Understanding the Uniform Demand Guarantee Rules No. 758

Introduction

In May 2016 the Nigerian government announced the deregulation of the oil and gas sector which involved the removal of fuel subsidy[1] and the freedom of oil importers to source for foreign exchange (**FX**) from the secondary sources to facilitate their international trade.

Laudable as this deregulation policy may seem, the decline in world crude oil prices and Nigeria's depleting foreign reserves means that the positive impact has not been readily felt by Nigerians, particularly importers, due to their inability to access the FX needed to open Letters of Credit (LCs) for importation of petroleum products.

In a bid to mitigate the challenges posed by the FX crisis, the Central Bank of Nigeria (**CBN**) has attempted several intervention mechanisms, and the jury is still out on the determination of the effectiveness of these mechanisms and their potential to resolve the FX scarcity. An example of such intervention mechanism is the creation of a priority list for accessing the available FX, including to the manufacturing and oil and gas sector.

Despite the CBN's efforts, the fact remains that importers are still unable to meet up with their FX demands to facilitate the importation of goods. Potentially, the offshore market may create a financing stop gap in meeting Nigerian importers' FX requirements and offshore financiers in sponsoring FX backed LCs, may require Nigerian importers to provide demand guarantees from Nigerian banks.

This article will discuss the provisions of the ICC Uniform Rules for Demand Guarantees No. 758[2] (**URDG**), (which are of standard terms international banking practice in the operation of demand guarantees), and which would be familiar to offshore financiers and their bankers), as well as provide justification for Nigerian banks' incorporation of the provisions of the URDG in their demand guarantees to facilitate international trade.

[1] Which had the effect of spiking the maximum approved price for the sale of PMS from N86.50 to about N145 per litre, as revealed in the National Bureau of Statistics: Premium Motor Spirit, Price Watch (June 2016).

What is the URDG?

The ICC Uniform Rules for Demand Guarantees No. 758[2] (**URDG**) is a set of voluntary contractual rules, published by the International Chamber of Commerce (**ICC**) with the aim of regularising and creating a standard set of international banking practice on demand guarantees and counter demand guarantees.

The URDG consists of 35 Articles which in clear, simple and precise terms set a balance in the legitimate and competing interests of the applicant, the guarantor and the beneficiary; limit the risk of unfair calls and demands on guarantors and counter-guarantors; and explain the various important phases in the lifecycle of a demand guarantee, just like the ICC's Uniform Customs and Practice for Documentary Credits (UCP) 600[3] which is used for Letters of Credit (LCs) and other documentary credits.[4]

The URDG, being a voluntary instrument, lacks the force of law, and must thus be expressly incorporated by the parties in order for it to apply to a demand guarantee or counter-guarantee. Likewise, parties are free to exclude provisions they are not comfortable with.[5] This means guarantors and counter-guarantors are rest assured that demand guarantees issued by them which incorporate the URDG, are entirely subject to their own terms, while incorporating beneficial terms of the URDG.

It is important to note that the URDG may apply without the parties expressly including it in certain instances, including where it is in the general usage of a particular trade;[6] where the applicable law provides for its application; or where it has been in consistent use in the course of a transaction or dealings between the parties.

Being a standard form of contract, once incorporated, there is little need for parties to draft a long form contract. The provisions of the URDG are limited to the scope of the matters upon which the contracting parties are free to contract on and is subject to mandatory national laws of the governing jurisdiction, which is the law and jurisdiction of the guarantor or counter guarantor, unless otherwise agreed by the parties.

General principles of the Uniform Rules for Demand Guarantees 758

The URDG describes a demand guarantee as any signed undertaking, however named or described, providing for payment on presentation of a complying demand.[7]

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[2] Uniform Rules for Demand Guarantees 2010 Revision, ICC Publication No.758
[3] The ICC Uniform Rules for Demand Guarantees No. 758 is the most current international contractual set of Rules applicable to demand guarantees and counter demand guarantees.
[4] ICC Uniform Customs and Practice for Documentary Credits, 2010 Revision (UCP 600)
[5] B. Amit, "International Rules for Demand Guarantees – URDG 758". [Online] Available at: https://www.scribd.com/mobile/doc/63397237/International-Rules-for-DemandGuarantees-URDG-758 Accessed [5 September 2016]
[6] Article 1(a) ICC Uniform Rules for Demand Guarantees No. 758; Exclusion is by parties expressly stating in the agreement that certain clauses are excluded.
[7] Common law principle

It provides that where an applicant (that is the party who applies for the issue of a demand guarantee, which in this instance would be the Nigerian importer) defaults, the beneficiary (that is, the party in whose favour the demand guarantee is issued, which in this instance would be the foreign financier) is entitled to make a demand, by presenting certain documents specified in the guarantee agreement to the guarantor (which in this instance would be the local Nigerian bank), whose role essentially is to examine the documents on their facial appearance only, in order to verify whether they are complying and where they comply, make payment without arguments, except in the case of fraud, which entitles such guarantor bank to refuse payment.

