited.1, (2008)
[74] *Id* at 2.
[75] *Id* at 3.

merely liable to the same extent that the principal debtor is liable to the creditor and the surety is not liable if the underlying obligation is void or unenforceable. This is known as the principle of co-extensiveness.

A contract of indemnity is a contract that the person gives the indemnity to secure the performance of another's obligation. The essential characteristic of the contract of indemnity is a primary liability falls on the surety and such liability is independent of liability between the principal debtor and the creditor.[76] In addition, a contract of indemnity includes a contract which the surety has liability even if the principal debtor was never liable, for example, because the principal debtor lacked the capacity to contract.[77]

Therefore, the suretyship is a secondary obligation which depends on the default of the principal debtor and the obligation of the surety does not arise until the principal debtor has failed to perform his primary obligation under the underlying contract. The liability of the surety may be restricted to obligations of the principal debtor which have already arisen prior to the contract of guarantee or which are incurred after the contract of guarantee is made or liable both.

2.9.3.1 Similarity of the demand guarantee and the suretyship

The demand guarantee and the suretyship share a major characteristic in that they both provide security to the beneficiary in respect of non-performance of the applicant under the underlying contract between the applicant (the debtor) and the beneficiary (the creditor).

2.9.3.2 Difference between the demand guarantee and the suretyship

Although both the suretyship and the demand guarantee are the security, they have different characteristics. The demand guarantee is primary and independent obligation whereas the suretyship is secondary and it depends upon the default of the primary obligation. Accordingly, they have several different characteristics as follows:

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[76] *Id* at 11.
[77] *Id* at 12.

(1) Since the demand guarantee is the independent guarantee, therefore, the payment obligation of the guarantor depends upon the terms and conditions of the demand guarantee and the presentation documents from the beneficiary, whereas the payment obligation of the surety depends upon the default under the underlying contract.

(2) Liability of the guarantor is immediate when the beneficiary calls for payment whereas proof of default is not a condition of payment. Liability of the surety incurs when the beneficiary can prove that the principal debtor has defaulted and the surety may invoke the defense against the beneficiary, also, the guarantor may set-off his debt before paying to the beneficiary.

(3) The surety has obligation to pay under non-performance of the principal debtor under the underlying contract, so that the surety is entitled to invoke the principal debtor's defenses against the creditor. On the contrary, according to the principle of independence of the demand guarantee, the guarantor cannot invoke the applicant's defense derived from the underlying contract against the beneficiary. Additionally, the guarantor's payment obligation is solely determined by the terms and conditions of the demand guarantee.

2.10 Advantages of using the demand guarantee to the parties

According to the natural characteristics of the demand guarantee; independence and being the document in character, there are several benefits to all parties as below:

2.10.1 Advantages to the beneficiary

The most important advantage that the beneficiary derives from the demand guarantee is the independent nature of the demand guarantee. If the guarantee is found to be an independent guarantee, the beneficiary is entitled to be paid when the beneficiary presents a demand that complies with the terms of the guarantee, regardless of whether or not any breach has actually occurred in the underlying contract and regardless of the amount of the final resulting loss (no proof of actual payment of the demand guarantee is require). By contrast, under a suretyship

or an accessory guarantee relationship, the beneficiary has to prove the applicant's breach and may be paid after setting-off or the surety may invoke the applicant's defenses arising from the underlying contract against the beneficiary.[78] In addition, the beneficiary would receive payment immediately when he calls for demand without the need of having to establish a case first and regardless of the applicant's objections.[79] A further advantage to the beneficiary under the function of first demand guarantee is that the applicant will be put pressure to complete the contract because if the guarantor is called for payment from the beneficiary, the guarantor has to pay immediately and then recourses from the applicant.

2.10.2 Advantages to the applicant

In almost projects, the owners project always request the demand guarantee which is similar to cash for securing performance obligation of contractors. A contracting party whose bank issued the guarantee is likely to be a trustworthy partner. Therefore, it shows that such party has a financial standing and ability to perform a contract.[80] Furthermore, in the normal practice of issuing bank guarantee, the bank usually uses deposit money to be a collateral (security of payment), therefore, if the bank guarantee is claimed from the beneficiary, the bank will pay to the beneficiary and then recourses from the applicant by setting-off from such collateral account. Hence, the applicant will have no cash flow problems because he has already deposited that money with the bank.

2.10.3 Advantages to the guarantor

The demand guarantee is the independent guarantee which is separated from the underlying contract. Therefore, the guarantor is entitled to pay for demand immediately and then call the applicant to reimburse under the terms of the application (a contract between the guarantor and the applicant). When the guarantor has received a claim from the beneficiary, the guarantor's role is confined to examine

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[78] Affaki,G.,& Goode, R.M., *supra* note 14, at 40.
[79] Roeland Bertrams, *supra* note 1,at 14.
[80] *Id.*

the terms and conditions of the demand guarantee merely.[81] The guarantor does not examine that a default under the underlying contract incurred or not. In addition, the guarantor has not the obligation to invoke any applicant's defense against the beneficiary, and then the guarantor can pay without examining a defense of the applicant.

Additionally, there is a limit of liability period which releases the bank from its liability if no call has been made on or before the expiry date so that the bank will know the period of his risk and can manage his reserved money.

[81] *Id* at 85.

CHAPTER 3
DEMAND GUARANTEE, LETTER OF CREDIT AND STANDBY LETTER OF CREDIT IN INTERNATIONAL REGULATIONS

Due to the characteristics of demand guarantee which is independence from the underlying contract and it is a documentary character including it can be called from the beneficiary without proving breach of the underlying contract. So that it does not comply with the laws of Thailand, especially rules of guarantee under the Civil and Commercial Code of Thailand which has characteristics as similar as a suretyship.

Moreover, some countries may have problems to issue demand guarantee because their local laws are different characteristic from the demand guarantee or there is some rule obstructs to issue demand guarantee.

For instance, the United Kingdom, which has the rule of consideration which may effect to issue demand guarantee. Therefore, clauses which oblige the guarantor to pay immediately following a statement of default from the beneficiary have been a regular practice in the United Kingdom. These clauses are known as "conclusive evidence" clauses which show that the beneficiary's statement which the principal debtor has defaulted on his obligations is considered conclusive evidence for the purposes of the contract of security. These clauses are valid and enforceable; in addition, they are operated in the same way as first demand guarantee. Insertion of conclusive evidence clause, which has a characteristic as same as "payment on first demand" clause, to be a common technique for British banks to express that payment to the beneficiary without any further evidence of the principal debtor’s default.[82]

Furthermore, some countries may have a rule nearly complied with the characteristics of demand guarantee e.g. the United States of America which has the Uniform Commercial Code or U.C.C. The U.C.C. related to documentary credit, a letter of credit, which characteristic differs from the demand guarantee as aforementioned in Chapter 2. Article 5 of U.C.C is the set of rules which governs letters of credit as defined in § 5-103

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[82] Roeland Bertrams, *supra* note 1, at 65.

"(a) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit."

Therefore, many parties who involved in international transactions and desire to issue demand guarantee may choose the rule of the International Chamber of Commerce to be a governing law of their demand guarantee because the parties of demand guarantee should not concern about a conflict of each local law.

However, there are several international regulations and other countries' laws which complied with the characteristics of the demand guarantee. And some regulations can be adapted to the issuing of demand guarantee in Thailand.

This chapter exemplifies some international regulations that have specific rules related to demand guarantee e.g. the rules of the International Chamber of Commerce: the Uniform Rules for Demand Guarantees, the Uniform Customs and Practice for Documentary Credits and the International Standby Practices. In addition, as the letter of credit and the standby letter of credit have nearly similarity characteristic as the demand guarantee and sometimes it was issued substituting the demand guarantee because of specifically prohibited rule as mentioned in chapter 2. Therefore, some international regulations which are specific rules of the letter of credit or the standby letter of credit may be applied to demand guarantee.

3.1 An overview of international regulations related to demand guarantee, letter of credit and standby letter of credit

The United Nations Commission on International Trade Law or UNCITRAL is the core legal body of the United Nations system in the field of international trade law.[83] In 1970, the UNCITRAL set up working commission "Guarantees and Securities as Related to International Payments" for setting up rules for guarantees. Consequently, in 1995, the UNCITRAL resulted in a final text of the UN Convention on independence guarantees and standby letters of credit which

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[83] United Nations Commission on International Trade Law, http://www.uncitral.org/uncitral/en/about_us.html (accessed May 15, 2016)

entered into force on January 1, 2000.[84] And then, laws related to the demand guarantee or independence guarantee or guarantee was developed consecutively.

There are several international rules related to the demand guarantee. This thesis focuses on rules of the International Chamber of Commerce because the International Chamber of Commerce is the largest and most representative business organization in the world and there are many members all around the world. Although these rules are voluntary, they are used in numerous transactions and have become part of international trade.

