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Chapter 15

Letters of Credit

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Introduction

In international sales, because of the long periods during which the cargo is in transit and the location of the seller and the buyer is in different countries, problems arise when it comes to payment since a simultaneous exchange of goods for money is not possible. The seller (exporter) cannot deliver goods to the buyer (importer) with one hand and take money from the buyer with the other. Ideally, the exporter would prefer to be paid for the goods as soon as they are put on board the ship. Financially, it is best if capital tied in the goods is released at the earliest opportunity, so that uncertainty about whether payment will be received on arrival at the destination is removed. Insolvency of the importer by the time goods reach their destination, or inability to raise sufficient funds to pay for them, does not concern the exporter. Of course, the seller could sell the goods at the port of destination, if he still retains property in the goods but then takes on the risk of unfamiliar conditions of a foreign market. Equally troubled about tying capital to cargo in transit, the buyer would wish to delay payment until arrival. Payment on arrival would also enable him to ascertain that he has not received sub-standard goods.

Payment can be affected in a number of ways. The degree of risk, be it from the seller's perspective or the buyer's, is dependent on the mode of payment. Which method is used is guided by factors such as the bargaining strengths of the parties to the sale contract, the economic climate in the importing and exporting countries, the political stability of the countries affecting the sale transaction and the degree of trust and confidence of each party in the other. Payment may be affected by:

(a) open account,
(b) bill of exchange,
(c) documentary bill and
(d) letter of credit (also known as documentary credit).

This chapter examines the first three modes of payment briefly to assess their relative strengths and weaknesses before focusing on letters of credit (also known as documentary credits or commercial credits),[1] the most frequently used mode of payment.

Open account

Parties to a sale contract may agree to payment by cash on order. This type of arrangement exposes the buyer to maximum risk since he parts with the cash before delivery. The parties may agree to payment on sight of documents ('sight payment'). On presentation of documents,[2] the buyer remits money to the buyer, using telegraphic transfer or mail transfer. Such arrangements are extremely risky from the exporter's point of view and are used only when he has confidence in the financial standing of the importer. This may have been established through past dealings with the importer. Typically, this arrangement is used in transactions between a parent and its subsidiaries.

Where the exporter is unsure about the financial health of the importer, he could arrange for payment in cash against documents, or on delivery. This way, he protects himself from the financial disasters of the importer. In rail and road transport, it is common for the rail or road carrier (transport operator) to undertake the task of collecting cash on delivery (COD) of goods at destination.[3]

1 See also 'Standby letters of credit', below.
2 Typically, transport documents, such as a bill of lading or certificate of quality. See also Chapters 1, pp 30, and 6, pp 174–85.
3 See, for example, CIM Rules (Uniform Rules Concerning the Contract for the International Carriage of Goods by Rail) (Chapter 11) in relation to rail and The Convention on the International Carriage of Goods by Road 1956 (CMR) (Chapter 12) in relation to road.

COD can also be used where the buyer collects goods from the seller's premises, as in 'ex works' contracts.[4]

Bills of exchange

The parties may agree to affect payment by bill of exchange. A bill of exchange (also known as a draft), along with others (e.g., cheques or share warrants), belongs to a class of documents called negotiable instruments. A negotiable instrument, which evidences an obligation to pay money by one party to another, has the following characteristics. First, it is transferable by delivery and, with the transfer, rights embodied in it are transferred, such that the transferee can enforce them in his own name. (No notice to the obligor, or assignment, is necessary.) Second, where the transferee takes it in good faith and for value, he takes it free of any defects of title of the transferor.[5]

The bill of exchange is an autonomous contract and is not affected by breach in the underlying contract that resulted in the creation of a bill of exchange. Because of these characteristics, bills of exchange are treated as cash.[6]

The law relating to bills of exchange in English law is to be found in the Bills of Exchange Act 1882 (hereinafter 'BEA'). Section 3(1) defines a bill of exchange as 'an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or bearer'.[7] A bill of exchange will look something like this:

Suppose that Smokey Sprays Ltd (S) has sold sprayers worth £1,000 to Benedict Noble (B). S (drawer) will draw a bill of exchange on B (drawee). It will be drawn in favour of a payee (to whom money is payable). It is not necessary that the payee is a third party. It could, for instance, be drawn in favour of the drawer (see Figure 15.1), or the bearer (see Figure 15.2). As to when money is payable will depend on the terms of the bill. Where it is payable on demand, or at sight (known as sight bills), money is payable on presentation. Where money is payable at a fixed or determinable time in the future (known as time bills), the buyer gets credit until the due date. The seller, for his part, will be able to realise money by selling the bill of exchange at a discount.[8] A time bill will be sent to the drawee for acceptance, who, if willing, will enter the words 'accepted' and sign it. On acceptance, the drawee will become the acceptor. It is not necessary that the bill is accepted by the drawee prior to negotiation (i.e., transfer by delivery), if a bearer bill (s 31(2)), or by endorsement and delivery, if an order bill (s 31(3)). The rights of the party to whom the bill is negotiated (holder) will depend on his status as holder. All holders are *prima facie* presumed to be holders in due course (s 30(1)), unless it is admitted or proved that the acceptance, issue or negotiation of the bill is affected by fraud, duress or illegality (s 30(2)). In this case, the holder has the burden of proving, according to s 30(2) of the BEA, that, subsequent to the alleged fraud or illegality, value has in good faith been given for the bill. A holder in due course takes the bill of exchange free of any defects and will be able to enforce payment against all parties liable on the bill (namely, indorsers, drawer and drawee). Any personal defences that may exist between the parties do not affect the holder in due course (s 38(2)). However, the holder in due course must meet the conditions laid down in s 29(1) of the BEA.

4 See Chapter 1, Ex Works.
5 *Crouch v Credit Foncier of England* (1873) LR 8 QB 374, at p 382.
6 *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 2 All ER 463, at p 470.
7 See also *Hamilton v Spottiswoode* (1894) 4 Ex 200; *Korea Exchange Bank v Debenhams* [1979] 1 Lloyd's Rep 548.
8 *Jade International Steel Stahl und Eisen GmbH and Co KG v Robert Nichols (Steels) Ltd* [1978] QB 917.

Figure 15.1: Illustration of an order bill of exchange

Exeter
1 March 2009

30 days after date pay to our order the sum of one thousand pounds, value received.
£1,000

Smokey Sprays Ltd

To: Benedict Noble Ltd,
Mollies Lane,
New York.

Figure 15.2: Illustration of a bearer bill of exchange

Exeter
1 March 2009

30 days after date pay to bearer the sum of one thousand pounds, value received.
£1,000

Smokey Sprays Ltd

To: Benedict Noble Ltd,
Mollies Lane,
New York.

A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely:

(a) that he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact;
(b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

A bill will be regarded as regular if there is nothing on the bill to arouse suspicion. In *Arab Bank Ltd v Ross*,[9] the payee, Fathi and Faysal Nabulsy Company, discounted the bills to the bank. The backs of the bills were indorsed 'Fathy and Faysal Nabulsy'. The word 'Company' was omitted. The issue was whether the bank could claim against Ross as holders in due course. The court held that the bank was not a holder in due course since the bill was irregular on its face. It did not set out the indorser's name in full. According to Lord Denning LJ:

> The first question in this case is whether the Arab Bank Ltd were holders in due course . . . that depends on whether, at the time they took it, it was 'complete and regular on the face of it' within s 29 of the Bills of Exchange Act 1882. Strangely enough, no one doubts the 'face' of a bill includes the back of it. I say 'strangely enough', because people so often insist on the literal interpretation of Acts of Parliament, whereas here everyone agrees that the literal interpretation must be ignored because the meaning is obvious . . . looking at the bill, front and back, without the aid of outside evidence, it must be complete and regular in itself.

9 [1952] 2 QB 216.

> Regularity is a different thing from validity. The Act itself makes a careful distinction between them. On the one hand, an indorsement which is quite invalid may be regular on the face of it. Thus, the indorsement may be forged or unauthorised and, therefore, invalid under s 24 of the Act, but nevertheless there may be nothing about it to give rise to any suspicion. The bill is then quite regular on the face of it. Conversely, an indorsement which is quite irregular may nevertheless be valid. Thus, by a misnomer, a payee may be described on the face of the bill by the wrong name, nevertheless, if it is quite plain that the drawer intended him as payee, then an indorsement on the back by the payee in his own true name is valid and sufficient to pass the property in the bill . . . but the difference between front and back makes the indorsement irregular unless the payee adds also the misnomer by which he was described in the front of the bill [at p 226].

A drawer and payee cannot be holder in due course for the simple reason that s 29 requires the bill of exchange be negotiated to the holder. However, a drawer or payee can become a holder in due course in circumstances prescribed by s 29(3), which provides:

> A holder (whether for value or not), who derives his title to a bill of exchange through a holder in due course, and who is not himself a party to any fraud or illegality affecting it, has all the rights of the holder in due course as regards the acceptor and all parties to the bill prior to the holder.

For instance, where the seller, S (the drawer/payee), indorses the bill to I1, I1 indorses it to I2, and I2 indorses it to S, S will be a holder in due course under s 29(3). This issue was considered in *Jade International Steel Stahl und Eisen GmbH and Co KG v Robert Nichols (Steels) Ltd*.[10] Jade International sold steel to the defendants and drew a bill of exchange on the buyers. The sellers discounted the bill to Sparkasse, a German bank. They discounted it to another German bank, and they, in turn, to Midland Bank. Midland Bank presented the bill to the buyers, who accepted it, but subsequently dishonoured it. Midland Bank exercised its right of recourse against the German bank, which, for its part, exercised its right of recourse against Sparkasse. It, eventually, reached Jade International, who brought an action against the buyers. The question before the court was whether the sellers as drawers/payees had become holders in due course under s 29(3) of the BEA. In a unanimous decision, the Court of Appeal found that Jade International had lost their capacity as drawer on discounting the bill and acquired the capacity of holder in due course when the bill was delivered to them as a result of Sparkasse's right of recourse.

A bill of exchange offers the seller the opportunity to realise cash, and the buyer obtains credit under a time bill. However, as Jade International exhibits in the previous example, a buyer (drawee) may dishonour a bill that he has accepted – that is, not pay the money when the bill is presented for payment on the due date. Although the primary liability lies with the drawee, the drawer becomes liable on recourse, provided notice of dishonour has been given by a holder or indorser. So, the seller might find himself holding the short straw where the buyer does not honour his obligations under the bill of exchange.

Mention needs to be made of the United Nations Convention on International Bills of Exchange and International Promissory Notes (hereinafter 'UNCITRAL Convention') adopted in 1988.[11] This convention is not yet in force. It requires 10 states to take action to come into force. So far, it has received five ratifications/accessions.[12] The intention, as with any international convention, is to harmonise the law relating to bills of exchange and, in doing so, introduces new concepts.[13]

10 [1978] QB 917.
11 The text of this convention is available at www.uncitral.org. Also reproduced in Carr and Goldby,, *International Trade Law Statutes and Conventions*, 2nd edn, 2011, Routledge-Cavendish.
12 According to information available at www.uncitral.org.
13 For example, the notion of a protected holder. See Arts 5(g) and 29.

Currently, legislation in most countries follows either the Anglo-American system (reflected by the United Kingdom (UK) BEA) or the Geneva system[14] adopted by countries with a civil law system. There are some differences between these two systems – for instance, in relation to forgeries and the distinction between different types of holders.[15]

The UNCITRAL Convention is primarily aimed at international bills of exchange, defined in its Art 2(1). For attracting the application of the UNCITRAL Convention, Art 1(1) requires that the bill of exchange be headed 'International bill of exchange (UNCITRAL Convention)', as well as included in the text. Were this convention to come into force, it would inevitably introduce a third system that could affect a bill of exchange provided the factors set out in Arts 1 and 2 are met. Unless there is a widespread willingness to adopt the UNCITRAL Convention, all it produces is disharmony and uncertainty.

Documentary bill

The parties may agree to affect payment through documentary bills. Here, the seller (drawer) draws a bill of exchange on the buyer (drawee) and attaches this to the bill of lading. The advantage for the seller is that, on acceptance of the bill of exchange by the buyer, money can be obtained by the seller, before the maturity date of the bill of exchange, by selling it at a discount (discounting) to a bank. As for the buyer, he obtains credit until the bill of exchange's maturity date. A major disadvantage for the seller, however, with a documentary bill, is that the buyer may not honour the bill of exchange, in which case, the party to whom the seller discounted the bill of exchange would have recourse to him. In the event of dishonour of the bill of exchange by the buyer, the property remains with the seller and the buyer is required to return the bill of lading to the seller according to s 19(3) of the Sale of Goods Act 1979.

If the buyer retains the bill of lading, he will be liable in conversion to the seller. Were he to collect the goods and sell them on to a third party, he will be liable to the seller again in conversion. The third party, as long as he has acted in good faith, may avail himself of the statutory protection under s 25 of the Sale of Goods Act 1979 or s 9 of the Factors Act 1889. Since a documentary bill arrangement is open to abuse, it is common practice to use a bank for the presentation of documents and collection of payment. Acting on instructions from the seller, the seller's bank (the remitting bank) will arrange for a bank in the buyer's country (the collecting bank) to deliver documents against acceptance of bill of exchange (D/A), or against payment (D/P).[16] Where a collecting bank releases the documents without obtaining an acceptance or payment, the seller can sue the collecting bank. Lack of privity of contract will not be an issue, since the remitting bank acts as the seller's agent.[17] Practices in relation to collection arrangements have been standardised by the ICC in its Uniform Rules for Collections (URC). The latest version of the URC[18] was formulated in 1995 and came into force on 1 January 1996. The revision was necessitated by developments in the

14 See Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes 1930. Text reproduced in Carr and Goldby, *International Trade Law Statutes and Conventions*, 2nd edn, 2011, Routledge-Cavendish.

15 See Odeke, 'The United Nations Convention on International Bills of Exchange and Promissory Notes' [1992] JBL 281.

16 See Art 2(a) of the International Chamber of Commerce (ICC) Uniform Rules for Collection (Brochure No 522), 1996, ICC.

17 See *Calico Printers Association Ltd v Barclays Bank* (1930) 36 Com Case 197. A bank may decide to release the documents to the buyer under a trust receipt that evidences the bank's ownership. The buyer as trustee is under an obligation to maintain the goods or the sale proceeds distinct from his assets so that they are identifiable. The buyer, in other words, holds them ready for repossession. See also *Lloyd's Bank v Bank of American National Trust and Saving Association* [1937] 2 KB 631; *Midland Bank Ltd v Eastcheap Dried Fruit Co* [1921] 1 Lloyd's Rep 359.

18 ICC Brochure No 522, 1995, ICC.

use of information technology and changing banking practices. As with other ICC rules, such as INCOTERMS,[19] they need to be specifically incorporated in the contract.[20]

Letters of credit

Letters of credit (also known as documentary credits or commercial credits) are better alternatives to a documentary bill. Depending on the type of credit, they offer the seller (beneficiary of a credit arrangement) greater security.[21] Their popularity in international commerce has led judges to describe them as 'the life blood of international commerce'.[22] Their origins have been traced to various ancient cultures, such as that of Rome, Egypt and China. It is difficult to point with certainty to the culture responsible for introducing this mechanism in some form or another.[23] In modern times, reference to letters of credit in England can be found in *Pillans v Van Mierop*.[24] Regardless of their origins, merchants across the world embraced and continue to embrace them whole-heartedly, and much of the law governing letters of credit is grounded in custom and mercantile practice.[25]

Law relating to letters of credit

No attempt was made to harmonise the law on letters of credit through international conventions. A near global unification, however, has been achieved through the efforts of the ICC, which is responsible for the Uniform Customs and Practice of Documentary Credits (hereinafter 'UCP'). An eminent academic, Professor RM Goode, describes it as the 'most successful harmonising measure in the history of international commerce'.[26] The unification is, as Professor EP Ellinger (a leading expert on letters of credit) observes, a consequence of necessity and use of banks as agents in international trade.[27] The UCP was by no means an overnight success. The first set of rules drafted by the ICC in 1929 was not well received, with adoptions from only France and Belgium. A new version of the UCP, formulated in 1933, met with moderate success, with 40 countries adopting it. The UK and the Commonwealth countries were not among them. The 1951 version, despite adoption in 80 countries (including the US), was received unfavourably in both the UK and the Commonwealth. A much revised version in 1962 (addressing the concerns of the UK) gained acceptance in the UK. Further revisions were produced in 1974 and 1983 to refine some of the provisions and introduce rules to reflect new modes of transport and emerging practices among the mercantile community. Although the 1983 version was used in over 170 countries, the ICC felt the need to undertake yet another revision in the 1990s and that resulted in the 1994 version (UCP 500). However, the UCP 500, over time, came to be seen as complicated and prone to ambiguity, which resulted in many presentations being rejected because of minor discrepancies thus raising doubts about the role of letters of credit as a secure method of payment. So, the ICC

19 See Chapter 1, INCOTERMS 2010.

20 Ibid. See also 'Letters of credit', below.

21 See 'Letters of credit: their nature and advantages', p 439.

22 *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)* [1982] 2 QB 208, at p 222; *Harbottle (RD) (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146, at p 155.