Under the URDG, demand guarantees are completely independent of any underlying relationship between the applicant and beneficiary, and subject to only the terms contained in it, thereby limiting the liabilities and rights of the guarantor bank to only matters it voluntarily commits itself to.

In this context, demand guarantees differ from true guarantees in that, a true guarantee is an undertaking or promise (of a secondary nature) made by a bank to pay a beneficiary in the event that an applicant fails to pay, upon proof of default.[8] Whereas, a demand guarantee is an undertaking or promise (of a primary nature) made by a bank, to pay the beneficiary **on its first demand for payment**, in the event that an applicant fails to pay, without proof of default. The maxim "pay first and argue later" best describes one of the key principles underlying demand guarantees.[9]

The demand guarantee also differs from LCs in that the LC is in itself a means of payment by the applicant in the normal course of the transaction; whereas the demand guarantee is an assurance of payment in the event that the applicant fails to make payment under the actual means of payment, as agreed. However, the demand guarantee is similar to the Standby Letter of Credit, as the payment obligations are alike but differing only in structure.

The Diagram above depicts a rudimentary structure of a demand guarantee and the relationship between the Applicant, the Guarantor and the Beneficiary. The actual structure would however depend on the complexity and other features of the transaction.

Why should Nigerian banks incorporate the URDG in their demand guarantees?

There are many reasons why a Nigerian bank should adopt the URDG in their demand guarantees, some of which are highlighted below:

1. ***Independence from underlying contracts***

Article 5 of the URDG expressly provides that the obligations of a guarantor and counter guarantor is independent of any issues in the underlying contract. This provision is rather favorable to the banks because guarantor and counter-guarantor banks are not usually parties

[8] Article (2) ICC Uniform Rules for Demand Guarantees No. 758; The demand must be for payment of a specific or maximum monetary obligation only.
[9] Here, the guarantor's obligations may be affected by issues over the underlying contract between the beneficiary and the applicant

to such underlying contracts, hence, it is unreasonable to have them entangled in issues emanating from such contracts.

2. ***Role***

The URDG limits the guarantor's responsibility and role in the agreement to dealing with,[11] and examining presented documents on their facial appearance of conformity only, without any need to verify the authenticity.[10] Furthermore, Article 7 of the URDG entitles a guarantor to disregard non-documentary evidence or requirements which cannot be verified from its records.

Although welcome by beneficiaries and guarantors, applicants on the other hand consider this rule as an exposure to the risk of fraud because in a situation where a beneficiary presents falsified documents or sends inferior goods, the guarantor bank is not required to verify the validity of the goods or services being rendered in the underlying contract, but merely to examine the presented documents on the facial appearance only.

That being said, the importance of this provision to the fluidity of international trade cannot be gainsaid, as banks remain unencumbered by the underlying contract, are entitled to rely on complying documents, and are protected from liability in instances where falsified documents are presented on a demand for payment, as it places the responsibility on the applicant to seek redress in the law courts.

3. ***Amendments***

Article 11 provides that where at the time of receiving instructions to amend a guarantee, a guarantor for whatever reason is not prepared or is unable to issue that amendment, the guarantor shall without delay inform the party that gave the instructions to amend of its refusal or inability to do so.

The guarantor thus has a discretion on whether or not to accept an instruction to amend a guarantee.

4. ***Entire Agreement***

Article 12 of the URDG limits the liability of the guarantor to only the terms contained in the agreement, hence further alienating and protecting the guarantor bank from liabilities emanating from other agreements entered into by the other parties to the contract of which it may or may not even be aware.

5. ***Demand***

Article 15 of the URDG provides that where a beneficiary makes a demand on a guarantor, the demand shall be accompanied by the documents specified in the guarantee and also by a

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[10] Here, the guarantor's obligations are not affected by issues over the underlying contract between the beneficiary and the applicant

supporting statement which indicates in what respect the applicant is in breach of its obligations under the underlying contractual relationship.

This rule undoubtedly stands in favour of the guarantor bank because it provides an opportunity or a basis upon which the guarantor may challenge a demand in court by claiming that an accompanying statement is false.

6. ***Currency Payment default***

Article 21 of the URDG ensures that a guarantor bank is not held in default in the event that it is unable to pay the beneficiary in the currency specified in the demand guarantee, due to an impediment beyond its control or because it is illegal under the law of the place for payment, by providing that the guarantor may make payment in the currency of the place for payment, which need not be the same as the place where the presentation was made.

