

Newsletter No. 13 (EN)

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

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I. Introduction

In any ordinary course of business, even though terms and conditions have been agreed, a contracting party assumes the risk that the other party will not perform their contractual obligations. To guard against this, legal instruments have been created to guarantee performance. The legal instruments commonly used for this are:

- Letters of Credit;
- Guarantees governed by the suretyship doctrine;
- Independent Bank Guarantees;
- Bills of Exchange (Domestic & International); and
- Promissory Notes/Cheques.

Although these instruments have the same purpose, they function differently. This newsletter will illustrate these differences.

II. Letter of Credit

A Letter of Credit (“**L/C**”) is usually used to secure payments in trades of goods. In such a transaction, the supplier will ask the buyer to provide an L/C in favour of the supplier, which is issued on request by the buyer’s bank.

1. Parties involved

The parties involved in an L/C transaction are:

- the issuer, which is the bank issuing the L/C;
- the applicant, which is the buyer; and

- the beneficiary, which is the supplier.

The bank usually guarantees to pay the supplier upon presentation of certain documents. Typically, these documents would be proofs of shipping to and/or inspection by the buyer, though their exact nature depends inter alia on what terms (e.g. International Commercial Terms) the parties agreed upon in the L/C.

2. Legal Framework

The general terms and conditions of L/Cs are usually governed by:

- the Uniform Customs and Practice for Documentary Credits (UCP 600), International Stand By Practice 1998 (ISP98);

or

- other internationally accepted rules endorsed by the International Chamber of Commerce (ICC), the United Nations Commission on International Trade Law (UNCITRAL), or other internationally recognised organisations.

Subject to certain exceptions, L/Cs governed by such rules will usually have an expiration date after which the bank is not obliged to pay any longer.

3. Factors to be taken into account

L/Cs must be drafted with care as banks may not always honour them, e.g. in situations where the buyer is deemed likely to become insolvent. There is also some risk of fraud where supporting documents are forged or falsified. These risks can be minimised by agreement, but it is advised to agree on payment only when the goods have been properly inspected.

III. Guarantees Governed by Thai Suretyship Doctrine (dependent guarantee)

A suretyship is a contract by which one person (called the surety or guarantor) guarantees the performance of another (the debtor) by taking responsibility for their failure. The surety is liable to pay if the debtor does not perform as required. In Thailand, suretyships are governed by Sec. 680-701 of the Thai Civil and Commercial Code (CCC).

Such a guarantee is typically required when there is doubt about the ability of the primary obligor to perform its obligation, or when a public or private interest requires additional protection against possible default. For example, in the lending business the prospective borrower may be deemed to be insufficiently creditworthy. In such a situation the lender will often require a guarantee by a third party that the borrower will pay the incurred debt. The guarantor offers their creditworthiness on behalf of the borrower and is liable in case the borrower defaults.

1. Parties involved

The parties involved in this transaction are respectively:

- the creditor (lender);
- the debtor (borrower); and
- the surety (guarantor) who guarantees the obligations of the debtor.

The creditor does not need to take legal action against the debtor before demanding payment from the guarantor in the case of default. The creditor must, however, fulfil certain legal requirements, e.g. calling for payment from the debtor, and giving notice of the default to the guarantor if the debtor does not pay.

2. Legal Framework

Under the new amendment, an individual guarantor cannot take responsibility for the debt as co-debtor, or to take the place of the original borrower (Sec. 681/1 CCC). How-

ever, this restriction does not apply to the guarantor who is a juristic person (Sec. 681/2 para.2 CCC).

The creditor needs to notify the guarantor in writing, within 60 days from the default date of the debtor, in order to claim interest, damages, and other charges incurred after the aforesaid 60 days period has passed. Failing to do so will render the creditor unable to claim for interest, damages, or other charges which occur after the 60 days period (Sec. 686 CCC).

Claims against the guarantor relating to a contract secured by a suretyship can be made up to 10 years after first arising, **even if the suretyship has expired** (Supreme Court Judgment No. 2208/2558). Note though that if the creditor does not notify the guarantor of debtor default within 60 days of this default, the guarantor is only liable for the main claim, but not for any interest, compensation or other encumbrance expenses arising from after this 60-day period.

According to Sec. 694 CCC, the guarantor can raise all objections that the debtor has against the creditor. It is not possible to agree otherwise, as this rule is compulsory according to Sec. 685/1 CCC. Any agreement/clause that is contradictory to this requirement, shall be void.