23 See De Rooy, *Documentary Credits*, 1984, Kluwer, for an excellent, comprehensive account on the evolution of letters of credit.

24 (1763) 3 Burr 1663, at p 1668.

25 Many disputes relating to letters of credit are referred to arbitration. The International Center for Letter of Credit Arbitration (ICLOCA) offers specialist arbitration in this area and their rules are modelled on the UNCITRAL Arbitration Rules. For more on ICLOCA visit www.iiblp.org. See also Chapters 19 and 20.

26 See Goode, *Commercial Law*, 2004, Butterworths.

27 See Ellinger, *Documentary Letters of Credit: A Comparative Study*, 1970, University of Singapore Press.

set to work again on the UCP in the early part of this decade, which culminated in the UCP 2007 version (Publication No. 600).[28] The 2007 version is leaner than the UCP 500 and is more user friendly. Consisting of 39 articles, the UCP 600 applies only to irrevocable letters of credit. Besides undertaking a tidying up exercise, it also contains new articles on definitions and interpretation, thus providing for more clarity. For instance, Art 3 states how words such as 'on or about', 'prompt', 'immediately', 'to', and 'until' often found in documents are to be interpreted for the purposes of the UCP 600, thus cutting down on the chances of uncertainty brought about by a variety of interpretations. The UCP 600 also contains other new articles – for example, advising credits and amendments (Art 9), the effect of nomination (Art 12) and dealing with originals and copies (Art 17). A number of articles found in UCP 500 have also been deleted (i.e., Art 5 on instructions to issue and amend, Art 6 on revocable credits, Art 8 on revocation of credits, Art 12 on incomplete instructions, Art 15 on complying presentation and Art 38 on other documents). In the following sections all references to UCP are to UCP 600, unless otherwise indicated.

The UCP 600, like INCOTERMS 2000,[29] does not have the force of law in England. This means that the UCP needs to be specifically incorporated. In the absence of incorporation, it will not apply. This, for the most part, will not affect the rights and liabilities of the parties greatly under the credit, since English courts do take mercantile customs and practices into account. Moreover, the rules of the UCP largely reflect those of common law, apart from a few differences. For instance, under Art 18(c) of the UCP, 'the description of the good services or performance in the commercial invoice must correspond exactly with that appearing in the credit'. There is, however, no corresponding requirement at common law since, it seems, a commercial invoice need not contain a description of the goods.[30] The UCP also allows certain tolerances in quantity, credit amount and unit price in Art 30, which is not the case in common law.[31] Since the UCP does not have the force of law in England, it will apply subject to any express terms. If an express term in the contract contradicts the UCP terms, the former prevails. As Mustill J stated in *Royal Bank of Scotland plc v Cassa di Risparmio delle Provincie Lombard*[32]:

> . . . it must be recognised that [the UCP] terms do not constitute a statutory code. As their title makes clear, they contain a formulation of customs and practices, which the parties to a letter of credit can incorporate into their contracts by reference. If it is found that the parties have explicitly agreed such a term, then the search need go no further, since any contrary provision in UCP must yield to the parties' expressed intention.

The UCP, it must be added, is not comprehensive. It does not, for instance, address the effect of fraud or illegality on the documentary credit arrangement. The sections that follow, therefore, take into account both the UCP provisions and common law, as relevant, when examining the nature and characteristics of documentary credits, the different types of credits, and obligations of the various parties involved in the transaction.

In 2007, the ICC also issued the International Standard Banking Practice (hereinafter 'ISBP'),[33] which explains in detail how the UCP 600 is to be applied. It provides a list of items that document examiners need to check.

28 This publication is available for purchase from the International chamber of Commerce, available at www.iccwbo.org.
29 See Chapter 1.
30 *Ireland v Livingstone* (1871) 27 LT 79; see also Chapter 1.
31 See 'Doctrine of strict compliance', pp 447–50.
32 (1992) *Financial Times*, 21 January.
33 Publication No 681, ICC Publishing. The 2002 version of ISBP was a supplement to UCP 500.

Letters of credit: their nature and advantages

Under a documentary credit, the buyer (applicant) agrees to pay the seller (beneficiary) using a reliable paymaster – generally, a reputable bank in the seller's country – who pays against the presentation of stipulated documents that comply with the terms of the credit. The UCP defines documentary credit in Art 2 as:

> . . . any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank (the bank that issues a credit at the request of an applicant or on its own behalf) to honour[34] a complying presentation.

The documentary credit arrangement is advantageous to both seller and buyer. The seller has the assurance that he will be paid by a bank – a reliable and solvent paymaster – in his own country as soon as he presents the stipulated documents to it. If necessary, he will also be able to use the documentary credit arrangement (using special transferable or back-to-back credit) to obtain goods from the manufacturer.[35] Localisation of the financial transaction, as in a confirmed letter of credit, will enable the seller to sue the bank in his own country should it – for instance, refuse to honour the credit on presentation of the documents specified in the contract of sale.[36] The buyer can raise funds from the bank on the strength of the documents, thus alleviating the need to have sufficient funds to pay the seller.[37]

Stages in a documentary credit transaction

A documentary credit transaction involves a number of stages:

Stage 1

The parties to the contract of sale agree to settle by documentary credit.[38]

Stage 2

The buyer (applicant) applies to his bank (issuing bank) to open a credit in favour of the seller (beneficiary). The applicant will give details of the documents required, such as transport documents, invoices, insurance policies, certificate of quality and certificate of origin to the bank.[39] The instructions will also include the time and place for presenting documents.

34 Honour according to Art 2 means:
(a)to pay at sight if the credit is available by sight payment;
(b)to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment;
(c)to accept a bill of exchange ('draft') drawn by the beneficiary and pay at maturity if the credit is available by acceptance.
35 See 'Back-to-back credits', p 455.
36 See 'Confirmed credit', pp 455.
37 See *Soproma SpA v Marine and Animal By-Products Corp* [1966] 1 Lloyd's Rep 367, at p 385.
38 Dependant on the terms of the contract, the provision for the opening of letter of credit may operate as a condition precedent to the obligation of the seller to load the cargo. See *Kronos Worldwide Ltd v Sempra Oil Trading SARL* [2004] 1 Lloyd's Rep 260.
39 See *Commercial Banking Co of Sydney Ltd v Jalsard Pty Ltd* [1973] AC 279; *European Asian Bank AG v Punjab and Sind Bank (No 2)* [1983] 1 WLR 642. See also *Bayerische Vereinsbank Aktiengesellschaft v National Bank of Pakistan* [1997] 1 Lloyd's Rep 59.

Given the different methods for transport documents in use, the UCP makes provisions for the acceptability of these different transport documents. Articles 20, 21, and 22 deal with the marine bill of lading, non-negotiable sea waybill[40] and charterparty bill of lading. Although the UCP recognises these other types of transport documents in relation to sea carriage, it does not follow that these will be acceptable substitutes where the letter of credit calls for a bill of lading. The UCP also enables the acceptability of air transport document (Art 23), multimodal transport document (Art 19), road and rail documents (Art 24) provided the documents contain the stipulated information[41] and meets the conditions as stipulated in the credit.

In relation to insurance, the banks will not accept cover notes (Art 28(c))[42] An insurance document containing references to exclusion clauses will be acceptable (Art 28(i)).

Stage 3

The issuing bank[43] (also sometimes called the opening bank) will generally instruct a correspondent bank in the beneficiary's country to advise the seller of the opening of the documentary credit. (Note, however, that the issuing bank may advise the beneficiary directly, although this is rare.) The correspondent/advising bank[44] would normally, although not necessarily, be the seller's bank. The instruction from the issuing bank to the advising bank will generally be worded as follows:

> Please advise the terms of this credit to the beneficiary (seller) without engagement on your part. Please honour presentation of documents and debit our account with you in settlement.[45]

The choice of bank in the exporter's country will depend on the issuing bank's banking network. However, it is not unknown for a seller to insist on a particular bank to act as the advising bank in the sale contract. For instance, American companies often insist that importing countries with nationalised banks use only major international banks (preferably US or English) as issuing banks and advising banks. Hostility toward nationalised banks is fuelled by lack of confidence about the solvency of such banks, fear of state intervention, and possible claim of immunity from suit, in the event of litigation, on the grounds of being an arm of the state.[46] Nationalised banks are commonly found in developing countries, such as India. The issue of which banks to use needs to be resolved when agreeing to documentary credit for affecting payment. If the documentary type is of a type called a confirmed credit,[47] the correspondent bank will add its own confirmation to the credit.

40 That is, a straight bill of lading. For more on bills of lading, see Chapter 6.
41 For example, the name of the carrier, place of destination and shipment, and indication that goods have been shipped on board at the port of loading stated in the credit. See, for example, Art 20(a)(i)–(vi).
42 In UCP 500 cover notes were acceptable provided the letter of credit authorised it.
43 The issuing bank is defined in Art 2, UCP as 'The bank that issues a credit at the request of an applicant or on its own behalf'.
44 Advising bank is defined in Art 2, UCP, as 'the bank that advises the credit at the request of the issuing bank'. There is a contractual relationship between the issuing bank and the advising bank/confirming bank. If a confirming bank does not receive reimbursement, it can obtain damages. See *Bayerische Vereinsbank Aktiengesellschaft v National Bank of Pakistan* [1997] 1 Lloyd's Rep 59. See also the interesting case of *Standard Chartered Bank v Pakistan National Shipping Corp (Nos 2 and 4)* [2003] 1 Lloyd's Rep 227 and Todd, 'Outlawing dishonest international traders' [2000] LMCLQ 394.
45 Clause used by National Westminster Bank plc – *Documentary Credits Service Booklet*.
46 See *Trendtex Trading Corp v Central Bank of Nigeria* [1977] QB 529.
47 See 'Confirmed credit', pp 455.

Stage 4

The advising/confirming bank will inform the beneficiary of the opening of the credit. Where the credit is a confirmed one, it is likely to contain a clause worded as follows:

> We are requested to add our confirmation to this credit and we hereby undertake to pay you the face amount of your bills of exchange (drafts) drawn within the credit terms and provided such bills of exchange bear the number and date of the credit and that the letter of credit and all amendments thereto are attached.[48]

As gathered from the reading of this clause, important rights in favour of the beneficiary flow from the adding of the confirmation by a bank. These are considered later in this chapter under Confirmed credit below.

Stage 5

The seller will ship the goods, provided the letter of credit conforms with what was agreed in the sale contract. The seller, however, may decide to ship goods even where the terms of the credit do not conform with the terms agreed in the contract of sale. The seller's behaviour may constitute a waiver or variation. This will depend on the circumstances.[49]

Stage 6

On shipment, the seller will obtain the transport documents (e.g., bill of lading, consignment note) and other documentation as required under the credit, such as certificate of quality and certificate of origin, and present them to the advising or confirming bank. The banks normally expect clean transport documents. A clean transport document is defined in Art 27 as a document that 'bears no clause or notation which expressly declares a defective condition of the goods the packaging'. According to Art 27, however, the word 'clean' need not appear on the transport document, even if a credit has a requirement for that transport document to be 'clean on board'. Of course, it is open to the parties to stipulate the notations or clauses that may be accepted.

Stage 7

The bank will effect payment, provided the documents conform. Payment will depend on what has been agreed in the credit. The agreement may be for:

(a) payment at sight,
(b) deferred payment,
(c) acceptance credit (also known as usance credit or term credit) or
(d) negotiation credit.

Where payment at sight is agreed, the seller will receive cash on presentation of conforming documents. In a deferred payment situation, payment in cash will take place at a future time as agreed by the parties – for example, '30 days after sight', '60 days after shipment'. In an acceptance credit, the bank will accept bills of exchange drawn on it by the seller. The bill of exchange could call for immediate payment (payment at sight)

48 Clause used by National Westminster Bank plc – *Documentary Credits Service Booklet*.
49 See 'Waiver and variation', p 460.

or payment on a fixed date or determinable future date (time bill). In most cases, it is likely to be a time bill. Once the bill of exchange is accepted and returned to the seller, he will be able to sell it at a discount. In the case of a negotiation credit, the bank will agree to negotiate the bill of exchange drawn on the issuing bank or the buyer. Whether negotiation[50] is restricted to the advising bank, the confirming bank, or is freely negotiable with any bank in the exporter's country, will depend on the terms of the agreement. A negotiating bank will normally have recourse to the seller if the issuing bank does not reimburse the negotiating bank due to discrepancies in the documents. A confirming bank will negotiate without recourse, provided documents conform with the terms of the credit.

Stage 8

The advising bank or the confirming bank will forward the documents to, and will be reimbursed by, the issuing bank, which, in turn, will pass the documents on to the buyer and collect payment.

The above stages can be diagramatically expressed in the following manner (Figure 15.3):

Characteristics of letters of credit – autonomy and strict compliance

Fundamental to letters of credit are two characteristics which establish their importance in international commerce. These are:

(a) the autonomy of letters of credit and
(b) the doctrine of strict compliance.

Autonomy of letters of credit

According to the principle of autonomy, the undertaking of the issuing bank or confirming bank to pay against the documents is seen as a primary obligation. Any dispute that may exist between seller and buyer in respect of the contract of sale that brought the documentary credit into existence will not affect the credit. The obligations of the banks (issuing bank and confirming bank) are in respect of the documents, not in respect of the goods. As long as the documents are in order, the banks cannot get out of their obligations by pointing to incidents, such as shipment of defective goods. This principle of autonomy, which secures payment of price against documents, is well established in law. As Jenkins LJ said, in *Hamzeh Malas and Sons v British Imex Industries Ltd*[51]:

> We have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective

50 Negotiation is defined in Art 2 of UCP as 'the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank'. Nominated bank is defined as 'The bank with which the credit is available or any bank in the case of credit available with any bank'. See also Arts 7(c) and 8(c) UCP on reimbursement to nominated bank upon negotiation by nominated bank.

51 [1958] 2 QB 127.

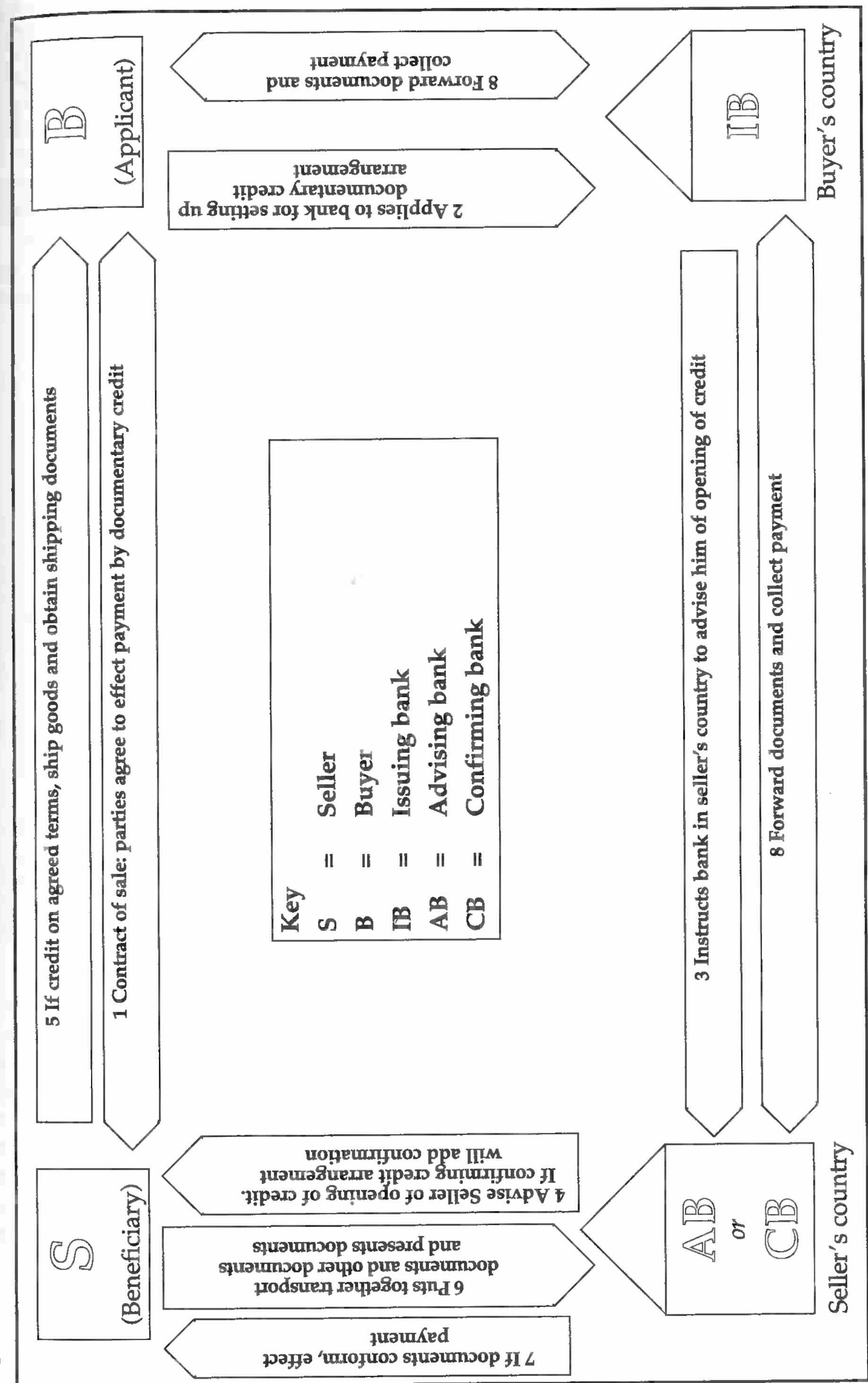


Figure 15.3: Stages in a typical documentary credit arrangement

of any dispute there may be between the parties as to whether the goods are up to contract or not . . . A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. That is of no mean advantage when goods manufactured in one country are being sold in another. It is, furthermore, to be observed that vendors are often reselling goods bought from third parties. When they are doing that, and when they are being paid by a confirmed letter of credit, their practice is . . . to finance the payments necessary to be made to their suppliers against the letter of credit. That system of financing these operations, as I see it, would break down completely if a dispute as between the vendor and the purchaser was to have the effect of 'freezing', if I may use that expression, the sum in respect of which the letter of credit was opened [at p 129].[52]

The separation of the letter of credit transaction from the sale transaction, regarded as sacrosanct, is enshrined in Arts 4 and 5 of the UCP as follows:

CREDITS v CONTRACTS

[4] (a) A credit, by its nature, is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit, is not subject to claims or defences by the applicant resulting from his relationships with the issuing bank or the beneficiary.