This provision also works in favour of the beneficiary, as it can rest assured that irrespective of unforeseen disruptions, payment can be made in a different currency (that is, the currency of the place of payment) according to the applicable rate of exchange prevailing there when payment or reimbursement is due.

In a country beset by unpredictable currency fluctuations, the ability to pay in a currency other than the currency stipulated in the guarantee must have considerable advantages. Hopefully, the financier should have in place a Certificate of Capital Importation, which then entitles it to purchase foreign exchange in the official exchange market for remittance offshore.

7. ***Discretion***

Article 23 provides that where a guarantor receives an extend or pay request, which is a request made by a beneficiary for the extension of the validity of the guarantee, or alternatively for payment of the demand sum, a guarantor bank may suspend payment for a period not exceeding 30 calendar days; and where following the suspension, the guarantor makes an extend or pay request under the counter-guarantee, the counter guarantor may suspend payment for a period not exceeding 26 calendar days to enable the parties resolve any dispute between them and agree to extend the validity of the guarantee.[11]

Where no extension is granted, the guarantor must pay after the 30 calendar days have elapsed without any further demand being required. But if the extension is granted during that time, the demand is deemed to be withdrawn,[12] and the guarantee and counter-guarantee will need to be amended to effect this change. In practice, extend or pay requests which result in an extension happen far more frequently than actual payment of the guarantee.

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[11] Article (6) ICC Uniform Rules for Demand Guarantees No. 758 and Article (28) ICC Uniform Rules for Demand Guarantees No. 758

In favour of the guarantor bank, the URDG entitles a guarantor and counter-guarantor to a discretion on whether or not to accept an extend or pay request.[13]

8. *Exemption from Liability*

Articles 27 to 30 of the URDG exempts the guarantor from liability on the quality of documents presented to it;[14] on errors it may make in the transmission of documents;[15] or the acts of its agents and subagents[16] and any act or omission carried out by it in the course of carrying out the applicant's directives where it acts in good faith.

9. *Indemnity*

Article 31 of the URDG provides for unlimited indemnity in favour of a guarantor and counter guarantor with regard to all obligations and responsibilities imposed on them by foreign laws and usages. These obligations or responsibilities may include foreign regulations obligating guarantor to indemnify other third parties or pay fees or charges outside the scope of the transaction or impose a validity period on guarantees.[17]

The URDG backed guarantee ensures that the guarantor and counter guarantor banks are indemnified for their loss in such instances.

10. *Transfer and Assignment*

Article 33 of the URDG provides that a guarantee is transferable only if it specifically states that it is "transferable", in which case it may be transferred more than once for the full amount available at the time of transfer. However, a counter-guarantee is not transferable.

It further provides that a guarantor may refuse a request by a beneficiary for the transfer of a guarantee and assignment of proceeds. Hence such transfers can only be done to the extent that a guarantor has expressly consented to it, failing which the guarantor has a right to refuse to pay the proposed assignee.

This provision is highly beneficial to the guarantor, who can withhold its consent to a transfer or assignment of a guarantee, even if the guarantee provides that it is transferable. [18] Thus, the URDG provides an in-built protective mechanism for the guarantor.

This protection is important for various reasons amongst which are: the likelihood of termination of an existing insurance coverage by reason of such transfer; the need for banks to

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[13] This is a vast improvement compared to its predecessor the URDG 458 which provided that the suspension should be for a reasonable time, without defining what amounts to a reasonable time.

[14] Article 23(d) ICC Uniform Rules for Demand Guarantees No. 758

[15] A vast improvement from its predecessor which obligated the guarantor to accept the request.

[16] Article (27) ICC Uniform Rules for Demand Guarantees No. 758 and Article (28) ICC Uniform Rules for Demand Guarantees No. 758

[17] Article (19) ICC Uniform Rules for Demand Guarantees No. 758

[18] Article (29) ICC Uniform Rules for Demand Guarantees No. 758

be able to assess the credit worthiness of the potential beneficiary;[19]and to help a guarantor bank determine the possibility of payment recovery in the event that the courts decide that the proposed beneficiary is not entitled to payment.

11. ***Applicable law and Jurisdiction***

Articles 34 and 35 of the URDG provide that except the parties agree otherwise, the guarantor's law and jurisdiction apply to the demand guarantee and in the case of a counter guarantee, the counter guarantor's law and jurisdiction applies to the counter guarantee.

Thus, where a Nigerian bank gives a guarantee, Nigerian law automatically governs the guarantee and the courts of Nigeria have jurisdiction over any dispute, without any need for the guarantee to provide to that effect.