3.1.1 Rules of the International Chamber of Commerce (ICC)

International Chamber of Commerce (ICC) was found in 1919 by some traders who created an organization that would represent business everywhere. They founded the International Chamber of Commerce and called themselves "the merchants of peace.[85] In the present, ICC provides a forum for businesses and other organizations to examine and better comprehend the nature and significance of the major shifts taking place in the world economy. Furthermore, there are several regulations of ICC complying with demand guarantee, letter of credit and standby letter of credit such as follows:

3.1.1.1 The Uniform Rules for Contract Guarantee, ICC Publication No.325 ("URCG")

The ICC introduced the Uniform Rules for Contract Guarantee, ICC Publication No.325 in 1978.[86] The URCG was created to encourage more equitable practices in the area of guarantee. However, the URCG have unaccepted since the URCG did not provide for first demand guarantee which is payable without any evidence of default because of the strong bargaining position of the importer. In addition, the URCG are rather general, imprecise, fragmentary and conceptually fragile.

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[84] Roeland Bertrams *supra* note 1, at 25-28.
[85] International Chamber of Commerce, http://www.iccwbo.org/about-icc (accessed February 1, 2016)
[86] Roeland Bertrams *supra* note 1, at 28.

3.1.1.2 The Uniform Rules for Contract Bonds, ICC Publication No.524 ("URCB")

There were some representatives of ICC, especially those from the Scandinavian countries and Japan, who were in the insurance industry and the construction industry, had a tendency to be on the principal debtor's side. They were felt that there was some need for a security device whereby the guarantor's liability is accessory to that of the principal debtor and based on the principal debtor's default.[87] So the ICC Commission on Insurance was requested to draw up rules which were effective in January 1994. The URCB merely apply to bonds which have the provisions that the guarantor's liability under the bond is accessory and arises on the principal debtor's default and the guarantor has a right to invoke the principal debtor's defenses under the underlying contract against the beneficiary. According to the different nature, these rules were not accepted to use. In addition, the URCB are difficult to understand because of their structure and language.[88]

3.1.1.3 The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 ("UCP 600")

The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 (hereinafter refer to as "UCP 600") is the latest revision of the Uniform Customs and Practice rules, in force as of July 1, 2007. The Uniform Customs and Practice for Documentary Credits is applied to any documentary credit including standby letter of credit and extent to which they may be applicable as defined in Article 1 of UCP 600:

Article 1 Application of UCP 600

"The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 (UCP) is the set of rules that apply to any documentary credit (credit) (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates

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[87] *Id* at 34.
[88] *Id* at 35.

that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit."

3.1.1.4 International Standby Practices, ICC Publication No. 590 ("ISP 98")

International Standby Practices, ICC Publication No. 590, 1998 Edition (hereinafter refer to as "ISP 98), developed by the Institute of International Banking Law & Practice at the request of the United States Department of State and in consultation with banks and other interested parties including the ICC[89] ISP 98 was in force as of January 1, 1999. It is the set of rules that governs standby letters of credit as defined in Rule 1.01 a. of ISP 98 as the following:

"1.01 Scope and Application

a. These Rules are intended to be applied to standby letters of credit (including performance, financial and direct pay standby letters of credit)."

Before an execution of ISP 98, standby letters of credit were issued subject to UCP 400 and later UCP 500 which are applied to letters of credit. Even though standby letters of credit have many similarities with letters of credit and other financial instruments such as bank guarantees, scope and practice are somewhat different.[90]

3.1.1.5 The ICC Uniform Rules for Demand Guarantees, ICC Publication No. 758 ("URDG 758")

The limited success of the 1978 URCG stimulated the ICC to work on a new set of uniform rules. The ICC desired to include a first demand guarantee to a new set of uniform rules as well as a more comprehensive and detailed body of rules, would promote wider adoption in practice.[91] The Uniform Rules for Demand Guarantees were eventually completed in December 1991. They were

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[89] Ali Malek QC and David Quest, *supra* note 26 at 349.
[90] International Standby Practices, ICC Publication No. 590, ICC
[91] Roeland Bertrams, *supra* note 1, at 28.

published as ICC Publication No. 458 in April 1992 and then they were revised in 2010. The ICC Uniform Rules for Demand Guarantees, ICC Publication No. 758, 2010 Revision (hereinafter refer to as "URDG 758"), in force as of July 1, 2010. It is a set of rules that governs standard practice in the use of demand guarantees or counter-guarantees as defined in Article 1 a. of URDG 758 as the following:

"Article 1 Application of URDG

a. The Uniform Rules for Demand Guarantees ("URDG") apply to any demand guarantee or counter-guarantee that expressly indicates it is subject to them. They are binding on all parties to the demand guarantee or counter-guarantee except so far as the demand guarantee or counter-guarantee modifies or excludes them."

3.2 Characteristics of demand guarantee under UCP 600, ISP 98 and URDG 758

Even though ICC rule that specifies to the demand guarantee is URDG 758, but rules under UCP 600 which comply with a letter of credit and rules under ISP 98 which comply with a standby letter of credit, have characteristics as same as demand guarantee. Therefore, in the practice of international trade, some demand guarantees are issued by choosing UCP 600 or ISP 98 to be a governing law of such demand guarantee.

Due to characteristics of the demand guarantee; an independent obligation from the underlying contract, first demand undertaking without no proof of breach and can be claimed by merely presenting documents, there are several characteristics of the demand guarantee specified under UCP 600, ISP 98 and URDG 758 as follows:

3.2.1 Independence of demand guarantee from the underlying contract (documentary in nature)

One of the fundamental characteristics of the demand guarantee is the independence of the demand guarantee and the guarantor from the underlying contract between the applicant and the beneficiary, and independence from the

application (a contract between the guarantor and the applicant). A reference in the demand guarantee to the underlying contract for the purpose of identifying, but it does not change independent nature of the demand guarantee to dependent guarantee.[92] Furthermore, the guarantor merely believes in the documents that the beneficiary has presented to him.

In the ICC regulations, there are several rules concerned with this character for example as follows;

3.2.1.1 URDG 758: Article 6

This characteristic is specified in Article 6 as states that

"Article 6 Guarantors deal with documents and not with goods, services or performance to which the documents may relate."

3.2.1.2 Cross-references to other ICC rules:

(1) **UCP 600**: Article 5

This characteristic is specified in Article 5 as states that

"Article 5 Banks deal with documents and not with goods, services or performance to which the documents may relate."

(2) **ISP 98**: Rule 1.06 and 1.07

This characteristic is specified in Rule 1.06 a, c and d and Rule 1.07 as states that

"1.06 Nature of Standbys

a. A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not so state.

c.Because a standby is independent, the enforceability of an issuer's obligations under a standby does not depend on:

i. the issuer's right or ability to obtain

[92] Affaki,G.,& Goode, *supra* note 14, at 239.

reimbursement from the applicant;

ii. the beneficiary's right to obtain payment from the applicant;

iii.a reference in the standby to any reimbursement agreement or underlying transaction; or

iv.the issuer's knowledge of performance or breach of any reimbursement agreement or underlying transaction.

d. Because a standby is documentary, an issuer's obligations depend on the presentation of documents and an examination of required documents on their face."

"1.07 Independence of the Issuer-Beneficiary Relationship

An issuer's obligations toward the beneficiary are not affected by the issuer's rights and obligations toward the applicant under any applicable agreement, practice, or law."

According to Article 5 of UCP 600, Rule 1.06 and Rule 1.07 of ISP 98 and Article 6 of URDG 758, they show that documents issued under such rules are independence from the underlying contract. Hence, the guarantor's undertaking to pay under the demand guarantee does not subject to claims or defenses arising from any contract other than a contract between the guarantor and the beneficiary that is the demand guarantee.[93]

3.2.2 Irrevocability

Demand guarantee is irrevocable even if it does not state so. However, it is open to the parties issuing revocable demand guarantee.[94] As mentioned before, all regulations provide that the documents applied with these rules are irrevocable documents.

In the ICC regulations, every rule concerned with this character for example as follows;

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[93] *Id* at 239.
[94] *Id* at 236.

3.2.2.1 URDG 758: Article 4 b.

This characteristic is specified in Article 4 b. as states that

"A guarantee is irrevocable on issue even if it does not state this."

3.2.2.2 Cross-references to other ICC rules:

(1) **UCP 600**: Article 2 and Article 3

This characteristic is specified in Article 2 and Article 3 as states that

"Article 2 Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation."

"Article 3 A credit is irrevocable even if there is no indication to that effect."

(2) **ISP 98**: Rule 1.06

This characteristic is specified in Rule 1.06 a. and b. as state that

"1.06 Nature of Standbys

a. A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not so state.

b. Because a standby is irrevocable, an issuer's obligations under a standby cannot be amended or canceled by the issuer except as provided in the standby or as consented to by the person against whom the amendment or cancellation is asserted."

According to mentioned rules, they show that documents issued under such rules have to be irrevocable so that even if the demand guarantee issued under URDG 758 or UCP 600 or ISP 98 did not specify that it was irrevocable, it was always irrevocable by itself.

3.2.3 Expiration Date: Period of Validity

The demand guarantee is documentary in character which the guarantor concerns with the terms and conditions specified in the guarantee, especially the amount and duration of the duty to pay. Therefore, the demand guarantee has to specify the expiry date.

