

# **STOP PAYMENT OF DEMAND GUARANTEE IN CHINA**

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*Strictly Confidential. Commercial Secret.*

# A bird view of Chinese laws of demand guarantee

## China Domestic Law

- *Civil Code of China*: does not cover the demand guarantee
- *Guarantee Law of People Republic of China*: the Supreme People's Court of China clearly indicates that it does not apply to the demand guarantee
- *Provisions of the Supreme People's Court on Several Issues concerning Trial of Disputes over Independent Guarantee (the "Independent Guarantees Interpretation")*: before 2016, the issuance of the Independent Guarantees Interpretation, China don't acknowledge the validity of the pure domestic demand guarantee.

## International Commercial Practices (International Customs)

- *ICC The Uniform Rules for Demand Guarantees No. 758 (URDG 758)*
- *International Standard Demand Guarantee Practice (ISDGP) for URDG 758*

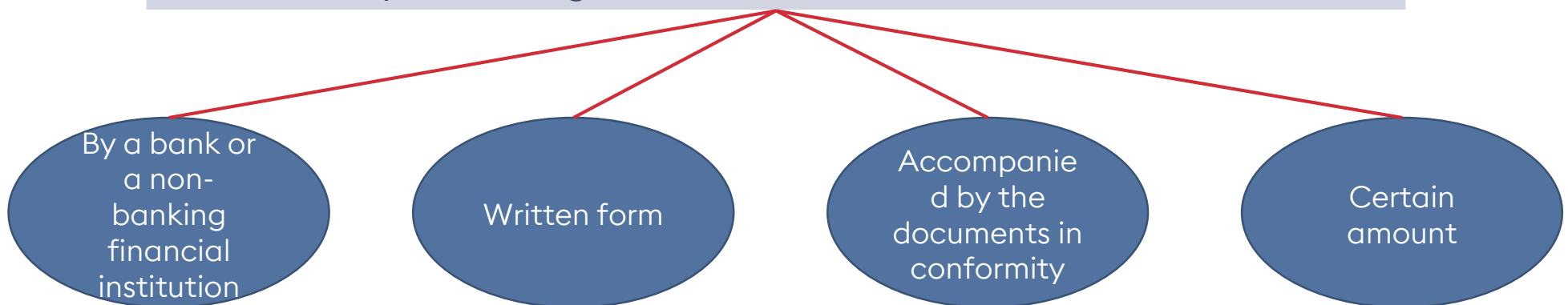
# What is demand guarantee under Chinese law?

## ICC Uniform Rules for Demand Guarantees (URDG 758) Art.2

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

## Independent Guarantees Interpretation, Art. 1

the "independent guarantee" refers to a written commitment made by a **bank or a non-bank financial institution** as the issuer to pay the beneficiary a certain amount or an amount within the maximum guaranteed amount upon demand accompanied by the documents in conformity with the guarantee.



# “Non-Bank Financial Institution Explained”

*The ‘Understanding and Application of the Judicial Interpretation of the Security System of the Civil Code of the Supreme People's Court’* elaborates on the term ‘bank or non-bank financial institution’.

The Supreme Court held that:

- banking financial institutions regulated by the China Banking and Insurance Regulatory Commission (CBIRC, now replaced by National Financial Regulatory Administration)
- other non-bank financial institutions regulated by CBIRC
- Insurance institutions regulated by the CBIRC and
- securities and futures institutions regulated by the China Securities Regulatory Commission (CSRC )

may issue independent letters of guarantee in accordance with the law.

# China's judiciary practices for stop payment of demand guarantee

## Notice by the Supreme People's Court on Issuing the Minutes of the National Court Work Conference for Civil and Commercial Trials 2019 (2019 Ninth Conference Minutes)

Supreme People's Court Judge Zhang Yongjian published a research article in 2017 , pointed out that Chinese enterprises/organizations/ individuals have issued demand guarantee in many situation.

