Words, drafting and the law

LARS GORTON

"If it had grown up", she said to herself,
"it would have made a dreadfully ugly child:
But it makes rather a handsome pig, I think."
(Alice in *Alice's Adventures in Wonderland*)

1. Some introductory remarks

Hans Jacob Bull has for many years performed various functions at the Scandinavian Institute of Maritime Law (NIFS), University of Oslo, having served as director of the Institute for a considerable period. His primary fields of research have been maritime law including, above all, marine insurance law. Particularly in the case of maritime law, we have a common interest, and over the years our various interests have coincided at a number of points. One such point lies at the intersection of maritime law, sales law, insurance law and the law related to payments and financial undertakings.

Since Hans Jacob will shortly retire from his position at NIFS and the university, it has been decided that this volume of *Simply* will be in his honour, and I am very happy to have been allowed to participate with a small contribution.[1] My choice of topic is neither maritime law nor insurance law, but rather a spectrum of legal questions that may arise in connection with the use of various words that are to some extent found in, and in relation to, insurance. These various words are, however, more commonly related to various payment undertakings and types of financial security and their respective relationships with the underlying contract.

As Samuel Johnson once said, language is the dress of thought, and words may often present lawyers with a dilemma. Words and phrases that are used

[1] Let me also take this opportunity to extend to Hans Jacob and his colleagues at NIFS my thanks for many years of informative and congenial cooperation.

for different purposes may gradually come to have various legal meaning with different implications.[2] Words do not necessarily mean the same thing when used by the legislator and by the contract draftsman. When drafting a contract, the use of certain terminology may make certain rules applicable, while the use of other words may result in the application of other rules. Sometimes it may be hard to determine the legal significance (if any) of certain words, because in a contractual context they may have to be understood in the light of the surrounding circumstances. Against this background I will discuss something of the relationship between the significance of words, the role of custom and trade practice and the role of law.

As is well known, a distinction is normally made between instructions, statements and undertakings, although it is not always easy to distinguish between a statement and an undertaking.[3] It is, however, also important to bear in mind the fact that the words used may have to be construed in the context of various data relevant to their interpretation, such as items regarded as being implied and the behaviour of the parties (although this is generally less true in common law jurisdictions than under Swedish law).[4]

Swedish law will naturally form the basis for this little legal excursion, but I will also make occasional reference to other legal systems for the purposes of illustration.

2. Law and usage and the significance of words

We will take an insurance contract as our point of departure. Insurance normally involves an undertaking by the insurer to pay out a sum of money in

[2] Words may have a particular meaning in one context but not in another. Words that may have certain implications when used in legislation may, when used in a contract, also have to be understood in the context of other facts.

[3] For example, loan agreements commonly contain both "representations" and "covenants". These terms have different legal implications, but where certain legal techniques are applied, a representation may actually have more or less the same effect as a covenant. See, *e.g.*, Cranston, *Principles of banking law,* 2nd ed. London 2002 and Wood, *Law and practice of international finance*, London 2008. Even if this terminology is not used in exactly the same way in other legal systems, it does seem to be recognised at least in international loan agreements.

[4] There are certainly several differences between the Scandinavian and English approaches to interpreting contracts. One example concerns the courts' willingness (or not) to fill in "gaps", but having said that, it appears that the fundamental differences in approach have been lessening to some extent.

the event the insured has a valid claim under the insurance policy.[5] Roughly speaking, insurance involves an undertaking by the insurer to cover an economic loss incurred by the insured. The insurance may relate to an underlying agreement, such as a sales agreement, that contains certain agreed conditions.[6] The insurance undertaking normally contains a promise by the insurer to cover, either generally or on specific terms, such risks as the insured party may encounter, whether this is the risk of loss or damage to an insured item, or the risk of the insured encountering liability, *etc.* One particular type of insurance, credit insurance, covers losses that may be encountered under a financial agreement. This type of insurance may be drafted in words that are similar to those of a financial guarantee.

In several other types of agreements we find similar, although not identical types of undertakings, *e.g.*, in connection with payments and certain financial undertakings.[7] Many of these types of transactions have their roots in *lex mercatoria*[8] and have often developed step-by-step into their present

5 As stated in *Black's Law Dictionary*, 4th ed. 1951: "An /insurance/ contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils."

6 Taking a sales contract as an example, there will often be a clause setting out which of the parties is to bear certain costs and risks. The parties will, for example, often agree on a particular Incoterms clause (Incoterms as drafted by the ICC, the most recent version as amended in 2010) to specify the particular allocation of costs and risk as between the seller and the buyer.

7 Credit insurance is a particular type of insurance taken out by an insured party at risk of encountering specific financial losses, *i.e.*, losses due to other types of events than physical events (such as damage to or loss of goods), political events, *force majeure* events. Risks under credit insurance have often proved very hard to determine precisely in advance, since the traditional insurance methods for determining risk are not available. Traditional insurance risks are predetermined and are absorbed in a different way than financial risks under, *e.g.*, a loan agreement, where the lender will have to assess the risk of default by the borrower. By lending the lender has parted with money, but in traditional insurance the insurer often has a limitation clause and will be liable to pay out only in certain agreed circumstances.

8 The law merchant, or *lex mercatoria*, has been dealt with in many connections. For example, Schmitthoff attempted to establish a modern *lex mercatoria*, see Schmitthoff, *Nature and evolution of the transnational law of commercial transactions* (see *The Transnational law of international commercial transactions*, ed. by N. Horn and C. Schmitthoff, Deventer 1982 p. 19), while Roy Goode in *A new international Lex Mercatoria*, JT 1999–2000 p. 253 *et seq.* discusses its use and development particularly in relation to the recent creations of the Unidroit Principles of Commercial Contracts (PICC) and the European Principles of Contract Law (PECL). Cranston has approached the topic from a slightly different perspective in *Law Through Practice: London and Liverpool. Commodity Markets C.1820–1975*, in *Liber Amicorum Guido Alpa*, *Private law beyond the national systems*, ed.

form. During this process of change and amendment, legislation has sometimes been introduced in order to give the original transactions a more precise and solid legal foundation.

So this is the area we are navigating in an attempt to establish how words and phrases may be carried into different areas of the law. In the following I provide some examples, as well as analysing some of these undertakings in the light of various legal frameworks. In doing so I also try to illustrate how various undertakings may stem from different backgrounds and then may gradually develop from undertakings of a more general character to take on more specific functions. By drafting an undertaking or a statement in a particular way and by using particular phrases, the parties will often intend certain rules to apply.[9]

Sometimes, however, the parties may not have foreseen the precise effect of the words used in a particular case. They may have misunderstood each other, or they may have misinterpreted a particular word in a particular situation or attributed to it different meanings. As a result we will also have to pay some attention to questions related to the construction and interpretation of contracts.[10]

by M. Andenas, S. Diaz Alabarta, Sir B. Markesinis, H. Micklitz & N Pasquini, London 2007 p. 290 *et seq.* See also Berger, *The creeping codification of the lex mercatoria*, London & The Hague 1999 p. 135 *et seq.* and Annex 1.