If the guarantor is required to pay or perform due to the debtor's failure to do so, the law will usually give them the right of subrogation. This allows the guarantor to use the contractual rights of the debtor to recover the costs of making payment on their behalf. This is usually the case even when there is no explicit agreement to this effect between the debtor and the guarantor.

IV. Independent Bank Guarantees

An independent bank guarantee is a security developed to facilitate international trade and business. It is a binding agreement between a bank and a customer. The bank agrees to pay a named beneficiary without the beneficiary hav-

ing to prove that the customer is unable to fulfil its contractual obligations to this beneficiary or that the underlying claim even exists.

It is said to have an “abstract nature”. Typical independent bank guarantees are down payment guarantees, performance guarantees, warranty guarantees etc.

For example, in construction projects it is common for the project owner/developer to make a down payment to a construction company. The down payment is provided to the construction company against a bank guarantee which creates a liability independent of the contract between the construction company and the owner/developer. Under international rules, “[a] reference in the guarantee to the underlying relationship for the purpose of identifying it does not change **the independent nature** of the guarantee” (Article 5 Uniform Rules for Demand Guarantees issued by the ICC (URDG 758)). The owner/developer can directly request payment from the bank at any point without being required to provide evidence that their claim against the contractor is justified.

Similar agreements can be arranged for the performance of a contract (“performance guarantee”) or to secure the warranty obligations of the contractor after the completion of the contract (“warranty guaranty”).

The independent nature of the guarantee ensures that the undertaking of a guarantor to pay under the guarantee is not subject to counterclaims or defences arising from any relationship other than the relationship between the guarantor and the beneficiary.

1. Legal Framework

In an international context, an independent bank guarantee should be drafted in accordance with internationally accepted rules, such as those endorsed by the ICC or UN-CITRAL.

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

The guarantee document is neither a commercial paper nor a negotiable instrument, so the retention of the document itself has no legal significance. Once the guarantee has expired in accordance with its own terms, then, assuming expiry dates are effective under local law and practice, possession of the physical document does not confer any rights to the beneficiary. This rule is e.g. clearly confirmed in Article 24 Uniform Rules for Demand Guarantees (URDG) endorsed by the ICC, which reads:

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

The reason why in practice banks require the return of the original document is owed to uncertainties in certain jurisdictions which may qualify such document as a commercial paper or a negotiable instrument or invalidate the expiry date (as e.g. Thai law) and may thereby give the beneficiary rights beyond the expiry date.

In practice, when returning the original bank guarantee, the beneficiary signs a waiver releasing the bank for any further liability under the guarantee.

3. Other Practical Difficulties

While bank guarantees under international standards (i.e. the ICC or UNICITRAL) are independent and flexible, the suretyship guarantee under the CCC of Thailand is governed by a strict set of rules.

The main difference to independent bank guarantees is that suretyship guarantees are accessory to the underlying contract between the creditor and the debtor, meaning the validity and enforceability of the bank guarantee depends on the validity of the original

obligation between the creditor and the debtor.

Under Thai Law, there is no regulation concerning independent bank guarantees or other payment securities which is why so far courts have interpreted any bank guarantee that was issued in Thailand as a Suretyship under the CCC

One of the biggest advantages of independent bank guarantees is the possibility of receiving the payment on first written demand from the bank which guarantees a high standard of protection for the creditor. This does not work under Thai Law. It is not possible to waive the assertion of any objections the creditor might have against the debtor in a bank guarantee.

One might argue that under the principle of “freedom of contract”, the parties could agree on independent bank guarantees to be governed by the ICC rules or foreign jurisdictions. But this might be a risky undertaking, as Thai courts only apply the law of another country (or international rules), if it is not contrary to the public order or the good morals of Thailand, Sec. 3 of the Conflict of Laws Act. Hence, there is no certainty that the court will apply the rules of international bank guarantees.

On the other hand, it is also risky to rely on banks applying the above surety rules strictly. Particularly, Thai banks with international exposure might nevertheless pay on first written demand simply to avoid negative reputation in the international business. To make things even more complex, there may be cases of cherry picking (particularly with smaller Thai banks with no international exposure) which pay as long the client has enough funds with the bank, but refuse to pay and raise the objections of the debtor if they cannot take recourse or the debtor is an important customer of the bank..