The 2019 Ninth Conference Minutes made it clear that ‘an demand guarantee issued by a party other than a bank or non-bank financial institution shall be found to be invalid’. However, it is possible that the demand guarantee made by the party to be recognized as a normal guarantee.

The invalidity mentioned above is only with respect to the agreement on an demand guarantee issued by the non-conforming parties; if the parties have indeed expressed the intention to provide a guarantee, the demand guarantee may be considered to be a normal guarantee

# China's judiciary practices for stop payment of demand guarantee

During the press releasing conference of the Independent Guarantees Interpretation, the Supreme People's Court Judge Zhang Yongjian announced that:

- the Supreme People's Court has found that the lower courts do not have a unified standard of review on stop-payment of demand guarantee
- The use of demand guarantee is widely used by Chinese bank and enterprises, especially for Chinese construction enterprises
- Some local court stop the payment of demand guarantee by a very low standard, causing harm to reputation to Chinese banks
- The Independent Guarantees Interpretation is aim to create a strict standard of review on stop-payment of demand guarantee

# China's judiciary practices for stop payment of demand guarantee

Standard of review of stop payment of demand guarantee:

## SUBSTANTIAL REVIEW ON UNDERLYING TRANSACTION

- Limited but necessary

Whether the beneficiary was in breach of contract in the underlying transaction is, in principle, outside the scope of review.

The scope of the underlying transaction to be examined in order to determine whether the beneficiary knew that it had no claim to payment should continue to be based on the guarantee document

- The burden of proof is on the party claiming fraud and should be 'beyond a reasonable doubt'.



# Procedures for stop payment of demand guarantee in China

**Applicant:** demand guarantee applicant, issuer/beneficiary

**When to apply:** before or during litigation/arbitration

**Jurisdiction:** can be agreed in written agreement, if not agreed - court of domicile of issuer/ court of domicile of defendant

**Stop payment conditions:** must meet all conditions:

- A. the existence of fraud with a high degree of probability - to meet the standard of proof of a high degree of probability of civil proceedings
- B. the situation is urgent: (if not then difficult to remedy)
- C. the stop payment applicant to provide security: (sufficient to compensate for the losses that the respondent may suffer as a result of the stop payment),
- D. where payment has been made in good faith under an independent guarantee issued by an issuer on instructions, no stop payment shall be ruled on an independent guarantee guaranteeing the right of recovery of such issuer

**Guarantee:** the stop-payment applicant shall provide a enough guarantee/insurance to cover the damage might caused to counter party by the wrongful stop-payment

**Time:** decision within 48 hours; once made, immediately enforceable. Stop payment applicant should file a lawsuit/arbitration claim for fraud within 30 days of the decision or the court discharges the decision

**Review :** within 10 days of delivery of the decision, apply to the court of the decision; review by the court within 10 days of receipt of the application; enforcement of the decision will not be stopped during this review period