In the ICC regulations, every rule concerned with this character for example as follows;

3.2.3.1 **URDG 758**: Article 2

This condition is specified in Article 2 as states that

*"**Expiry** means the expiry date or the expiry event or, if both are specified, the earlier of the two*

***Expiry date** means the date specified in the guarantee on or before which a presentation may be made*

***Expiry event** means an event which under the terms of the guarantee results in its expiry, whether immediately or within a specified time after the event occurs, for which purpose the event is deemed to occur only:*

a. when a document specified in the guarantee as indicating the occurrence of the event is presented to the guarantor, or

b. if no such document is specified in the guarantee, when the occurrence of the event becomes determinable from the guarantor's own records."

3.2.3.2 Cross-references to other ICC rules:

(1) **UCP 600**: Article 6

This condition is specified in Article 6 d. i. and e. as state that

"Article 6 d. i. A credit must state an expiry date for presentation. An expiry date stated for honor or negotiation will be deemed to be an expiry date for presentation"

"Article 6 e. Except as provided in sub-article 29 (a), a presentation by or on behalf of the beneficiary must be made on or before the expiry date."

(2) **ISP 98**: Rule 9.01

This condition is specified in Rule 9.01 as states that

*"A standby **must**:*

a. contain an expiry date; or

b. permit the issuer to terminate the standby upon reasonable prior notice or payment.

As mentioned rules, they show that documents issued under such rules have to specify the expiry date, it means that the demand guarantee does not expire until the end of that date. Moreover, according to URDG 758 and UCP 600, the expiry date is the latest date to present documents for claiming. Then after ending of the expiry date, the beneficiary has no right to call for payment.[95]

In addition, if the demand guarantee, under URDG 758, does not specify expiry date or expiry event, the demand guarantee will terminate after three years from the issuing date as states in Article 25 that

"If the guarantee or the counter-guarantee states neither an expiry date nor an expiry event, the guarantee shall terminate after the lapse of three years from the date of issue and the counter-guarantee shall terminate 30 calendar days after the guarantee terminates."

Moreover, in Article 14 of URDG 758, specifies that the beneficiary has to present the documents on or before the expiry date.

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[95] *Id* at 217.

"Article 14 ii. A presentation shall be made to the guarantor: On or before expiry."

According to Article 2, 14 and 25, URDG 758 designed to avoid open-end guarantee.[96] An open-end guarantee is the bank guarantee which does not specify the expiry date or expiry event.

3.2.4 Presentation

When the beneficiary intends to call for payment, the beneficiary has to present documents that identify (link to) such security documents without proof default under the underlying contract or invoke defenses against the beneficiary.

In the ICC regulations, UCP 600, ISP 98 and URDG 758, concerned with this character as follows;

3.2.4.1 **URDG 758**: Article 14 and 20

This condition is specified in Article 14 f. as states that

"Article 14 f. Each presentation shall identify the guarantee under which it is made, such as by stating the guarantor's reference number for the guarantee."

Additionally, if a presentation does not identify the demand guarantee under which it is made, the time for examination under Article 20 does not commence until the demand guarantee is identified.[97] Article 20 of URDG 758 specifies the period that the guarantor has to consider the presentation within five business days.

"Article 20 a. If a presentation of a demand does not indicate that it is to be completed later, the guarantor shall, within five business days following the day of presentation, examine that demand and determine if it is a complying demand. This period is not shortened or otherwise affected by the expiry of the guarantee on or after the date of presentation."

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[96] *Id* at 366.
[97] *Id* at 291.

According to Article 20 specifies that the five-business day period is not shortened or otherwise affected by the expiry of the guarantee on or after the date of presentation, this is because it expires only the time for making completed presentation. It is not necessary that the examination of the presentation must be completed. Then, in case that the presentation does not comply with the presentation and the demand guarantee expires during the examination of the documents, hence it is too late for the beneficiary to make a new presentation. Therefore, it is the beneficiary's risk if he makes a presentation nearly an expiry date.[98]

3.2.4.2 Cross-references to other ICC rules:

(1) **UCP 600**: Article 2 and 14

This condition is specified in Article 2 as states that

“Article 2 Presentation means either the delivery of documents under a credit to the issuing bank or nominated bank or the documents so delivered.”

In addition, the guarantor has to examine such presentation within five banking days subject to Article 14 as states that

“Article 14 b. A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day for presentation”

(2) **ISP 98**: Rule 3.03 and 5.01

Under ISP 98, if the beneficiary would like to call for payment, he has to present documents to identify standby letter of credit to which it relates. This condition is specified in Rule 3.03 as states that

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[98] *Id* at 325.

"3.03 Identification of Standby

a. A presentation must identify the standby under which the presentation is made.

b. A presentation may identify the standby by stating the complete reference number of the standby and the name and location of the issuer or by attaching the original or a copy of the standby."

Additionally, Rule 5.01 of ISP 98 specified period to decline payment that notice of dishonor has to make in a reasonable time which is not more than seven days.

"5.01 Timely Notice of Dishonor

a. Notice of dishonor must be given within a time after presentation of documents which is not unreasonable.

ii. Notice given within three business days is deemed to be not unreasonable and beyond seven business days is deemed to be unreasonable."

As mentioned rules, they show that when the beneficiary intends to call for a claim, the beneficiary has to make a presentation. In addition, such presentation must identify demand guarantee which it relates and the guarantor has to examine within five business days in case of the demand guarantee is issued under URDG 758 or UCP 600 and within seven business days in case of the demand guarantee is issued under ISP 98.

3.2.5 Extend or pay

When the applicant breaches the underlying contract, the beneficiary has two choices; first, call for payment from the guarantor, or second, extend the demand guarantee for a defined period. Such an extension is designed to give the applicant an opportunity to remedy the breach and preserve the beneficiary's relationship to the applicant. Furthermore, the extension is quicker and cheaper to

have the breach remedied by the applicant than to draw on the demand guarantee and appoint another contractor to remedy the breach.[99]

In the ICC regulations, URDG 758 and ISP 98, concerned with this character as follows;

3.2.5.1 URDG 758: Article 23

This condition is specified in Article 23 a. as states that

"Article 23 a. Where a complying demand includes, as an alternative, a request to extend the expiry, the guarantor may suspend payment for a period not exceeding 30 calendar days following its receipt of the demand."

3.2.5.2 Cross-references to other ICC rules:

(1) **UCP 600**: none

(2) **ISP 98**: Rule 3.09

This condition is specified in Rule 3.09 as states that

"3.09 Extend or Pay

A beneficiary's request to extend the expiration date of the standby or, alternatively, to pay the amount available under it:

a. is a presentation demanding payment under the standby, to be examined as such in accordance with these Rules; and

b. implies that the beneficiary:

i. consents to the amendment to extend the expiry date to the date requested;

ii. requests the issuer to exercise its discretion to seek the approval of the applicant and to issue that amendment;

iii. upon issuance of that amendment, retracts its demand for payment; and iv. consents to the maximum time available under these Rules for examination and notice of dishonor."

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[99] *Id* at 148.

As a result, if the beneficiary desires to extend the period of demand guarantee, he may request to the guarantor. The guarantor has two choices; either to extend the period of the demand guarantee or to pay the demand forthwith.

CHAPTER 4
RULES OF GUARANTEE UNDER THAI LAWS AND REGULATIONS: AN ANALYSIS

Although bank guarantees are widely used worldwide including in Thailand, there is no specific law or regulation concerning bank guarantees in Thailand. Under Thai law, there are merely the rules of guarantee under the Civil and Commercial Code of Thailand, which are related and have similar characteristics of the demand guarantee. In general, characteristics of the demand guarantee are independent undertaking, pay on first demand and claim for payment by presenting related documents. However, if the cases are defend in the courts related to the bank guarantee in Thailand, Thai courts will adapt existing Thai law to decide that case. Therefore, this may cause problems because the rules of guarantee under Thai law are different from the characteristics of the demand guarantee.

4.1 Characteristics of guarantee under Thai law

The rules of guarantee under the Civil and Commercial Code have characteristics similar to suretyship, because Section 680 of the Civil and Commercial Code provided that

*"*Section 680 *Suretyship is a contract whereby a third person, called the surety, binds himself to a creditor to satisfy an obligation in the event that the debtor fails to perform it."*

The guarantor (the surety) under Thai law has liability to pay when the principal debtor fails to perform the obligation under the underlying contract between the principal debtor and the creditor. The rule of guarantee (suretyship) under Thai law is a secondary obligation because the duty of the guarantor (the surety) depends on the default of the principal debtor and the obligation of the guarantor (the surety) does not arise until the principal debtor has failed to perform their primary obligation under the underlying contract. As the characteristics of the guarantee under the Civil

and Commercial Code are similar to the characteristics of the suretyship, this thesis will refer to the guarantee under Thai law as the suretyship and refer to the guarantor as the surety.

According to suretyship under the Civil and Commercial Code, the characteristics of suretyship are as follows:[100]

(1) Suretyship will incur when there are the duties under the contract between the primary debtor (the principal debtor) and the creditor. This contract is called “the underlying contract.” Suretyship is the accessory contract which the surety undertakes to ensure that the principal debtor will perform their primary obligation. The accessory contract will be effective or not, depending on the validity of the underlying contract. Suretyship can be given only for a valid and enforceable obligation.

