

Newsletter No. 13 (EN)

**How to secure Performances and Obligations
under Contracts**

August 2011

Although Lorenz & Partners always pays great attention on updating information provided in newsletters and brochures we cannot take responsibility for the completeness, correctness or quality of the information provided. None of the information contained in this newsletter is meant to replace a personal consultation with a qualified lawyer. Liability claims regarding damage caused by the use or disuse of any information provided, including any kind of information which is incomplete or incorrect, will therefore be rejected, if not generated deliberately or grossly negligent.

I. Introduction

In an ordinary course of business, a contracting party assumes the risk of non-performance of the obligations under contracts by the other party although the terms and conditions have already been agreed upon. Therefore, certain legal regulations have been created in order to secure and guarantee such performance. The legal instruments are amongst others:

- Letter of Credit (L/C)
- Guaranties governed by suretyship doctrine
- Bills of Exchange (Domestic & International)
- Independent Bank Guaranties
- Cheques / Promissory Notes

The above mentioned instruments are commonly used nowadays.

Although they function similarly with respect to the purpose of securing the obligations and performances of the underlying contracts, such instruments operate differently in several aspects. The similarities and the differences among them will be illustrated in this Newsletter.

II. Letter of Credit

A Letter of Credit (“L/C”) is normally used to secure payments owed by buyers in trades of goods. In such a transaction, the supplier will ask the buyer to provide a L/C and the buyer will request its bank to issue such L/C in favour of the supplier.

1. Players concerned

The parties to a L/C transaction will be named and recognised as:

- the issuer, which is the bank issuing the L/C,
- the applicant, which is the buyer and
- the beneficiary, which is the supplier.

In general banking practice, the bank guarantees to pay the supplier upon the presentation of certain documents, depending on the terms and condition of each L/C. Generally such documents involved would be the documents proving that the goods have been shipped to the buyer, exported to certain ports, and/or inspected by the buyer. This depends inter alia on what International Commercial Term (INCOTERM) was agreed on.

2. The Laws, Rules and Regulations

With respect to the general terms and conditions, L/Cs are governed usually by:

- the Uniform Customs and Practice for Documentary Credit (UCP 600), International Stand By Practice 1998 (ISP 1998), or
- other internationally accepted rules endorsed by the International Chamber of Commerce (ICC), the United Nations Commission on International Trade Law (UNCITRAL), or any other internationally accepted private organisations.

Subject to certain exceptions, L/Cs governed by such rules will indicate their expiration date, and after such date the bank will not be obliged to pay on the L/C, but the bank may pay if ordered by its customer (generally the buyer).

3. Factors taken into account

Drafting an L/C must be done with care, since banks have a tendency not to honour L/Cs, especially when the buyer is deemed likely to become insolvent, or when a bankruptcy proceeding has been filed against the buyer. That is why the possibility of the buyer to reimburse the bank will be low. Furthermore an L/C contains some risk of fraud as the credit itself may be forged or the payment will be obtained for non-existing or worthless merchandise against presentation by the beneficiary of forged or falsified documents. However, this can be secured by the agreement. It is therefore advisable to agree on payment only when the goods have been inspected etc.

III. Guaranties Governed by Thai Suretyship Doctrine

Governed by Sections 680-701 of Thai Civil and Commercial Code (CCC), a suretyship is a contract by which one person called the surety becomes liable to pay upon a certain non-performance of another. In the course of lending business consisting of a lender and a borrower, it is usual that the borrower does not meet sufficient credit or creditworthiness.

The lender then asks for a guarantee to merit the making of the loan to the borrower. The guarantor, as an additional payer, who is directly liable, will consequently offer its creditworthiness to the lender, so a guarantee will serve as an additional security instrument.

The situation in which a surety is most typically required is when the ability of the primary obligor or principal to perform its obligation under contract is in question or when there is some public or private interest which requires the protection from the consequences of the principal's default or delinquency.

1. Parties involved

The parties involved in this transaction are respectively:

- the creditor,
- the debtor, and
- the guarantor, which is the person guaranteeing the obligations of the debtor.

Although the guarantor is the secondary obligor to the obligations, the lender does not need to bring a suit and have remedy in order to ask for the payments from the guarantor. In a lending transaction, when the borrower defaults on a payment of either interest or principal, the lender can go directly to the guarantor to claim the money owed by the borrower if respectively agreed in the guarantee deed.

2. The Laws

Applying the aforementioned to an ordinary creditor-debtor relationship, or creditors are not required to exhaust remedies against debtors or to look to any other party before collecting debts from guarantors. Several Thai Supreme Court Decisions such as Decisions No. 804/2500 (1957), 3944/2525 (1980), and 2093/2526 (1983) support this point of view.