A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant and the issuing bank.

(b) An issuing bank should discourage any attempt by the applicant to include as an integral part of the credit, copies of the underlying contract, proforma invoice and the like.

DOCUMENTS v GOODS, SERVICES OR PERFORMANCE

[5] Banks deal with documents, and not with goods, services or performance to which the documents may relate.

Buyers often seek an injunction to stop the bank from paying where goods do not match the contract description, but courts are unwilling to grant such injunctions. *Discount Records Ltd v Barclays Bank Ltd*[53] illustrates this. On delivery of the cargo, the buyer discovered that some of the boxes (which should have contained records) were empty, whereas others contained cassettes, rather than records. The buyer sought an injunction to stop the bank from paying the seller. It was refused by the court. According to Megarry J, the banker's obligation to pay under the credit was separate from the contract of sale, and the court could intervene only if a sufficiently grave cause was shown. To allow buyers to intervene in the payment arrangements between the issuing bank and the seller (beneficiary) where the goods do not match the contract description would seriously

52 See also *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168, at pp 182–3; *Tukan Timber Ltd v Barclays Bank plc* [1987] 1 Lloyd's Rep 171, at p 174. The autonomy of the letter of credit was recently reasserted in *Montrod Ltd v Grundkotter Fleischvertriebs GmbH, Standard Chartered Bank* [2001] EWCA Civ 1954. See also *Solo Industries UK Ltd v Canara Bank* [2001] 2 Lloyd's Rep 57.

53 [1975] 1 Lloyd's Rep 444.

affect international trade since the seller enters into the contract of sale with a documentary credit arrangement in the belief that he will be paid under an irrevocable credit and may rely on the provision of the credit to purchase goods from manufacturers, or manufacture the goods himself. If courts were to intervene, certainty of payment normally associated with commercial credits is seriously affected.

Payment by the bank, however, does not affect the buyer's rights under the contract of sale. The buyer can always sue the seller for breach of contract in the event of receiving no goods, or sub-standard goods.

The sanctity of the separation of a letter of credit from the underlying sale contract is also illustrated by *Power Curber International Ltd v National Bank of Kuwait*,[54] where the English courts enforced payment by the bank despite an order from a Kuwaiti court forbidding payment. In this case, Power Curber, an American company, sold machinery to a firm in Kuwait. An irrevocable letter of credit was issued by the National Bank of Kuwait, who instructed the Bank of America to advise the sellers of the credit. On delivery, the buyers raised a counterclaim against the sellers and obtained a provisional attachment order from the courts in Kuwait, restraining the bank from paying the seller on the credit. The bank, who had a registered office in London, was sued by the sellers in the English courts. At first instance, and in the Court of Appeal, it was held that the order obtained in Kuwait did not affect the bank's obligation to pay the seller on the credit since the bank is not concerned with any dispute that arises from the contract of sale. As Lord Denning MR said:

. . . it is vital that every bank which issues a letter of credit should honour its obligations. The bank is in no way concerned with any dispute that the buyer may have with the seller. The buyer may say that the goods are not up to contract. Nevertheless, the bank must honour its obligations. The buyer may say that he has a cross-claim in a large amount. Still, the bank must honour its obligations. No set-off or counterclaim is allowed to detract from it . . . a letter of credit is given by a bank to the seller with the very intention of avoiding anything in the nature of a set-off or counterclaim [at p 1241].

The principle of autonomy favours the banks (be it an issuing bank or confirming bank) and the seller. Banks are not placed under an obligation to ensure that the cargo corresponds to the contract description. Risk is on the buyer, because he cannot involve the issuing bank to police the seller's activities in the exporting country. The principle of autonomy places the buyer at the beneficiary's mercy.

It is always open to the issuing bank to agree to get involved in the underlying sale contract – to ensure the actual performance of the underlying contract. A reference to the sale contract with statements such as 'Documents evidencing shipment in accordance with Contract No BEN/CT/321 dated 12/7/98 must be presented', found normally in letters of credit, is not indicative of consent on the part of the banker. This view is preserved in Art 4(a) of the UCP when it states that reference to the contract of sale in the credit does not destroy the separation of the credit transaction from the sale transaction. Clearer words are needed for incorporation of the underlying contract into the letter of credit.[55] It is questionable whether the wide wording – 'any reference whatsoever to it' – in Art 4(a) of the UCP will nullify an express term to incorporate the contract of sale in the letter of credit under English law. As stated in *Royal Bank of Scotland plc v Cassa di Risparmio delle Provincie Lombard*,[56] the UCP must yield to the parties' expressed intention. In practice, it would be extremely rare to find a bank willing to get involved beyond the level of payment against documents.

54 [1981] 1 WLR 1233.

55 For an American decision on this point, see *NMC Enterprises Inc v Columbia Broadcasting System Inc* 14 UCC Rep 1427 (1974 NYSC).

56 (1992) *Financial Times*, 21 January.

The principle of autonomy is affected in the event of illegality in the underlying transaction or fraud. The fraud defence is examined subsequently.[57] As for illegality, there is precedent to say that no obligation exists to pay on a letter of credit issued contrary to exchange control regulations. In *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)*,[58] English sellers contracted for the sale of a manufacturing plant to Peruvian buyers. The sellers quoted double the genuine purchase price, at the request of the buyer, with the intention that the sellers, on obtaining payment, would transfer the excess amount to a bank account in the US. In other words, the intention was to exchange Peruvian currency for US dollars using the contract of sale and the documentary credit. This was contrary to the exchange regulations of Peru. Article VIII, s 2(b) of the Bretton Woods Agreement, to which England was a party, provided:

> Exchange contracts which involve the currency of any member and which are contrary to exchange regulations of that member maintained or imposed consistently with this agreement shall be unenforceable in the territories of any member . . .

The House of Lords concluded that the transaction in respect of the excess amounted to an exchange contract and was unenforceable since it contravened the Bretton Woods Agreement. In Lord Diplock's view:

> . . . if in the course of the hearing of an action the court becomes aware that the contract on which a party is suing is one that this country has accepted an international obligation to treat as unenforceable, the court must take the point itself, even though the defendant has not pleaded it, and must refuse to lend its aid to enforce the contract. But this does not have the effect of making an exchange contract that is contrary to the exchange control regulations of a Member State other than the United Kingdom into a contract that is 'illegal' under English law or render acts undertaken in this country in performance of such a contract unlawful . . . it is [simply] unenforceable and nothing more [at pp 188–89].

As is obvious from Lord Diplock's judgment, the transaction was seen as unenforceable, not illegal under English law. The illegality of the underlying contract will also, according to a recent case, affect the payment undertaking in letters of credit.[59] In *Mahonia Ltd v JP Morgan Chase Bank and Another*,[60] the underlying swaps transactions were illegal under US law. Although acknowledging the impregnability of letters of credit, the court went on to say that, as a matter of public policy, they would not permit the process to be used to obtain the benefit of an unlawful act. According to Colman J:

> It would, however, be wrong in principle to invest letters of credit with a rigid inflexibility in the face of strong countervailing public policy considerations. If a beneficiary should as a matter of public policy (*ex turpi causa*) be precluded from utilizing a letter of credit to benefit from his own fraud and it is hard to see why he should be permitted to use the courts to enforce part of an underlying transaction which would have been unenforceable on grounds of illegality if no letter of credit had been involved, however serious the material illegality involved. To prevent him doing so in an appropriately serious case such as one involving international crime could hardly be seen as a threat to the lifeblood of international commerce [at para 68].

57 See 'The Fraud exception', pp 467–9.
58 [1983] 1 AC 168.
59 See *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 Lloyd's Rep 345, at pp 362–3.
60 [2003] EWHC 1927 (Comm).

Many interesting questions can be asked in this context. Is a bank under a duty to look into the underlying contract of sale before agreeing to issuing or confirming a credit? Is the bank expected to have expert knowledge of descriptions used in a particular trade, scientific descriptions of chemicals, and so on? If a bank is suspicious about the underlying transaction, should it make further enquiries? How vigilant should the bank be?

Doctrine of strict compliance

As stated earlier,[61] the beneficiary will present documents to the issuing, advising or confirming bank as appropriate. Acceptance or rejection of the documents by the bank is dependent on whether the documents conform on their face to the terms of the credit. If, on their face, they are in strict conformity with the terms of the credit, the bank will accept the documents. If they are not, they will reject the documents. This is commonly referred to as the doctrine of strict compliance.

The tender of documents that are similar is not acceptable under the doctrine of strict compliance. As Lord Summer said in *Equitable Trust Co of New York v Dawson Partners Ltd*,[62] '. . . there is no room for documents which are almost the same, or which will do just as well' (at p 52). The strict application of the doctrine is well illustrated by *Moralice (London) Ltd v ED and F Man*[63] and *JH Rayner and Co Ltd v Hambros Bank Ltd*.[64] In the former case, the credit stipulated a bill of lading for 5,000 bags. The bank's rejection of the tendered bill, which referred to 4,997 bags, was allowed. According to McNair J, *de minimis non curat lex* could not be applied. In the latter case, the credit referred to a shipment of 'Coromandel groundnuts'. The bill of lading tendered by the seller referred to 'machine-shelled groundnut kernels'. This was understood in the trade to be the same as 'Coromandel groundnuts'. The bank, however, rejected the documents, and the Court of Appeal held that it was right to do so. According to Mackinnon LJ:

> The words in that bill of lading clearly are not the same as those required by the letter of credit. The whole case of the plaintiffs is, in the words of Lord Summer, that 'they are almost the same, or they will do just as well'. The bank, if they had accepted that proposition, would have done so at their own risk. I think on pure principle that the bank were entitled to refuse to accept this sight draft on the ground that the documents tendered, the bill of lading in particular, did not comply precisely with the terms of the letter of credit which they have issued [at p 40].

He also went on to say that the bank was not expected to know the customary terms of the trade, a reasonable view since the bank is an expert in finance and not in a particular trade. In other words, the bank trades in documents, not in goods. This sentiment is also expressed in the UCP by Art 5, when it states that parties to a documentary credit 'deal with documents, and not with goods, services or performance to which the documents may relate'.

Since the bank is not imputed with knowledge of trade practices, this means that the documents must meet the specific requirements of the credit, however trivial they might appear. In *Seaconsar v Far East Ltd v Bank Makazi Jomhouri Islami Iran*,[65] the credit required that each document tendered should list the letter of credit number and the name of the buyer. However, these were omitted on one of the documents, and the bank rejected the tender. The seller argued that the omission of the credit

61 See Stage 7 under 'Stages in a documentary credit transaction', above.
62 (1927) 27 LlL Rep 49.
63 [1954] 2 Lloyd's Rep 526.
64 [1943] 1 KB 37, at pp 40–1, per McKinnon LJ.
65 [1993] 1 Lloyd's Rep 236; [1994] 1 Lloyd's Rep 1.

number and name of buyer was of a trivial nature. The court held that the bank was entitled to reject the documents; the credit number and the name of the buyer could not be treated as trivial since they were specifically required.

The harshness of the doctrine of strict compliance is eased by the UCP. Although Art 18(c) requires that the 'description of the goods in a commercial invoice must correspond with the credit', other documents, according to Art 14(e) may describe the goods in general terms not conflicting with the description of the goods in the credit. The UCP also allows various tolerances in credit amount, weight and value of the goods under Art 30:

(a) The words 'about' or 'approximately', used in connection with the amount of the credit or the quantity or the unit price stated in the credit, are to be construed as allowing a tolerance not to exceed 10% more or 10% less than the amount or the quantity or the unit price to which they refer.
(b) A tolerance not to exceed 5% more or 5% less than the quantity of the goods is allowed, provided the credit does not state the quantity in terms of a stipulated number of packing units or individual items and the total amount of the drawings does not exceed the amount of the credit.
(c) Even when partial shipments are not allowed, a tolerance not to exceed 5% less than the amount of the credit is allowed, provided that the quantity of the goods, if stated in the credit, is shipped in full and a unit price, if stated in the credit, is not reduced or that sub-Art 30(b) is not applicable. This tolerance does not apply when the credit stipulates a specific tolerance or uses the expressions referred to in sub-Art 30(a).

It is not uncommon for copies of documents to be tendered, rather than the originals. Although the common law rule is that only originals are acceptable, Art 20(b) of the UCP 500 seemed to relax this rule and allow documents that were not originals or did not appear to be originals since it stated that, unless otherwise stipulated in the credit, banks would also accept as an original document(s) a document(s) produced or appearing to have been produced:

(i) by reprographic, automated or computerised systems;
(ii) as carbon copies;

provided that it is marked as an original and, where necessary, appears to be signed.

Article 20(b), however, created uncertainties and resulted in a number of cases in the English courts. In *Glencore International AG v Bank of China*,[66] the dispute was over photocopies of a certificate that had been printed with a laser printer. The laser printed document and the photocopies were indistinguishable. One of the photocopies was signed by the beneficiary and tendered. The documents were rejected by the issuing bank. Two arguments were put forward in the litigation: one that the signature on the document made it an original and took it outside the purview of Art 20(b); two, if the document was caught by Art 20(b), then the signature was sufficient to mark the document as an original. Both at first instance and on appeal, the arguments were rejected. According to Sir Thomas Bingham MR, 'a signature on a copy does not make it an original; it makes it an authenticated copy; and Art 20(b) does not treat a signature as a substitute for marking as "original", merely as an additional requirement' (at p 153). The documents needed to be marked 'original' to meet the conditions set out in Art 20(b). The court perceived Art 20(b) as a clear provision intended to

66 [1996] 1 Lloyd's Rep 135.

clarify any doubts there might be about documents produced by modern technology. According to Sir Thomas Bingham MR:

> . . . there is abundant room to debate what, in the context of modern technology, is an original. A handwritten or typed document plainly is, but other documents can also plausibly be said to be so. Article 20(b) is, as it seems to us, designed to circumvent this argument by providing a clear rule to apply in the case of documents produced by reprographic, automated or computerized systems. The sub-article requires documents produced in a certain way (whether 'original' or not) to be treated in a certain way. It is understandable that those framing these should have wished to relieve issuing bankers of the need to make difficult and fallible judgments on the technical means by which documents were produced. The beneficiary's certificates in this case may, in one sense, have been originals: but it is plain on the evidence that they were produced by one or other of the listed means and so were subject to the rule [at p 153].

The scope of Art 20(b) was considered yet again in *Kredietbank Antwerp v Midland Bank plc*.[67] The dispute was over an insurance contract produced with a word processor on headed, watermarked, high quality paper. The contract was signed with a blue pen and stapled to a form containing standard terms. The issue was whether the conditions stipulated in Art 20(b) applied to documents produced by computerised systems. The defendants (the issuing bank who rejected the documents) argued that it did and, since it was not marked 'original', it did not meet the stipulations laid down in Art 20(b). The plaintiffs for their part suggested that Art 20(b) did not apply to obvious originals – the use of the word 'also' in Art 20(b) lending support for this view. Further, they said that, even if the document under examination fell within Art 20(b), the documents tendered indicated that it was an original. Although exhibiting sympathy with this suggestion, the court of first instance held that the document fell within the purview of Art 20(b). According to Diamond J, the requirement that the document be marked 'original' would be satisfied 'if it's a necessary implication from the terms and marks in the bill of lading, or . . . the set of documents, that the document or documents are originals' (at p 183). In the case under discussion, the document met the requirements since it was produced on original headed paper; it also stated that it had been issued both in the original and duplicate (the duplicate being the photocopy of the document on the headed and watermarked paper), and the photocopied document accompanied the document on the headed, watermarked paper. On appeal, the court concluded that the document was not caught by Art 20(b) but was clearly an original. In the words of Evans LJ:

> . . . there is nothing in Art 20(b) which entitles the bank to reject an original document which previously was a valid tender under the credit. A document which is clearly the original, in the sense that it contains the relevant contract, and which is not itself a copy of some other document, is certainly an original for the purposes . . . [at p 227].