9 Related questions have been touched upon by Ingvarsson in *Borgensliknande säkerheter*, Stockholm 2000, in which, in chapter 14, he deals specifically with guarantees issued in the form of insurance. He also deals with the question whether a guarantee issued by an insurance company should be regarded as insurance or as a guarantee and concludes that this type of undertaking should rather be regarded as a form of insurance. My personal view, expressed in *Något om gränsdragningen mellan borgen och kreditförsäkring, Festskrift till Børge Dahl*, København 1994 p. 85 *et seq.*, is that the functions of the undertaking itself rather than the entity making the undertaking should be decisive. That view was not shared by the arbitrators in the case on which the article was based.

10 Words and phrases used in a contract may have precise meanings, but they may also have to be construed against the background in which they are applied. See, *e.g.*, regarding Swedish law, Ramberg, *Medveten avtalsotydlighet*, JT 1989–90 s. 639, Ramberg & Ramberg, *Allmän avtalsrätt*, 8 ed. Stockhoolm 2010 p. 152 and Adlercreutz & Gorton, *Avtalsrätt II*, 6th ed. Lund 2010 p. 146 *et seq.*

3. Different types of payment undertakings

3.1 Some general points

Payments and financial undertakings may have similar bases.[11] Payments are basically primary in nature. In other words, the obligor has a primary duty to pay on certain terms and conditions, *e.g.*, the buyer's duty to pay under a sales contract, the borrower's under a loan agreement *etc.* This is also the case, for example, under a "note of indebtedness",[12] which might be worded along the following lines: "I shall (re)pay to you (NN) the amount of USD XX on … day". Other undertaking can be added to this very simple basic formula, such as the payment of interest, amortisation, *etc.*[13]

A financial security is often based on an underlying transaction. In other words, the security is consequential on an undertaking that is set out in the underlying transaction. As already mentioned, a payment is sometimes based on an instruction to pay ("pay to X the sum of …against …). This was the case historically with letters of credit. A letter of credit was a document that a traveller could carry with him for presentation to a particular person who would make payment to the bearer ("pay to NN bearing this letter a sum of …") in return for the instructing party's promise to reimburse the sum con-

[11] I should emphasise that various new payment methods have been introduced during recent decades, see *e.g.* Arnesdotter, *Moderna betalningsmetoder: betalning och girering*, Stockholm 1995 and Lehrberg, *Moderna betalningsformer*, 3rd ed. 2005.

[12] Swedish law makes a distinction between an instruction to pay (*e.g.*, in connection with a bill of exchange) and an undertaking to pay (*e.g.*, under a promissory note). Since the late 1930s, the Nordic countries have had identical legislation on instruments that under these legal systems are considered to constitute promissory notes. The Swedish statute is known as *lag (1936:81) om skuldebrev*. Since the term "promissory note" may not have exactly the same meaning in Swedish law as in common law jurisdictions, parties involved in international transactions instead use the term "note of indebtedness", and for that reason I sometimes use this term here. See, *e.g.*, Rowe, *Bills of exchange and promissory notes in the law of international trade finance* (in *The law of international trade finance*, ed. N. Horn), Deventer 1999 p. 243 *et seq.* Rowe states that a bill of exchange is an order to another party to pay, but that a promissory note is a promise of payment by the person who signs it. Both documents are by their nature negotiable instruments. In Swedish law only documents issued in favour of "[a named person] or to order" or to "the bearer" are negotiable, but an "*enkelt skuldebrev*" ("I will pay to [a named person]") is not. In footnote 24 below I refer to a recent Swedish Supreme Court decision, in which it was held that the holder of a negotiable promissory note could not rely on the issuer's payment undertaking.

[13] Such a payment undertaking may be related to a specific plan of repayment such as "payable in X instalments each of … USD XX and the payment of interest at the rate of Y percent above LIBOR until fully repaid". It may also be repayable *on demand*.

cerned.[14] The same basic concept is embodied today in cheques and bills of exchange. The issuance of a cheque or bill of exchange is generally done in compliance with a requirement in an underlying transaction. Taking a functional approach, this is also the concept underlying modern letters of credit and on-demand guarantees (as well as suretyships), where an underlying transaction triggers the issuance of a letter of credit or a guarantee. Some of these instruments are independent of the underlying contract, others, however, are not.

If a payment takes place in advance or on a "Zug-um-Zug" basis (*i.e.*, payment is made upon counterperformance by the other party), there will not normally be any need for financial security, but in other cases a secondary payment undertaking may be called for. In other words, a second obligor promises to pay if the first obligor defaults on his contractual duty to do so.

Depending on how any such secondary payment undertaking is drafted, the second obligor may take on a payment duty that is *either* secondary to that of the primary obligor *or* primary, *i.e.*, on the same level as that of the primary obligor. Naturally this makes a difference. Such an undertaking is, however, basically an "accessory" to the underlying transaction, although the undertaking may also be designed as an *independent* undertaking, possibly drafted in a somewhat different way.[15]

Accordingly, depending on how the undertaking is drafted, the primary obligor and the secondary obligor may be liable to pay the payee (sometimes known as the beneficiary) in a certain sequence, *i.e.*, the primary obligor first, then – only if the latter defaults – the secondary obligor. In other cases the beneficiary may opt to direct his claim against either one of them. In some cases the guarantee may be of an independent nature, in which case the guarantor will be liable to make payment irrespective of the validity of the underlying transaction. In all cases the question of redress may also arise, so that payment liability ultimately rests with the party responsible under the various agreements.

Accordingly it will be necessary to evaluate the payment undertaking and the role of the financial security, which may sometimes be closer to, or even equivalent to, a payment undertaking.

[14] See Gorton, *Rembursträtt*, Lund 1980, p. 26 *et seq.* with references.

[15] Some guarantees are commonly made out as "irrevocable, payable on demand and independent [from the underlying transaction]", as will be further discussed below. "Independent" is the term used in the Uncitral international convention on independent guarantees and standby letters of credit.