Using bank guarantees in Thailand has therefore become quite complicated and less

secure. Due to the risk highlighted above, it is therefore advisable, that companies in Thailand only cooperate with renowned Thai banks with international exposure or international banks that would apply international standards in their daily business in order to keep their reputation.

V. International Bills of Exchange and Promissory Note

Bills of exchange and promissory notes play an important role in the commercial and financial sectors. They not only provide a way to make payments or provide credit but can also act as security for credits. In particular using bills and notes will often facilitate the enforcement of accounts receivable.

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

The UNCITRAL Convention on “International Bills of Exchange and International Promissory Notes 1988” attempts to harmonize various competing systems for using bills of exchange and promissory notes. This convention has been adopted by United Nations General Assembly since 9 December 1988 and shall be applied when all parties expressly agree upon and use a particular form of a negotiable instrument, indicating that the instrument is subject to the UNCITRAL Convention.

The Convention applies to international bills of exchange and international promissory notes, and, if its use is agreed, allows the sum payable to be expressed in a monetary unit of account (agreed currency for the medium of exchange). It also allows stipulation to pay interest, either definite or variable rate, or payment of the sum in instalments

a) Specific characteristics of the Convention

Bills and notes governed by the Convention have certain specific and interesting characteristics, which may vary considerably from those governed by local laws. 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 is signed.
- 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 where they are payable.
- The effects of the signatures of the other liable parties 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 time limit of a 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 a bill or a note shall not be subordinated to the payment of stamp duty.

These documents are usually used in the course of business between parties from different jurisdictions, so it may be particularly useful for international business. However, if used in this way the governing law provision of such a bill or note must specify that it is governed by the Convention.

b) Permitted delay in making payments

Delay in making payments may be permitted according to Art. 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.”

Presentment for payment can be dispensed with if the drawer, an endorser, or a guarantor has expressly waived it.

c) Additional liability under the Convention

The expiration of a bill of exchange or promissory note is governed by Art. 28 (3) of the Convention, which stipulates that:

“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 wish to purchase an existing bill or note, or have one transferred to you, we advise you to carefully investigate the terms and conditions and proceed with caution.

VI. Bills of exchange under Thai Law

Under the Thai CCC bills generally consist of:

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

Subject to certain exceptions, a person executing a bill is personally liable unless they state they are acting on behalf of another party. There is no grace period allowed (Sec. 903 CCC).

The holder is normally deemed to be the payee. In bills payable to the bearer, the bearer or endorsee is the payee. Forged or unauthorised signatures do not legally bind the person whose signature has been forged, unless they are precluded from asserting a defence to such forgeries. Note that in some circumstances unauthorised signatures can be ratified (Sec. 1008 CCC).

1. Bills of exchange

In a bill of exchange transaction, a person called the “drawer” orders another person,

called the “drawee”, to pay to or to the order of a third person called the “payee”.

Under Thai law bills must contain an order to pay a sum of money, and a maturity date (Sec. 909 CCC). No other conditions may be put on a bill of exchange. Maturity dates of bills can be (i) fixed, (ii) at the end of a fixed period after the date ascribed to the bills, (iii) on demand or at sight, and (iv) at the end of a fixed period after sight (Sec. 913 CCC). If no maturity date is specified, the bill will be payable on demand (Sec. 910 CCC). Interest can be imposed on the payable sum (Sec. 911 CCC), and bills can be drawn on account of the drawer or of any third party (Sec. 912 CCC).

Under Sec. 914 CCC, any person drawing or indorsing a bill of exchange asserts that the bill will be paid upon presentment. The drawer or endorser also asserts that, if the bill is dishonoured by non-acceptance or non-payment, they will pay the listed sum to the current holder, or, in the case where the bill has been indorsed multiple times, to the subsequent endorsee, who, in turn is compelled to pay the holder or a subsequent endorsee. This chain of payments is conditional on the requisite non-payment or non-acceptance proceedings being taken. Partial or conditional indorsements are not valid (Sec. 922 CCC).

Subject to some exceptions that can be stipulated by the drawer, the possessor of a bill of exchange may present it for acceptance to the drawee at the place where the drawee resides up to its maturity date. A third party, or even a party to the bill itself, can guarantee either all or part of the bill payment. This kind of guarantee is called an “aval” (Sec. 938 CCC).