In addition, all claims arising out of or incurred in connection with the obligations under the contract secured by such guarantee can be forwarded and claimed for the next 10 years commencing from the date the claims have arisen against the guarantor even if the guarantee has expired (prescription period), but only if the ground for such claims was incurred during the time the suretyship document was valid.

If the surety is required to pay or perform due to the principal's failure to do so, the law will usually give the surety the right of subrogation, allowing the surety to "step into the shoe" of the principal and use his contractual rights to recover the costs of making payment or performing on the principal's behalf, even in the

absence of an express agreement to that effect between the surety and the principal.

IV. Independent Bank Guarantees

Sometimes suretyship legal relations are mixed up with independent standards underlying bank guarantees.

There are various types of bank guaranties such as down payment guarantees, performance guarantees, warranty guarantees, and many others.

An independent guarantee is a totally independent contract between a bank and a third party and not directly related to the underlying contract. It is of so-called “abstract nature.”

It is not uncommon in construction agreements that the owner of the project makes a down payment to the construction company. However, this down payment will be made only against a bank guarantee independent from the transaction between the owner and the construction company issued in favour of the owner from a bank acceptable to the owner.

Such instrument will be very useful in the event that the contractor becomes insolvent and can no longer continue the construction since the owner can immediately and directly request payment under the guarantee from the issuing bank, without being required to provide evidence that the claim against the contractor is justified.

Again, it is very important to know that a bank guarantee is an independent contract. It does not affect any other claims of the underlying contract, which it secures and it only regulates the legal relationship between the bank and the principal.

1. The Laws, Rules and Regulations

An independent bank guarantee should be drafted in a way that it is governed by internationally accepted rules, such as those en-

dorsed by the ICC or UNCITRAL so that it can be construed in accordance with such rules and can maintain its independent characteristic. Otherwise, the guarantee might be interpreted wrongly as a suretyship.

2. Non-Return of the Guarantee Document; Legal Significance; Expiration

The guarantee document is neither a commercial paper nor a negotiable instrument. The retention of the document in itself is, therefore, of no legal significance. Thus, if the guarantee or counter-guarantee has expired in accordance with its own terms, either on the original or on the amended expiry date, and if expiry dates are effective under local law and practice, the physical possession of the documents do not confer any rights upon the beneficiary and the (counter-) guarantee can no longer be validly called. This rule is clearly confirmed in article 24 Uniform Rules for Demand Guarantees (URDG) endorsed by the ICC, which reads:

“Where a Guarantee has terminated by payment, expiry, cancellation or otherwise, retention of the Guarantee or of any amendments thereto shall not preserve any rights of the Beneficiary under the Guarantee.”

V. International Bills of Exchange and Promissory Note

Bills of exchange play an important role in commercial and financial segments not only as a method of payments or means of providing credit, but also as security for credits. Using bills and notes will often facilitate the enforcement of account receivables in particular.

Due to barrier removal and market integration effects, the number of bills and notes signed by foreign parties has been increasing. Consequently, many business entities will become involved in the legal questions arising out of the international use of such instruments.

1. The Convention on International Bills of Exchange and International Promissory Notes (“Convention”)

A few years ago an attempt to harmonise the system of using and implementing bills of exchange initiated by UNCITRAL was concluded. The United Nations General Assembly unanimously approved the text of the Convention on International Bills of Exchange and International Promissory Notes in its 43rd Plenary Session on 9 December 1988.

The Convention applies to international bills of exchange and international promissory notes and allows the sum payable to be expressed in a monetary unit account. A stipulation to pay interest at an indicated rate, either definite or variable, is also permissible as is the payment of the sum in instalments. However, due to the lack of ratifications the bill has not yet come into force.

(1). Specific characteristic of the convention

Bills and Notes which are governed by the convention have certain specific and interesting characteristics, which may vary considerably from those governed by local laws. Such specific and interesting characteristics include, for example:

- The form of any contract arising out of a bill of exchange or a promissory note is regulated by the laws of the territory in which the contract has been signed.
- The effects of the obligations of the acceptor of a bill of exchange or the maker of a promissory note are determined by the laws of the place in which these instruments are payable.
- The effects of the signatures of the other parties liable on a bill of exchange or a promissory note are determined by the law of the country in which the signatures were affixed.

- The form and the limits of time to protest are regulated by the laws of the country in which the protest must be drawn up.
- The contracting states shall undertake to alter their laws so that the validity of obligations arising out of an instrument shall not be subordinated to the payment of stamp duty.