4. Various statements/undertakings and the relevant legal frameworks

4.1 In general

A financial undertaking (whether a payment, a loan, a guarantee, a suretyship or other form of undertaking) may be given by any person, *i.e.*, by a private or legal person, or by a private or public entity.[16] This means that there is a limited amount of legislation specifically regulating the various financial undertakings given, and so to a large extent they will have to be interpreted and construed in accordance with their wording and against the background of particular and general legal rules. These may include restrictions on the ability of certain entities to get involved in certain dealings, as well as rules on unreasonable contract terms. As a result the involvement of certain entities in particular dealings has been questioned, *e.g.*, on the basis of the doctrine of *ultra vires*, or because the person signing the document was not regarded as having authority to do so, or due to the "piercing the corporate veil" doctrine, or for another reason.[17]

To consider some somewhat similar examples in Swedish law (although not involving *ultra vires* questions), in case 1992 s. 375, the Supreme Court dealt with a situation that also involved to some extent the question of piercing the corporate veil. In this case a local authority had issued a letter of comfort spelling out its intention to retain its majority stake in a certain entity and also to maintain a long-term policy of operating the entity in such a manner as to enable it to fulfil its obligations *vis-à-vis* the bank. The questions arose whether the wording constituted an undertaking or not, whether the local authority was entitled to involve itself in such deal and whether, due to the "piercing the corporate veil" doctrine, the local authority would be li-

[16] A general survey of personal financial security is found in the study on Personal Security (PEL Pers. Sec.) in one of the books in the *Principles of European Law* project, Munich 2007, prepared by U. Drobnig. There are provisions on dependent personal security (suretyship gurantees), as well as independent personal security (indemnities/independent guarantees). In the study, reference is made to the UCP, the URDG, as well as to the Convention on Independent Guarantees, see p. 321 *et seq.*, which will all be discussed further below.

[17] In English law the *ultra vires* question was considered in a couple of cases during the 1990s, namley *Hazell v. Hammersmith and Fulham London Borough Council* /1992/ 2 AC 1 and *Kleinwort Benson v. Lincoln City Council* /1999/ 2 AC 349. Related questions have been discussed by McCormack, *Legal risk in the financial markets*, Oxford 2006 pp. 35 *et seq.*

able. The Supreme Court discussed the use and the relevance of letters of comfort, but found that the bank was fully aware of the situation and could have protected its interests by demanding better financial security. The court concluded that under the circumstances there was no liability on the part of the local authority.

Under Swedish law the question of authority in connection with financial undertakings and banks has been illustrated in two cases from 2001 and 2002. In the first case (NJA 2001 p. 191), the Supreme Court concluded that a bank officer (a branch manager) was authorised to bind the bank when releasing some private guarantors from their guarantee undertaking *vis-à-vis* the bank. In the second case (NJA 2002 p. 244), however, a bank officer holding a similar position but in a smaller branch was considered not to have bound the bank when issuing a bank guarantee for a substantial amount. This was because the transaction was regarded as both unusual and unusually large for a relatively small branch.[18]

Below I will discuss some of the wording used in connection with letters of comfort and financial undertakings.

4.2 Letters of comfort

Although not generally designed to constitute definitive payment undertakings, we should mention "letters of comfort" in this context.[19] The main reason for starting our discussion with the "letter of comfort" is that it has no clear legal significance, and so its legal effect will depend on its wording and other circumstances. This is an area where there is no solution to be found in legislation in either Swedish or English law, which means the court has to fall back on principles for the interpretation of contracts.[20] This is particu-

[18] The first case dealt with an ordinary suretyship, while the latter concerned the issuance of an on-demand guarantee.

[19] Letters of comfort are sometimes referred to as letters of awareness or letters of intent. The terminology varies and the contents and functions of any particular document are often not very precise. It is questionable whether they really comprise a contractual undertaking or should rather be considered as statements lacking any precise legal contractual implications. In Nordic legal doctrine works on this topic include Røsaeg, *Garantier eller fattigmans trøst? Støtteerklaeringer i selskapsforhold av typen "comfort letters"*, Oslo 1992, but reference can also be made to Iversen, *Støtteerklaeringer*, København 1994 and Gäverth, *Stödbrev – borgensliknande handlingar utställda företrädesvis för svagt kapialiserade bolag*, Uppsala 1994.

[20] The situation is similar in the other Nordic countries, as it is in many other countries, *i.e.*, the significance of how a contract is drafted has to be determined taking into considera-

larly difficult when the wording used does not necessarily imply a particular understanding between the parties, who in fact are often in disagreement as to they wish to achieve with their chosen wording, and also frequently on what (if anything) they have actually agreed. The court will then have to revert to general principles for the interpretation and construction of contracts. This means that different factors may have to be taken into consideration, such as the common intention of the parties, the wording used by the parties, implied undertakings *etc.* The Swedish case NJA 1995 p. 586 thus illustrates a different approach to that taken, as in *Kleinwort Benson v. Malaysia Mining*, under English law.

If the parties have used words signifying a clear undertaking, there will undoubtedly be a contractual obligation to that effect.[21] But a mere statement will hardly give rise to a legal obligation, although certain wording taken in the context of the surrounding circumstances could conceivably impose some kind of legal obligation, even if this is not contractual in nature.[22] Alternatively, a statement may not have any legal consequence at all.

This means that the result when words are taken independently may differ from the result when they are taken together with the common intention of the parties. In some circumstances a phrase may have no legal significance, but in view of the circumstances it may either cause some obligation to arise ("*culpa in contrahendo*" – a concept not generally accepted in English common law) or may even constitute an explicit undertaking.

tion the principles for interpreting contracts developed in different legal systems. See, *e.g.*, in Swedish Supreme court practice NJA 1992 p. 375, NJA 1994 p. 204 and NJA 1995 p. 586. English case law in this area is very sparse and the most widely discussed case is a Court of Appeal decision, *Kleinwort Benson v. Malaysia Mining Corporation* /1989/ 1 Lloyd's Rep. 556. The Court of Appeal held that the wording used did not constitute an undertaking but should rather be regarded as a statement that probably involved an undertaking for a short time after it was given. See, *i.a.*, Treitel, *An outline of the law of contract*. Oxford 6th ed. 2004 p. 60.

21 In NJA 1995 p. 586, the Swedish Supreme Court applied interpretative principles to come to the opposite conclusion to that reached by the English court in *Kleinwort Benson v. Malaysia Mining*, *i.e.*, that there was a binding undertaking, see footnote 20.

22 This seems to be the reasoning behind the Supreme Court decision in NJA 1994 p. 204. The first person in Swedish legal doctrine to deal with the topic was Knut Rodhe who, in *Moderbolags ansvar för dotterbolags skulder, Festskrift till Jan Hellner*, Stockholm 1994 pp. 481 *et seq.* and pp. 494 *et seq.* enumerated a number of phrases used when drafting letters of comfort. These different formulations may have different effects.

4.3 "I shall pay to you"

The phrase quoted above would, in Swedish (Scandinavian) law, basically be covered by the Promissory Notes Act (*Lagen 1936:81 om skuldebrev*). It is a simple statement announcing the debtor's undertaking to pay to the creditor a certain sum on a specific date (or dates), either on demand or in accordance with a repayment schedule.[23] Such a payment undertaking often reflects the receipt of a loan, but it could also reflect, for example, an open credit under a sales agreement. The Act provides that the promissory note can be made out to a named person only (in which case it is not negotiable or transferable and will sometimes be referred to as a "note of indebtedness"), to a named person or to order or to the bearer. In the two latter cases a new holder of the note will have a direct claim against the debtor.