(2) The surety is not the creditor or debtor of the underlying contract. The surety must be a third party of the underlying contract.

(3) The obligation of the surety is a secondary obligation. The surety's obligation depends on default by the principal debtor and does not arise until the principal debtor has failed to perform their primary obligation.

4.2 Limitation on the surety’s obligation

The most important aspect of the nature of the surety’s liability as a secondary liability is that it is coextensive with the liability of the principal debtor. This means that as a general rule, the surety's liability is no greater and no less than the principal debtor's liability, in terms of amount, time for payment and the conditions under which the principal debtor is liable. However, the surety might modify their liability to be different to that of the principal debtor's liability; for example, the surety may agree that the surety will not invoke any defense against the creditor. The defense may be the surety's defense or the principal debtor's defense. If the surety agrees that he will not invoke a defense about the lapse of the period of

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[100] Professor Suda Wisarutpit, **Principle of Suretyship, Mortgage, Pledge**, 11th edition, January B.E. 2558

prescription for a claim of the underlying contract against the creditor, this condition can be enforced.[101]

If there are specific conditions to limit the liability of the surety, such conditions should be enforceable. For instance, the suretyship agreement has the condition that the creditor has to notify the surety in writing within fifteen days after the principal debtor has failed to perform the obligation, so that the creditor is entitled to claim from the surety when the creditor has already complied with that precedent condition.[102]

4.3 Related Thai law to the characteristics of demand guarantee

4.3.1 Independent undertaking (documentary in nature)

Under the Civil and Commercial Code of Thailand, the rules of guarantee states that the obligation of the guarantor will occur when the debtor fails to perform his obligation subjected to Section 680 of the Civil and Commercial Code provided that

*"*Section 680 *Suretyship is a contract whereby a third person, called the surety, binds himself to a creditor to satisfy an obligation in the event that the debtor fails to perform it."*

According to Section 680, the guarantee agreement under Thai law is an accessory contract[103] which the guarantor's obligation to the beneficiary is subject to the performance of the principal debtor under the existing or validity of an underlying transaction or underlying contract.

Moreover, the Civil and Commercial Code specifies the relationship between the surety and the principal debtor in Section 692, 693 and 698 as stated that

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[101] *Id*

[102] *Id*

[103] Earl C.Arnold, *"Primary and Secondary Obligations*", George Washington University Law School, Washington, D.C. , http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=8066&context=penn_law_review (accessed December 20, 2015)

"Section 692 *An interruption of prescription against the debtor is also an interruption against the surety."*

"Section 693 *The surety who has performed the obligation has a right of recourse against the debtor for the principal and interest, and for the losses or damages which he may suffer by reason of the suretyship."*

"Section 698 *The surety is discharged as soon as the obligation of the debtor is extinguished by any cause whatsoever."*

According to the laws mentioned above, the guarantor's liability depends on the underlying contract between the creditor and the principal debtor. However, the rules under UCP 600, ISP 98 and URDG 758 do not address these rules because those regulations have already complied with the independent undertaking characteristic of the demand guarantee.

4.3.2 Pay on first demand (primary obligation)

The nature of a demand guarantee, when the bank receives a demand for payment from the beneficiary, the bank has to pay on first demand when the document is presented to the bank. In contrast, the Civil and Commercial Code Section 694 and 695 specify that the surety has a right to defend against the beneficiary by setting up the defense of the principal debtor against the creditor. In addition, if the surety (the guarantor) ignores to do that, the surety (the guarantor) will lose the right of recourse from the principal debtor (the applicant), as specified in Section 694 and Section 695 that states:

"Section 694 *In addition to the defense which the surety has against the creditor, he can also set up defense which the debtor has against the creditor."*

"Section 695 *The surety who neglects to set up against the creditor defense of the debtor loses his right of recourse against the debtor to the extent of these defense, unless he proves that he did not know of such defense and that his ignorance was not due to his oversight."*

Therefore, under Thai law, the bank may deny payment to the beneficiary when the beneficiary requests payment. If the applicant has a defense against the beneficiary, the bank has to set up the applicant's defense against the beneficiary who may demand payment. Otherwise, the bank may lose the right of recourse from the applicant.

On the contrary, in case that the bank agrees to joint obligation with the applicant, the bank has no right to require the applicant to be first called to pay the beneficiary and other executions as specified in Section 688, 689 and 690 which are provided in Section 681/1, as states that

"Section 681/1 *Any agreement that imposes the surety of joint liability with the debtor or as joint debtors, such agreement is void.*

The first paragraph is not applicable to a surety who is a juristic person and who has consented to be bound in the same manner as that of a joint debtor, or in the capacity of a joint debtor. In such a case, a surety who is a juristic person shall have no rights as provided in Section 688, 689 and 690."

According to Section 681/1, the surety who is a juristic person and has consented to be bound as a joint debtor can still be held jointly liable with the principal debtor. Thus, if the bank is the juristic person, who specifies the conditions of the bank's guarantee that binds the bank, as a joint debtor, with the applicant, the bank has no rights as a secondary debtor to request or require the beneficiary to demand and call on debts from the applicant first.

"Section 688 *When the creditor demands performance of the obligation from the surety, the latter may require that the debtor be first called upon to perform unless the debtor has been adjudged bankrupt, or his whereabouts in Thailand is unknown."*

"Section 689 *Even after the debtor has been called upon as provided in the forgoing section, if the surety can prove that the debtor has the means*

to perform and that execution would not be difficult, the creditor must first make execution against the property of the debtor."

"Section 690 *If the creditor holds real security belonging to the debtor, he must, on request of the surety, have the obligation to perform first out of the real security."*

According to this scheme, it seems to be complying with the rule of payment for first demand or a primary obligation but in fact the bank still has the right to deny payment to the beneficiary by setting up the applicant's defense or the bank's defense against the beneficiary. Additionally, Section 681/1 states that the guarantor who agrees joint liability with the applicant. In particular, the guarantor only has no right of which is mentioned under Section 688, 689, and 690, and he is not a joint debtors with the applicant. Moreover, he cannot be charged as the primary obligation such as the Supreme Court's Decision No. 2569/2541 as follows:

The Supreme Court's Decision No. 2569/2541*: The guarantor who agrees to joint liability with the debtor does not change his status from being a guarantor to being a principal debtor. Therefore, he has the right to set up his defense and debtor's defense against the creditor.*

4.3.3 Irrevocability

In accordance with the rules under UCP 600, ISP 98 and URDG 758, they provide that the documents which are applied to these regulations are irrevocability. But under the Civil and Commercial Code, there is no rule prescribing irrevocability of the suretyship but Section 699 specifies that the surety can terminate the suretyship if that suretyship is the suretyship for consecutive debtor's obligation.

"Section 699 *The suretyship for a series of transactions without limit of time in favor of the creditor can be terminated by the surety for future transaction by giving notice to the creditor to that effect.*

In such case, the surety is not liable for transactions done by the debtor after the notice has reached to the creditor."

Hence, if the content specified in the bank guarantee shows that it guarantees for ongoing transactions, for instance, guarantees the continued performance to complete the obligations, and does not have a limit of time (Opened-end bank guarantee), the bank has the right to terminate the bank guarantee.

4.3.4 Expiration date

According to UCP 600, ISP 98 and URDG 758, they addressed the expiry date and the presentation has to make on or before the expiry date. Hence, the expiry date under UCP 600, ISP 98 and URDG 758 means the period of the bank's obligation.

Section 681 of the Civil and Commercial Code provides the condition that the suretyship has to specify the period of the main contract, which creates the surety's obligation. There is no rule under the Civil and Commercial Code that specifies the expiry date or end of the guarantee period. Nevertheless, in practice, the bank always negotiates to specify the expiry date in the bank guarantee, because the bank attempts to limit the period of its responsibility. Consequently, it means that if the default by the applicant under the underlying contract occurs after the expiry date, the bank will deny payment to the beneficiary. Thus, if the default of the applicant occurs before the expiry date, the bank will be liable even if the beneficiary calls for payment after the expiry date.