Further, the use of the word 'also' in Art 20(b) indicated that the intention of the drafters was to extend the types of documents that would be acceptable. Article 20(b) was not meant to apply to documents that were originals but to those that were copies of an original document.

Subsequent to these decisions, the ICC (Commission on Banking Technique and Practice) in 1999 published guidelines for the purposes of interpreting Art 20(b).[68] They list a wide range of

67 [1998] Lloyd's Rep Bank 173; [1999] Lloyd's Rep Bank 219 (CA).
68 See 1999 Documentary Credits Insight. Also reproduced in UCP 500 and eUCP Publication No 500/2, 2002 ICC. Note: The ICC also published four position papers in respect of Arts 9(d)(iii), 18(b)(ii), 13(c) and Arts 23 and 24 of UCP 500. These are not relevant to UCP 600.

documents as originals that fall outside the ambit of Art 20(b): written/typed/perforated documents; documents carrying a hand/facsimile signature; documents on original headed paper (original stationery); documents that state they are originals, unless the statements do not appear to apply to the document tendered. Statements such as 'duplicate original' and 'third of three' would also indicate that the document is an original in its own right. Article 20(b) applies to documents that are produced by a telefax machine, any document that appears to be a photocopy lacking marking,[69] and a document that states that it is a true copy of another document or that another document is the sole original.[70]

The UCP 600 addresses what is acceptable as original for its purposes in much clearer terms than the earlier version of UCP. Art 17 provides:

(a) At least one original of each document stipulated in the credit must be presented.
(b) A bank shall treat as an original any document bearing an apparently original signature, mark, stamp, or label of the issuer of the document, unless the document itself indicates that it is not an original.
(c) Unless a document indicates otherwise, a bank will also accept a document as original if it:
  (i) appears to be written, typed, perforated or stamped by the document issuer's hand; or
  (ii) appears to be on the document issuer's original stationery; or
  (iii) states that it is original, unless the statement appears not to apply to the document presented.
(d) If a credit requires presentation of copies of documents, presentation of either originals or copies is permitted.
(e) If a credit requires presentation of multiple documents by using terms such as 'in duplicate', 'in two fold' or 'in two copies', this will be satisfied by the presentation of at least one original and the remaining number in copies, except when the document itself indicates otherwise.

It must be noted that the doctrine of strict compliance applies not only between the seller and the bank, but also between the buyer and the issuing bank,[71] and between the issuing bank and the confirming bank.[72]

Ambiguous instructions from buyer and linkage of documents

It is extremely important that clear instructions are given by the buyer since ambiguity will mitigate the doctrine of strict compliance. Where instructions are ambiguous, and the bank has construed them reasonably, there would be no breach of contract. In *Midland Bank Ltd v Seymour*,[73] instructions were given on the bank's application form. Under 'Description, quantity and price', the buyer entered 'Hong Kong duck feathers – 85% clean; 12 bales each weighing about 190 lb; 5 s per lb'. The bill of lading did not contain the entire description, although an entire description was possible when all the documents tendered were read together. The bank accepted the documents. The buyer, when sued for reimbursement by the issuing bank, put forward the defence that the documents tendered did not conform to the credit, since the bill of lading did not give a description, quantity and price of the goods. The court held that the buyer had not clearly stated that the bill of lading should contain all these details, and the bank had adopted a reasonable meaning.

In linking the documents, the banks, however, must ensure that there is consistency between the documents in that there must be unequivocal reference to the same goods in all the documents. In *Banque de l'Indochine et de Suez SA v JH Rayner (Mincing Lane) Ltd*,[74] the contract was for the sale of sugar. The credit required certificates of origin, EUR 1 certificates, and a full set of clean bills of lading. According to the bills of lading, shipment had taken place on board *Markhor*, but, according to one of the certificates of origin, goods were on board *MV Markhor* or substitute. The court came to the conclusion that it was unclear whether the bill of lading and the certificate of origin were referring to the same parcel of sugar, since *MV Markhor* or substitute could be a different vessel. In other words, there was no consistency between the documents.

Types of letters of credit

Letters of credits are categorised into revocable and irrevocable credits, irrevocable confirmed and irrevocable unconfirmed credits. There are also a number of variants, such as transferable credits, back-to-back credits, revolving credits, red clause credits and green clause credits. In this section, the nature and differences between revocable and irrevocable credits, and confirmed and unconfirmed credits are examined, before moving on to the special forms.

Revocable credit

Unlike UCP 500, UCP 600 does not recognise revocable credits and, therefore, will not apply to such credits. Parties who use revocable credits will have to make them subject to the UCP 500. Article 8(a) of the UCP 500 defines a revocable credit as a credit which:

> . . . may be amended or cancelled by the issuing bank at any moment and without prior notice to the beneficiary.

In practice, banks normally inform the beneficiary of the withdrawal of credit. Desirable and business-like though this may be, banks are not legally obliged to give prior notice to the seller. The common law rule is no different. In *Cape Asbestos Co Ltd v Lloyds Bank Ltd*,[75] Lloyds Bank advised the sellers that they had opened a credit in their favour, and expressly stated 'This is merely an advice for the opening of the above mentioned credit, and is not a confirmation of the same'. The sellers initially shipped 17 tons of the cargo, for which they were paid under the credit by the bank. Subsequent to the payment for the 17 tons, Lloyds Bank was instructed by the buyer's bank that the credit was cancelled. Lloyds Bank, however, failed to inform the beneficiary of the cancellation of the credit. The sellers shipped the remaining cargo. On presentation of documents, the bank refused

69 A photocopy on original stationery will be treated as an original.
70 For an excellent critique of these proposals, see Bennett, 'Original sins under the UCP' [2001] LMCLQ 88.
71 See *Equitable Trust Co of New York v Dawson Partners Ltd* (1927) 27 LIL Rep 49.
72 See *Bank Melli Iran v Barclays Bank DCO* [1951] 2 Lloyd's Rep 367.
73 [1955] 2 Lloyd's Rep 147. In *Credit Agricole Indosuez v Muslim Commercial Bank Ltd* [2000] 1 Lloyd's Rep 273, cl 9 of the letter of credit stated that 'original documents along with eight copies each of invoice, package list, weight and measurement list, Bill of Lading and certification of origin should be sent to us by courier . . .'. Credit Agricole did not send the weight and measurement list or the certificate of origin and the tender was rejected by the Muslim Bank. The Court of Appeal held that Credit Agricole was entitled to payment since it was unclear whether cl 9 was stating that the documents referred to were stipulated documents essential for the operation of the credit. It did not as required by Art 5(b) state precisely that the weight and measurement list and certificate of origin were documents against which payment was to be made. See also *Commercial Banking Co of Sydney Ltd v Jalsard Pty Ltd* [1973] AC 279 at p 286.
74 [1983] QB 711; *Baumwoll Manufactur von Carl Scheibler v Furness* [1893] AC 8.
75 [1921] WN 274.

to pay. The sellers brought an action against the bank, claiming that the bank had a duty to inform the seller of the revocation. The court held the bank had no legal duty. According to Bailhache J:

> . . . the crucial question is whether the defendants are under any legal duty to inform the plaintiffs when the credit is withdrawn of the fact of its withdrawal. It is clear from the evidence that it is the practice of the defendants to inform persons to whom credits of this kind are given of the withdrawal of the credit, and that they would have done so in this instance but that, under pressure of business, they forgot to do so. What has to be considered, however, is not the practice of the defendants, but whether any legal duty is laid upon them to give notice. It is to be observed that the letter of 14 June 1920, from the defendants to the plaintiffs, announced the opening of a revocable and not of a confirmed credit. A letter in that form intimates to the person in whose favour the credit was opened that he might find that the credit is revoked at any time. That being the representation by the defendants to the plaintiffs, are the defendants under any legal duty to give notice to the plaintiffs when the credit is revoked? . . . there is no legal obligation on the defendants to give notice in the circumstances. In a case of this kind, the wise course for the seller to take before making a shipment of the goods would certainly be to inquire of the bank whether or not the credit had been withdrawn. The practice of the defendants to give notice in such cases is a most prudent, reasonable and business like practice, and I hope that nothing I have said in this case leads banks to alter that practice; but at the same time, it does not seem to be based upon any legal obligation or duty. It has been said that the defendants regard the giving of notice as an act of courtesy which they always perform except when, as in this case, it is unfortunately forgotten. That is the true view of the proceeding. It is an act of courtesy which it is very desirable should be performed, but it is not founded upon any legal obligation [at p 275].

Bailhache J's suggestion that it might be prudent for the seller to inquire whether the credit is withdrawn, or not, before making the shipment, is of interest. Whether this course of action will aid the seller since the credit can be revoked at any time prior to acceptance of the tendered documents is questionable. It could well be that the credit is revoked after the seller's inquiry, or before the tender of documents.

In terms of risk, from the seller's viewpoint, without doubt, revocable credits offer the least security for obtaining payment from a bank since the issuing bank does not undertake to pay on tender of stipulated documents. Coupled with this is the rule that there is no obligation on the part of the bank to inform the beneficiary of revocation of the credit. Revocable credits are uncommon, unless the sale transaction is, for instance, between sister companies, or between a parent and a subsidiary, since the bank charges for servicing revocable credits are far lower than those for irrevocable letters of credit. Economic conditions (e.g., recession) might fuel their use in the future.

The credit can be revoked either by the buyer (applicant), or the issuing bank on its own initiative, to protect itself should the buyer get into financial difficulties. A likely question is: at what moment does a revocable credit become irrevocable? Until when can a bank revoke the credit? It depends on the stage reached in the transaction. Until, and also on, presentation of documents, the bank will be well within its rights to revoke the credit. Once documents are accepted, it will not be able to revoke the credit. At the moment of acceptance, the credit stops being a revocable credit. Article 8(a) of the UCP 500 states that the credit can be cancelled at any moment – this is meaningless, unless the words 'prior to acceptance' are inserted in this provision.

Because of the gap in time before transmission and receipt of instructions, it is possible that the advising bank receives instructions from the issuing bank to cancel or amend the credit after it has paid the seller. In these circumstances, the issuing bank will have to reimburse the advising bank under Art 8(b) of UCP 500.

Realising the beneficiary's exposure to great risk, common law and the UCP 1994 require that the revocable or irrevocable nature of a documentary credit should be clearly spelt out. In the absence of a statement to this effect, the credit will be regarded as irrevocable (Art 6(b) and (c)).[76]

Irrevocable unconfirmed credit

According to Arts 2 and 7(a) of the UCP, the issuing bank assumes the legal responsibility of paying the beneficiary should he present the documents in accordance with the credit. Once the credit has been communicated to the seller, it cannot be amended or cancelled without the agreement of the issuing bank, confirming bank (if any) and the seller (beneficiary), according to Art 10(a) of the UCP. The common law position is no different.

Payment will normally be arranged in the buyer's country through an advising bank. (Appointment of an advising bank in the beneficiary's country is not necessary. The issuing bank can advise the opening of the credit directly, although this is unusual.) The advising bank acts as an agent of the issuing bank, and does not give an independent undertaking to pay the seller. The undertaking comes from the issuing bank. As apparent, a number of contractual undertakings are found in this type of credit. They are:

(a) between seller and buyer as a result of the contract of sale;
(b) between buyer and issuing banks, as a result of arrangements made for opening the credit;
(c) between issuing bank and advising bank; and
(d) between issuing bank and seller.

The undertakings found in an irrevocable credit can be diagrammatically represented as subsequently shown in Figure 15.4.

In terms of risk, the beneficiary is in a far better position since the credit cannot be withdrawn or cancelled as under a revocable credit. The disadvantage with an unconfirmed irrevocable credit is that, should the issuing bank reject the documents, litigation will take place in a foreign jurisdiction. The contractual undertakings between seller and buyer, buyer and issuing bank, and issuing and advising bank present no problems at the conceptual level since offer, acceptance and consideration are present in these undertakings. What is difficult to see is how there could be a contractual link between issuing bank and seller (and, in the case of a confirmed credit, between seller and confirming bank)[77] since no consideration seems to be present. Various explanations have been put forward to resolve this lack of fit between letters of credit and traditional concepts of contract law.[78] The view that is most appealing to date is to treat the letter of credit as an exception to the doctrine of consideration. An issue with irrevocable credits is the moment at which it becomes irrevocable. Does it become irrevocable on notification of the credit to the seller? Or, does it become irrevocable when the seller acts upon the undertaking given by the bank? Existing case law is not of much help. Support can be found for both views. *Urquhart Lindsay and Co v Eastern Bank Ltd*[79] backs the latter, and *Dexters Ltd v Schenkers Ltd*[80] backs the former. The view propounded in

76 Note, however, that, in the 1983 version of the UCP, the absence of a statement in respect of the credit's revocable or irrevocable nature rendered it revocable – Art 7(c).
77 See 'Confirmed credit' above.
78 See Sarna, *Letters of Credit*, 1989, Carswell; Gutteridge and Megrah, *Law of Bankers' Commercial Credits*, 2001, Europa.
79 [1922] 1 KB 318, at pp 321–2.
80 (1923) 14 LlL Rep 586, at p 588.

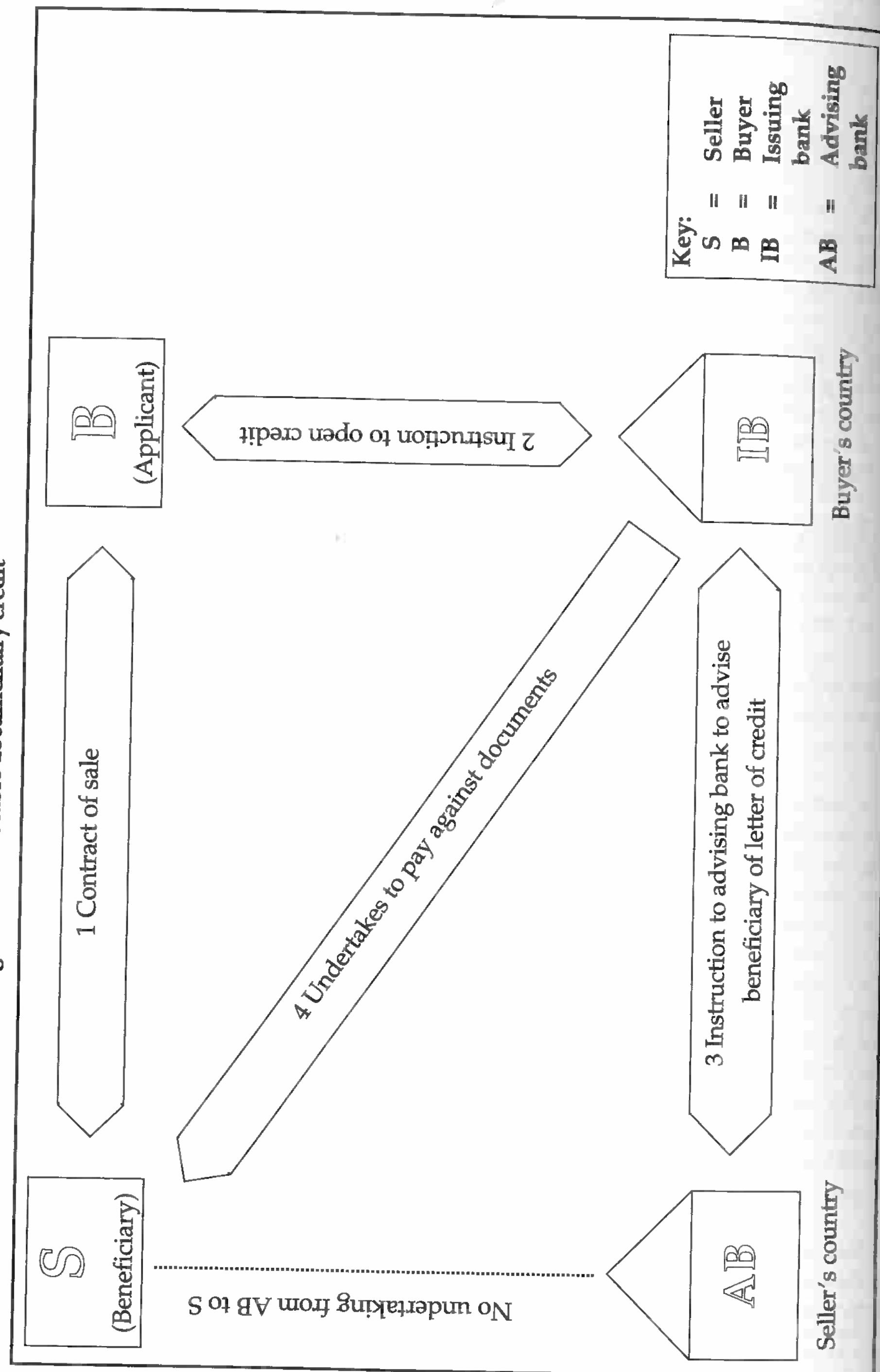


Figure 15.4: Contractual undertakings in an irrevocable documentary credit

Urquhart Lindsay and Co v Eastern Bank Ltd may fulfil the requirements of conventional contract law, but it brings with it uncertainty. From a commercial viewpoint, *Dexters Ltd v Schenkers Ltd*, incapable of accommodation in contract theory, imparts certainty; and men of commerce desire certainty. The sensible direction is to treat documentary credit as an exception to the doctrine of consideration – adopted, for instance, by the US.[81]

Confirmed credit

A confirmed[82] credit is always irrevocable. Where the letter of credit is a confirmed credit,[83] the seller also receives an undertaking from the confirming bank (situated in his country), in addition to that of the issuing bank, that he will be paid on presentation of the stipulated documents. In other words, in a confirmed credit, there 'is a direct undertaking by the banker that the seller, if he presents the documents as required in the required time, will receive payment'.[84] The UCP also takes the same approach to confirmed irrevocable credits according to Art 2 and Art 8(a).[85]

A confirmed credit gives maximum security to the seller; if the confirming bank is a reputable bank, he is certain of receiving payment. Moreover, should the seller wish to initiate proceedings for non-payment under the credit arrangement, he will be able to do so in his own jurisdiction. In a confirmed credit, other than the four contractual undertakings listed under irrevocable credits,[86] there is a fifth contractual undertaking – that is, between confirming banks and seller. The undertakings between the various parties are diagramatically represented in Figure 15.5.