If the debt is in the form of a document made in favour of "[a named person] or to order" or to "the bearer", the debtor has a primary duty to pay as agreed. Such a duty exists unless there is no valid underlying contract, for example, where the loan agreement is not enforceable for other reasons. This would be the case in a situation where the debtor has a counterclaim against the creditor *in specie*, for instance because the goods sold did not comply with the terms and conditions of the sales contract. This means that the payment undertaking may in some cases be subject to the validity of the creditor's claim under the underlying transaction, but in general the holder in good faith of a note made "[to a named person] or to order" or to "the bearer" will be entitled to payment.[24]

[23] Similarly the buyer may undertake to pay the seller in exchange for goods delivered. In Swedish law this follows from art. 48 of the Swedish Purchase Act, *cf.* also art. 49.

[24] In an interesting Swedish case (case no. T 4904-08), the Supreme Court decided in a decision dated 16 September 2010 that the negotiability of a promissory note under certain circumstances ceases when the promissory note has been transferred in such a way that the obligor has not been in a position to have it returned. The case concerned promissory notes that had been signed by the debtor several years previously and had been transferred to another holder. The question was whether the debtor under a negotiable promissory note was entitled to claim that it had already been paid. Pursuant to art. 15 of the Promissory Notes Act, a debtor could do this only if the holder could be proved to have been aware that payment had already been made. However, the Supreme Court held that, under circumstances such as those at hand, holders of promissory notes (at least if they were financial institutions) would have to prove that payment had not been made. This is an example of the court modifying legislative provisions.

4.4 "We guarantee the due repayment by … to you"

In Swedish law, so-called personal guarantees (suretyships, in Swedish "*borgen*") are governed by the rather rudimentary legal rules of the Swedish "commercial book" ("*HB*").[25] There are also a number of academic books and articles dealing with related topics.[26] Swedish law, like a number of other legal systems, distinguishes between a joint guarantee ("*enkel borgen*" *(HB 10:8)*) and a joint and several guarantee ("*proprieborgen*" *(HB 10:9)*). The former is the basic version, signifying a suretyship/guarantee that imposes on the surety a secondary duty to pay the payee (the beneficiary) in the event the primary obligor fails to pay. Thus it is a guarantee of a secondary nature: its function is to make sure that the beneficiary gets paid, but only if the primary debtor fails to do so. In Swedish law this means that the party entitled to performance must use all reasonable measures against the primary debtor before turning to the surety, although the creditor does not have to wait for the bankruptcy of the debtor, since the debtor's inability to pay will suffice to allow the creditor to claim against the surety.

Although the legislation appears to deal with private persons acting as sureties (guarantors), it may also involve suretyships (guarantees) issued by legal entities, especially banks. Banks always charge a fee for issuing a guarantee, whereas a private person acting as a surety would rarely request any remuneration. This is a difference of some practical significance.[27]

4.5 "We guarantee as for our own debt the due repayment by … to you"

In contrast to the situation with a joint guarantee ("*enkel borgen*"), the wording (as quoted above) of a joint and several guarantee ("*proprieborgen*") makes the guarantor (the surety) and the primary debtor equally liable to pay the beneficiary. Thus the beneficiary is entitled to turn towards either of the two for payment – there is no requirement first to demand payment from the primary debtor. In practice, however, a bank as payee would normally first pur-

[25] Known as *Handelsbalken* and containing some few sections on personal guarantees in 10:8–10:12.

[26] See *i.a.* Bergström, *Några problem rörande bankgaranti. i Teori och praxis. Skrifter tillägnade Hjalmar Karlgren*, Stockholm 1964 p. 21 *et seq.*, *Lennander, Kredit och säkerhet. Lärobok i krediträtt*. 9 ed. Uppsala 2006 p. 37 *et seq.* and Walin, *Borgen och tredjemansrätt*, 3 ed. Stockholm 2002 p. 25 *et seq.*

[27] See the discussion in Bergström p. 21 *et seq.*

sue the primary debtor for payment before claiming from the surety.[28] This is also how banks generally describe the situation when negotiating a "*proprieborgen*", but the law is clear on the fact that the payee could turn against either.[29] A "*proprieborgen*" is, however, dependent on ("accessory to") the validity of the underlying transaction.

4.6 "We guarantee the due performance by … under the…"

In general a suretyship is a financial guarantee, *i.e.*, the guarantor is liable to pay an amount of money, *e.g.*, the debt of the primary debtor. A guarantee may, however, also consist of the surety's secondary undertaking to perform *in specie* in accordance with the primary obligor's duty to perform its contractual obligations. Consequently, the guarantor may, depending on the drafting of the guarantee and other circumstances, either have a duty to perform the contract *in specie* or to pay damages if the primary obligor fails to do so.

It is not always clear whether a guarantee is of one type or the other. Nor is it always clear whether the undertaking is only of a secondary nature (*i.e.*, the guarantor will only become liable if it becomes clear that the primary obligor will not perform). A guarantee may sometimes clearly set out that it is a guarantee *in specie*. Parent company guarantees given for the performance of a subsidiary may sometimes be of this type, and guarantees may also be given by particular companies undertaking to perform an underlying contract if the primary obligor fails to perform.

Banks do not normally issue this type of undertaking, since they would not agree to perform *in specie*, but only by providing financial compensation. However it is not unusual for the World Bank, when lending money to construction projects, to request a substitute construction firm to undertake to step in and perform the contract if the first contractor defaults.[30]

[28] In Norway the *Lov om finansavtaler of finansoppdrag (Finansavtaleloven)* from June 25, 1999 and July 1, 2000 contains a number of rather detailed provisions on suretyships and the relationship between the parties involved.

[29] Another possible question is whether banks, by stating that they would not first claim payment from the surety, create a trade practice to this effect, preventing them from falling back on the primary undertaking by the surety.

[30] In project finance and PP projects, the financers fairly commonly demand the inclusion in the contract documentation of a so-called "step-in rights" clause, entitling them to take over the project if the debtor defaults.

4.7 "We shall pay to … against the presentation of the following documents."