Furthermore, the bank practically specifies the clause that the beneficiary has to call for payment within a specific period after the expiry date, such as follows:

"This guarantee is valid from……… and shall continue in effect until……….. (hereinafter called the "Expiry Date"), and is condition upon claim being made and received by the bank not later than one month from the Expiry Date. Thereafter, the bank's liability hereunder shall automatically cease and this guarantee shall become null and void."[104]

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[104] Bank guarantee template of the International Air Transport Association, http://www.iata.org/sites/fmc/files/lebanon_pax_application_guide_eng.pdf (accessed November 8, 2015)

However, the Supreme Court decided that the condition in which the bank stipulated the claim period showed that the bank tried to reduce the period of prescription due to the prohibition of Section 193/11[105] of the Civil and Commercial Code. For example, the Supreme Court's Decision No. 16947/2557 and No. 2208/2558 are given as follows:

The Supreme Court's Decision No. 16947/2557*: Contract provision that the beneficiary has to call for a claim within fifteen days is not a condition that limits the surety's liabilities or a condition stipulating that the beneficiary has to follow first. However, it designates the beneficiary's duration to exercise the right, which shares the same characteristics as the designation of prescription of the right of claim. Prescription of the right of claim on the bank guarantee is ten years. Any related parties are not allowed to suspend, extend, or expedite. Hence, contract provision stipulating to expedite the duration for the beneficiary which is shorter than the prescription of the right of claim on the bank guarantee is contrary to the law and unenforceable.*

The Supreme Court's Decision No. 2208/2558*: Contract provision in the bank guarantee states that the claim for payment needs to begin within fifteen days after the expiration date of the bank guarantee. If it occurs later than fifteen days, the bank no longer has any responsibility or any obligations to the bank guarantee. This statement means the designation of the right to claim or prosecute the bank. According to the Civil and Commercial Code, if the prescription of the guarantee is not specifically designated, the prescription will be set to ten years. Any related parties are not allowed to suspend, extend, or expedite. Hence, the contract provision in the bank guarantee is considered as the expedition of the prescription. Additionally, it is also contrary to the law related to the public order. As a result, it is void under Section 150. The contract provision is not a precedent condition that the beneficiary has to do before claiming.*

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[105] Section 193/11 of the Civil and Commercial Code "The periods for prescription fixed by law cannot be extended or reduced."

In contrast, the Supreme Court also decided that the bank has the right to specify the claim period clause because it did not reduce the period of prescription subjected to Section 193/11 of the Civil and Commercial Code, such as the Supreme Court's Decision No.6622/2546 and No. 3739/2551 as follows;

The Supreme Court's Decision No.6622/2546*: Limit of liabilities of the surety and the bank guarantee is liable to the surety only. The interpretation of the suretyship has to follow this limit strictly. The condition that the beneficiary has to make a demand for payment within fifteen days is different from the period of prescription. The beneficiary will be able to exercise the right of claim if and only if he follows the conditions of the bank guarantee beforehand.*

The Supreme Court's Decision No. 3739/2551*: The beneficiary is able to exercise the right to entreat as in the bank guarantee if and only if he follows the conditions of the bank guarantee (submitting the demand within fifteen days) beforehand. For this case, the beneficiary does not make a demand within fifteen days, so the bank has no obligation to the beneficiary.*

According to those two decisions, if the bank has the right to specify a claim period condition in the bank guarantee, the bank will know the period of its risk and prepare the funds that may be claimed. Also, the applicant will not pay a guarantee fee for ten years. Moreover, the beneficiary must call for claim in a proper time.

Additionally, the bank separates the bank guarantee into two types; closed-end guarantee and opened-end guarantee. They can be described as follows:

The closed-end guarantee is the bank guarantee that specifies the expiry date, which means that the bank has limited its period of liability. If the default of the applicant occurs after such specified date, the bank will deny payment to the beneficiary.

The opened-end guarantee is the bank guarantee which does not specify the expiry date or specifies the expiry date but the beneficiary has the right to extend that expiry date. Therefore, the bank will be bound until the beneficiary returns the guarantee to the bank or the beneficiary sends a letter to the bank stipulated that the bank is released from its undertaking under the bank guarantee. This specification has already been given in Section 327 of the Civil and Commercial Code, which states that the guarantor's obligation still exists if the guarantee is not released.

"Section 327 *If the document embodying the obligation has been surrendered, it is presumed that the obligation has been extinguished."*

The types of the guarantee; opened-end or closed-end; affect the duty of the applicant to pay a fee for the issuing bank guarantee to the bank because the applicant still has to pay a guarantee fee until the bank is released from the bank guarantee undertaking.

In addition, the right of the beneficiary to call for payment occurs when the applicant fails to perform the obligation and the beneficiary has to give notice the bank within sixty days as dated from the notice arriving to the bank, as mentioned in Section 686.

"Section 686 *As soon as the debtor is in default, the creditor is required to send the notice to the surety within sixty days since the first day of default. Additionally, the creditor is unable to call for payment from the surety before the notice arrives. In the meantime, the surety still has the right to pay debts to the creditor when it is due.*

If the creditor does not submit the notice within the time as in the first paragraph (the time), the surety will be free from the obligation on interest, indemnity, and other debt-related charges which incur after the time has passed."

The period sixty days specified in Section 686 is not a claim period. If the beneficiary does not call for payment within sixty days, the beneficiary will still have the right to call for payment from the bank. Nevertheless, the

beneficiary does not have the right to claim for interest and other charges from the bank.

Moreover, the beneficiary has the right to claim within ten years from the day that the bank received notice.[106]

The bank guarantee should contain a condition regarding the period of validity since it is significant to all parties. For the bank, it marks the period during which it has a possible liability for which it has to have reserve funds. For the beneficiary, it marks the period during which the beneficiary can take advantage of the benefits of the bank guarantee. For the applicant, it marks the period during which he is exposed to a financial risk, has to pay bank charges and during which part of his credit facilities, collateral, and other resources may be tied up as security for reimbursement to the bank.[107]

Certainly, where a loss arises during the validity period of the bank guarantee but is only capable of quantification after the bank guarantee has expired, the bank remains liable.[108]

4.3.5 Identified Presentation (claim for payment by presenting related documents)

According to ICC regulations, these rules specify that if the beneficiary would like to claim for payment, the beneficiary has to present only documents that identify such security documents. However, in Thailand, the process is much more complicated. Besides presenting the identified document, the beneficiary has to inform the bank that the applicant has failed to perform the obligation under the underlying contract. Moreover, the bank has to verify that the applicant is actually in default as the beneficiary claims.

In addition, ICC regulations stipulate that the bank has to examine the presentation within five business days in the case of the demand guarantee being issued under URDG 758 or UCP 600 and within seven working days in the case of the demand guarantee being issued under ISP 98. On the contrary, suretyship under the

[106] Professor Suda Wisarutpit. *Description of the amendment of guarantees and mortgage (The amended the Civil and Commercial Code (No. 20), B.E.2557*
[107] Roeland Bertrams, *supra* note 1, at 98.
[108] Geraldine Mary Andrews and Richard Millet, *supra* note 73, at 256.

Civil and Commercial Code does not stipulate that condition. Thus, the bank may take a long time for examining the default of the applicant before paying the beneficiary.

4.4 Bank of Thailand's regulations related to bank guarantee

Even though the bank guarantee has been widely used and issued nationwide, the Bank of Thailand still has no direct supervision on bank guarantee's related issues. As a result, the bank can issue a bank guarantee under uncontrolled issuance. However, it may affect the reliability of the bank guarantee to the beneficiary because he may not have confidence in the pay on first demand principle under a Thai bank guarantee.

4.5 Unfair Contract Terms Act B.E. 2540 (1997) related to bank guarantee

When the applicant requests a bank to issue a bank guarantee in favor of the beneficiary, in practice, a Thai bank always asks the applicant to sign the application form which is an independent contract between the bank and the applicant that is separate from the underlying contract and bank guarantee. In addition, the application form usually contains conditions that in the event that the bank has received a demand for payment from the beneficiary, the applicant agrees that the bank has the right to make such a payment immediately without notifying the applicant. According to such condition, it seems an unfair condition to the applicant under the Unfair Contract Terms Act B.E. 2540 (1997).

Section 3 of the Unfair Contract Terms Act B.E. 2540 (1997) specified that

*"**Standard form contract** means written contract in which essential terms have been prescribed in advance, regardless whether being executed in any form, and is used by either contracting party in his business operation."*

According to Section 3 of this Act, the application form of bank guarantee issued by a Thai bank is a standard form contract because it is prescribed in advance and is used by every applicant who requests the bank to issue a bank guarantee.

Additionally, Section 4 of this Act specifies that

"The terms in a contract between the consumer and the business, trading or professional operator or in a standard form contract or in a contract of sale with right of redemption which render the business, trading or professional operator or the party prescribing the standard form contract or the buyer an unreasonable advantage over the other party shall be regarded as unfair contract terms, and shall only be enforceable to the extent that they are fair and reasonable according to the circumstances."

And paragraph 3 of Section 4 specifies that

"The terms with characters or effects in a way that the other party is obliged to comply or bear more burden than that could have been anticipated by a reasonable person in normal circumstance may be regarded as terms that render an advantage over the other party, such as:

(3) terms rendering the other party to be liable or to bear more burden than that prescribed by law."

According to Section 4, the condition that the bank has the right to pay for demand from the beneficiary immediately without notifying to the applicant, is a condition that gains an unreasonable advantage over the applicant which shall be regarded as unfair contract terms and it may only be enforceable to the extent that they are fair and reasonable.