The documents mentioned here are usually utilised in a course of business involving parties from different jurisdictions, and it will be useful in connection of the transactions as such. Therefore, it will be an interesting alternative if the transaction you will be involved in is to be dealt internationally. However, it is necessary to keep in mind that the governing law provision of such bills or notes must read in a way that it is governed by the Convention.

(2) Permitted delay in making payments

Delay in making payments may be permitted according to. Article 56(1) of the Convention, which reads:

“Delay in making presentment for payment is excused if the delay is caused by circumstances which are beyond the control of the holder and which he could neither avoid nor overcome. When the cause of the delay ceases to operate, presentment must be made with reasonable diligence.”

Article 56 of the Convention also provides certain excuses for the issuer not to pay upon the presentment if the bill has been protested for dishonour by non-acceptance or if the drawer, an endorser, or a guarantor has expressly waived presentment.

(3) Additional liability under the bills

With respect to the expiration of the instruments and the legal effects thereafter, under United Nations Convention on International

Bills of Exchange and International Promissory Notes, it is mandated that:

Article 28(3) *“A holder who takes an instrument after the expiration of the time-limit for presentment for payment is subject to any claim to, or defence against liability on, the instrument to which his transferor is subject.”*

Therefore, if you decide to enter into a transaction of purchasing this instrument at discount, or being a transferee to the instrument for certain consideration, we insist that you investigate the terms and conditions and conduct such undertaking carefully.

VI. Bills of exchange under Thai Law

In general, bills under Thai CCC consist of:

- Bills of exchange (Sec. 908 - 981)
- Promissory notes (Sec. 982 – 986)
- Cheques (Sec. 987 - 1000)

Subject to certain exceptions, the persons executing bills are personally liable if they do not state that they are acting on behalf of someone else and, more importantly, there shall be no grace period allowed (Sec. 903).

The holder of a bill is deemed the payee, the indorsee or the bearer of such bill in case of bills payable to bearer. Moreover, forged or unauthorised signatures have no legal effect against whom the rights resulting from such signature is sought. This is unless such party is precluded from asserting the defence as to such signatures. Notwithstanding this fact, however, unauthorised signatures can be ratified (Sec. 1008) Finally, alone to bills are allowed if there is not enough space to write on the bills.

1. Bills of exchange

In a bill of exchange transaction, a person called “drawer” orders another person called “drawee” to pay to or to the order of another person called “payee.” Under Thai law, bills must contain, in particular, an un-

conditional order to pay a sum of money and maturity dates (Sec. 909 CCC) and if the maturity dates are not specified, such maturities are at sight (Sec. 910 CCC). Maturity dates of bills can be 1) fixed, 2) at the end of a fixed period after the date ascribed to the bills, 3) on demand or at sight, and 4) at the end of a fixed period after sight (Sec. 913 CCC). Furthermore, interest may be imposed on the sum payable of the bills, and bills can be drawn on account of drawer or of any third party (Sec. 912).

Under Section 914 CCC, any person drawing or indorsing a bill of exchange represents and warrants that, upon due presentment, the bill shall be accepted and paid in accordance with its terms, and that, if the bill is dishonoured by non-acceptance or non-payment, it will pay to the holder or to a subsequent indorsee who has been compelled to pay it, provided that the requisite proceedings on non-acceptance or non-payment have been duly taken. However, partial indorsement or a conditional one is void (Sec. 922 CCC).

Subject to certain exceptions as may be stipulated by the “drawer to a bill,” a bill of exchange may be presented, either by the holder or other possessors of such bill, to the drawee to the bill for acceptance at the place where the drawee resides up to its maturity date. In addition, a third party or any party to the bill may guarantee payments due under a bill of exchange, in whole or in part. Such undertaking is called “aval” (Sec. 938 CCC).

The holder of a bill of exchange must present the bill for payments upon its maturity. (Sec. 941 CCC) Under Thai law, intervention of a bill of exchange transaction, either for acceptance or for payments thereto, by a third party is allowed (Sec. 950 CCC).

2. Promissory note

A promissory note is a written instrument by which a person called “maker” promises to pay a certain sum of money to (or to the order of) another person called “payee” (Sec. 982 CCC). Under Thai law, such promissory note must

contain certain provisions such as an unconditional promise to pay a certain sum of money and a maturity date.

Most aspects of a promissory note are, to the extent that it is not inconsistent with the nature of the instrument, governed by the law concerning bills of exchange.

3. Cheques

A cheque is an instrument in a written form in which a person called “drawer” orders a bank or banker to pay on demand a certain amount of money to, or to the order of, a person called “payee.” A cheque must contain specific information, which is, among other things, the name or trade name and address of the bank and the name or trade name of the payee along with its address or a statement indicating that the cheque is payable to bearer (Sec. 988 CCC). Again, most aspects of cheque transaction are governed by the provisions regulating those of bills of exchange as far as they do not contradict the nature of cheques (Sec. 989 CCC).