In letters of credit (documentary credits) the payment statement made by the bank (the opening bank or the issuing bank, or the confirming bank as the case may be[31]) sets out the bank's obligation to pay the beneficiary (often the seller), against the presentation by the latter of certain enumerated documents (such as an invoice, insurance documents, transport documents *etc.*), either a fixed amount of money or an amount of money subject to a stated maximum. This payment method should already have been agreed between the seller and the buyer in the sales contract. This contract should form the basis for the drafting of the letter of credit by the opening bank when issuing the credit. Consequently the bank steps into the shoes of the buyer as the primary payor. The bank's undertaking in this case not only provides security for the payment, but is an immediate promise of payment, provided that the beneficiary presents the correct documents. In this sense the bank's undertaking differs from those discussed previously. The bank will, of course have a redress claim against the buyer.[32]

The way a letter of credit is drafted reflects the trading nature of the document, *i.e.*, it is a payment device entitling the seller (the beneficiary) to receive the price of the goods in exchange for presentation of the agreed documents.[33] Under the prevailing rules (presently the UCP 600), the documents presented should conform with the requirements of the letter of credit as well as those of the UCP 600,[34] to which most letters of credit refer.

The question of conforming documents is probably the single most disputed issue in relation to letters of credit, and also concerns the issue of fraud

[31] The issuing or opening bank promises to pay irrevocably and the confirming bank adds its independent payment undertaking, see definitions and art. 7 of the UCP 600.

[32] In practice a bank, when undertaking to issue the letter of credit, will either demand payment of the relevant amount into an account or grant a specific credit to the buyer. Alternatively the buyer may use an existing credit facility.

[33] In Gorton, *Sammanflätade avtal – några reflektioner, särskilt med avseende på relationen mellan köp och remburs*. The *Stockholm Centre for Commercial Law Årsbok I*, Stockholm 2008 p. 55 contains a discussion on the relationship between the letter of credit and the underlying transaction. As follows from arts 4 and 5 of the UCP 600, the letter of credit is explicitly separate from the underlying transaction, although the underlying transaction is the basis for the letter of credit.

[34] See *i.a.* Kurkela, *Letters of credit and bank guarantees under international trade law*, 2nd ed. Oxford 2008 and his comments with respect to art. 14 (standard for examination), art. 15 (complying presentation) and art. 16 (discrepant documents, waiver and notice) in UCP 600.

either under or in the document itself. This is also an area where we may encounter a variety of national material or procedural legal rules.[35]

4.8 "We shall pay you unconditionally and on first demand".

The phrase quoted above basically reflects the wording of a so-called on-demand guarantee.[36] Generally an on-demand guarantee will refer to an underlying transaction, which might be a loan, a sale, a construction contract or virtually anything else. Like a letter of credit, however, it is *independent* from the underlying contract. In the URDG this follows from art. 5 and 6.[37]

Although the wording used is for all practical purposes that of a primary obligation, the function of an on-demand guarantee is secondary in nature. It is not intended to be used as an immediate payment undertaking, but rather to provide financial security if the primary debtor fails to pay.[38] The guarantee's wording, however, makes it an immediate payment undertaking, and the guarantor cannot refuse to pay on the grounds that the claim should first have been directed towards the primary debtor.[39] The wording appears close to that of documents referred to above as promissory notes or notes of indebtedness. The words "first demand" entitle the holder to demand payment on first demand, while the word "unconditionally" makes the guarantee an independent undertaking, *i.e.*, the beneficiary is entitled to payment whether or not the underlying transaction is enforceable, as well as in circumstances where there is a breach of contract or similar.[40]

[35] See *i.a.* Schmitthoff, *International and procedural aspects of letters of credit* (in *The law of international trade finance*, ed. by N. Horn) p. 227 *et seq.* Related questions concerning fraud often arise in connection with documents presented, see *e.g.* also Gorton, *Seller's or shipper's fraud* (in *Maritime fraud*, ed. by K. Grönfors, Gothenburg 1984 – Swedish Maritime Law Association no. 64) p. 27 *et seq.*

[36] See Bertrams, *Bank guarantees in international trade*. 3rd rev. ed. ICC 2004, which also refers to ISP 98, the International Standby Practices. Bertram's book is probably the most comprehensive available on bank guarantees.

[37] *Cf.* corresponding articles in UCP 600 4 and 5.

[38] We should mention that on-demand guarantees, at least in some instances, were developed to function as an alternative to advance payments.

[39] The URDG, in articles 14, 15 and 16, contains provisions for making a call under the guarantee.

[40] Here again it is fundamentally important to recognise that the duty to pay out under the guarantee does *not* mean that a wrongful demand may *not* be questioned in relation to the underlying transaction. The effect of the duty to pay out is that the beneficiary is entitled to obtain the money and keep it until his right to the money under the underlying trans-

As long as there was no particular regulation with respect to on-demand guarantees, national courts had to deal with the legal problems arising out of them, taking as their point of departure the law relating to payment undertakings, the law related to suretyships, the principles for the interpretation of contracts *etc.*

In the only Swedish Supreme Court case[41] so far to deal with on-demand guarantees, the following wording had been discussed by the parties:

> "As security for a short turn facility which you have granted to Mr. J.-E. M., Gotabanken hereby unconditionally and irrecocably guarantee as for your debt the amount of SEK 50 000 000:- …"

This type of wording is frequently used in on-demand guarantees. In this case the undertaking was not signed. There was also another undertaking, which was the one central to the case (here in English translation):

> "Subsequent to a sales agreement made concerning the acquisition of shares in /company/ between you as seller and /Y company/ as buyer, we undertake to pay at the earliest on 1988-09-022 on your first written demand the amount of SEK …"[42]

Again these words illustrate the relative proximity of an on-demand guarantee to a promissory note payable on demand. The Swedish Supreme Court in this case accepted the independent nature of this type of guarantee. In its discussion the court also referred to the importance of the then-prevailing URDG 458 and the UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit, neither of which was, however, applicable to

action has been determined. In this sense the guarantee does give the beneficiary the same financial security as an advance payment. See the English case *Cargill v. Bangladesh* /1996/ 2 Lloyd's Rep. 524. Should the guarantee cover liability under a liquidated damages clause, the payment under the guarantee will be affected by the underlying transaction only in the rare circumstances that the liquidated damages clause is set aside.

41 In Swedish law, where very few Supreme Court cases have involved on-demand guarantees or, for that matter, letters of credit, the Supreme Court judgment in NJA 2002 p. 244 concerned an on-demand guarantee. This case has been discussed by, among others, Håstad, *Något om demand-garantier*, in *Festskrift till Lars Gorton*, Lund 2007 p. 185 *et seq.*

42 The Swedish text says: "*Mot bakgrund av att köpeavtal träffats om förvärv av aktier i Ibis A/S mellan Er såsom säljare och DC Management AB såsom köpare, förbinder vi oss att tidigast 1988-09-22 på er första skriftliga anmodan erlägga SEK …*" This text is apparently close to that found in promissory notes.

the case. Their mention in the court's reasoning was intended to illustrate the nature and functions of on-demand guarantees.