4.6 Bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992)

All Thai government agencies have to comply with the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) which is the core procurement regulations that specified the pattern of the procurement related to a procurement contract between the private and public sector or between a public and public sector. Additionally, these regulations stipulate the template of the bank

guarantee. Therefore, private companies that are requested for a bank guarantee to secure their obligation of a procurement contract with the government agencies, have to use the template attached with these regulations. After the amendment of guarantees and mortgage (The amended the Civil and Commercial Code (No. 20), B.E. 2557) and the amendment of guarantees and mortgage (The amended the Civil and Commercial Code (No. 21), B.E. 2558) had been enacted, the Comptroller General's Department has issued new templates of the bank guarantee subject to the Announcement of the Comptroller General’s Department No. Gor Kor (Gor Wor Por) 0421.3/Wor 509 dated December 24, 2015.

Even though the issuing of a bank guarantee under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) has to comply with the rules of guarantee (suretyship) under the Civil and Commercial Code, the same as the bank guarantee which is issued between private and private sector, there are several differences between bank guarantee issued to the private sector or the public sector as follows:

4.6.1 The difference between templates of the bank guarantees under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) and the characteristics of demand guarantee.

In general, the bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) specify the expiration date. But there is a condition that in the event that the parties of the underlying contract have to extend the expiration date, the guarantor (the bank) has to agree to that extension in advance. The guarantee by the bank can specify the condition to extend the expiration date in advance subject to Section 700 of the Civil and Commercial Code (Section 6 of the amendment of guarantees and mortgage (The amended the Civil and Commercial Code (No. 21), B.E.2558).

However, the bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) do not comply with the characteristics of the demand guarantee for the following reasons:

(1) The demand guarantee is an independent undertaking (documentary in nature) from the undertaking of the underlying contract bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) do not have that condition specified, accordingly they are an independent guarantee.

Additionally, one of the nature characteristics of the demand guarantee is that the beneficiary can claim for payment only by presenting the related documents whereas the bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) do not specify a condition to cover this characteristic. Hence if the government agency would like to call for payment from the bank, the government agency has to present the identified document and inform the bank that the applicant failed to perform the obligation under the underlying contract.

(2) The demand guarantee has to be paid on demand or paid on first demand, but the bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) do not specify such condition. Even though the bank guarantee templates specify that the guarantor (the bank) has a liability as the joint debtor with the applicant, it does not alter that bank guarantee to the pay on demand guarantee according to the reason as mentioned in 4.3.2.

(3) The demand guarantee under URDG is irrevocable, but the bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) do not specify this condition. Therefore, according to Section 699[109], the guarantor (the bank) can terminate the guarantee if that guarantee is the guarantee for continuing the applicant's obligation.

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[109] Section 699 of the Civil and Commercial Code “The suretyship for a series of transactions without limit of time in favor of the creditor can be terminated by the surety for the future by giving notice to the creditor to that effect.

In such case, the surety is not liable for transactions done by the debtor after the notice has reached the creditor"

Even though the bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) specifies the expiration date, but they have a condition that this expiration date may be extended and valid until the principal debtor's obligation are completed. Nevertheless, the bank guarantee templates do not specify the claim period, which is the period that the beneficiary has the right to call for payment from the guarantor. While, the demand guarantee issued under URDG 758, the beneficiary has to call for payment within the expiry date or expiry event or within three years from the issuing date as stated in Article 25 of URDG 758.[110] Therefore the beneficiary (the government agency) is entitled to call for claim within ten years from the date that the applicant defaulted.

4.6.2 Period for returning an original guarantee to the guarantor

In general, if the government agency does not return the original bank guarantee to the bank or does not issue a letter to release the bank from the undertaking under the bank guarantee, the applicant will pay a letter of guarantee fee to the bank until (1) the original bank guarantee is returned to the bank or (2) the government agency issues a release letter to the bank or (3) ten years from the date that the applicant has defaulted, which is the date that the bank will be released from the obligation. However, the government agency shall return the bank guarantee, which is the security of the bidding, to the bidder or guarantor within fifteen days after the completion of the bid evaluation in the case of the bid bond or within fifteen days after the applicant is free from the obligation in the case of the performance bond subject to Clause 144 of the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992).[111] In addition, in the case that the letter of guarantee is

[110] Article 25 of URDG 758 "If the guarantee or the counter-guarantee states neither an expiry date nor an expiry event, the guarantee shall terminate after the lapse of three years from the date of issue and the counter-guarantee shall terminate 30 calendar days after the guarantee terminates."

[111] Clause 144 : The government agency shall return the security to the bidder, the contracting party or guarantor in the following criteria:

(I) The bid security shall be returned to the bidder or guarantor within 15 days after the completion of the bid evaluation. Except the 3 lowest selected

issued by a bank, if the bidder does not come to pick up the original bank guarantee within the time as mentioned before, the government agency has to send the original bank guarantee return to the bidder by registered mail promptly.

On the other hand, in the case of an issuing bank guarantee between private sector and private sector, there is no rule that the beneficiary has to return the original bank guarantee within a reasonable period the same as the condition specified in Clause 144 of the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992). Therefore, if the bank guarantee, of which the beneficiary is a private company, does not specify such condition, the beneficiary does not need to return the original bank guarantee to the guarantor or does not need to issue a letter to release the guarantor from the obligation. Consequently, the applicant is still charged bank guarantee fee from the bank until the applicant takes the original bank guarantee return to the bank or the bank receives a letter to release the bank from the bank guarantee undertaking.

4.6.3 The bank guarantees are the security to perform an obligation under the underlying contract and they are a penalty which the Court may reduce it if it is disproportionately high.

In case there are conflicts between the parties and that one party is the government agency, the party who desires to sue another party has to file the case

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bidders, the security shall be returned after the contract or agreement is signed or the bidder is free from the obligation.

(2) The performance security shall be returned to the contracting party or guarantor urgently and at latest not beyond 15 days after the contractor is free from the obligation.

The procurement which warranty against the defect is not required, the security shall be returned to the contracting party or guarantor in the proportion of the materials accepted by the government agency. It shall be also stipulated as a condition in the price inquiry document or bid document and the contract.

In case of guarantee issued by bank, Industry Financial Corporation of Thailand, finance company or security and finance company which the bidder or contracting party does not come to pick up within the time mentioned above, its original shall be sent rapidly to the bidder or contracting party by registered mail. It shall inform the bank, Industry Financial Corporation of Thailand, finance company or security and finance company as well.

to the Administrative Court. In several cases, the Administrative Court judges decide that the bank guarantee, which is the security of the bidding, is a penalty which the Court is entitled to reduce to a reasonable amount if it is disproportionately high, subject to Section 383 of the Civil and Commercial Code[112] such as the Supreme Administrative Court's Decision No. Aor.78/2558 and No. Aor.154/2559 which are given as follows:

The Supreme Administrative Court's Decision No. Aor.78/2558[113]

: The bidder intended to join the bidding but he cannot register for bidding on time because of an accident and there is no evidence showing that the bidder intended collusion or obstruct the bidding. In addition, the event that no bidding of the bidder did not incur a damage to the government agency. The bidding agreement specified condition that if the bidder does not register to bid by a specified date and time, the bidder may be claimed the bid guarantee from the government agency. This is punitive damages, so it is a penalty according to Section 379 of the Civil and Commercial Code. If a forfeited penalty is disproportionately high, it may be reduced to a reasonable amount by the Court. In determination of reasonableness every legitimate interest of the creditor, not merely his property interest, shall be taken into consideration. Additionally, there is the Announcement of the Comptroller General's Department No. Gor Kor 0421.3/Wor247 dated July 14, 2010 specified to reduce a forfeiture of penalty from five percent to two point five percent of the procurement amount. The Supreme Administrative Court reasonably considered every legitimate interest of the creditor, not merely property interest, if the Court has an opinion that the forfeited penalty was disproportionately high hence it is reduced to two point five percent of the procurement amount.

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[112] Section 383 of the Civil and Commercial Code of Thailand stated that "If a forfeited penalty is disproportionately high, it may be reduced to a reasonable amount by the Court. In determination of reasonableness every legitimate interest of the creditor, not merely his property interest, shall be taken into consideration. After payment of the penalty the claim for a reduction is barred."