Back-to-back credits

This type of credit is mainly used where the seller is a 'middleman' – for instance, where the seller (S) in the UK buys goods from the manufacturer (X) in Australia, and sells them to the buyer (B) in Kenya. In a back-to-back credit arrangement, S will use the credit opened in his favour by B (Credit 1) as security for opening a credit in favour of X (Credit 2). On presentation of documents that conform by X, S's bank will pay X. S will be asked to replace X's invoice in the letter of credit with his (that is, S's) invoice. The documents will be presented to B's bank for payment. Since the documents presented to B by S are the documents presented by X to S, it is important to ensure that the documents required by B and those provided by X match. Where X's documents do not

81 See Arts 5–105 of the Uniform Commercial Code.

82 On ambiguity in the act of confirmation, see *Wahbe Tamari and Sons Ltd v Calprogeca-Soceidada Geral de Fibras* [1969] 2 Lloyd's Rep 18.

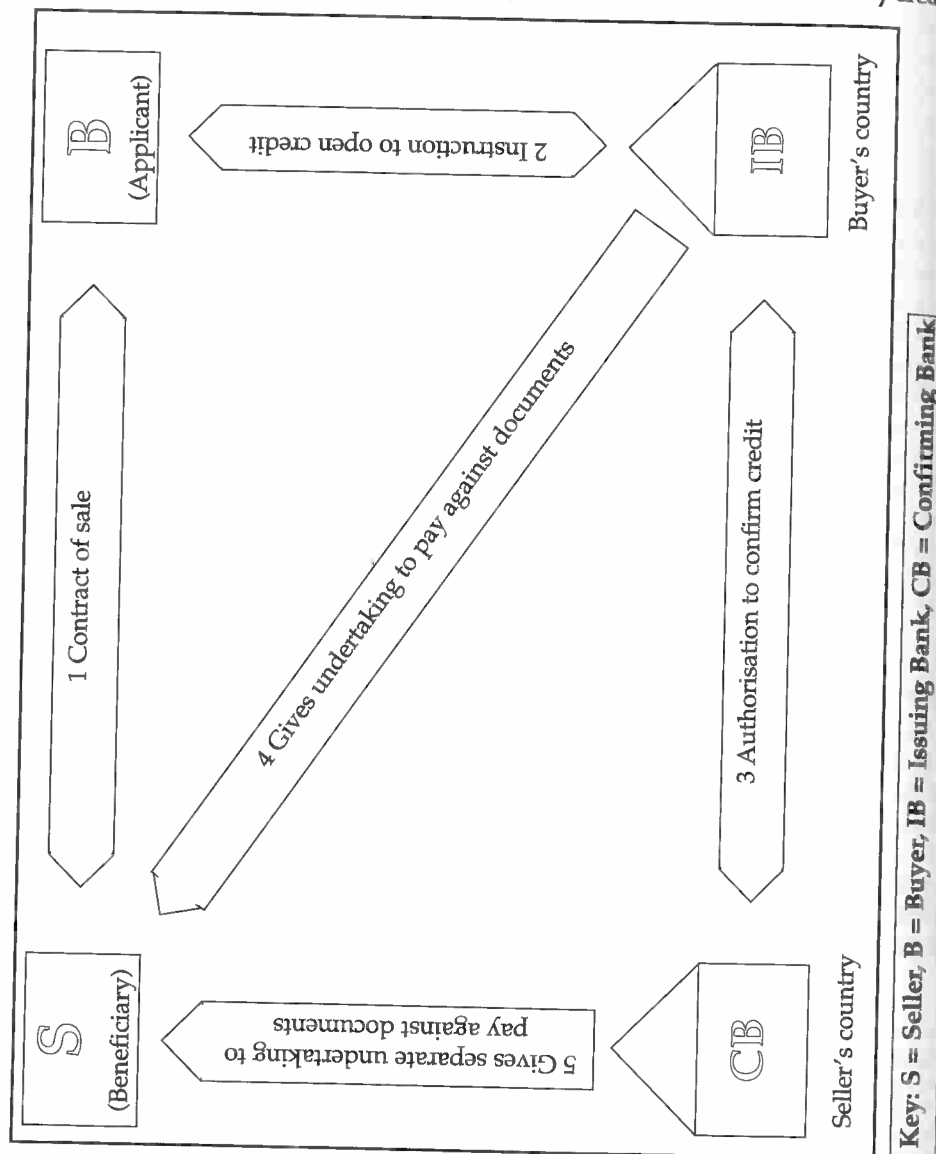
83 This is not to be confused with a credit where the confirmation is silent. For further on this, see Lloyd, 'Sounds of silence: emerging problems of undisclosed confirmation' (1990) 56 Brooklyn LR 139.

84 See *Ian Stach Ltd v Baker Bosley Ltd* [1958] 2 QB 130.

85 Art 2 defines Confirmation as 'a definite undertaking of the confirming bank, in addition to that of the issuing bank, to honour or negotiate a complying presentation'.
And According to Art 8(a): Provided that the stipulated documents are presented to the confirming bank or to any other nominated bank and that they constitute a complying presentation, the confirming bank must:
(i) honour, if the credit is available by
(a) sight payment, deferred payment or acceptance with the confirming bank;
(b) sight payment with another nominated bank and that nominated bank does not pay;
(c) deferred payment with another nominated bank, and that nominated bank does not incur its deferred payment undertaking or, having incurred its deferred payment undertaking, does not pay at maturity;
(d) acceptance with another nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;
(e) negotiation with another nominated bank and that nominated bank does not negotiate.

86 See 'Irrevocable unconfirmed credit', above.

Figure 15.5: Contractual undertakings in an irrevocable confirmed documentary credit



tally with the documents that B requested in his credit arrangement, B's bank may reject the documents. S's bank may find that payment is affected under Credit 2, but that payment under Credit 1 does not take place. Further, if S were to become insolvent, S's bank may find itself in deep waters, unless it has taken sufficient precautions to protect its interests. Because of the complexities with documentation, the resulting administration costs and risk, banks are extremely reluctant to use back-to-back credits.

Transferable credits

A better alternative to a back-to-back credit for a 'middleman' seller is a transferable credit. Article 38(b) of the UCP recognises transferable credit.

The transferable credit operates in the following way. Suppose S (first beneficiary) in London sells 1,000 lifeboats to the buyer (B) in Malaysia. S is not a manufacturer of lifeboats and has to purchase them from the manufacturer (X) in Cardiff. S could use the transferable credit mechanism to pay X by transferring rights and duties in respect of the documents to X who, as second beneficiary, will be paid from the credit set up by B. In other words, under a transferable credit, the first beneficiary (S) arranges for the transfer of the whole or part of the credit to the second beneficiary (X). A transferable credit arrangement is set up where the parties agree and it is expressly agreed to by the issuing bank.[87] Articles 38(a) and (b) of the UCP provide:

> (a) A bank is under no obligation to transfer a credit except to the extent and in the manner expressly consented to by that bank.
>
> (b) Transferable credit means a credit that specifically states it is 'transferable'. A transferable credit may be made available in whole or in part to another beneficiary ('second beneficiary') at the request of the beneficiary ('first beneficiary').
>
> Transferring bank means a nominated bank that transfers the credit or, in a credit available with any bank, a bank that is specifically authorized by the issuing bank to transfer and that transfers the credit. An issuing bank may be a transferring bank.
>
> Transferred credit means a credit that has been made available by the transferring bank to a second beneficiary.

In practice, a transfer form will be attached when the credit to the value of, say, £50,000 is advised to S (first beneficiary). S, who completes the form, will request that the credit for £40,000 be transferred to X (second beneficiary). X will be advised of the credit and will show S as the buyer. On presentation of documents by X, X's invoice will be substituted with S's invoice and presented to B. S will be paid £10,000 and X £40,000. Article 38(h) of the UCP allows for the substitution of documents.

In practice, by and large, there is likely to be a substitution of the invoice.[88] It may be that the first beneficiary fails to supply it. In these circumstances, the UCP allows the transferring bank to deliver documents received from the second beneficiary (Art 38(i)).

A transferable credit is transferable only once, unless it is indicated otherwise. In other words, the second beneficiary cannot transfer the credit (Art 38(d)).

It must, however, be stated at this juncture that a letter of credit is not a negotiable instrument like a bill of exchange. It is unfortunate that Lord Denning, when talking about the autonomous character of a letter of credit in *Power Curber International Ltd v National Bank of Kuwait SAK*,[89] went on to say that a letter of credit is like a bill of exchange. It must be said that a letter of credit is not like a bill of exchange, for the following reasons:

(a) it is non-negotiable;
(b) it is not possible to be holder in due course of a letter of credit[90]; and
(c) a letter of credit is not as good as cash, since the opening of a letter of credit in most cases is a conditional payment.[91]

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87 See also *Bank Negara Indonesia 1946 v Lariza Singapore Pte Ltd* [1988] AC 583.

88 In *Jackson v Royal Bank of Scotland* [2005] UKHL 3, the transferring bank inadvertently sent the second beneficiary's invoice to the applicant. This meant that the mark-up on the goods on the part of the first beneficiary was revealed to the applicant. The bank was held liable for breach of confidentiality.

89 [1981] 3 All ER 607.

90 See 'Bills of exchange', above.

91 See 'Obligations of the bank(s) to the seller', below.

Revolving credits

Used in relation to transactions conducted on a regular basis between seller and buyer, this type of credit revolves around an agreed value or time. Where the credit revolves around a value agreed between the parties, once payment has been made against documents, the value of the credit will be automatically reinstated. For instance, if the revolving credit is for the value of £50,000, on payment of £30,000 against documents to the beneficiary, the credit will be topped up to £50,000.

Red clause credits and green clause credits (also known as anticipatory credits)

Red clause credits first came to be used in the wool trade in New Zealand, Australia and South Africa. They are also said to have been used in trade with China. These credits allow the seller to draw on the documentary credit in advance of shipment. The advances are made against the warehouseman's receipt, even though the beneficiary is able to deal with the goods. This type of credit came to be known as the red clause credit since the clause is printed in red ink. Although its origins are in the wool trade, its use is not restricted to it.[92] Since the seller under this credit can deal with the goods, it is used when there is a high degree of trust between the parties to the contract.[93] The typical clause is likely to read as follows:

> Under the credit, advance payment of up to — % of the credit amount is allowed prior to shipment against beneficiaries' receipt accompanied by signed declaration stating that shipping documents prescribed under this credit will be delivered in good order and within the validity of this credit. The advance must be deducted from payment to beneficiaries against prescribed documents.

Green clause credits came to be used in the coffee trade in Zaire and operate in the same way as red clause credits. The only difference is that, in this type of credit, the goods are stored in the name of the bank.

The opening of a letter of credit

Arrangements for opening a documentary credit are made by the buyer. He also gives instructions about the documents that need to be tendered by the seller. Opening of a letter of credit is generally regarded as a condition precedent to the delivery of the goods by the seller. This means that the seller is not under an obligation to perform his side of the bargain until the letter of credit is opened.[94] However, it is possible that the parties may have agreed to the opening of the credit as a condition precedent of the contract of sale itself. In such a situation, where no letter of credit is provided, there will be no contract between the parties. As Denning LJ observed, in *Trans Trust SPRL v Danubian Trading Co Ltd*[95]:

> ... sometimes [the opening of a letter of credit] is a condition precedent to the formation of a contract, that is, it is a condition which must be fulfilled before any contract is concluded at all.

92 *Tukan Timber Ltd v Barclays Bank plc* [1987] 1 Lloyd's Rep 171.
93 *South African Reserve Bank v Samuel and Co* (1931) 40 LlL Rep 291.
94 *Garcia v Page* (1936) 55 LlL Rep 391.
95 [1952] 1 Lloyd's Rep 348.

> In those cases, the stipulation 'subject to the opening of a letter of credit' is rather like a stipulation 'subject to contract' . . . In other cases, a contract is concluded and the stipulation for a credit is a condition which is an essential term of the contract. In those cases, the provision of the credit is a condition precedent, not to the formation of the contract, but to the obligation of the seller to deliver the goods. If the buyer fails to provide the credit, the seller can treat himself as discharged from any further performance of the contract and can sue the buyer for damages for not providing the credit [at p 355].

It must, however, be said that the opening of the letter of credit as a condition of the contract of sale is extremely rare.

The credit opened by the buyer must conform with the terms agreed by the parties in the sale contract. So, if the parties have agreed to an irrevocable confirmed contract, the opening of a revocable credit will not do. However, were the buyer to open a credit that does not conform with the terms agreed, he can cure the defect provided it can be done before the credit is required.

When must the credit be opened?

The contract of sale may stipulate a fixed date for opening the letter of credit. In this case, it must be opened[96] by that date. Where the sale contract provides that the credit should be opened 'immediately', according to *Garcia v Page*,[97] it must be opened 'within such time as is required for a person of reasonable diligence to get the credit established' (at p 392). Where the contract does not expressly provide a date for opening the credit, but stipulates a shipment period, the credit should be opened before the entire shipment period. In *Pavia and Co SpA v Thurmann-Neilsen*,[98] a CIF contract of sale provided for shipment from 1 February to 30 April 1949. Payment was to be by confirmed irrevocable credit. The contract was silent on the date for opening the credit. The buyers opened the credit on 22 April. The seller sought damages for breach of contract caused by delay in opening the credit. The buyers argued that they saw no reason as to why the credit should be opened prior to the shipment period since the credit was just a way of paying the seller on the tender of documents. The court, however, came to the conclusion that the object of the credit is to assure the seller, prior to shipment, that he will be paid upon shipment. The buyers were, therefore, in breach of contract. As Denning LJ said:

> . . . the question in this case is this: in a contract which provides for payment by confirmed credit, when must the buyer open the credit? In the absence of an express stipulation, I think the credit must be made available to the seller at the beginning of the shipment period. The reason is because the seller is entitled, before he ships the goods, to be assured that, on shipment, he will get paid. The seller is not bound to tell the buyer the precise date when he is going to ship: and whenever he does ship the goods, he must be able to draw on the credit. He may ship on the very first day of the shipment period. If, therefore, the buyer is to fulfil his obligations he must make the credit available at the very first date when the goods may be lawfully shipped in accordance with the contract [at p 157].

Where there is a fixed date for shipment, the buyer must open the credit at a reasonable time before shipment date.[99] What is reasonable will depend on the circumstances of each case.[100]

96 On the meaning of 'opened', see *Bunge Corp v Vegetable Vitamin Foods (Pte) Ltd* [1985] 1 Lloyd's Rep 613.
97 (1936) 55 LlL Rep 391.
98 [1952] 1 Lloyd's Rep 153.
99 See *Plasticmoda SpA v Davidsons (Manchester) Ltd* [1952] 2 Lloyd's Rep 527.
100 See *Etablissements Chainbaux SARL v Harbormaster Ltd* [1955] 1 Lloyd's Rep 303.

Failure to open a letter of credit

Where the buyer fails to open a credit as stipulated by the sale contract,[101] the seller can sue the buyer for damages. The damages awarded in such a situation are not restricted by s 50(3) of the Sale of Goods Act 1979, according to which, the amount of damages awarded is the difference between the contract price and the market price. The damages awarded would include the profit the seller would have made had the contract been successfully completed, subject to the rule of remoteness of damage.[102] In *Trans Trust SPRL v Danubian Trading Co Ltd*,[103] the contract was for the purchase of steel. The buyers did not open the letter of credit on time, and the seller claimed lost profits as damages. The buyers argued that only nominal damages were payable since the sellers could have sold the steel at a profit in a market that was rising. The court viewed the credit arrangement as not simply a mode of paying the seller, but a mechanism which provided the seller with security and the opportunity of raising credit for the purchase of materials he may need to fulfil the sale contract. The foreseeable loss of profits could, therefore, be recovered. As Denning LJ said:

> . . . this argument reminds me of the argument we heard in *Pavia and Co v Thurmann-Nielsen*. It treats the obligation to provide a credit as the same thing as the obligation to pay the price. That is, I think, a mistake. A banker's confirmed credit is a different thing from payment. It is an assurance in advance that the seller will be paid. It is even more than that. It is a chose in action which is of immediate benefit to the seller. The seller may be relying on it to obtain the goods himself. If it is not provided, the seller may be prevented from obtaining the goods at all. The damages will not in fact be nominal . . . His loss will be the profit which he would have made if the credit had been provided [at p 356].