On-demand guarantees have been in use for at least 30–40 years, but have not been regulated by any particular rules. This means that when determining the effect of the words used, a court has to decide on the relevant legal framework (by looking at, *e.g.*, the wording, case law, other similar transaction types *etc.*). This is also how on-demand guarantees have evolved and how they have been interpreted against a background of promissory notes, suretyships, letters of credit *etc.* Various courts have also had to determine issues concerning fraud and abuse.[43]

4.9 Standby letters of credit

Another beast in our collection is the standby letter of credit (or standby credit), which is for all practical purposes an on-demand guarantee dressed up as a letter of credit. Standby credits developed in the United States, where banking regulation stopped banks from issuing guarantees as a separate business, causing the banks instead to operate an equivalent business based on standby credits.[44] Standby credits are nowadays offered by many banks as an alternative to on-demand guarantees. Standby credits are also covered by the UCP 600, although their functions are not identical to those of on-demand guarantees (thus they are not intended to be payment undertakings). They cannot be drafted as primary undertakings, but the intention is to provide financial security rather than a payment undertaking. They are thus not the equivalent of traditional letters of credit.[45] Standby credits are furthermore covered by the URDG 758, and the Convention on Independent Guarantees and Stand-by Letters of Credit is drafted to apply also to standby credits. Furthermore, a dedicated set of principles has been developed for standby credits, namely the International Standby Practices 98 (ISP 98).

[43] This is illustrated in the English case *Edward Owen v. Barclays Bank International* /1978/ 1 Lloyd's Rep. 166 (*cf.* at p. 171 .2). The case of *Turkiye Is Bank v. Bank of China* /1998/ 1 Lloyd's Rep. also referred to the Owen test. See also Debattista, *Performance bonds and letters of credit: a cracked mirror image*. *In Festskrift till Jan Ramberg*, Stockholm 1996, p. 101 *et seq.*, where the author discusses the similarities and differences between fraud in connection with letters of credit and abuse in connection with on-demand guarantees.

[44] See *e.g.* art. 1 in UCP 600.

[45] Standby credits developed in the US, see *e.g.* Gorton, Rembursrätt *i.a.* p. 42 and 116 and Kurkela.

4.10 "We shall indemnify you"

Some mention should also be made of so-called "indemnities" or "hold harmless" clauses, which may have a function similar to that of a guarantee, although in other cases they may operate similarly to exemption clauses.[46] In English law, such indemnity clauses have been described as "clauses by which one party undertakes to indemnify the other party for any liability incurred by the latter in the performance of a contract; for example where equipment is hired out with a driver and the contract provides that the hirer is to indemnify for any liability incurred by the owner as a result of the driver's negligence. In Swedish law, it follows as a general principle of obligatory law that a contracting party will not be able to contract out of his liability in case of intentional or (probably) gross negligence/recklessness.[47]

No particular legislative framework exists with respect to indemnities, but like "letters of comfort" they have to be understood and interpreted in accordance with their wording and other relevant data.

An indemnity may thus have to be distinguished from a guarantee, but may also have to be seen, in Swedish law, in the light of section 36 of the Swedish Contract Act and, in English law, of the Unfair Contract Terms Act. In English law, the doctrine of consideration may also be significant.

Suretyships and guarantees sometimes contain specific clauses with regard to indemnities but, as mentioned above, it will otherwise follow from general principles of mandatory law that a guarantor who has made a payment to the creditor is entitled to take over the creditor's claim against the primary debtor. In the UCP 600, article 13 explicitly provides for bank-to-bank reimbursement arrangements.

> We should also mention the use of letters of indemnity (often known as back letters) in connection with the ocean carriage of goods and practices concerning transport documents. The issuance of clean bills of lading has for decades often involved the issuance of a back letter by the shipper. The carrier may thus have issued a clean bill of lading to the shipper in exchange for a back letter. This back letter sets out a promise to hold the carrier harmless for all consequences of having issued the clean document, even though it should have been marked with a reservation.[48] In many jurisdictions this practice is illegal, and the Swedish Mar-

[46] See *Anson's law of contract* (by J. Beatson) where related questions are discussed on p. 78 *et seq.*

[47] Treitel p. 105. See also McKendrick, *Contract law*, 7th ed. London 2007 p. 237 *et seq.* and 245.

[48] *I.a.*, Grönfors, *Inledning till transporträtten*, 2, ed. Stockholm 1989, p. 102.

itime Code at 13:51 contains provisions to similar effect. A carrier may also in connection with the delivery of cargo without presentation of a bill of lading request the cargo receiver to undertake to indemnify the carrier for all consequences thereof. This undertaking may sometimes also backed by a bank guarantee.[49]

5. Legislation, case law, *lex mercatoria* and contract law

5.1 Some general points

As we have seen, the use of the various words discussed above may lead us into different areas of the law. In some cases and in some countries legislation applies, while in other cases the words' meanings and functions have to be determined on the basis of the law of contract. In some instances the rules that have developed – whether contained in legislation, case law or standard terms – go back to *lex mercatoria* and have evolved into specialised transactions and documents used for trading and financing.

Although many jurisdictions have general contract legislation, this is not the case, for instance, in English law. Specific aspects of English contract law are, however, regulated by statues such as the Unreasonable Contract Terms Act, the Misrepresentation Act and the Contracts (Rights of Third Parties) Act. All the Nordic countries have more-or-less identical Contracts Acts (with rules on contractual formation, contractual invalidity and authority to enter into contracts), but there is no legislation concerning the interpretation (or construction) of contracts.[50] In these jurisdictions the principles applied for the interpretation of contracts have developed entirely in case law.[51]

Contract law is the basis for the understanding of most of the undertakings discussed in this article. Thus the law of contract forms an overall framework for many of these instruments. Even where a particular financial product is regulated by specific legislation or rules or standard forms, the law of

[49] Regarding this practice see, *i.a.*, Gorton, *Transporträtt. En översikt*. 2nd ed. Stockholm 2003 p. 80.

[50] Those acts were introduced in the 1910s and the 1920s. *Cf. Avtalslagen 90 år* (ed. B. Flodgren, L. Gorton, E. Lindell-Frantz & P. Samuelsson), p. 9. We should also mention, however, that much case law has been needed to establish the precise details of contract law, even where the issues are covered by legislation.

[51] This means that Nordic textbooks on contract law, like English textbooks, contain large sections setting out the principles for the construction and interpretation of contracts. It is worth mentioning that the PICC as well as the PECL contain particular sections on the interpretation of contracts.

contract may also have to be applied in order fully to understand the transaction or document. Accordingly the meaning of a suretyship may have to be construed in accordance with principles derived from the law of contract. Similarly, a letter of credit, although principally regulated by the UCP, like a guarantee regulated by the URDG, may have to be supplemented by applying principles from the law of contract.[52]

In the legal area we are dealing with here, the current rules may have rather different roots. In some cases there is specific legislation (sometimes developed out of principles stemming from *lex mercatoria* and later developed into national law as well as into international conventions, which have then been adopted in many national jurisdictions). Thus the bill of exchange has its roots in *lex mercatoria*, but the relevant principles have subsequently been embodied in specific legislation. Later the need for harmonisation resulted in efforts to effect international conventions.