[113] The Supreme Administrative Court, http://admincourt.go.th/admincourt/upload/admCase/Document/judgement/PDF/2552/01012-520689-1F-580416-0000549332.pdf (accessed April 12, 2016)

The Supreme Administrative Court's Decision No. Aor.154/2559[114]*: The bank guarantee is damages specified in advance if there is a default of the underlying contract so it is a penalty. According to Section 383 of the Civil and Commercial Code specified that if a forfeited penalty is disproportionately high, it may be reduced to a reasonable amount by the Court. In determination of reasonableness every legitimate interest of the creditor, not merely his property interest, shall be taken into consideration. In this case, there are not many damages to the government agency (the beneficiary) so it is disproportionately high forfeiture of penalty. The Court considered reducing a penalty to twenty percent.*

However, there are some cases that the Supreme Administrative Court decided that a condition to forfeiture of penalty for the purpose to punish the wrongdoer party in the breach rather than to compensate the injured party. Hence the Court has not the right to reduce a penalty e.g. the Supreme Administrative Court's decision No. Aor.221/2558 is given as follow:

The Supreme Administrative Court's Decision No. Aor.221/2558[115]*: The bid security is provided as security for performing the obligation of the underlying contract which has a characteristic the same as a liquidated damages hence it is a penalty subject to Section 379 of the Civil and Commercial Code.*[116] *Section 383 of the Civil and Commercial Code specified that if the penalty is disproportionately high, the court could reduce it to a reasonable amount. The court shall determine the reasonable amount not only the creditor's property interest but also every legitimate interest of the creditor. In this case, the*

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[114] The Supreme Administrative Court, http://admincourt.go.th/admincourt/upload/admcase/Document/judgement/PDF/2553/01012-531065-1F-590401-0000570894.pdf (accessed April 12, 2016)

[115] The Supreme Administrative Court, http://www.admincourt.go.th/admincourt/upload/admCase/Document/judgement/PDF/2555/01012-550039-1F-580416-0000550503.pdf (accessed April 15, 2016)

[116] Section 379 of the Civil and Commercial Code of Thailand states that "If the debtor promised the creditor the payment of a sum of money as penalty in case he does not perform it in the proper manner, the penalty is forfeited if he is in default. If the performance due consist in a forbearance, the penalty is forfeited as soon as any act in contravention of the obligation is committed."

purpose of a bidding condition specified that the bidders have to provide bid bonds and other documents before bidding is a method to prevent corruption and bid rigging. The purpose of a condition to forfeiture of penalty is a punishment to the wrongdoer party for the breach rather than to compensate the injured party. Therefore, in this case, there is not a provision specifying a disproportionately high penalty.

On the contrary, if there are conflicts between parties and that every party is in the private sector, the courts do not decide that the bank guarantees are the forfeited penalty, so the courts have no right to reduce the penalty.

4.6.4 Period of prescription

According to Thai law, a call for claim is barred by prescription if it has not been enforced within the specific period. In the case of a dispute concerning an administrative contract, the case must be filed within five years from the day that the cause of action was known or should have been known, subject to Section 51 of the Establishment of Administrative Courts and Administrative Court Procedure Act B.E.2542 (1999).[117] Whereas in case of a dispute between the application and the beneficiary of which the beneficiary is not a government agency, such dispute must be filed with the Civil Courts within ten years from the day that the claim could be enforced subject to Section 193/30 of the Civil and Commercial Code.[118] However, the bank guarantee is an accessory contract, so the period of prescription of the accessory contract depends on the period of prescription of the underlying contract. Therefore, if there are disputes between the application and the beneficiary under the

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[117] Section 51 of the Establishment of Administrative Courts and Administrative Court Procedure Act B.E.2542 (1999) states that "The case under section 9 paragraph one (4) shall be filed within five years as from the day the cause of action known or should have been known, but the filing shall not be later than ten years as from the date of such cause of action."

Section 9 of the Establishment of Administrative Courts and Administrative Court Procedure Act B.E.2542 (1999) states that "Administrative Courts have the competence to try and adjudicate or give orders over the following matters:

(4) the case involving a dispute in relation to an administrative contract."

[118] Section 193/30 of the Civil and Commercial Code states that "The period of prescription for which no other period is provided by law is ten years."

underlying contract and the beneficiary desires to claim from the guarantor, the guarantor may invoke defense concerning with the period of prescription against the beneficiary. In addition, the guarantor has the right to invoke both the guarantor's defense and the principal debtor's defense against the beneficiary.

Nevertheless, there are some cases which the Supreme Administrative Court has given order that in the event that a compensation of the guarantor paid for claiming from the beneficiary made an interlude only to the period of prescription of the guarantor, it did not interrupt the period of prescription of the principal debtor. For instant, the Supreme Administrative Court's Order No. 150/2558 as follow:

The Supreme Administrative Court’s Order No. 150/2558[119] : *When the bank (the guarantor) paid the beneficiary according to the condition of the bank guarantee between the bank and the beneficiary, it means that the bank (the guarantor) has already settled only its part, and the period of prescription was interrupted only its part, subject to Section 193/14 and Section 193/15 of the Civil and Commercial Code. Additionally, there is no rule specified that a settlement from the guarantor which interrupted the period of prescription of the guarantor's part will effect to the principal part. Therefore, the settlement of the bank to the beneficiary (the government agency) did not interrupt the period of prescription of the principal debtor.*

4.7 Freedom of contract

In European countries, any case of doubt has to be resolved by interpretation of the contract.[120] The doctrine of freedom of contract promotes the idea

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[119] The Supreme Administrative Court, http://www.admincourt.go.th/admincourt/upload/admcase/Document/judgement/PDF/2557/01013-570305-2F-580511-0000553610.pdf (accessed April 18, 2016)

[120] Professor Ulrich Drobnig, **Personal Security (PEL Pers. Sec.)**, Sellier European Law Publishers, BRUYLANT, Staempfil Publishers Ltd. Berne, Germany, 325, (2007)

that since parties are the best judges of their interests, so they should be free to make contracts on any terms they choose.[121]

Whereas, an aspect of the Civil and Commercial Code states, if conditions specified in a contract are not prohibited by law or do not oppose public order or good morals, the parties can specify and comply with that conditions subject to Section 150 of the Civil and Commercial Code as follows;

"Section 150 *An act is void if its object is expressly prohibited by law or is impossible, or is contrary to public order or good morals.*"

Moreover, there is a remark of the Supreme Court's Decision No. 3647/2549 that specified according to Roman Law which was given precedence on the consent of the parties (consensus) that related to the declaration of intention; subjective intention and objective intention. That intention is called the doctrine of freedom of contract and autonomy of will. An individual person has the freedom to declare his intention to specify conditions in the contract even if it does not conflict with Section 150 of the Civil and Commercial Code.

[121] Catherine Elliott and Frances Quinn, **Contract Law**, 4th ed, Pearson Education Limited, 4, (2003)

CHAPTER 5
CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

Even though a bank guarantee has become a foundation of business and has been widely used in Thailand, the banks in Thailand always issue the bank guarantee under the Civil and Commercial Code of Thailand, which is extremely different from the characteristics and the principle rule of the demand guarantee. The nature characteristics of the demand guarantee are as follows:

1. Independent undertaking

The demand guarantee is a separated contract from the underlying contract between the applicant and the beneficiary. Also, it is separated from the contract between the guarantor and the applicant (the application). The rights and obligations created by the demand guarantee are independent of those arising from the underlying contract. Therefore, a guarantor who issues a demand guarantee must honor the demand guarantee according to its terms. The guarantor has a duty to pay when the beneficiary presents related documents. When the guarantor receives the presentation, the guarantor has to pay on first demand and does not have a duty to prove any default of the applicant under the underlying contract. Since the demand guarantee is separated from the contract between the applicant and the guarantor (the application), the guarantor is not entitled to invoke a breach of such contract (the applicant) against the beneficiary.

2. Documentary in character

The demand guarantee is a documentary in character. The conditions of payment and termination of the payment obligation depend on the terms of the guarantee itself. Thus, the guarantor will pay as the conditions specified in the demand guarantee, and the presentation of a demand and other related documents. Moreover, the guarantor has no obligation to authenticate such presentation documents that the beneficiary submits to him.

3. No proof of breach

According to the guarantor complies merely with the terms and conditions specified in the demand guarantee. Hence the guarantor did not know the conditions under the underlying contract. When the beneficiary presents documents for claiming, the guarantor has to pay without proving a default by the applicant. Most demand guarantees issued in practice are payable ‘on demand' or ‘on first demand', which clearly implies that such guarantees create a binding obligation to pay against the simplest of demands by the beneficiary without any proof of any default by the applicant on the underlying contract.

At present, Thailand still has no direct rule concerning the demand guarantee. Therefore, the Civil and Commercial Code of Thailand has to be applied instead for enforcement purposes. However, the use of the Civil and Commercial Code to enforce demand guarantee still does not conform or suitable for the natural characteristics of demand guarantee. Moreover, several rules which have been accepted and approved in international regulations, i.e., UCP 6oo, ISP 98 and URDG 758, are not found in the Civil and Commercial Code or any Thai law and regulation. In addition, UCP 600, ISP 98 and URDG 758 which are used worldwide and stipulate rules concerning the unique characteristics of the demand guarantee that are issued under such rules, for instance as follows:

(1) The demand guarantee governed by UCP 600 or ISP 98 or URDG 758 is independent from the underlying contract or the underlying transaction.

(2) The demand guarantee is irrevocable, even if the demand guarantee issued under UCP 600 or ISP 98 or URDG 758 did not specify that it was irrevocable, it was always irrevocable by itself. However, the parties may negotiate to issue a revocable demand guarantee.

(3) The demand guarantee must specify an expiration date or an expiration event, in a case of issuing a demand guarantee under URDG 758. Regularly, it means that the demand guarantee does not expire until the end of that date. Moreover, the expiry date is the latest date to present documents for claiming. Furthermore, URDG 758 specifies that if the demand guarantee does not specify the expiry date or expiry event, such demand guarantee will terminate after three years

from the issuing date. Thereafter, post the expiry date, the beneficiary has no right to call for payment.