Waiver and variation

Even though the buyer fails to open a credit, or the terms of the credit do not conform to the terms agreed by the parties in the sale contract, the seller may decide to ship the goods. The question of whether the seller's action is a waiver or a variation seems to depend on whether the term in the contract is for the benefit of the seller or whether it is of benefit to both the seller and the buyer – that is, where there is consideration. Where it is the former, the seller's act will be regarded as a waiver, and, where it is the latter, it will be regarded as a variation.

If the seller has waived a requirement, he can reinstate the requirement on giving the buyer reasonable notice. In *Panoustos v Raymond Hadley Corp of New York*,[104] the contract was for a number of shipments of flour. The buyers agreed to open a confirmed letter of credit but opened an unconfirmed credit instead. The sellers, aware of this defect, made a few shipments on unconfirmed letters of credit but repudiated the contract when an unconfirmed credit was provided for a later shipment. The court held that the seller could not revoke the waiver without giving the buyer reasonable notice.

Where there is a variation, the seller will be unable unilaterally to reinstate the terms initially agreed on by the parties. In *WJ Alan and Co Ltd v El Nasr Export and Import Co*,[105] under the terms, payment was to take place in Kenyan shillings under a letter of credit. The credit that was opened, however, stated that payment was to be in sterling. The seller, who did not object at first, did so as soon as the sterling was devalued and claimed damages for the difference between the two currencies. The Court of Appeal, by a majority, held that the contractual term had been varied since it was supported by consideration – the fluctuations in the currency were of benefit to both the seller and the buyer.

101 The opening of a letter of credit may be a condition precedent for the loading of the goods. See *Kronos Worldwide Ltd v Sempra Oil Trading SARL* [2004] 1 Lloyd's Rep 260.
102 See *Hadley v Baxendale* (1854) 23 LJ Ex 179.
103 *Trans Trust SPRL v Danubian Trading Co Ltd* 1 Lloyd's Rep 337. See also *Ian Stach Ltd v Baker Bosly Ltd* [1958] 2 QB 130, at p 145.
104 (1917) 117 LT 330.
105 [1972] 2 QB 189.

Tender of documents by seller (beneficiary)

Once the seller is advised about the opening of the credit, he must arrange shipment and tender the documents.[106] He is under an obligation to tender the stipulated documents to the bank. The seller cannot waive the requirement of tendering the documents to a bank, and tender them directly to the buyer, and demand payment from the buyer directly. In *Soproma SpA v Marine and Animal By-Products Corp*,[107] the seller made a tender to the bank, which was validly rejected. The seller re-tendered the documents to the buyer, who rejected them. The seller sued the buyer. The court held that the second tender was invalid since it was tendered to the buyer; to allow otherwise would go against the express terms of the contract. As McNair J said:

> . . . it seems to me to be quite inconsistent with the express terms of a contract such as this to hold that the sellers have an alternative right to obtain payment from the buyers by presenting the documents direct to the buyers. Assuming that a letter of credit has been opened by the buyers for the opening of which the buyer would normally be required to provide the bank either with cash or some form of authority, could the seller at his option disregard the contractual letter of credit and present the documents direct to the buyer? As it seems to me, the answer must plainly be in the negative [at p 386].

The restriction against approaching the buyer for payment under the letter of credit does not apply where the bank, for instance, goes insolvent. Where the bank is unable to pay the seller because of insolvency, the seller can go directly to the buyer for payment. The seller is able to approach the buyer in such circumstances since payment by letter of credit is regarded as a conditional payment of the price. As Lord Denning stated *obiter*, in *WJ Alan and Co Ltd v El Nasr Export and Import Co*:

> I am of the opinion that in the ordinary way, when the contract of sale stipulates for payment to be made by confirmed irrevocable letter of credit, then, when the letter of credit is issued and accepted by the seller, it operates as conditional payment.
>
> It is analogous to the case where, under a contract of sale, the buyer gives a bill of exchange or a cheque for the price. It is presumed to be given, not as absolute payment, nor as collateral security, but as conditional payment. If the letter of credit is honoured by the bank when the documents are presented to it, the debt is discharged. If it is not honoured, the debt is not discharged: and the seller has a remedy in damages against both the bank and the buyer [at p 212].

However, it is possible that the parties have agreed that payment by letter of credit is an absolute payment. They may do so expressly or impliedly. A stipulation by the seller that the credit should be opened by a particular bank may lead to the inference that the letter of credit is an absolute payment.[108] The agreement on a particular bank by the parties should not, however, lead to the conclusion that the letter of credit is an absolute payment – it is just one factor amongst others.[109]

Treating the letter of credit as a conditional payment may, in some circumstances, leave one of the innocent parties bearing the loss, as *Ng Chee Chong, Ng Weng Chong, Ng Cheng and Ng Yew (a firm trading as Maran Road Saw Mill) v Austin Taylor and Co Ltd*[110] well illustrates. The defendants acted as the plaintiffs' agents for the sale of timber in the UK and the Continent. Payment for the goods was made by irrevocable letters of credit. The letters of credit provided that drafts were to be negotiable by the

106 See Stage 5 under 'Stages in a documentary credit transaction', above.
107 [1966] 1 Lloyd's Rep 367. See also *Ficom SA v Soceidad Cadex Limitada* [1980] 2 Lloyd's Rep 118; *Shamsher Jute Mills Ltd v Sethia (London) Ltd* [1987] 1 Lloyd's Rep 388.
108 See *WJ Alan and Co Ltd v El Nasr Export and Import Co* [1972] 2 QB 189, at p 220.
109 *Man, ED and F Ltd v Nigerian Sweets and Confectionery Co Ltd* [1977] 2 Lloyd's Rep 50.
110 [1975] 1 Lloyd's Rep 156.

Bangkok Bank in Kuala Lumpur (Malaysia) at the sight rate. Interest was to be claimed from Sale and Co (the merchant bankers used by the defendants) when the documents were presented for acceptance. The arrangement went through the following stages:

(a) the plaintiffs took the shipment documents and the bill of exchange (drawn by them on Sale and Co) to the Bangkok Bank;
(b) Bangkok Bank took the shipment documents and bill of exchange from the plaintiffs and passed the shipment documents to Sale and Co in return for their acceptance of the bill of exchange;
(c) Sale and Co passed the shipment documents to the defendants upon payment or against a trust letter, that is, a letter where the defendant undertook to hold the documents and the goods and proceeds for the bank (trust letters, also known as trust receipts, are fairly common in international commerce, since a buyer will normally raise money against the documents from the bank to pay the seller from whom he has bought the goods, and sell the goods on to third parties and use the proceeds of the sale to repay the bank. It is normal for banks to insist, when they release the goods, that the goods be warehoused in their name so that they can retain the goods until payment);
(d) the defendants would release the shipping documents to the buyer on payment.

This arrangement worked well until Sale and Co became insolvent. The buyer had paid for the goods and the seller had deposited the sums with Sale and Co. Sale and Co failed to honour the bills of exchange when the Bangkok Bank presented them for payment. The bills of exchange were protested, and the Bangkok Bank sought recourse to the plaintiffs as the drawers of the bills of exchange.[111] The plaintiffs reimbursed the Bangkok Bank and looked to the defendants (their agents) for payment on the basis of the agency agreement. The defendants argued that they had discharged their contractual obligation by opening the irrevocable letter of credit, on the basis of the clause in the agency contract, which provided:

> ... in consideration of our [the defendants] paying by letter of credit 100% of the invoice value of the goods shipped less our commission ... you [the plaintiffs] agree in the event of a dispute arising under such contract that cannot be decided amicably that we [the defendants] have the power, and that you hereby authorise us, to appoint the arbitrator on your behalf in such dispute. Further, we may take this letter as your authority to use and to pursue in your name for the recovery of any monies due from the buyers in respect of goods shipped under this contract.

Ackner J, after due consideration of this clause, reached the conclusion that the defendants had 'promised to pay by letter of credit, not to provide by a letter of credit a source of payment which did not pay' (at p 158). The fact that the letter of credit was opened by the plaintiffs' agents made no difference to the commonly held view that the letter of credit is a conditional payment. No implied or express agreement that the plaintiffs were to look to a particular banker to the exclusion of the agent existed. He agreed that the submissions made by the plaintiffs' counsel were correct in that:

> ... a letter of credit operates as a conditional payment and not as absolute payment [and] is based on the analogy of a case of contract of sale where the buyer gives a bill of exchange or a cheque for the price. This is presumed to be given, not as absolute payment nor as collateral security, but as conditional payment. If this view, with which I respectfully agree is correct in relation to contracts of sale where payment is to be made by letter of credit, I can see no reason why it does not equally apply to a contract of agency in which the agent is to make the payment

111 See s 55(1) of the BEA 1882.

> due to his principal by letter of credit. Of course, the very nature of any detailed instructions which a principal may give his agent as to the mode and method of payment of the money held by the agent to the principal's use, may well rebut the presumption that there is nothing in the genesis and aim of this transaction, viewed objectively, or in any other relevant circumstance which can properly be said to have this effect [at p 159].

The defendants were, therefore, held liable – in effect, they had to pay twice. For the letter of credit mechanism to work effectively – that is, to reduce the risk of the innocent party to a near negligible level of risk – it is essential to employ a *reliable and solvent paymaster*. The buyer can also protect himself against the possibility of the paymaster's insolvency by providing that the letter of credit is an absolute payment. Such a provision needs to be clearly stated. A buyer's disclosure that it is a small business and that payment was to be by unconfirmed letter of credit does not raise the inference that the buyer is not liable to the seller for the price where no payment under the letter of credit takes place.[112]

Obligations of the bank(s) to the seller

On presentation of the documents by the seller,[113] the advising/issuing or confirming bank (depending on the type of credit) must examine the documents to ensure that they comply on their face with the terms of the credit and decide whether to accept or reject the documents.[114] Article 14(a) of the UCP sets out the standard of examination of documents as follows:

> A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.

The wording adopted by UCP in Art 14(a) is different from that of Art 13(a) of the UCP 500, which stated:

> (a) Banks must examine all documents stipulated in the credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the credit. Compliance of the stipulated documents on their face with the terms and conditions of the credit, shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the credit.

It is apparent that, if the bank were to exercise reasonable care, then this position was no different from that adopted in common law. The bank is to conduct a visual examination and exercise reasonable care.[115] There is some debate that UCP 600 does away with reasonable care and introduces a strict liability on the bank, although practitioners in England seem to think that it is 'unlikely to affect what was in any event a restatement of the common law position',[116] although it could be argued that the absence of the phrase 'reasonable care' introduces strict liability.

112 See *Chloride Batteries SA Asia Pte Ltd v BPS International plc* (1996) unreported, 21 March, available on LEXIS.
113 See Stage 6, 'Stages in a documentary credit transaction', above.
114 See Stage 7, 'Stages in a documentary credit transaction', above. See also ISBP on the practice adopted in relation to the documentation such as the invoice and transportation documentation in its various guises, such as bills of lading, multimodal transport documents and consignment notes.
115 *Gian Singh and Co Ltd v Banque de l'Indochine* [1974] 1 WLR 1234.
116 Isaacs and Barnett, 'International Trade Finance – Letters of credit, UCP and Examination of Documents' 2007 JIBLR 660, at p 662.

The UCP gives each bank a maximum of five days for examining the documents. Article 14(b) provides:

> A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days[117] following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day for presentation.

It seems from this provision that the bank is obliged to pay as soon as it has checked that the documents comply, since Art 15 provides as follows:

> (a) When an issuing bank determines that a presentation is complying, it must honour.
> (b) When a confirming bank determines that a presentation is complying, it must honour or negotiate and forward the documents to the issuing bank.
> (c) When a nominated bank determines that a presentation is complying and honours or negotiates, it must forward the documents to the confirming bank or issuing bank.

Does this mean that a bank may be liable to the beneficiary if it does not honour after an examination completed on the second banking day, but nonetheless takes advantage of the maximum five banking days available to it under Art 14(b))? Is the combined operation of Arts 14 and 15 likely to result in litigation? Will reasonable practice of banks be taken into account?

Banks, in England, normally take three days, although the size of the bank and its expertise may be relevant.[118] Where documents do not conform, the bank is free to consult the applicant but must not send them to the applicant for examination. Consultation with the applicant, however, will not extend the time allowed for examination. Article 16(b) states:

> When the issuing bank determines that a presentation does not comply, it may in its sole judgment approach the applicant for a waiver of the discrepancies. This does not, however, extend the period mentioned in sub-Art 14(b).

In the event of rejection of the documents by the bank, the bank must inform beneficiary of the reasons for rejection. Under the UCP, the beneficiary is to be notified, at the very latest, by the end of the five days allowed for examination of documents.

Articles 16(c), (d) and (e) provide as follows:

> (c) When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank decides to refuse to honour or negotiate, it must give a single notice to that effect to the presenter.
>
> The notice must state:
>
> (i) that the bank is refusing to honour or negotiate; and
> (ii) each discrepancy in respect of which the bank refuses to honour or negotiate; and
> (iii) (a) that the bank is holding the documents pending further instructions from the presenter; or
> (b) that the issuing bank is holding the documents until it receives a waiver from the applicant and agrees to accept it, or receives further instructions from the presenter prior to agreeing to accept a waiver; or
> (c) that the bank is returning the documents; or
> (d) that the bank is acting in accordance with instructions previously received from the presenter.
>
> (d) The notice required in sub-article 16 (c) must be given by telecommunication or, if that is not possible, by other expeditious means no later than the close of the fifth banking day following the day of presentation.
>
> (e) A nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank may, after providing notice required by sub-article 16 (c) (iii) (a) or (b), return the documents to the presenter at any time.

117 Banking day is defined in Art 2 as 'a day on which a bank is regularly open at the place at which an act subject to these rules is to be performed'.

118 See *Bankers Trust Ltd v State Bank of India* [1991] 2 Lloyd's Rep 443.

Article 16 does not, however, make clear how soon after a timely rejection the bank must return the documents. This issue was considered in the recent case of *Fortis Bank SA/NV and another v Indian Overseas Bank*.[119] The Indian Overseas Bank (IOB) had rejected letters of credit, and the discrepancy ('issuing bank's cost' instead of 'beneficiary's cost') in relation to the payment of despatch of the shipping documents was regarded as rightful rejection. However, Fortis argued that the bank in not returning the documents promptly and, by taking another three months to return, had not met the obligations set by Art 16. They had, therefore, lost the right to reject the documents under Art 16(f), which states 'If an issuing bank or a confirming bank fails to act in accordance with the provisions of this article, it shall be precluded from claiming that the documents do not constitute a complying presentation'. They also argued that, if Art 16 could not be construed as placing an obligation to return the documents promptly on their rejection, then a term to that effect should be implied into Art 16. IOB argued that a term could not be implied and that 16(f) was irrelevant since they were not in breach of the obligations placed on them by Art 16. According to evidence on best banking practice submitted at the court of first instance, two slightly divergent views emerged. Mr Collyer, Chairman of the ICC Drafting Group which had revised UCP 500, said that, where return is indicated on the document, then it 'should occur immediately or at the very latest during the course of the following working day'.[120] The witness put forward by IOB, Mr Jones, chairman of ICC UK, stated that 'best practice' entails 'speedy return'. However, he went on say that there was 'room for limited divergence in market practice dependent on local conditions'.[121] Given these statements, how was the court going to interpret Art 16? Taking into account market practice and a previous DOCDEX decision,[122] the Court of Appeal concluded that the issuing bank must return the documents promptly and without delay on their rejection. A number of reasons were given by Thomas LJ. If a bank rejects the documents 'it cannot be entitled to retain the documents, as it is implicit, that it has refused to accept them. It must either hold them at the disposal of or in accordance with the instructions of the presenter or return them. . . . Thus, it was not necessary to spell out in the article the issuing bank's obligation to act in accordance with the notice. It was implicit in the wording of that article'.[123] It was standard banking and trading practice.[124] As for Art 16(e), it was not an exception to the notice provision or included to provide clarity but 'an obligation to act in accordance with the notice imposed by article 16(c)'.[125]

119 [2011] EWCA Civ 58.

120 *Ibid.* para. 32.

121 *Ibid.*

122 Decision No 242. These decisions are made by selected ICC listed experts on disputes referred to them for resolution of a non binding character.

123 [2011] EWCA Civ. 58, para 38.

124 *Ibid.* paras 39–41.

125 *Ibid.* para. 41.

It is possible to criticise the implication of terms into the UCP since it leaves scope for confusion in different jurisdictions and undermines the principles of harmonisation driving UCP. There is some mileage in this argument in that the rules of interpretation differ across jurisdictions, thus leaving room for variation. However, it must also be pointed out that the best banking practices was an important factor taken into account by the courts. This pragmatic approach to commercial cases is an important factor that is unlikely to be ignored in international commercial disputes.