# Procedures for stop payment of demand guarantee in China

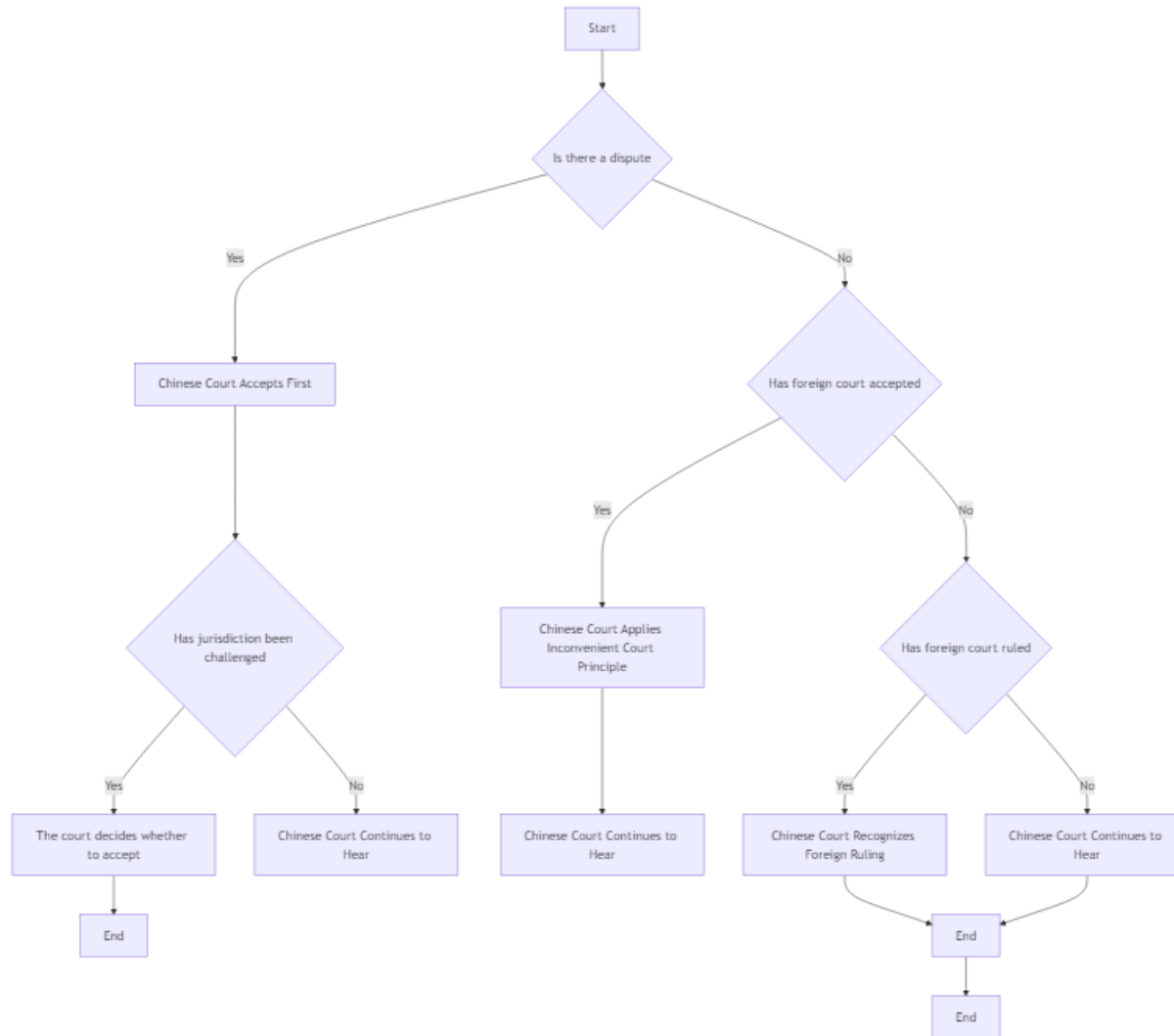
- Unless otherwise agreed by the parties, the issuing bank generally pays in accordance with the five business days specified in the URDG, and once the issuing bank pays the beneficiary, the process is no longer reversible. Therefore, a major feature of the independent guarantee temporary stop payment system in China is 'race against time'.
- In practice, the general practice is apply the stop payment with a policy issued by insurance company. And this is often the most urgent time limit, how to coordinate and communicate with the insurance company to the fastest possible speed to issue the policy, will directly affecting the success or failure of the results of the 'race against time'.