(4) When the beneficiary intends to call for payment, the beneficiary only need presents the documents that identify (link to) that security documents without proof of default under the underlying contract or invoke defense against the beneficiary. Moreover, the guarantor also has to examine the presentation within a reasonable period. In the case of a demand guarantee issued under URDG 758 or UCP 600, the guarantor must consider within five business days. In the case of a demand guarantee issued under ISP 98, the guarantor must determine within seven working days.

(5) When the applicant cannot perform the obligation, the beneficiary and the guarantor have two options; extend or pay. This feature may give the applicant an opportunity to remedy the breach which is better than change a contractor.

The rules of guarantee under the Civil and Commercial Code of Thailand have the characteristics the same as of the suretyship, which are different from the characteristics of the demand guarantee. The particular difference is that the demand guarantee is an independent undertaking from the underlying contract whereas, the suretyship is an accessory contract which the guarantor's obligation to the beneficiary is subject to the performance of the principal debtor under the existing or validity of an underlying transaction or underlying contract. Furthermore, the obligation of the surety is a secondary obligation, which depends on the default of the principal debtor and does not arise until the principal debtor has failed to perform his primary obligation under the underlying contract.

Moreover, the guarantor may deny payment to the beneficiary when he calls for payment because the guarantor has a duty to invoke the applicant's defense against the beneficiary; otherwise, the guarantor may lose the right of recourse with the applicant. This feature is contrary from the pay on first demand characteristic. In addition, in case that the guarantor agrees to be a joint debtor with the applicant, the guarantor has no right to require the applicant to be first called upon to perform the obligation and other executions as specified in Section 688, 689 and 690 of the Civil and Commercial Code. But the guarantor still is not a joint debtor with the applicant

and does not change the status from being a guarantor to being a principal debtor and the guarantor will not be charged as the primary obligation.

According to UCP 600, ISP 98 and URDG 758, they addressed the expiry date and the presentation has to make on or before the expiry date (the claim period). But when the banks in Thailand specify the claim period as a condition in the bank guarantee, the Supreme Court's decisions give two viewpoints as follows:

For the first viewpoint subject to the Supreme Court's Decision No.16947/2557 and No. 2208/2558, the bank guarantee contained a condition that the beneficiary has to demand for payment within a specific period or the bank has no duty to pay to the beneficiary. The Supreme Court decided that the bank reduced the period of prescription due to Section 193/11 of the Civil and Commercial Code which is prohibited.

The other viewpoint subject to the Supreme Court's Decision No.6622/2546 and No.3739/2551 which decided that the bank has the right to specify such clause because it did not reduce the period of prescription subjected to Section 193/11 of the Civil and Commercial Code.

Furthermore, there are several differences between a bank guarantee issued to the private sector and the public sector. The issuing bank guarantee in favor of the beneficiaries, who are the government agencies, have to use bank guarantee templates under the Regulations of the Office of the Prime Minister on Procurement B.E.2535 (1992) which is the strict pattern and does not comply with the characteristics of the demand guarantee.

Accordingly, the practice of the banks in Thailand, they desire to issue a bank guarantee complying with the fundamental characteristics; independent undertaking, documentary in character, no proof of the principal debtor's breach and with similar conditions as specified in UCP 600, ISP 98 or URDG 758 because that rules have advantages to all parties. Therefore, the banks in Thailand usually request the applicant for signing an application form which is an independent contract between the bank and the applicant. The form is also separated from the underlying contract between the applicant and the beneficiary.

In addition, the application form usually contains a condition specifying that if the bank has received the demand for payment from the beneficiary, the

applicant agrees that the bank has the right to make such payment immediately without notifying to the applicant. This clause may be a standard form contract which is defined in Section 3 of the Unfair Contract Terms Act B.E. 2540 (1997). It is a contract that is prescribed in advance and is used by every applicant who requests the bank to issue a bank guarantee. Additionally, it may be the condition gives an unreasonable advantage over the applicant which shall be regarded as unfair contract terms, and it may only be enforceable when they are fair and reasonable. These fundamental legal problems are the main obstacles for developing the necessary instruments to regulate the use of securities against payment in Thailand.

5.2 Recommendations

Since Thailand has no direct law or regulation concerning the demand guarantee. The Author's point of view is that, the issuing bank guarantee in Thailand should comply with the ICC regulations; UCP 600 or ISP 98 or URDG 758, because such rules give advantages to all parties. If the guarantee is found to be an independent guarantee, the beneficiary will be paid immediately and without proving of the applicant's default under the underlying contract. An advantage to the applicant is that if the bank issues the bank guarantee, it shows that the applicant has a financial standing and ability to perform the contract. Furthermore, when the guarantor has received a claim from the beneficiary, the duty of the guarantor is only examination the terms and conditions of the demand guarantee. The guarantor has not the obligation to invoke any applicant's defense against the beneficiary, and then the guarantor can pay without examining a defense of the applicant.

As mentioned previously, the issuing bank guarantee in Thailand should comply with the characteristics of demand guarantee and have the conditions the same as ICC regulations. Therefore the proposed solution for issuing bank guarantee in Thailand is that the designated conditions complying with ICC regulations. Under existing Thai law, the Civil and Commercial Code and the doctrine of freedom of contract and autonomy of will, including Section 150 of the Civil and Commercial Code, the parties of the bank guarantee should comply with the following conditions:

(1) For complying with the independent undertaking characteristic, all parties should agree with the concept that the bank guarantee is separated from the underlying contract. Therefore, there are three (direct demand guarantee) or four (indirect demand guarantee) separate contracts; the underlying contract, the bank guarantee (and the counter-guarantee) and the application.

(2) The bank should specify the expiry date and the claim period for limiting the period of the obligations of the bank (the guarantor) and the applicant (the principal debtor). Therefore the bank will reserve fund for a proper period, and the applicant will not pay a guarantee fee for ten years. In addition, this specification probably forces the beneficiary to claim within the period and to receive the payment over an appropriate duration. If the beneficiary takes a long time to call the claim, the documents which must be used to prove the default of the applicant may disappear.

(3) For complying with pay on demand characteristic, the bank guarantee should specifies a condition that the bank agrees to be a joint debtor with the applicant, so the bank has no right to require that the applicant is first called to perform the obligation and other executions as specified in Section 688, 689 and 690 of the Civil and Commercial Code.

(4) In practice, the bank and its customer, who requests the issue of a bank guarantee, always sign the application form which is the independent contract. In addition, conditions of the application between the bank and the applicant and the bank guarantee must not be unfair to the applicant, for example, the condition that the bank has the right to pay for demand from the beneficiary immediately without notifying to the applicant, because such condition may be unfair term under the Unfair Contract Term Act B.E. 2540 (1997).

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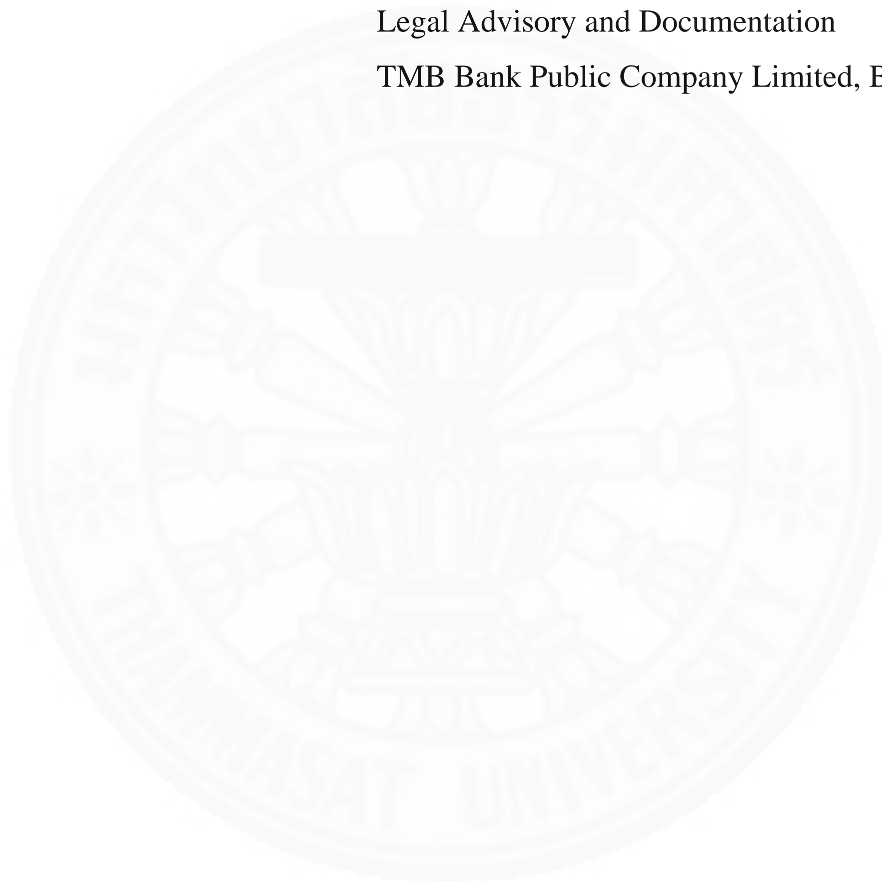

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