There is thus presently much national legislation on bills of exchange, sometimes based on one of the international conventions, but in some countries none of the international conventions have been adopted. In English law, the Bills of Exchange Act was passed as early as 1909 and is a very comprehensive piece of legislation. With regard to promissory notes, the Nordic countries have their own near-identical statutes, following the adoption of the Swedish Promissory Notes Act in 1936.[53]

In other cases, as we have seen, specific national rules have developed, *e.g.*, in relation to the traditional suretyship. In some cases, however, (basically where particular trade practices are involved) we can follow the evolution of particular sets of international rules.

Some special mention should be made of letters of credit and on-demand guarantees and the surrounding legal frameworks. I have chosen these documents in particular as the relevant legal frameworks have developed differently and over different periods of time.

[52] Somewhat haphazardly, we could refer here to the English case *Credit Agricole v. Muslim Bank* /2000/ 1 Lloyd's Rep. 275, where the court used interpretative methods, and to the Swedish case NJA 1983 p. 332, where the Supreme Court applied Section 36 of the Swedish Contracts Act to set aside a provision in a letter of credit.

[53] It is worth mentioning that the Promissory Notes Act introduced the first general clause allowing a court to modify contractual provisions under certain circumstances. Its wording was narrower than that used in 1976, when the so-called general clause was introduced into the Contracts Act as Article 36.

5.2 Letters of credit

5.2.1 Some general points

Letters of credit have developed within *lex mercatoria* and are subject to specific legislation only in some countries (in the United States, for example, chapter 5 of the Uniform Commercial Code contains rules on letters of credit issued, and used for interstate commerce, within the United States).

There is an enormous volume of English case law in this particular area, as well as much case law in France, Germany and the United States. For much of the 19th and early 20th centuries London was the dominant financial centre and since then English case law has had a particular impact on the development of financial law. The Uniform Custom and Practices (UCP) relating to letters of credit were designed by the International Chamber of Commerce (ICC). The first set of these rules was introduced in 1933. Since then they have been revised on several occasions up to the present UCP 600.[54] Contracting parties are generally careful to refer to the UCP in order to make them applicable to the particular contractual relationship.[55]

One legal consideration is of particular relevance in the context of letters of credit and on-demand guarantees, and this concerns their independence from the underlying contract. As mentioned already "ordinary" guarantees/suretyships are dependent on the underlying transaction, *i.e.*, if the transaction is invalid then the guarantee will be also. With respect to letters of credit and on-demand guarantees this is not the case, and here the independence of the respective instruments will mean that claims for payment under them are valid even if the underlying transaction is, for various reasons, not.[56] Here again the close legal proximity of letters of credit, on-demand guarantees and promissory notes is obvious.[57]

There are, however, limits to this rule, which developed in relation to letters of credit. If fraud by the beneficiary can be proven, it may be possible to

[54] 1951, 1962, 1973, 1984, 1992 and most recently in 2006.

[55] It has been suggested that application of the UCP might be regarded as trading practice even if no reference is made.

[56] See *e.g.* Gorton, *Rembursträtt* p. 114 *et seq.*

[57] It is thus important to bear in mind that a letter of credit (as well as an on-demand guarantee for that matter) is based on, but at the same time separate from, the underlying transaction. This means that a letter of credit should be judged in its own right, even though the legal effects of the underlying transaction will persist with respect to the parties to it.

persuade a court to issue an injunction (not available in all jurisdictions) forbidding payment by the bank under the letter of credit.[58]

There have been similar discussions with respect to on-demand guarantees, for example in English law in *Edward Owen v. Barclays Bank International* and *R.D. Harbottle (Mercantile) Ltd v. National Westminster Bank et al.*[59] In these cases the English courts established the particular nature of on-demand guarantees. Whether the arguments put forward by the English courts in connection with letters of credit and on-demand guarantees should be based on the same considerations has been discussed by Debattista.[60]

5.2.2 Trading letters of credit

It would appear that banks, when undertaking to issue a letter of credit, always refer to the UCP. However, the parties to the underlying transaction (often a sales contract) may not always be so careful. Accordingly there may be a conflict between the contract in the underlying transaction (with no reference to the UCP) and the letter of credit (which almost invariably includes such a reference). Could a party to the underlying transaction refuse to accept a letter of credit opened by a bank that referred to the UCP? Probably not, but why is this? Would the argument be that commercial parties should be aware that the UCP is the generally accepted set of rules regulating letters of credit? Would the argument be that the UCP is "commercial usage"? Or that the principles underlying the UCP amount to some kind of general legal principles? On the one hand, we tend to believe that the UCP are not commercial usage (even if they are described as uniform custom and practices) or that they are not, by way of generally accepted principles, accepted as having such a character. As mentioned, one particularly difficult point concerns fraud in, or in connection with, letters of credit. Although the problem initially developed in connection with letters of credit, similar problems have

[58] See Schmitthoff, *International and procedural aspects of letters of credit*, where he also discusses the role of the UCP as trade practice, and Kurkela, p. 120 *et seq.* and 173 *et seq.*

[59] /1978/ 1 Lloyd's Rep. 166 and /1977/ 2 All E.R. 862 respectively.

[60] Debattista, *Performance bonds and letters of credit*. Charles Debattista argues that the English courts have developed a reasoning whereby, without good legal foundation, on-demand guarantees have been treated in the same way as letters of credit with respect to the abuse of on-demand guarantees and fraud in connection with letters of credit. In his view, this line of reasoning is not absolutely convincing.

arisen with respect to on-demand guarantees, although the true similarity of the problems has been questioned.[61]

5.2.3 Standby letters of credit

As mentioned above, standby letters of credit (or standby credits) are a particular type of legal instrument that developed out of the trading letter of credit, but with a view to providing the banks with another vehicle to meet a similar need to that filled by on-demand guarantees.[62] Standby credits have a somewhat different history to trading letters of credit, in that they were introduced by US banks as an alternative to bank guarantees, which banks under the then-existing banking legislation were allowed to issue as a separate business undertaking. Today many international banks offer their customers a choice of standby credits or on-demand guarantees, and, as mentioned above, these instruments are subject to separate sets of rules.[63]

Standby credits are also dealt with in the Convention on Independent Guarantees and Stand-by Letters of Credit.