As a practical matter, foreign financiers typically prefer that English law govern their financing instruments (except with respect to security located in Nigeria, which must be governed by Nigerian law as the *lex situs*). Incorporating the URDG automatically swings the balance of negotiation in favour of the Nigerian bank, who may rely on the default provisions.

12. ***Irrevocability***

While the foregoing Articles seem to be mainly in favour of the guarantor, it is useful to mention that Article 4(b) of the URDG appears to swing in favour of the beneficiary to the disadvantage of the guarantor, by providing that a demand guarantee issued subject to the URDG is deemed irrevocable, even though the guarantee declares itself to be revocable. This obviously precludes guarantors from issuing revocable demand guarantees.

In our view, this rule is not as dis-advantageous as it appears. In reality, a bank is not likely to issue a revocable guarantee in international trade as the probability of beneficiaries accepting revocable guarantees is very low because of the little protection it affords them. Also, even where a guarantor bank is desirous of issuing a revocable guarantee, it can simply exclude the applicability of Article 4(b)[20].

The URDG: Should Nigerian Banks adopt it as a matter of course?

As a matter of practice, demand guarantees issued by Nigerian banks tend to be bespoke and differ largely from bank to bank. Overall, Nigerian banks tend to include some of the protection afforded by the URDG in their respective demand guarantees to varying extent.

We are of the view that since the URDG offers more protection to Nigerian banks, negotiating bespoke guarantees can be more trouble than it is worth. By adopting the URDG, demand guarantees issued by Nigerian banks can be much simpler documents, as all the protection found

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[19] Which may have the effect of overriding the intended or agreed period of the guarantee.
[20] Article 33 (b) ICC Uniform Rules for Demand Guarantees No. 758

in a standard Nigerian bank guarantee are included in the URDG, while the URDG has additional protection which may not necessarily be found in bespoke bank guarantees.

Consequently, we are of the view that Nigerian banks should adopt the URDG in their demand guarantees, (subject to any exclusions they may wish to make) for the following cogent reasons:

- Various editions of the Uniform Rules for Demand Guarantees have been in use by banks and other guarantors around the world for over 24 years[21] and have proven to be advantageous and dependable, as it creates a reasonable balance between the competing interests of the contracting parties, tilting in favour of the guarantor;

- The URDG 758 has been endorsed by various bank regulators, financial institutions[22], international organizations such as the World Bank and the United Nations Commission on International Trade Law (UNCITRAL)[23] as well as a number of professional bodies[24].

- Following the widespread acceptance and application of the URDG on demand guarantees all over the world, relevant regulators and institutional bodies in Nigeria like the Central Bank of Nigeria and the Nigerian National Committee of the ICC, have supported the adoption of URDG by organizing and conducting various seminars to reflect and disseminate information on the URDG to authorized dealers and stakeholders.[25]

These widespread acceptance and endorsements are mainly due to the fact that adopting the URDG brings on board the benefits of adopting a standardized agreement, especially in cross border transactions, as it:

- brings transparency to the guarantee, especially where the beneficiary has limited understanding of Nigerian law;
- reduces risk for all parties involved as they are contracting based on tried and tested legal terms and structure;
- reduces negotiation and brings efficiency to the transaction documentation and timelines;
- saves time and costs;

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[21] Central Bank of Nigeria (2013). "Anti-money Laundering and Combatting the Financing of Terrorism in Banks and Other Financial Institutions in Nigeria, Regulations 2013, Part VII".

[22] Although Article 4(b) provides that a guarantee is irrevocable on issue even if it does not state this, Article 1(b) however provides that the provisions of the rules may be modified by the parties.

[23]It has been in existence since 1992, till date and No. 758 is the current version. World Bank likewise announced in 2012 that it updated its Procurement Division's model guarantee forms so they are now subject to URDG 758

[24] United Nations Commission on International Trade Law which endorsed URDG 758 in 2011; Organization for the Harmonization of Business Law in Africa (OHADA) approved URDG 758. International Federation of Consulting Engineers upgraded the model guarantee forms used in connection with its model construction contracts to include the new URDG 758 in 2012.

[25] Vanguard Newspaper. 2010. 'CBN, ICC Nigeria collaborate on Uniform Rules for Demand Guarantees'. 8 June 2010. [Online] Available at: dhttp://www.vanguardngr.com/2010/06/cbnicc-nigeria-collaborate-on-uniform-Rules-for-demand-sguarantees/Accessed [30 August 2016]

- is internationally acceptable.

Finally, banks should remember that the terms and conditions of the URDG are not cast in stone, and they are free to exclude any terms they find not suitable or amenable to their appetite.

20B Kingsley Emu Street, Lekki Scheme 1, Lagos, Nigeria

Info@seftonfross.com