# War of injunctions: parallel proceedings

## Spliethoff's Bevrachtungskantoor BV v. Bank of China limited [2015] EWHC 999

- (1) whether the stop-payment order of the Chinese court was valid in the English trial? Should the English court have taken into account the principles of international comity and thus recognized the effect of the Chinese court's stop-payment order on the trial of the case; and
- (2) should the English court, when it made a judgement that the Bank of China should pay the amount of the letter of guarantee, at the same time declare a stay of performance of that judgement until the Chinese court's stop-payment order had been set aside?
- Although the English court found that the Chinese court's stop-payment order was still valid at the time of the hearing and should be taken into account in accordance with the principles of international comity, the English court refused the Bank of China's request for a stay of performance of the judgement, on the grounds that:
  1. The purpose of the 'demand guarantee' was to protect the beneficiaries' access to payment, and the beneficiaries in the case had not been able to obtain an advance payment for a number of years.
  2. The Commercial Court of the English High Court have a duty to provide the beneficiary with immediate access to that cash; and
  3. The Bank of China had done its utmost to refuse to pay the amount of the guarantee; if it were to pay in the face of a judgement by the English court, it should not be considered as refusing to assist the Chinese court, and would be unlikely to be subjected to a 'criminal penalty' under Chinese law

# Double jeopardy: race to sue then race to judgement



## Alternative: DOCDEX

- DOCDEX (Documentary Instruments Dispute Resolution Expertise) is a dispute resolution mechanism specifically designed by the ICC International Centre for ADR.
- If the application of the ICC banking rules has been agreed in the terms of the documents of the type mentioned above, then either of the parties may refer the dispute directly to the experts appointed by DOCDEX for a hearing. If not, the case shall be administered in accordance with the Rules only if the respective claimant and respondent agree to do so. As the ICC Banking Rules are commonly applied to all types of documents, the vast majority of document-based disputes can be referred to DOCDEX for dispute resolution.
- DOCDEX selects three experts from a list of experts provided by the International Chamber of Commerce Banking Commission to form a panel of experts to resolve the documentary disputes through written hearings based on the evidence provided by the parties, and the entire process usually takes two to three months. Compared to local court proceedings, which can take years and result in unpredictable judgements, DOCDEX is more independent and can handle disputes efficiently and protect the rights and interests of the parties.

A Chinese state-owned enterprise was the general contractor, Company A, for a road project in a Central Asian country and subcontracted part of the work to a local subcontractor, Company B. The subcontractor provided an advance payment bond and a performance bond to a third-country bank, Bank C. In order to guarantee performance, the subcontractor provided an advance payment bond and a performance bond to the general contractor, which were issued by a bank in a third country, Bank C. The subcontractor also issued a performance bond to the local owner, Company E, for the entire project. The general contractor issued a performance bond and an advance payment bond to the local owner, company E, for the entire project.

Later, due to the subcontractor's breach of contract, the owner requested the general contractor to replace the subcontractor and threatened to confiscate the general contractor's bank guarantee. The main contractor had no choice but to pursue the subcontractor for breach of contract. 16 May 2022, the main contractor submitted a claim to Bank C through the notifying bank; 10 days later, Bank C notified the main contractor of its refusal to pay the bond amount

The Chinese parties want to submit this case to DOCDEX

Issues:

Whether the DOCDEX Panel has jurisdiction over this case ?

**The DOCDEX Panel had jurisdiction over the case.**

- URDG 758 is the ICC Banking Rules, one of the rules applicable by DOCDEX. Secondly, according to the scope of application of the DOCDEX Rules, disputes over demand guarantees or counter-guarantees are within the scope of application of the DOCDEX Rules. Further, according to Article 2(2) of the DOCDEX Rules, either party may initiate the proceedings under the DOCDEX Rules. Therefore, the Panel has jurisdiction over the dispute
- It is worth noting that, although in principle DOCDEX decisions are not enforceable and are to be voluntarily complied with by the parties, given that most of the world's banks are members of the ICC Banking Committee, the DOCDEX decisions made by the ICC Banking Committee's experts have a certain degree of authority, and that more and more national courts are now respecting DOCDEX decisions, adopting the relevant opinions, and ultimately reflecting them in The DOCDEX decisions are authoritative..

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