A number of possibilities are open to the seller when he learns of the rejection. He could rectify the defects, and re-tender the documents, provided he can do so within the expiry period. Article 6(d) of the UCP requires that:

> (i) A credit must state an expiry date for presentation. An expiry date stated for honour or negotiation will be deemed to be an expiry date for presentation.
>
> (ii) The place of the bank with which the credit is available is the place for presentation. The place for presentation under a credit available with any bank is that of any bank. A place for presentation other than that of the issuing bank is in addition to the place of the issuing bank.

The seller may also contact the buyer and inform him of the reasons for rejection, and he may agree to instruct the bank to accept the documents as they stand. The seller may also be able to persuade the confirming bank to pay him on the non-conforming documents by agreeing to indemnify the bank for any loss or damage the bank suffers as a result of the lack of conformity of the tendered documents with the credit terms. Alternatively, the bank may agree to make payment 'under reserve'. There is no generally accepted meaning of 'payment under reserve'. So, one has to look to what the parties had in mind. Did they agree that the seller would repay the confirming bank should the issuing bank reject the documents? In *Banque de l'Indochine et de Suez SA v JH Rayner (Mincing Lane) Ltd*,[126] it was held that the confirming bank could demand repayment of the money paid 'under reserve' to the seller since the issuing bank had rejected the documents. According to Kerr LJ:

> What the parties meant, I think, was that payment was to be made under reserve in the sense that the beneficiary would be bound to repay the money on demand if the issuing bank should reject the documents, whether on its own initiative or on the buyer's instructions. I would regard this as a binding agreement between the confirming bank and the beneficiary by way of a compromise to resolve the impasse created by the uncertainty of their respective legal obligations and rights [at p 733].

The judgment of Sir John Donaldson MR is extremely instructive. The arrangement must be viewed from the commercial point of view. He imputed a dialogue between the beneficiary and the bank on the following lines:

Merchant:	'These documents are sufficient to satisfy the terms of the letter of credit and certainly will be accepted by my buyer. I am entitled to the money and need it.'
Bank:	'If we thought that the documents satisfied the terms of the letter of credit, we would pay you at once. However, we do not think that they do and we cannot risk paying you and not being paid ourselves. We are not sure that your buyer will authorise payment, but can, of course, ask.'
Merchant:	'But that will take time and meanwhile I shall have a cash flow problem.'
Bank:	'Well, the alternative is for you to sue us and that will also take time.'

126 [1983] QB 711.

Merchant:	'What about your paying me without prejudice to whether I am entitled to payment and then your seeing what is the reaction of your correspondent bank and our buyer?'
Bank:	'That is all right, but if we are told that we should not have paid, how do we get our money back?'
Merchant:	'You sue me.'
Bank:	'Oh no, that would leave us out of our money for a substantial time. Furthermore, it would involve us in facing in two directions. We should not only have to sue you, but also to sue the issuing bank in order to cover the possibility that you might be right. We cannot afford to pay on those terms.'
Merchant:	'All right. I am quite confident that the issuing bank and my buyer will be content that you should pay, particularly since the documents are, in fact, in order. You pay me, and if the issuing bank refuses to reimburse you for the same reason that you are unwilling to pay, I will repay you on demand and then sue you. But I do not think that this will happen.'
Bank:	'We agree. Here is the money "under reserve" ' [at pp 727–78].

Given the uncertainty, it would be wise for the parties to agree to payment under reserve only while stating what is meant by it.

The fraud exception

The bank's obligation to pay on documents that appear to conform on their face is curtailed in the event of fraud. The first English case that considered fraud as an exception to the principle of autonomy was *Discount Records Ltd v Barclays Bank Ltd*,[127] where the buyers, alleging fraud, sought an injunction to stop the bank from paying the sellers on the credit. Mere allegation of fraud was insufficient to issue an injunction. Similarly, information that would lead a reasonable banker to infer fraud is insufficient.[128] According to the courts, the fraud must be proven. The subsequent case of *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)*[129] considered the circumstances in which the fraud exception[130] could be successfully raised. Shipment under the contract terms was to take place by 15 December 1976. The cargo was shipped on 16 December 1976, and the bill of lading backdated by the loading brokers. The sellers, however, were unaware of the loading brokers' fraud. The bank, having discovered the fraud, refused to pay the seller, who brought an action against the bank for non-payment against the documents. The question before the court was whether the bank could refuse to pay against documents that appeared to be in order on their face, but where goods had not been shipped as stipulated in the sale contract. The House of Lords held that, unless the seller was fraudulent, or was privy to the fraud, the bank could not

127 [1975] 1 Lloyd's Rep 444.

128 See *The Society of Lloyd's v Canadian Imperial Bank of Commerce and Others* [1993] 2 Lloyd's Rep 579.

129 [1983] 1 AC 168. See also *Banco Santander SA v Bayfern Ltd* [2000] 1 All ER (Comm) 776. In this case, the confirming bank discounted its deferred payment undertaking before the maturity fraud in the documents was discovered. It was held by the Court of Appeal that the issuing bank did not have to reimburse the confirming bank, thus placing the risk on the bank that discounted. This unfairness has been rectified by Arts 7(c) and 8(c) since they establish an undertaking to reimburse on maturity, thus placing the risk on the issuing bank. See also *The Society of Lloyd's v Canadian Imperial Bank of Commerce and Others* [1993] 2 Lloyd's Rep 579.

130 The fraud exception is traceable to the American case *Sztejn v Henry Schroder Banking Corp* (1941) 31 NYS 2d 631. See *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159, at p 169. Note that this case dealt with performance bonds. On more about performance bonds, see 'Performance Bonds/Guarantees and Standby Letters of Credit', pp 503–6 below. See also *Solo Industries UK Ltd v Canara Bank* [2001] 2 Lloyd's Rep 57.

refuse payment. Of course, where the seller is himself fraudulent, or has knowledge of the fraud, policy considerations would fully justify depriving the seller from benefiting from his fraud. As Lord Diplock said:

> . . . to this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue . . . The exception of fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio* or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out a fraud [at p 183].

This decision clearly protects the beneficiary who, with no knowledge of fraud, buys goods afloat and sells them to the buyer.[131] However, the risk of paying for valueless documents is on the buyer. The narrow ambit of the fraud exception is generally justified on grounds of commercial efficacy. In other words, the fraud exception is construed restrictively to maintain the efficiency of documentary credit as an instrument for financing international commerce – a view expressed unambiguously by *Kerr J in RD Harbottle (Mercantile) Ltd v National Westminster Bank*,[132] as follows:

> It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not concerned with their difficulties to enforce such claims: these are the risks which the merchants take . . . The machinery and commitments of banks are on a different level. They must allow to be honoured, free from interference by the courts. Otherwise trust in international commerce could be irreparably damaged [at p 870].

There is truth in the observation that trust in the documents is essential for preserving commerce to flourish. Documentary fraud is on the increase.[133] In these circumstances, in policy terms, would it not be better to consolidate the trust placed in letters of credit by reassessing the narrow fraud exception?[134] The current attitude is to the detriment of the buyer, even where the bank, or the buyer, has strong grounds for suspecting foul play. The burden is cast on the party alleging

131 See Chapter 1.

132 *Harbottle (RD) (Mercantile) Ltd v National Westminster Bank Ltd* [1977] 2 All ER 862.

133 For instance, loss through fraud involving letters of credit is estimated to be around US$1 bn per annum. See www.bolero.net.

134 In the US, the fraud exception as expressed in the *Sztejn* case has been variously interpreted. The fraud rule was expressed in *Sztejn* as applying to situations where the 'seller has intentionally failed to ship any goods ordered by the buyer . . .' (at pp 634–5). The use of the word 'intentionally' has resulted in a myriad of suggestions: from intentional fraud, egregious fraud, equitable fraud to no clear statement on degree of fraud required. See *New York Life Insurance Co v Hartford National Bank and Trust Co* 378 A 2d 562 (Conn 1977); *NMC Enterprises v Columbia Broadcasting System, Inc* 14 UCC Rep Ser 1427 (NY Sup Ct 1974); *United Bank Ltd v Cambridge Sporting Goods Corp* 392 NYS 2d 265 (NY 1976); *Dynamics Corp of America v Citizens and Southern National Bank* 356 F Supp 991 (ND Ga 1973). See also Xiang and Buckley, 'A comparative analysis of the standard of fraud required under the fraud rules in letter of credit law' (2003) 13 Duke Journal of Comparative and International Law 293.

The Uniform Commercial Code in Art 5, s 109 adopts the following fraud standard for letters of credit:

If . . . required document is forged or materially fraudulent, or honor of the presentation would result in a material fraud by the beneficiary on the issuer or applicant . . . the issuer, acting in good faith, may honor or dishonour the presentation.

fraud[135] – a burden difficult to discharge in the majority of cases. The present rule makes investigators of buyers and banks. (There are not many cases where fraud has been established.)[136]

One avenue open to the buyer to protect himself is a performance guarantee from the seller that is issued by a reputable bank.[137]

Information technology (IT) and letters of credit

As with other trade documents (e.g., the bill of lading), a question that inevitably arises is whether there is scope for electronic letters of credit. The issue of a paperless letter of credit has been considered by various academics since the IT revolution.[138] In 2002, the ICC produced a supplement to the UCP – the eUCP Version 1– and this has been replaced with Version 1.1 (hereinafter 'eUCP').[139] The eUCP enables electronic presentation and caters for the recognition of electronic documents. Signature in the digital context is addressed and the meaning of an original in the electronic environment is clarified. The requirement of presenting one or more originals or copies is satisfied by an electronic record according to Art e8, and an electronic record is defined in Art e3(b)(i) as:

- Data created, generated, sent, communicated, received or stored by electronic means;
- That is capable of being authenticated as to the apparent identity of the sender and the apparent source of the data contained in it, and as to whether it has remained complete and unaltered; and
- Is capable of being examined for compliance with the terms and conditions of the eUCP credit.

The eUCP takes a technology-neutral approach so that an electronic signature is defined in Art e3(b)(ii) as 'a data process attached to or logically associated with an electronic record and executed or adopted by a person in order to identify that person and to indicate that person's authentication of the electronic record'.

Recognising that electronic data are prone to corruption, Art e11 addresses the issue of a bank's procedure in relation to corrupted electronic records.

As with the UCP, the eUCP has to be specifically incorporated. It is a supplement to the UCP, so the UCP will continue to apply equally to the electronic presentation (Art e1).[140] Although most commercial lawyers are skeptical about the use of electronic documentary credits or, for that matter, electronic bills of lading, it must be said that this skepticism is unwarranted. Legal frameworks exist[141] alongside technical means to make paperless document transactions a vital and necessary part of the international commercial arena. The recognition of negotiable and non-negotiable transport records is also made possible by the recently adopted Rotterdam Rules.[142]

135 Uncorroborated statements are insufficient. Strong corroborative evidence in the form of contemporary documents is required. See *United Trading Corp SA and Murray Clayton Ltd v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554.

136 See *Rafsanjan Pistachio Producers Co-operative v Bank Leumi (UK) plc* [1992] 1 Lloyd's Rep 513. See also *Themehelp Ltd v West and Others* [1996] QB 84.

137 See 'Performance bonds/Guarantees and standby letters of credit', below.

138 See, for instance, Kozolchyk, 'The paperless letter of credit and related documents of title' (1992) 55 Law and Contemporary Problems 39.

139 UCP 500 and eUCP Publication No 500/2 ICC. It came into force as of 1 April 2002.

140 Note that the presentation of documents could consist of a combination of electronic records and paper documents.

141 See Chapters 3 and 4 on electronic commerce, and Chapter 6, on the BOLERO project.

142 See Chapter 9.

Performance bonds/guarantees and standby letters of credit

Performance bonds/guarantees

These are usually used to secure the performance of the seller under a sale contract. In other words, performance bonds, also frequently termed performance guarantees, provide security in the event of non-performance of the contract. The way performance bonds work is provided by *Edward Owen Engineering Ltd v Barclays Bank International Ltd*.[143] Edward Owen (S) contracted with the buyer (B) in Libya to supply and erect glasshouses. Payment was to be affected under a confirmed letter of credit, and S was to provide a performance bond of 10% of the contract value. S instructed the defendants to provide the bond against their counter-guarantee. The defendants instructed Umma Bank in Libya – the bond payable 'on demand without proof or conditions'. Since B failed to open the letter of credit, S refused to supply the items. B, nonetheless, claimed from Umma Bank under the performance bond, and Umma Bank, in turn, claimed from Barclays Bank International. S was granted an interim injunction to restrain the defendants from paying. On appeal, the Court of Appeal held that an injunction could not be granted. The performance bond was seen as similar to a documentary credit – that is, the undertaking of the bank was independent of the underlying contract. The bank, therefore, had to honour its obligations if the terms of the bond were satisfied. According to Lord Denning:

> A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has long been established that, when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. . .
>
> . . . these performance guarantees are virtually promissory notes payable on demand. So long as the Libyan customers make an honest demand, the banks are bound to pay: and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate, they will not be able to prove it to be dishonest. So they will have to pay.
>
> All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour the guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice [at pp 169–71].

In *Edward Owen Engineering Ltd v Barclays Bank International Ltd*, the bond was payable on demand without proof or conditions. If a party wishes to protect himself, he can do so by imposing conditions, such as a certificate signed by an independent third party.[144]

The ICC has formulated a set of rules for use with performance guarantees. The 1978 version entitled Uniform Rules for Contract Guarantees has been replaced with the Uniform Rules for Demand Guarantees (URDG) in 1992 (Brochure 458). Like the UCP, these rules apply only if

143 [1978] QB 159.

144 For instance, in *Gur Corp v Trust Bank of Africa Ltd* ((1986) unreported, 28 October – see LEXIS), the performance guarantee was payable on production of a certificate signed by a certified quantity surveyor.

incorporated. The term 'demand guarantee' used in URDG includes the two types of performance bonds mentioned. Article 2 of the URDG defines demand guarantee as:

> (a) . . . any guarantee, bond or other payment undertaking, however named or described, by a bank, insurance company or other body or person (hereinafter referred to as 'guarantor') given in writing for the payment of money on presentation in conformity with the terms of the undertaking is a written demand for payment and such other document(s) (for example, a certificate by an architect or engineer, a judgment or an arbitral award) as may be specified in the guarantee, such undertaking being given:
>
> (i) at the request or on the instructions and under liability of a party (hereinafter called the 'principal'); or
>
> (ii) at the request or on the instructions and under the liability of a bank, insurance company or any other body or person (hereinafter the 'instructing party') acting on the instructions of a principal to another party (hereinafter the 'beneficiary').

The URDG reiterates in Art 2(b) the views found in the cases mentioned – that is, that the guarantee is autonomous, and the banks are in no way concerned with the underlying contract.

Because guarantees are payable on demand by the beneficiary, they are open to abuse in that a beneficiary can demand payment even when there has been no breach by the principal (the party who has requested the issue of a guarantee). To give some protection, Art 20 of URDG provides that any demand for payment under the guarantee be accompanied by a written statement stating that '(i) the principal is in breach of his obligation(s) under the underlying contract(s) . . . and (ii) the respect in which the principal is in breach'. As to how effective this will be in curtailing abuse is open to doubt since the statement is required only of the beneficiary. On receiving the statement, the guarantor (bank) is required to transmit, without delay, the message to the principal (Art 21), thus alerting the principal and enabling him to take action should he wish to.

Standby letters of credit

At this juncture, it would be convenient to introduce an arrangement known as standby letters of credit. Although termed letters of credit, standby letters of credit have more in common with performance bonds/guarantees that call for payment against documents. Under a standby letter of credit, the agreement is to pay the beneficiary against documents in the event of default by the applicant. Standby letters of credit were designed in the US to circumvent rules that prevent a bank from giving guarantees. Standby letters of credit are widely used in construction industries, although their use is not unknown in other contexts, such as supporting a reinsurance obligation and an obligation to repay money. As Professor Goode observes, standby credits, in practice, are now used as a 'general purpose financial tool . . . to support financial as well as non-financial undertakings and domestic as well as international transactions, and to secure credit enhancement of public issues of securities, which if underpinned by a standby credit issued by a first class bank may attract a higher credit rating from agencies . . .'.[145] The difference between a standby credit and performance guarantee, it seems, is in business practice not in law.

Although the UCP is applicable to standby letters of credit if the parties so wish, the rules are not satisfactory since they were primarily devised for letters of credit.[146] In 1998, the ICC adopted a set

145 *Commercial Law*, 2004, Butterworths, at p 1018. See also Kozolchyk, 'The emerging law of standby letters of credit and bank guarantees' (1982) 24 Arizona LR 319; Ryan, 'Letters of credit supporting debt for borrowed money: the standby as backup' [1983] 100 Banking LJ 404.