5.3 On-demand guarantees

Compared to the trading letter of credit, on-demand guarantees are a different kettle of fish. Should the on-demand guarantee be regarded as derived from the law of surety or from the law related to promissory notes (or notes of indebtedness)? Or should it be regarded as something else entirely? As mentioned above, the on-demand guarantee has three basic attributes: it is irrevocable, unconditional (independent) and payable on demand.[64]

Some features of suretyship extend far back into legal history and the concept seems to have developed in national law, rather than in *lex mercatoria*. The general use of suretyships does not indicate a particular relationship with *lex mercatoria*. Should the on-demand guarantee be regarded as a particular form of suretyship/guarantee, in which case a court may have to look for legal "guidance" in the law of contract, the law related to suretyships *etc.*? Un-

[61] See Debattista.

[62] Standby credits have been described by, among many others Bertrams, who refers to ISP 98 and Kurkela.

[63] ISP 98.

[64] Following the principles of the Swedish Contract Act, an offer is binding upon the offeror unless a "subject" of some kind was included in the offer making it subject to the occurrence of certain events.

doubtedly the documents have a common ancestry, and the on-demand guarantee might be seen as a particular type of suretyship from which a fundamental attribute has been removed, namely, dependence on the underlying transaction. On the other hand, the on-demand guarantee has developed in a different context. Should it rather be seen as a particular legal animal that has evolved out of either the promissory note or the letter of credit? For practical purposes this does not really matter, but I think the question serves to illustrate how in the financial markets a number of new instruments have developed over the course of time that have slightly different characteristics compared to other instruments.

However, present day guarantees (whether in the form of bank guarantees, demand guarantees *etc.*), seem to be instruments which have developed to satisfy mercantile needs. In this sense some of the guarantees used in today's trades have mercantile features, but it is doubtful whether they can really be described as instruments developed in *lex mercatoria*.

In English law the terms "bond" and "guarantee" seem to be used interchangeably, but it has been suggested that the guarantee and the bond are in fact different legal animals in that the bond is actually independent whereas the guarantee is not.[65] For a non-specialist in common law, it is difficult to determine whether there really is such a fundamental distinction between the two concepts, but the language used should probably be decisive. The URDG 758 (as for that matter its predecessor the URDG 458) cover "guarantees" even if they are intended to be independent in nature. This is clear from the Introduction to the URDG 758.

In this sense, and provided the above observation is correct, it is natural for the on-demand guarantee covered by the URDG to be regarded as closer to the letter of credit than to the suretyship. There is now a relative similarity between the URDG 758 and the UCP 600 which did not exist between the UCP 500 and the URDG 458. When drafting the URDG 758, the draftsmen also had before them the newly revised UCP 600 and apparently considered the resemblance between the two sets of rules to be useful in practice for the users. This does not necessarily mean, however, that the URDG 758 should be regarded as being more derived from the old *lex mercatoria* than

[65] See for example Dalby, *A performance bond deconstructed*, in *Business Law International*, vol. 11 no. 2. p. 105 *et seq.* The word "bond", however, is also used in a different context as the term for a payment undertaking through bonds traded (Swedish "*obligationer*").

the URDG 458.[66] In all circumstances, considerations concerning national rules will play an important role.

We should also mention that UNCITRAL, when drafting the Convention on Independent Guarantees, took account of the independent nature of the guarantee and tried to limit the possibility of its abuse to a greater extent than was done in the URDG 458. The solutions chosen in the Convention in this respect are quite complex and have created some uncertainty regarding how the wording should be applied. This uncertainty has not been received favourably in the market. Accordingly, the general view is that this convention will not be widely adopted.

6. Some concluding remarks

This study has tried to indicate the effect of the use of certain formulations in some specific situations. Most of the phrases are well known to the lawyers and businessmen involved in these transactions and I think that we generally like to believe that we are aware of their legal meanings and effects, at least in the most common situations. This is certainly also true for most court cases, but what has been said above implies that drafting parties should be careful when applying certain words and phrases, since they may be understood in different way than the parties – or at any rate one of them – intended.

The wording used may have different implications in different contexts: some considerations may lead to the application of certain rules, while a slight change of wording may make other rules applicable. In some cases a particular piece of legislation may be decisive, while in other cases particular practices or standard terms may become applicable.

This means, for example, that when the parties agree that there will be an on-demand guarantee, the wording "as for its own debt" should be avoided, since this particular wording will make the guarantee dependent on the underlying transaction. Undoubtedly situations may arise in contractual negotiations where the parties' promotion of their respective interests results in wording that implies both scenarios. This is what had happened in a case before the Swedish Court of Appeal.[67] In this case the document contained the wording both of an on-demand guarantee and of a joint and several guaran-

[66] I am convinced that the URDG 758 cannot currently be regarded as trade usage.
[67] The Court of Appeal for Skåne and Blekinge, Octobter 22, 1999.

tee. Since the parties ultimately agreed that the instrument should be regarded as an on-demand guarantee, the court did not have to resolve the question.

Let us conclude by referring to the loan agreements for the building of the bridge between Malmö and Copenhagen where the Danish and Swedish governments each had to sign a guarantee *vis-à-vis* the lenders.

The Information Memorandum issued on September 21, 1995 and registered in accordance with English rules states:

> "Øresundskonsortiet (established pursuant to a Treaty between the Kingdom of Denmark and the Kingdom of Sweden) Programme for the issuance of debt instruments, guaranteed (to the extent that the issuer is legally liable to pay) by the Kingdom of Denmark and the Kingdom of Sweden)."

The text of the guarantee says in section 2:

> "2.1. The Guarantors hereby jointly and severally guarantee to the Holders of the Instruments that if for any reason the Issuer shall fail to pay any Guaranteed Sum when and as the same becomes due and payable the Guarantors shall, within four Business Days of written demand by a Holder upon both Guarantors and the Issuer and stating that such sum was not paid on the due date in respect of an Instrument, unconditionally pay that sum."

Here the independent nature of the guarantee is quite plain, a fact that is further emphasised in section 2.3:

> "The Guarantee shall be unconditional, subject to its express terms, and the Guarantors hereby waive any requirement that a Holder should first make demand (other than the presentation of the relevant Instruments) upon or seek to enforce any claim against the Issuer before seeking to enforce this Guarantee …"

Clearly the intention of the parties (or at any rate one of them) is for this guarantee not to operate as an independent guarantee, but rather as a suretyship, *i.e.*, allowing creditors to turn to the guarantor but only after having claimed payment initially from the principal debtor. In spite of the other contradictory words used in the guarantee, these words may be sufficient to make it an "ordinary" (simple) suretyship rather than an on-demand guarantee.

I would for my part interpret this guarantee as an on-demand guarantee, but always subject to the limitation of what the issuer is liable to pay. Un-

doubtedly the wording used reflects negotiations between parties during which the lenders requested an unconditional, on-demand guarantee and the guarantors have not fully accepted this, insisting on a reservation that makes the guarantee *de facto* dependent on what the issuer is liable to pay. This indicates, however, the relative complexity of negotiations involving the choices of wording, expressions and concepts in various contexts.