The holder of a bill of exchange must present the bill for payment upon its maturity (Sec. 941 CCC). Thai law allows third parties to intervene and pay or accept on behalf of the drawee (Sec. 950 CCC).

2. Promissory note

In a promissory note one person, the “maker”, promises to pay a certain sum of money to, or to the order of, another person, called the “payee” (Sec. 982 CCC). Thai law demands that a promissory note contain certain provisions; e.g., an unconditional promise to pay a set sum, and a maturity date.

Most aspects of promissory notes are governed by the law for bills of exchange (Sec. 985 CCC).

3. Cheques

A cheque is a written document in which a person, called the “drawer”, orders a bank or banker to pay on demand a certain amount of money to, or to the order of, a person called the “payee”. A cheque must contain specific information. For example, among other things, the name or trade name and address of the bank and the name or trade name of the payee, along with the address of the payee or a statement indicating that the cheque is payable to the bearer (Sec. 988 CCC).

Again, most aspects of cheque transactions are governed by the law for bills of exchange (Sec. 989 CCC).

A cheque, if payable in the city where it was issued, must be presented for payment within one month of its issuance. If payable elsewhere, the cheque must be presented within three months (Sec. 990 CCC). The bank is not obligated to pay if the cheque is presented later than six months after its issuance (Sec. 991 CCC).

Apart from civil liabilities imposed on the drawer of the cheque, if a cheque bounces a criminal case can be prosecuted under the Offence Arising from the Use of Cheque Act B.E. 2534 (“OCA”). This criminal case is compoundable (Sec. 5 OCA)¹, so if the drawer

¹ Supreme Court Judgement No. 228/2544

pays the payee the correct amount, the case will be ceased (Sec. 7 OCA)².

4. Prescription

Subject to certain exceptions, the following comments apply to the prescription period of bills under Thai law:

- 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 its maturity date has passed. No action can be taken against the acceptor of a bill or the maker of a promissory note more than three years after its maturity date has passed (Sec. 1001)³.
- No action can be taken by holders against the drawer of a bill or the maker of a note after one year following its proper protest. In the case of a bill marked “no protest necessary” no action can be taken after one year following its maturity (Sec. 1002)⁴.
- Endorsers may not take action, either against each other or the drawer of a bill, after six months following the date an endorsee acquired it, or from the date he was sued (Sec. 1003)⁵.

VII. Summary

There are several legal instruments, which can be used to secure the performance and obligations under a contract. Each has inherent advantages and disadvantages, and care must be taken when deciding which instrument to use. Especially independent bank guarantees may not be possible under Thai Law as the strict rules of the Suretyship Doctrine make it difficult to deviate from the law and apply international standards.

² Supreme Court Judgement No. 7242/2553, 5240/2553, 566/2553

³ Supreme Court Judgement No. 3340/2536, 1401/2537

⁴ Supreme Court Judgement No 3023/2529, 4383/2545

⁵ Supreme Court Judgement No. 6339-6340/2539, 4383/2545,

Attachment: Differences between L/Cs, guarantees, independent bank guarantees, and bills of exchange/international promissory notes

Instruments	Independent/ Abstract Characteristics	Expiration of Instrument	Prescription period under applicable laws
1) Bills of Exchange			
1a) Under Thai Law	Depending on the terms and conditions of the instrument	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 indorsers 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 on 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 instrument	Prescription period under applicable laws
3) Guarantees			
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 instrument	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 the underlying contract
4c) International	Yes	Can be set by the parties to the transaction subject to the laws of the applicable jurisdiction	Depending on the laws of the applicable jurisdiction
5) Independent Bank Guarantees			
International/German Law	Yes	Can be set by the parties to the transaction subject to common banking practice	N/A
Thailand	N/A		
6) Cheques			
6a) Local cheques under Thai Law	Yes	1 month after its issuance (after that the indorser will not be liable) / 6 months against the bank	1 year (holders against endorsers) or 6 months (endorsers against endorsers)

Instruments	Independent/ Abstract Characteristics	Expiration of instrument	Prescription period under applicable laws
6b) International cheques under Thai Law	Yes	3 months after its issuance (after that the indorsers will not be liable) / 6 months against the bank	1 year (holders against indors- ers) or 6 months (in- dorsers against indorsers)
6c) Local cheques under German Law	Yes	8 days	6 months (holders against indorsers)
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.

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