146 Note the UCP itself acknowledges the limited applicability of its rules to standby letters of credit in Art 1, which states:
The . . . (UCP) are rules that apply to any documentary credit . . . (including to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules.

of rules known as the International Standby Practices[147] (hereinafter 'ISP 98'), initially formulated by the US Institute for International Banking Law and Practice, which reflects 'accepted practices, custom and usage'[148] relating to standby letters of credit. As with the UCP, the ISP 98 needs to be incorporated by the parties. The ISP 98 deals with various obligations, such as the undertaking to honour by issuer, presentation of documents as required by the standby, examination of the documents for compliance and the various standby document types and the transfer and assignment of drawing rights. Although the ISP 98 has a number of similarities with the UCP, it goes beyond the UCP in a number of respects. First, the ISP 98 is more extensive in its drafting and tries to clarify concepts that could cause uncertainties – for instance, the meaning of the words 'original' and 'copies', which raised substantial doubts in the context of Art 20(b) of the UCP 500.[149] The ISP 98 in r 4.15(c) states[150]:

(i) A presented document is deemed to be an 'original' unless it appears on its face to have been reproduced from an original.
(ii) A document which appears to have been reproduced from an original is deemed to be an original if the signature or authentication appears to be original.

Second it caters specifically for standby letters of credit. For instance, it allows for more than one transfer (r 6.02),[151] partial drawing (r 3.08), syndication (r 10.01) and participation (r 10.02). Like the UCP, the ISP 98 is silent on issues such as fraud. However, unlike the UCP, it specifically states that the ISP Rules do not define or otherwise provide for defences to honour based on fraud, abuse or similar matters (r 1.05(g)).

Alongside the UCP and ISP 98, there is another instrument that could well apply to a standby letter of credit. This is the United Nations Convention on Independent Guarantees and Standby Letters of Credit 1995 (hereinafter 'Standby Convention').[152] The Standby Convention's aim is to provide a harmonised set of rules for the use of standby letters of credit and independent guarantees (performance/demand guarantees) and ensures the independence of independent undertakings through the principles it sets out. It is consistent with the solutions found in rules of practice,[153] such as the UCP and URDG. It also supplements them by dealing with areas not currently dealt with in the UCP or, for that matter, ISP 98. The scope of application of the Standby Convention is set out in Art 1. It applies to an international undertaking where the place of the guarantor/issuer[154] is in a contracting state, or the private international law leads to the application of the law of a contracting state. It is open for the parties to exclude the application of the Standby Convention. The word 'undertaking' introduced in the Standby Convention is defined in Art 2(1) thus:

> For the purposes of this Convention, an undertaking is an independent commitment, known in international commercial law as independent guarantee or standby letter of credit, given by a bank or other institution or person ('guarantor/issuer') to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaking by the principal/applicant or another person.

147 ICC. Also visit www.ISP98.com. The ISP 98 came into effect on 1 January 1999.
148 See *International Standby Practices (ISP 98)*, 1998, ICC, Preface.
149 See *Glencore International AG v Bank of China* [1996] 1 Lloyd's Rep 135; see also 'Doctrine of strict compliance', pp 447–50.
150 See also r 4.15(a) and (b). 'Signature' is defined in r 1.09.
151 See also 'Transferable credits', above, and Art 38(6) of the UCP.
152 The text of this convention is available at www.uncitral.org. It is also reproduced in Carr and Goldby, *International Trade Law Statutes and Conventions*, 2nd edn, 2011, Routledge-Cavendish. It came into force on 1 January 2000.
153 The ICC endorsed the Standby Convention on 21 June 1999. It must be added that the Standby Convention was not drafted in isolation; full recognition was given to the ICC rules in this area. It is meant to work alongside rules of practice such as the UCP and URDG.
154 That is, the bank, person or institution giving the independent guarantee.

The internationality of the undertaking is determined on the basis of place of business. According to Art 4(1), '. . . an undertaking is international if the places of business, as specified in the undertaking, of any two of the following persons are in different states: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer'. What is innovative about the Standby Convention is its attempt to address fraud. As seen earlier, fraud, which poses a significant problem, is construed very restrictively with the result that, in the absence of actual fraud, the victim is the buyer. Fraud affects performance guarantees and standby letters of credit, and the approach of the English courts in relation to fraud in these types of undertakings is no different from the approach adopted in relation to documentary credits.[155] There is, however, no harmonised approach to fraud across jurisdictions.[156] The various ICC rules (e.g., UCP, ISP 98) are of no use in this thorny area. Article 19(1) of the Standby Convention does not use the word 'fraud' as such, but lists the circumstances in which the guarantor can withhold payment. So, where it is manifest and clear:

(a) any document is not genuine or has been falsified;
(b) no payment is due on the basis asserted in the demand and the supporting documents; or
(c) judging by the types and purpose of the undertaking, the demand has no conceivable basis,[157]

the guarantor/issuer acting in good faith will be well within his rights to withhold payment as against the beneficiary.

Article 19(1) does not impose an obligation on the guarantor/issuer to withhold payment. He has the discretion to do so. The Standby Convention takes this approach to preserve the commercial reliability of undertakings as independent from the underlying transactions.[158] It must also be pointed out that the Standby Convention recognises that the investigation of the underlying transactions are to be left to the courts, and Art 19(3) affirms the entitlement of the principal/applicant to provisional court measures in accordance with Art 20.

It is difficult to predict whether the Standby Convention will be accepted widely. Nonetheless, it must be said that it is well worth a serious consideration given its bold attempt to harmonise the controversial area of fraud.

Other means of minimising risk of non-payment

Undoubtedly, the letter of credit is a popular means of obtaining payment from the buyer. Despite its popularity, it does present a few risks in obtaining payment – for instance, where the buyer or indeed the bank becomes insolvent. There are other mechanisms available that may afford some protection to the seller. Insurance is one obvious answer. Private insurers provide credit insurance

155 See *Balfour Beatty Civil Engineering Ltd v Technical and General Guarantee Ltd* [2000] 68 Con LR 108; *Themehelp Ltd v West and Others* [1996] QB 84; *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London* [1999] 1 All ER (Comm) 890. Note that the principles, when obtaining an injunction, are the same regardless of whether it is sought against the bank or the beneficiary (see *Group Jose, Re v Walbrook Insurance Co Ltd* [1996] Lloyd's Rep 345).
156 Another emerging exception to autonomy is unconscionability in some jurisdictions – see *Bocotra Construction Pte Ltd v Attorney General (No 2)* (1995) 2 SLR 733; *Dauphin Offshore Engineering and Trading Pte Ltd v The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al Nayhan* (2000) 1 SLR 657 from Singapore. Unconscionability seems to be broadly defined as lack of *bona fides*.
157 See Art 19(2) for types of situations in which a demand has no conceivable basis.
158 See paras 45–9 of the Explanatory Note to the Standby Convention (available at www.uncitral.org).

where consumer goods and other materials are sold on credit terms of six months or less.[159] For longer-term credit, in the UK, a government department known as the Exports Credits Guarantee Department[160] offers an export insurance policy against the risk of not getting paid in circumstances, such as buyer's insolvency, default, and lack of foreign exchange.

Another popular method available to the seller that imparts the highest level of protection is the use of a factor – a third party to whom the seller assigns[161] his receivable (right to payment of monies from the buyer) without recourse.[162] The factor, obviously, offers these services at a charge since he takes on the task and risk of collecting the payment from the buyer. The factoring agreement can also be conducted on a recourse basis.[163] Generally, the factor offers what is known as 'full-service factoring' whereby he undertakes all credit management and collection work – that is, takes on the responsibility of the sales ledger.[164] The alternative to full-service factoring is invoice discounting where the operation of the sales ledger remains with the seller but cash is made available against invoices submitted by the seller.[165]

In 1988, an international convention called the UNIDROIT Convention on International Factoring was adopted in Ottawa (hereinafter 'Factoring Convention').[166] The convention's aim, as with other international conventions, is to harmonise the laws in respect of international factoring. It addresses factoring agreements arising from international contracts for the sale of goods. Internationality is determined, as in the Convention on the International Sale of Goods 1980,[167] on the basis of place of business being in different states (Art 2(1)). And a factoring contract is defined in Art 1(2) as concluded between the supplier and the factor pursuant to which:

(a) the supplier may or will assign to the factors receivables arising from contracts of sale of goods made between the supplier and his customers (debtors) other than those for the sale of goods[168] bought primarily for their personal, family or household use;
(b) the factor is to perform at least two of the following functions:
  - finance for the supplier, including loans and advance payments;
  - maintenance of accounts (ledgering) relating to receivables;

159 The British Insurance and Investment Brokers' Association provide information on credit insurance. Visit www.biba.org for further information.
160 Visit www.ecgd.gov.uk for further information about this organisation. They also provide other services, such as providing guarantees for loans to foreign buyers wishing to purchase from the UK.
161 The seller might disclose or not disclose the factoring arrangement to the buyer. The former is normally termed disclosed factoring, and the latter undisclosed factoring. Assignment in the event of disclosed factoring is a legal assignment and subject to the Law of Property Act 1925 (s 136), and in the latter equitable assignment.
162 Where the seller sends goods that do not conform to the contract description, the factor will be able to claim the monies back from the seller, even though the factoring was on a without-recourse basis.
163 For further information on this, see www.factors.org.uk.
164 Factoring is widely used in the UK. Visit www.factorscan.co.uk for details on the factored volume in the UK, both domestic and international.
165 See Salinger, *Factoring: The Law and Practice of Invoice Finance*, 1999, Sweet & Maxwell for a full and excellent account of factoring.
166 It came into force on 1 May 1995. The text of this convention is available at www.unidroit.org. It is also reproduced in Carr and Goldby, *International Trade Law Statutes and Conventions*, 2nd edn, 2011, Routledge-Cavendish. See also Goode, 'Conclusion of the leasing and factoring conventions, Pt 2' [1988] JBL 510.
167 See Chapter 2 for further on this convention. The Factoring Convention was intended to supplement the Vienna Convention. See also Ferrari, 'General principles and international uniform commercial law conventions: a study of the 1980 Vienna Sales Convention and the 1988 UNIDROIT Conventions' (1997) 2(3) Uniform LR 293; Ferrari, 'International factoring and leasing and UNIDROIT Principles' (1999) 19(3) European Journal of Law Reform 217; Sommer, 'Factoring, international factoring networks and the FCI Code of International Factoring Customs' [1998] Uniform LR 685; Alexander, 'Towards unification and predictability: the International Factoring Convention' [1989] Columbia Journal of Transnational Law 589. Also visit www.unidroit.org, which provides a useful bibliography of useful articles on this the Factoring Convention.
168 Goods include services and supply of services (Art 1(3)).

  - collection of receivables;
  - protection against default in payment by debtors;

(c) notice of the assignment of the receivables is to be given to debtors.

It must, however, be pointed out that the parties have the freedom to opt out of the application of the Factoring Convention to their contract (Art 3).

A question commonly posed is: what happens if the sale contract contains a clause prohibiting assignment? Would this be effective? The Factoring Convention in Art 6(1) provides that the assignment of a receivable by the supplier shall be effective notwithstanding a clause prohibiting assignment. However, this does not override any obligation of good faith that the supplier has to the debtor or any liability that the supplier has to the debtor in respect of an assignment made in breach of the terms of the contract of sale of goods according to Art 6(3).

More recently, the UNCITRAL has adopted a new convention[169] entitled United Nations Convention on the Assignment of Receivables in International Trade (hereinafter 'Receivables Convention'), which is wider in ambit than the Factoring Convention since it is not restricted to factoring agreements. According to Art 45, five states have to ratify, accede, approve or accept the Receivables Convention for it to come into force.[170]

The Receivables Convention is intended to create certainty and transparency, while taking into account the interests of debtors. The Receivables Convention applies to assignments of international receivables and to international assignments of receivables if the assignor at the time of the conclusion of the contract is located in a contracting state (Art 1(1)(a)).[171] Internationality is established on the basis of the location of the debtor and the assignor. According to Art 3, 'a receivable is international if, at the time of the conclusion of the original contract, the assignor and the debtor are located in different states; and an assignment is international if at the time of conclusion of the contract of assignment the assignor and the assignee are located in different states'. Combining Arts 1 and 3, it seems that, where a receivable is international, it will attract the application of the Receivables Convention, even if the assignment is domestic. Equally, where the receivable is domestic, it will attract the application of the Receivables Convention if the assignment is international.[172]

The meanings of 'assignment' and 'receivables' can be gathered from Art 2(1). Assignment is 'the transfer from one person ("assignor") to another person ("assignee") of all or part of an undivided interest in the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer'. Given the wide definition, it is clear that the Receivables Convention will apply to factoring. This is also endorsed by UNCITRAL's commentary on the draft convention[173] on receivables.[174]

The Receivables Convention appears comprehensive in addressing a number of issues relating to assignment, such as notification to debtor (Art 13), debtor protection (Arts 15–20), and the law

169 Adopted on 12 December 2001. The text of this convention is available at www.uncitral.org.
170 So far, Luxembourg, Madagascar and the US have signed this convention. Liberia has acceded to the Convention.
171 Note that subsequent assignment will also come within the ambit of the Receivables Convention provided any of the prior assignment in respect of the same receivable attracts the application of the convention (see Art (1)(1)(b)). The ICC has recently (November 2012) published its Uniform Rules of Forfaiting. The international forfaiting market is said to be worth US $300 billion.
172 See UN Doc A/CN 9/489, para 15; available at www.uncitral.org.
173 The wording of Art 2(1) in the adopted Receivables Convention is the same as that of the draft convention.
174 See para 7 (UN Doc A/CN 9/489). Also note that Art 4 excludes the application of the Receivable Convention to an individual for his or her personal, family or household purposes. For further on the draft conventions, see Bazinas, 'Lowering the cost of credit: the promise in the future UNCITRAL Convention on Assignment of Receivables in International Trade' (2001) 9 Tulane Journal of International and Comparative Law 259.

applicable to competing claims (Art 22) and priority (Art 30). It also provides alternative models of priority rules in the Annex for the contracting state to adopt. In the absence of adopting one of the suggested models, the national law will be relevant for deciding priority in relation to the receivables that have been assigned.[175] However, the Receivables Convention does not affect all matters relating to an assignment – for instance, the validity of an assignment agreement.[176] This will be determined according to the applicable law.

The Receivables Convention is equally applicable to another risk-minimising practice that is commonly found in the financing of international sale of goods known as 'forfaiting'.[177] In a forfaiting arrangement, the forfaiter purchases bills of exchange which evidences the buyer's obligation without recourse to the seller (the exporter). However, the forfaiter will require security from a bank that is normally given, after the bill of exchange has been accepted, in the form of an *aval*[178] (a signature) on the back of the bill of exchange. The avaliser (i.e., the bank) backs the bill of exchange, thus assuring payment on the bill of exchange.[179]

Given that only five states need to take action for the Receivables Convention to come into force, there is a high likelihood for it to come into force. This of course raises the all-important issue of its affect on the Factoring Convention. Article 38(1) of the Receivables Convention addresses the issue of conflict with other international agreements by stating that the 'convention does not prevail over any international agreement that has already been or may be entered into and that specifically governs a transaction otherwise governed by this convention'. However, there is a proviso to Art 38(1), which is important from the Factoring Convention perspective. Article 38(2) provides that 'notwithstanding para 1 . . . this convention prevails over the UNIDROIT Convention on International Factoring ("the Ottawa Convention"). To the extent that this convention does not apply to the rights and obligations of a debtor, it does not preclude the application of the Ottawa Convention with respect to the rights and obligations of that debtor'. Of course, this is in the event of the factoring agreement coming within the ambit of the Receivables Convention.

Conclusion

Letters of credit are a useful payment mechanism in international trade and are extremely popular and rightly deserve to be called 'the life blood of international commerce'. However, in certain circumstances, such as fraud and insolvency of the bank, the documentary credit method may not provide absolute assurance to the seller that he will get paid. It is possible for him to increase his protection through other mechanisms, such as performance guarantees and factoring. The law in relation to the variety of protective mechanisms available have been harmonised to some extent through rules formulated by the ICC and international conventions,[180] thus imparting some degree of certainty.

175 For a fuller account of the framework of the Receivables Convention, see Sigman and Smith, 'Toward facilitating cross-border secured financing and securitization: an analysis of the United Nations Convention on the Assignment of Receivables in International Trade' (2002) 57 Business Lawyer 727.

176 See UN Doc A/CN 9/489, para 25.

177 See UN Doc A/CN 9/489, para 8.

178 Normally, the phrase '*bon pour aval*' is used. The UNCITRAL Convention addresses the issue of guaranteeing payment of payment instruments in its Art 46. See also Arts 30–32 of the Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes, Geneva 1930. This convention is reproduced in Carr and Goldby, *International Trade Law Statutes and Conventions*, 2nd edn, 2011, Routledge-Cavendish. The framework embodied in this convention is often referred to as the Geneva system and is followed in most civil law countries such as France and Switzerland.

179 No special provision in the BEA, although *avals* are recognised in the UK. *See G&H Montage GmBH v Irvani* [1988] 1 Lloyd's Rep 460; [1990] 1 WLR 667. See also *Gerald MacDonald and Co v Nash and Co* [1924] AC 625; *Steele v M'Kinlay* (1880) 5 App Cas 754.

180 It must, however, be remembered that not all of the conventions are in force.

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