With respect to proper presentment of cheques, a cheque, if payable within the city of issuance, must be presented for payments within 1 month after its issuance, or, if payable elsewhere, the cheque must be presented within 3 months (Sec. 990 CCC). However, the bank is not obligated to pay if the cheque is presented later than six months after its issuance (Sec. 991 CCC).

4. Prescription

Regarding the prescription period under Thai law with respect to bills, subject to certain exceptions and other specific circumstances:

- There shall be no action against the acceptor of a bill of exchange or the maker of a promissory note allowed after three years following their maturity dates have passed (Sec. 1001).
- There shall be no action by holders against the drawer of a bill or the maker of a promissory note permitted after one year following its proper protest or its maturity, in the case of a bill with a “protest not necessary” provision has passed (Sec. 1002), and
- There shall be no action of recourse by endorsers against each other or against the drawer of a bill after six months following the date an indorsee acquired and paid the bill or from the date has was sued (Sec. 1003).

As shown above, there are several legal instruments, which can be used to secure the performance and the obligations under a contract. Each of them has both advantages and disadvantages inherent in its nature. Therefore, you must be careful about choosing the instrument you want to use.

*We hope that the information provided in this newsletter was helpful for you.
If you have any further questions please do not hesitate to contact us.*

LORENZ & PARTNERS Co., Ltd.

22nd Floor Sathorn City Tower

175 South Sathorn Road, Bangkok 10120, Thailand

Tel.: +66 (0) 2-287 1882

E-Mail: info@lorenz-partners.com

Attachment: Brief of differences among L/Cs, guaranties, independent bank guaranties, and bills of exchange/international promissory notes

| Instruments | Independent/ Abstract Characteristics | Expiration of instruments | Prescription period under applicable laws |
|-----------------------------|--|--|--|
| 1) Bills of Exchange | | | |
| 1a) Under Thai Law | Depending on the terms and conditions of the instruments | Can be set by the parties to the transaction or 6 months after its issuance if considered "at sight" | 3 years (holders against acceptors) or 1 year (holders against endorsers or drawers) |
| 1b) Under German Law | Yes | 1 year by law or can be set by the parties to the transaction | 3 Years |
| 1c) International | Yes | Can be set by the parties to the transaction subject to the laws of applicable jurisdiction | Depending upon the laws of applicable jurisdiction |
| 2) L/C | | | |
| 2a) Local | Yes | Can be set by the parties to the transaction subject to common banking practice | N/A |
| 2b) International | Yes | Can be set by the parties to the transaction subject to common banking practice | N/A |

| Instruments | Independent/ Abstract Characteristics | Expiration of instruments | Prescription period under applicable laws |
|---------------------------------------|--|---|--|
| 3a) Under Thai Law | No | Can be set by the parties to the transaction | 10 years |
| 3b) Under German Law | No | Can be set by the parties to the transaction | 30 Years |
| 4) Promissory Notes | | | |
| 4a) Under Thai Law | Depending on the terms and conditions of the instruments | Can be set by the parties to the transaction | 3 years |
| 4b) Under German Law | Yes | Can be set by the parties to the transaction | 30 years subject to the terms of underlying contracts |
| 4c) International | Yes | Can be set by the parties to the transaction subject to the laws of applicable jurisdiction | Depending upon the laws of applicable jurisdiction |
| 5) Independent Bank Guaranties | | | |
| | Yes | Can be set by the parties to the transaction subject to common banking practice | N/A |
| 6) Cheques | | | |
| 6a) Local cheques under Thai Law | Yes | 1 month after its issuance | 1 year (holders against endorsers) or 6 months (endorsers against endorsers) |

| Instruments | Independent/ Abstract Characteristics | Expiration of instruments | Prescription period under applicable laws |
|--|--|--|--|
| 6b) International cheques under Thai Law | Yes | 3 months after its issuance | 1 year (holders against endorsers) or 6 months (endorsers against endorsers) |
| 6c) Local cheques under German Law | Yes | 8 days | 6 months (holders against endorsers) |
| 6d) Continental cheques under German Law | Yes | 20 days | Depending on the law of the jurisdiction of issuance |
| 6e) International cheques under German Law | Yes | 70 days | Depending on the law of the jurisdiction of issuance |

We hope that the information provided in this newsletter was helpful for you.

If you have any further questions please do not hesitate to contact us.

LORENZ & PARTNERS Co., Ltd.

27th Floor Bangkok City Tower

179 South Sathorn Road, Bangkok 10120, Thailand

Tel.: +66 (0) 2-287 1882

E-Mail: info@lorenz-partners.com